

WEST BANK & GAZA

STRENGTHENING PUBLIC SECTOR MANAGEMENT

Social and Economic Development Group
Middle East and North Africa Region

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The World Bank



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ABBREVIATIONS AND ACRONYMS

GCI	=	General Control Institution
GDP	=	Gross Domestic Product
GFMIS	=	Government Financial Management Information System
GHI	=	Government Health Insurance
GNP	=	Gross National Product
GPC	=	General Personnel Council
MOE	=	Ministry of Education
MOF	=	Ministry of Finance
MOH	=	Ministry of Health
NIS	=	New Israeli Sheqalim
NGO	=	Non-Government Organization
PA	=	Palestinian Authority
PEA	=	Palestinian Energy Authority
PCBS	=	Palestinian Central Bureau of Statistics
PLC	=	Palestine Legislative Council
PLO	=	Palestine Liberation Organization
PTA	=	Parent-Teacher Association
PWA	=	Palestinian Water Authority
SDS	=	Service Delivery Survey
USAID	=	United States Agency for International Development
UNRWA	=	United Nations Relief and Works Agency
WBG	=	West Bank and Gaza

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EXECUTIVE SUMMARY

Executive Summary

I. Introduction

Strengthening the Capacity of Public Sector Institutions in the Palestinian Authority to Meet Coming Needs for Public Services and Investment

Despite a renewed round of pledges of donor support following the Wye Accords in late 1998, the Palestinian Authority faces potentially severe fiscal constraints in meeting the need for public services and investment over the medium term. While there are no simple ways of alleviating these constraints, efficient management of public expenditures would ensure the best possible use of available resources and avoid crises. Developing strong public sector institutions that foster good budgetary and public sector management thus deserves top priority. Donor support is needed to help strengthen these institutions, with emphasis on four priority areas.

First, present efforts to improve the management of public sector employment in the Authority need to be strengthened to avoid unsustainable levels of expenditures and to build an efficient and qualified civil service. Second, continued efforts to build effective budget management systems (such as the Government Financial Management Information System) are critical to ensure fiscal discipline, resource allocation according to strategic priorities, and efficient and effective use of resources. Third, to obtain more cost-effective public services, NGOs and the private sector need to be more fully involved in their delivery. And fourth, better management of local government and utilities can make a significant contribution to public sector responsibilities in service delivery.

The Authority is gradually moving beyond the reconstruction/rehabilitation of physical assets and the initiation of essential public sector functions. Donor assistance has been a critical factor in these achievements.

While the need for donor support for new investment remains critical, there is now an urgent need for increased donor support to strengthen the institutional framework for public sector management. Strong public sector institutions (rules, norms, and procedures) and supporting systems—with particular emphasis on those that bear on public finance—are needed to ensure the Authority's own capacity for good policy design and implementation and sustainable, high-quality provision of services to the Palestinian population.

The following example is just one among many

that show how much material difference improved public sector management can make to public service access and quality.

Although per capita consumption of water in the West Bank/Gaza is only one-third that in Israel and below the minimum amounts recommended by WHO, 45-50 percent of water in West Bank/Gaza municipal systems is lost in transmission and distribution! Such losses are far greater than in efficient utilities elsewhere in the world; in Singapore, for example, transmission and distribution losses are as little as 6 percent. Better management can reduce these losses, increase revenues and improve service without increasing payment burdens of utility customers. In Gaza, new management arrangements supported by donor credits have already resulted in significant improvements.

Additional donor support to build management capacity can similarly improve other infrastructure and "people" services.

II. The Medium-Term Fiscal Outlook is Fragile

At present, the recurrent budget is near balance (Figure 1), but the bulk of investment continues to be funded by donors. In this context, several factors point to an increasingly constrained fiscal situation in the medium term.

The scope for increasing central revenue is uncertain. While further increases in central government revenue may be feasible (e.g., if revenue-sharing under the Interim Agreement with Israel is modified), the major revenue increases resulting from improved PA tax administration appear to have been captured. Increasing the promptness and completeness of transfers to local governments and tax reimbursements to Palestinians and international organizations will also put downward pressure on net revenues. On the other hand, enforcing hard budget constraints on local governments and utilities will ease fiscal pressure on the Authority's central budget, which has been covering arrears in municipal utility payments (including those to Israel). Meanwhile, maintaining quality and access in the face of rapid population growth will put additional pressure on public health and education. Enrollment growth in the Authority's schools alone could result in extra annual recurrent expenditure needs of 1-2 percent of GDP by 2005, and more depending on

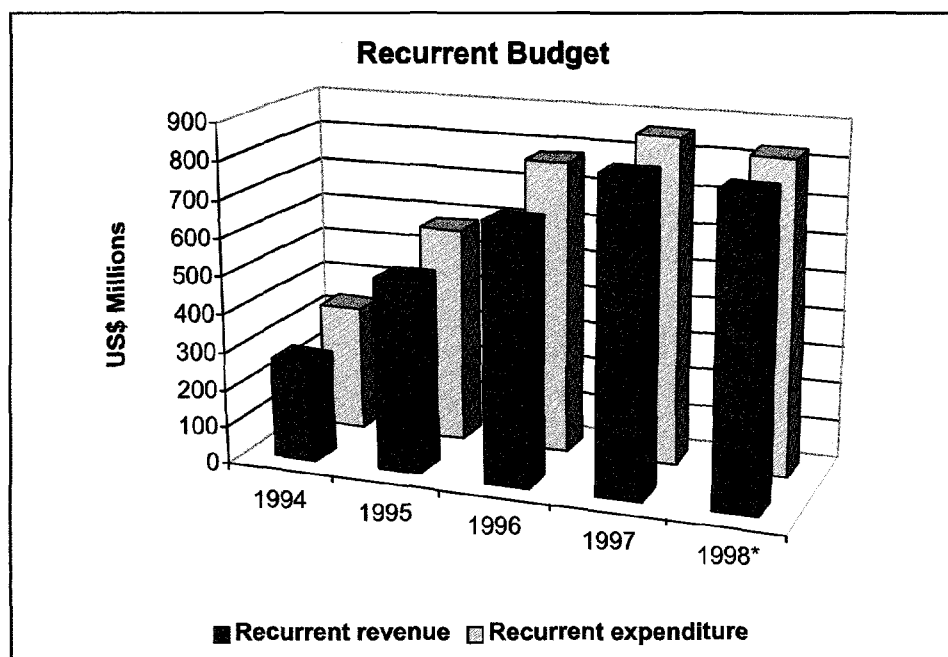


Figure 1

Final Status negotiations with Israel concerning refugees. Investment in all sectors will also increase the need for (in some cases already insufficient) allocations to operations and maintenance. And rapid growth in public sector employment implies future wage and long-term pension and benefit costs that reduce budget flexibility. Parts of the public pension system are also under-funded.

While renewed recent pledges may allow reliance on donor grant-funding for capital expenditures (presently 5-6 percent of GDP) in the near term, this is unlikely to be sustainable in the longer term. This implies a need to fund an increasing share of investment over and above the planned level of NIS 120 million in 1999 and may require taking on debt.

III. Managing Constraints

1. Better Management of Public Employment

The Authority has relied on public sector recruitment to provide jobs and alleviate declining incomes in a difficult economic environment over which it does not have full control. The Authority has also used recruitment into public sector jobs to integrate those returning from the diaspora into Palestinian society. An increasing concern of the Authority is employment of the growing numbers of graduates from post-secondary institutions.

The rapid expansion of public sector jobs means that the weight and cost of employment in the Authority is now very high in comparative terms. Figure 2 indicates that the share of the central government's payroll in recurrent expenditures in

West Bank/Gaza is the greatest of any jurisdiction in the Bank's Middle East and North Africa Region and much higher than the average share in any of the Bank's other regions.

This is a costly solution to the unemployment problem. There are long-term costs associated with creating permanent civil service positions, such as recurring wages and future pensions. Efficiency may also suffer through over-staffing and ineffective distribution of jobs (e.g., excessive personnel in support, rather than front-line, functions). In addition, the heavy burden associated with public sector employment effectively reduces policy choices with respect to present and future budget allocations.

A resolution of the uncertainty in the peace process and the resumption of economic growth are needed to produce a satisfactory balance between public and private employment. But it is also critical to strengthen the institutional framework for managing public sector employment in order that the Authority can better control recruitment and build a well-performing, merit-based civil service.

In most countries, the General Personnel Council or equivalent civil service ministry oversees the recruitment, promotion, and discipline of personnel, while the Ministry of Finance or equivalent typically has fiscal control over payrolls and enforces recruitment limits. In the Authority, GPC responsibility for public sector employment in Gaza increases its workload beyond personnel functions and at the same time impedes the Ministry of Finance's ability to enforce hard budget constraints. Unifying payroll procedures under the Ministry of Finance and assigning civil service

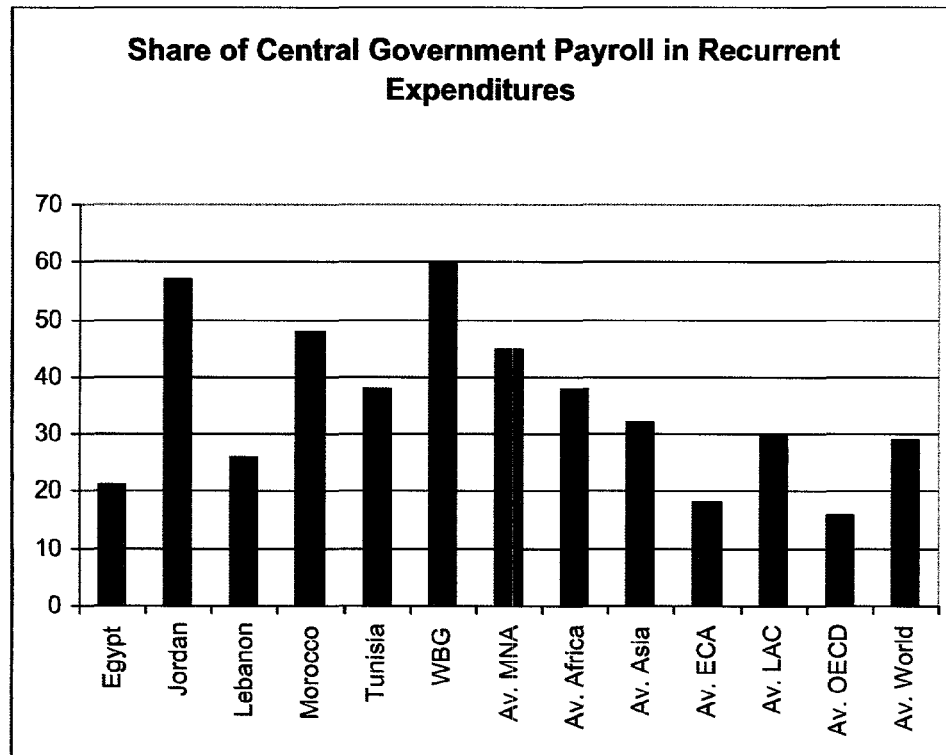


Figure 2

functions to the GPC, together with donor assistance to strengthen the systems required to fulfil these responsibilities, would help resolve these issues.

Difficulties in implementing provisions in the recently adopted *Civil Service Law*, in part relating to compensation, have recently led to the Law's suspension. But other provisions of the Law represent big steps forward in unifying the civil service under a consistent set of institutions, advancing merit and performance-based personnel management and allowing departmental managers the greater responsibility to manage payrolls that is essential to efficient service delivery. These positive contributions of the Law to more efficient personnel management in the PA should be preserved.

2. Effective Budget Management Systems

In order to foster good expenditure outcomes, institutional arrangements for budget formulation, execution, and follow-up must encourage fiscal discipline, clear priority-setting, and efficient and effective use of resources.

Significant progress has already been made in establishing effective institutional arrangements for good budgetary outcomes. The new *Organic Budget Law* formalizes many of the arrangements for sound budgeting. Efforts must now be directed to the implementation of these arrangements. The

Finance Ministry has recently started to develop capital budgeting and forecasting functions, which begin addressing the need for integration of budget proposals into a medium-term macroeconomic framework, and incorporation of all capital expenditure into the overall budget. Such arrangements are particularly important if the Authority's priorities are to be reflected in the use of its budgetary resources, and to plan the future O&M requirements of public investments.

Further efforts are also needed to strengthen accounting and auditing procedures. The Government Financial Management Information System (GFMIS) project has yet to be implemented. Control and audit functions are still developing and are fragmented. The capacity of audit bodies varies, but all have substantial unmet needs for professional training and equipment, and the enabling environment of formal regulations that define their mandates and empowers them needs to be further developed.

Institutional arrangements for good budget outcomes also help ensure that public funds are handled with propriety (i.e., minimal scope for abuse) and with regularity (i.e., the requisite authority).

Three key questions are helpful in assessing propriety safeguards. First, how clear are the standards? Two recent pieces of legislation, the *Organic Budget Law* and the *Civil Service Law*, go far towards setting comprehensive standards for the stewardship of public funds and for public

sector employment. A procurement law also came into effect in late 1998. Strengthening capacity to implement the standards in these laws is now a priority.

Next, how adequate is the authority and capacity for enforcing standards? These areas are also in need of further strengthening. For example, the General Control Institution would be more effective with a narrower mandate. Further, the normal reporting relationship of this supreme audit body is to the legislature, rather than to the executive.

Finally, are there provisions for accountability and sanctions should improper or irregular transactions be detected? To avoid arbitrariness, the Authority should seek to establish institutional arrangements based on *ex ante* rules rather than *ex post* discretion.

In summary, the following institutional arrangements and systems relating to budget and financial management deserve particular attention on the part of donors in their assistance to the Authority:

- implementation of plans for comprehensive and integrated (investment as well as recurrent) annual budgeting within a medium-term macroeconomic and public expenditure framework;
- implementation of the Government Financial Management Information System (GFMIS);
- establishment of a unified system for tracking external assistance flows and obligations;
- eventual introduction of fiscal accounts based on accrual principles, with interim calculations of the projected future costs of public sector pension plans;
- implementation of the new public procurement standards and guidelines across all ministries and agencies;
- systematic control and audit of all public sector transactions and accounts by bodies that are appropriately enabled and have adequate capacity; and
- strengthening institutional arrangements for accountability in the event of improper or irregular use of public funds.

3. More Efficient Service Delivery

Competition among service providers is now accepted as the best method of obtaining efficient provision of public services. It has become standard practice to seek these benefits of competition in infrastructure through participation of private sector for-profit firms in investment and service delivery. But public services can be delivered through other institutional arrangements besides the bureaucracy and private enterprises. In West Bank/Gaza, NGOs have traditionally

provided a significant share of services in such areas as health, education, agriculture, low-cost housing and micro-enterprise credit. This capacity can be of help to the Authority in serving the public.

In many countries, "voice" mechanisms such as service delivery surveys have been shown to improve the quality of services through feedback effects when the views of consumers on the services they receive are taken into account. Such surveys represent a promising way to increase the accountability of service providers and ultimately the quality of services. Although consumers may not be able to assess the technical quality of services they receive, the studies provide useful information on other aspects of services such as their accessibility, costs, and other factors explaining use of services. Under the Palestinian Authority, such surveys have recently been conducted in health and basic education, where NGO/private sector provision is greatest, and are now being considered for other services.

Present roles in many types of public service provision, such as health care, will likely develop over time under the Palestinian Authority in ways observed in many market economies. Under such a scenario, the Authority would focus increasingly on fulfilling its governmental responsibilities in determining policy, setting service standards, and planning and regulating service provision. It would reduce its capacity in direct service provision and concentrate instead on ensuring that there is effective service provision by private sector firms and NGOs. Several legal, regulatory and financial changes would assist this process of development. The principal examples are implementation of an appropriate enabling law for NGOs, the introduction and enforcement of quality standards for *all* service providers (including government agencies), development of an effective contracting framework to facilitate out-sourcing of service provision, and "leveling the playing field" by permitting NGOs and private sector firms to compete on an equal basis with the public sector in the provision of services or facilities under government programs such as the health insurance system.

4. Increasing the Role of Local Governments and Utilities

Local governments under the Palestinian Authority have modest responsibilities compared to those elsewhere. Figure 3 shows that in 1996, local government expenditures amounted to at most 2.3 percent of GDP, compared to averages of 12.7 percent for OECD countries and 4.6 percent for a sample of developing countries. But local government is critical in achieving sustainable development under the Authority because of its

importance in supplying utility services. Municipal capital outlays make up 40 percent of total public capital expenditures.

Serious concerns in local government finance are the lack of a major broad-based local tax, and heavy reliance upon revenue sources not closely related to local services and their benefits. Utilities supply between 17 and 46 percent of total revenue in four cities studied. Cost recovery for local services is often low: municipal waste collection and disposal fees only return one tenth of actual costs. Most importantly, the property tax is underutilized. In addition to their low share of household expenditure (Figure 4), property taxes amount to only 0.19 percent of GDP under the Authority, compared to an average 1.13 percent of GDP for 21 OECD countries. The property tax is an appropriate and equitable local revenue source because it pays for expenditures that directly benefit local property and because property ownership is reasonably related to ability to pay the tax.

Because their fiscal resources vary greatly, many local governments cannot fully meet local service requirements. Per capita expenditure in the highest-spending municipality studied was 5 times that in the lowest.

To help local governments and utilities increase their potential contribution to a strong public sector, priorities include:

- enforcing hard budget constraints to put utility and local government finance on a sound

footing and to ease fiscal pressure on the Authority's central budget, which has been backstopping arrears in municipal utility payments (including those to Israel);

- the *Local Government Law* provides for transfers to local governments of revenues such as half of vehicle licensing fees to support local functions such as road maintenance. Arrangements need to be made to ensure that these transfers are paid regularly and promptly;
- supporting Palestinian Water Authority and Palestinian Energy Authority efforts to create consolidated regional water and electricity utilities, so as to generate efficiency, resource and financing gains through better management;
- aligning the benefits of municipal expenditures with revenues by matching user fees more closely with service costs;
- improving the property tax by overhauling property assessments and land titling and registration, and by giving local governments the authority to set tax rates and to collect and retain revenues;
- once dependable measures of tax bases become available, establishing an "equalization" program of transfers to less well-off local governments, to ensure that all local governments have the ability to provide common services at reasonable tax rates; and
- strengthening the tax authority of local governments by increasing local accountability and representation (e.g., by proceeding with existing plans for local elections).

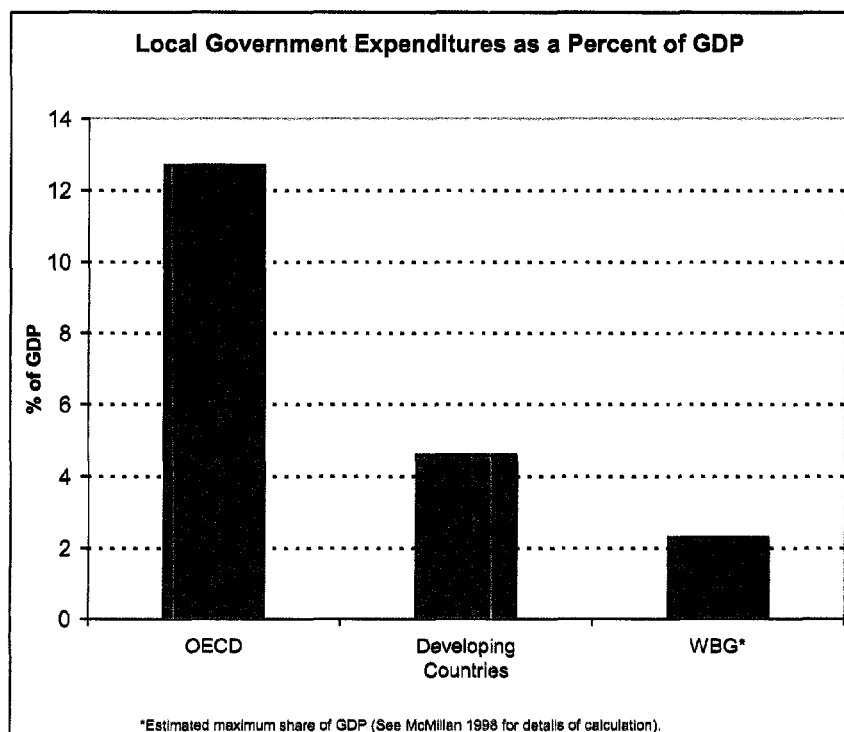


Figure 3

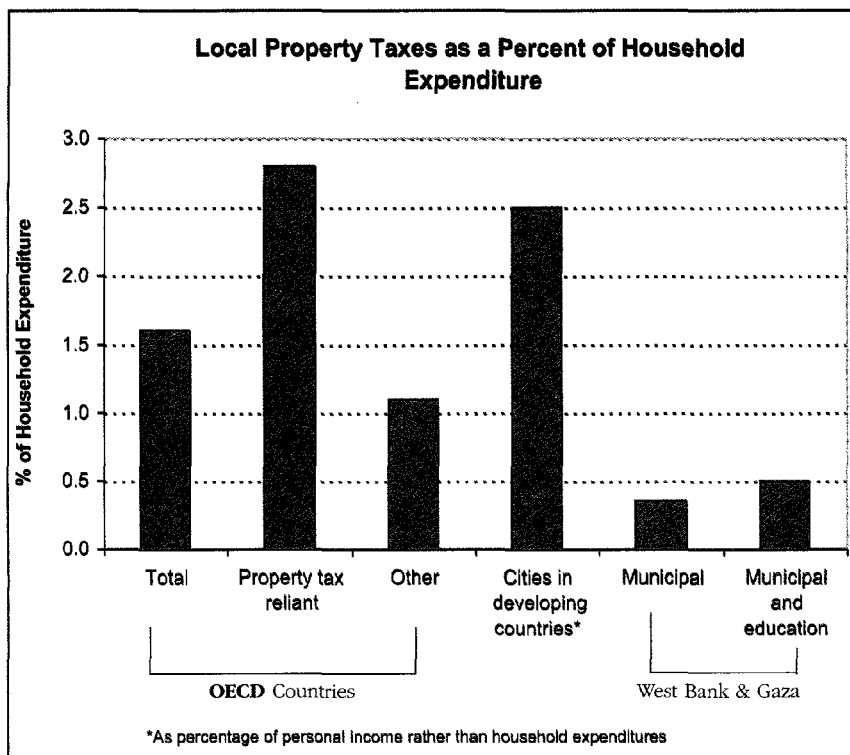


Figure 4

IV. How Can Donors Help Strengthen Public Sector Management Capacity?

Many donors are already helping the Authority strengthen its institutional framework for public sector management. Such efforts can be furthered in at least two ways.

The first is by tailoring assistance to ensure Palestinian capacity, both financial and institutional, to operate and maintain investments which donors themselves fund. For example, in funding new infrastructure or equipment, attention can be focused on the institutional arrangements under which the outlays required for operations and maintenance (O&M) will be budgeted and secured, those under which O&M itself will be carried out, etc.

The second is by directly assisting in strengthening institutional arrangements and capacity in areas of public sector management which are critical for the Authority. These areas include civil service management, integrated recurrent and capital budgeting, audit functions, a contracting framework for outsourcing public services, and property taxation and associated land titling and registration. Arrangements where donors fund technical assistance can be supplemented by direct agency-to-agency support for institution-building. For example, innovative twinning arrangements between donor and local ministries and agencies can bring donor experience to bear on the development of local functions and associated training of personnel.

INTRODUCTION

1

Analysis of current and prospective economic developments in West Bank/Gaza (henceforth WBG) suggests that a review of public sector and budget management is not only timely, but urgent. Despite a renewed round of pledges of donor support accompanying the Wye River Memorandum of late 1998, the Palestinian Authority (henceforth PA) faces severe fiscal constraints in the medium term as it evolves into a mature entity with a full range of governmental responsibilities. If the PA is to fulfill its existing obligations, let alone meet its emerging responsibilities or satisfy its future aspirations, well-performing budgetary and public sector management systems become a priority. These considerations provide the primary rationale for the focus on issues of public sector and budget management in the present review of PA public expenditures.

The Bank's strategic approach to economic development and poverty emphasizes helping countries develop the processes and institutions required to design good policies themselves, rather than in simply giving policy advice.¹ Our public expenditure review for West Bank/Gaza adopts this emphasis on institution-building. We are interested not simply in giving advice to the Palestinian Authority about the budget and other issues of public policy, but principally in suggesting how the Authority may build its own capacity for public sector management by focusing on the rules, norms and procedures that make up the incentive framework within which public officials and agencies formulate and implement public policy.

The review is organized as follows. The second chapter presents a snapshot of the recent and present fiscal situation in WBG and considers the medium-term fiscal outlook for WBG and its implications. The third chapter examines issues concerning the public service. The fourth chapter puts forward our principal recommendations concerning budget management and accountability. The fifth chapter explores the implications of alternative methods of public service delivery. The sixth chapter, on education, illustrates the application of public sector management concepts to one of the core responsibilities of the PA and the largest category

of social service expenditures in the PA budget. The seventh and final chapter shifts the focus to local government and utilities, and the interrelationships of their funding with that of the PA. A list of recommendations is advanced at the end of most chapters. Where relevant, the list is accompanied by our views as to priorities in tackling these recommendations, the sequence in which they should be undertaken, and options available to the authorities.

The principal issues examined in the following chapters can be briefly outlined. The second chapter examines some of the principal macroeconomic challenges facing the PA. The optimism accompanying the Oslo Agreement and the establishment of the Palestinian Authority in 1994 has been followed by disappointment as per capita incomes in WBG have declined by one sixth and unemployment rates have risen, fluctuating between 15 and 30 percent. Perhaps the most impressive achievement of the PA Ministry of Finance has been to increase its revenue raising capacity to cover rapidly rising recurrent expenditures. There is a widespread view, however, that it will be difficult to raise additional revenues, at least at the national level, because most potential improvements in revenue administration have already been introduced. Furthermore, although the recurrent budget is in balance, capital expenditure is financed entirely by donor assistance. In addition, nongovernment organizations (NGOs) supply and pay for extensive services: UNRWA makes health, education and other relief and social services available to 1.3 million Palestinian refugees in the West Bank and Gaza, for instance, although not all refugees use these UNRWA programs.

Public job creation by the PA will be a central issue examined in this review. Such public job creation is in large part a response to unemployment and declining incomes; it cannot be explained solely by the transfer of responsibilities from Israel to the PA. The PA civilian work force grew by 18 percent in 1996 and 9 percent in 1997, although no transfer of responsibilities occurred in 1997. Further evidence of the public service being used as a job creation program is seen when data on public sector employment growth is disaggregated by function. As we shall see, one of the highest birth-rates in the world has led to a dramatic bulge in the school-age population of WBG in recent years. The need for more teachers to deal with the resulting growth in educational enrolment is frequently cited by the authorities to illustrate the need for more PA

¹ Support for this emphasis is provided by the Bank's 1997 World Development Report, *The State in a Changing World*, which found that poorly functioning public sector institutions are major constraints to growth. Nearly all loans of the Bank now have an institution-building component and such components account in total for about one quarter of the cost of projects funded in whole or in part by the Bank.

hiring. Chapter 6 finds, however, that recruitment of teachers has surpassed the growth in enrolment, as evidenced by the decline in average class size (or the student/teacher ratio) since the creation of the PA. Moreover, there has also been a decrease in the ratio of teaching to administrative/support staff in education, indicating that the pace of recruitment of the latter categories of staff has been more rapid than that of teachers.

The result of this substantial government hiring program is, as Figure A.1 in the Data Annex indicates, that central government civilian employment relative to the labor force and population is now higher in WBG than in any other jurisdiction in the Bank's MNA Region. Another outcome, illustrated in Figure A.2. in the Data Annex, is that the share of the payroll in total public expenditures is higher for the PA than for other jurisdictions in the Bank's MNA Region and much higher than the average in all of the Bank's other regions.

The Palestinian Authority has been unsuccessful in attempting to cut back in its own hiring. The May 1998 Budget announced that new hiring would be restricted to filling 2500 additional positions in 1998 and a high level committee of civil servants was tasked with monitoring this hiring freeze. The Ministry of Finance's *Report on Fiscal Developments* for the third quarter of 1998 notes, however, that new hiring had already exceeded 6900 by the end of September 1998, 2300 new teaching positions still had to be filled in the remainder of the year and other hiring was continuing.

A consequence of the inability to meet these public employment targets is that the PA Executive does not have the same issues of choice facing cabinets in other governments, such as whether incremental resources should be spent on bricks and mortar for buildings or paving for roads, whether they should be used to raise public sector wages or even whether they should be given back to taxpayers in tax relief. These choices are effectively preempted in WBG by the domination of spending by new public service hiring.

A less obvious but ominous consequence is that future policy choices of the PA, and its capacity to handle future responsibilities, will be severely restricted by uncontrolled public hiring. Most newly hired public servants acquire pension rights whose future costs are substantial, although they do not appear in the public accounts.² Perhaps

more importantly, the PA cannot finance capital investment to increase future incomes from its own resources and inadequate allowances for maintenance lead to higher future capital costs because of the need for premature replacement of structures and equipment. The hazards of this trade-off between dealing with short-term (although pressing) issues and long-term fiscal capacity will be a major theme of this review.

We do not mean to minimize the problems that hiring by the Palestinian Authority has been intended to address: the economic disruptions accompanying the periodic chaos and permanent uncertainty caused by closures; the almost total isolation of the economy of the West Bank from that of Gaza; and the need to integrate those returning from the diaspora into Palestinian society. There is no doubt that normalization of international relations and resumption of economic growth are needed to satisfactorily address the problem of balance in public and private employment growth in WBG. But Chapters 3 and 4 will suggest that institutional weaknesses may also explain some of these increases in employment in the public sector. WBG is the only jurisdiction we know of where central government responsibility for employment and payrolls is not under the control of one Ministry—the Ministry of Finance exercises these controls in the West Bank and the General Personnel Council (or civil service ministry) in Gaza.

We address these issues related to public sector employment and budget management in Chapters 3 and 4. Chapter 3 deals with issues arising in the growth and management of the civil service. Among the problems tackled are the need to remove overlap in the mandates of ministries and agencies and to introduce a more rigorous system for merit-based recruitment, advancement and remuneration in the public service of the Authority.

The budget management part of our enquiry in Chapter 4 examines institutional arrangements to achieve fiscal discipline, see that government priorities in expenditures are implemented, and bring about efficient and effective delivery of public services. Institutional arrangements to safeguard fiscal discipline include use of medium-term projections of revenues and expenditures in the budget process, making the budget comprehensive (to cover all expenditure and revenue items) and ensuring that actual spending corresponds to budget allocations. The job of implementing the government's strategic spending priorities can be furthered by requiring ministries and agencies to make forward estimates of the resources they plan to use, include both capital and recurrent spending in budgets, and consult civil society and, to the extent possible, use objective criteria such as benefit-cost or impact analysis in the process of setting priorities. Ensuring efficient and effective

² This is because the public accounts of the PA, as is the case for many governments, are based on cash rather than accrual accounting principles. Chapter 4 suggests that addressing this accounting issue should also be on the agenda of PA policymakers.

spending at the agency level requires further that program managers have predictable access to resources, have clearly defined mandates, and are held accountable for program performance through information made available in the public domain. The "liquidity crisis" that occurred in WBG in 1998, and that resulted in ministries not being able to access the budgets allocated to them, indicates that these conditions for efficient and effective spending at the ministry or agency level have yet to be achieved in WBG.

The development of institutional arrangements to ensure propriety in the handling of public funds and accountability for their stewardship has a significance that is separate from the importance of these factors in budget management for the PA: they are basic elements in the good governance goals of nation-building. There have already been substantial advances in attaining accountability goals for which the PA and Palestinian Legislative Council (PLC) deserve recognition. To put this progress in perspective, it should be noted that the 1997 Budget was only the first to be approved by the PLC and voted into law. Since that time, the PLC and its Budget and Finance Committee have emerged as voices calling for increased accountability. The Budget Committee has issued a series of reports outlining institutional shortcomings in budget management together with constructive proposals for dealing with them. The PA executive also deserves commendation for such actions as development of the *Organic Budget Law* that has just been signed into law in 1998 and that provides an essential framework for budget management and the law governing procurement that also came into effect at the end of 1998. The publication in 1997 of the first annual report of the PA's supreme audit agency, the General Control Institution, while often seen simply as critical of PA practice, is really an example of the executive taking action itself to see that fundamental requirements for accountability were enforced.

Other budget management and accountability tasks indicated in Chapter 4 as needing to be completed include the introduction of accounting and financial information at the municipal and central government levels, the implementation of which has been delayed; ensuring that the budget is comprehensive with respect to all planned expenditure and revenue items; planning for budgets within a medium-term framework and the further development of institutional relationships between the executive and legislative branches in order to foster increased accountability.

The extreme pressure on resources to provide public services in West Bank/Gaza suggests that there should be an equally intense interest in making the delivery of public services as cost-effective as possible. Competition among alternative service providers is now accepted as

the best method of obtaining cost-effective provision of public services.³ It has become standard practice at the Bank to seek these benefits of competition in infrastructure through participation of private sector for-profit firms. But public services can be delivered through other institutional arrangements besides conventional bureaucracies and private enterprises, such as by non-government organizations (NGOs) and even other levels of government.⁴ These alternative types of provision are of particular relevance in West Bank/Gaza. As Chapter 5 shows, non-government organizations (NGOs) in particular have traditionally provided substantial shares of many public services in health, education, agriculture, low-cost housing and microenterprise credit.

Chapter 5 also introduces a non-traditional technique to improve service provision: service delivery studies to obtain the views of consumers on the merits of the services they receive. These surveys, by increasing citizen "voice," have promise as a means of increasing the accountability of service providers and ultimately the quality of public sector services. The Bank has recently sponsored the first studies of this type to be used in WBG, to assess service provision in health and education by PA ministries and the NGO/private sector. Although health and education were initially chosen because NGO/private sector provision is greatest in these sectors, the Bank is now extending these service delivery studies to other sectors where NGOs and the private sector deliver public services. A limitation of these studies is that consumers may not be able to assess the technical quality of services, but they provide useful information on other aspects of services such as their accessibility. Techniques to measure and publish the technical quality of public services, with a view to improving quality by encouraging "feedback effects" from service providers, have yet

³ A comprehensive assessment of studies on the provision of municipal services finds, for instance, that "most of the efficiency gains from contracting out have resulted from an increased scope for competition rather than from the fact that the service was provided by a private contract" (Harry Kitchen, *Efficient Delivery of Local Government Services*. Discussion Paper No. 93-15, School of Policy Studies, Queen's University, Kingston, Ontario, 1993).

⁴ In Canada, provinces and even towns can contract with the federal police force to provide police services, and the federal government contracts with one province to collect the federal value-added tax.

⁵ The UK Government's publication of indicators of local government service, and the US Health Care Financing Administration's publication of severity-adjusted mortality rates for hospitals that serve Medicare patients, are just two examples of surveys of the technical quality of services that have been shown to lead to changes in service quality.

to be introduced in WBG.⁵

WBG has one of the highest birth and population growth rates in the world and our sixth chapter on education illustrates the effects of the resulting juggernaut on social services. In basic and secondary education, which account for the bulk of PA spending on education, enrollment increased by one quarter between 1994-95 and 1997-98, and could increase by almost half as much again by 2005. Some construction increases have been avoided because slightly more than a third of PA students are now enrolled in double-shift schools. But dealing with the projected enrollment increase will involve massive increases in construction and the associated capital budget for education. Enrollment projections for 2005 suggest that up to 8400 new classrooms in basic and secondary education may be required in WBG by 2005. The chapter puts forward recommendations to improve the financing of education, the efficiency of spending on education and to build institutions to create the conditions for the sector's continued improvement.

Education was selected for further examination as a central government function in the review in part because of its importance to future economic growth. Investment in infrastructure is also important to growth but such investment is not exclusively a central government responsibility: local capital outlays account for an estimated 40 percent of all government capital expenditures in WBG. For this reason, local government is critical in achieving sustainable development in WBG. But changes are necessary if it is to function effectively. Chapter 7 indicates that hard budget constraints are necessary both to put utility and local government finance on a sound footing and to ease fiscal pressure on the central government, which has been backstopping arrears in municipal payments to Israel. It recommends a substantial effort to build the revenue-raising capacity of local governments in WBG, primarily by increasing the role of the local property tax and by pursuing user-pay principles for utilities and similar municipal services. A need is also seen in the future for a system of "equalization payments" to allow less well-off municipalities to offer standard municipal services. Finally, the economic gains from local governments rest on these governments being accountable to local constituents for local matters. The delays in holding local government elections in WBG since the creation of the Palestinian Authority have postponed the onset of these economic benefits.

The chapter on local government and utilities also provides an excellent example of weaknesses that can be remedied by introducing institutional arrangements that foster better public sector management. Much WBG infrastructure is in poor

condition and the supply and consumption of utility services such as electricity and water is low by regional standards; water consumption, for instance, is only one-third that in Israel and below minimum amounts recommended by the World Health Organization. In these circumstances, it may come as a shock to learn that 50 percent of water in WBG municipal systems is lost in transmission. Wastage in more efficient utilities is much less-sometimes only a small fraction of the overall rate for WBG.⁶ By reducing these losses, better management can improve revenues and service without increasing payment burdens on consumers, and this is exactly what is happening under a management contract in the Gaza Water and Wastewater project, which is supported by a Bank credit.

This example serves as a good introduction to the rest of our work in this review. It shows that good performance in public sector management provides a map which shows the way out of many of the mazes of existing economic difficulties confronting the Palestinian Authority and the route to satisfying future Palestinian aspirations.

⁵ For instance, wastage is 20-25 percent in the Jerusalem Water Undertaking at Ramallah, 12-15 percent in North America, and 6 percent in Singapore.



THE PALESTINIAN AUTHORITY'S MEDIUM-TERM FISCAL OUTLOOK

The Palestinian Authority's Medium-term Fiscal Outlook

What is the fiscal outlook for the Palestinian Authority in the medium term? This chapter addresses the issue from a macroeconomic perspective and concludes that the PA is currently facing liquidity constraints and risks facing a growing revenue gap in the coming years. The nature of this revenue gap will determine options for avoiding future deficits.

The West Bank and Gaza has a population of almost 2.7 million Palestinians according to the December 1997 Census (excluding East Jerusalem). Rapid population growth is driven by fertility rates that average 6 percent, among the highest in the world. The population profile is young, with almost half the population below the age of 15, and life expectancy is high at 70 years. Palestinians average 8 years of schooling, and a modest 16 percent of the population is illiterate. Gross domestic product (GDP) in 1997 was an estimated US\$3.4 billion and gross national product (GNP) was US\$3.9 billion, indicating significant earnings by Palestinians working in Israel or abroad.⁷ GDP per capita averaged US\$1,360, while GNP per capita was nearly US\$1,600 (exclusive of East Jerusalem). Since the signing of the Oslo Agreement, economic performance has not kept pace with the rapidly growing population, so that real GNP per capita fell by more than 17 percent between 1994 and 1997. Stagnant and even negative economic growth is largely attributable to exogenous factors such as restricted labor flows and Israeli border closures, which have had direct implications for unemployment. At the same time, the rate of inflation slowed from 12 percent in 1994 to about 7 percent in 1997. The prices of consumer goods have trended up in the fourth quarter of 1998 in conjunction with the depreciating Shekel.

The productive sectors of the economy are dominated by small-scale, family-run businesses. According to official statistics, about 35 percent of total output is generated by service activities in trade, transport, tourism and business services, while construction activities account for a further 10 percent, agricultural output and industrial production each contribute 15 percent, and public and community services generate the remaining

25 percent. Export growth continues to be constrained by political obstacles that restrict access to export markets, resulting in a large trade deficit particularly vis-à-vis Israel, which is the source of most imports into WBG. The low savings rate and high level of investment, primarily in housing, leads to a significant current account deficit (despite substantial labor income) that is financed mostly by donor assistance.

Recurrent Budget is Balanced and Donors Finance Capital Investment

An assessment of recent fiscal performance and the prospects for fiscal resources in the medium term highlights the risk that future revenue collections may not meet future expenditure needs. Since the PA was established in 1994, recurrent expenditures have risen in line with increasing revenue collections; recurrent expenditures rose from 18 percent of GDP in 1995 to 25 percent in 1997, whereas recurrent revenues increased from 16 percent to 24 percent of GDP (see Table 2.1). The rise in recurrent expenditure by the central government coincided with a decline in grant-financed current expenditure as the PA assumed responsibility for services previously provided by donors.⁸ Although the central government's recurrent budget has remained close to balance, with deficits ranging from 1 to 3 percent of GDP, capital expenditure for 1995-97 was financed solely by donor assistance.

Lower than anticipated revenue across all sources (i.e., taxes, clearances and non-tax revenue), due in part to the depreciation of the shekel, has raised the possibility of a slight recurrent budget deficit in 1998. Revenue shortfalls have resulted in liquidity constraints at the Ministry of Finance with implications across sectors. For example, the Ministry of Health has scaled back non-urgent operations and drug dispensing to non-emergency patients due to the lack of access to its allotted budget.

⁷ Taxes on labor income earned in Israel are remitted to the PA by the Israeli authorities and as such are included in the WBG tax base.

⁸ Grant-financed current spending, including UNRWA activities, fell from 13 percent of GDP in 1994 to 7 percent of GDP in 1997.

Table 2.1: Fiscal Accounts of the Central Government				
(percentage of GDP)	1994 ^a	1995	1996	1997
Central Government				
Recurrent revenue	8.9	15.5	20.0	24.3
Recurrent expenditure	11.0	17.6	22.9	25.4
Recurrent deficit ^b	-2.1	-2.0	-2.8	-1.1
Capital expenditure	7.1	5.0	5.4	6.2
o/w Donor-financed:	5.6	5.0	5.4	6.2
Capital grants	5.5	4.4	4.6	5.0
Loans	0.1	0.6	0.8	1.2
Overall deficit	-3.6	-2.0	-2.8	-1.1
^a Fiscal data for 1994 are consolidated accounts of the Palestinian Authority and the Israeli Civil Administration.				
^b Difference due to rounding errors.				
Sources: MOPIC, Ministry of Finance, IMF				

Social Sectors Consume Substantial Budget Resources

The functional composition of public expenditure has changed over the last three years with the creation of new ministries. The share of public funds allocated for the government's central functions is dominant, reaching 58 percent of total current expenditure in 1997 and 1998 (see Table 2.2). Expenditure on public order and safety (i.e. police and judiciary) absorbs some 30 percent of the budget, while general public services (i.e. legislative, executive, financial operations and planning) rose from 21 percent in 1996 to 27 percent of current expenditure in 1998.

Budget resources to the social ministries of health and education have increased in both nominal and real terms to keep pace with expanding service provision and demographic pressures. However, because the share of total budget resources has risen in favor of general government functions, the share available for education and health

services has declined slightly. In view of the rapid population growth, competition for budget resources will make it increasingly difficult to sustain the current social indicators with respect to primary enrollment rates and access to health care, for example. The share of central government funds allocated to the health sector has fallen from 14 percent in 1996 to a budgeted 11 percent for 1998, while the education budget declined from 19 percent to 18 percent. Moreover, since a small but growing share of public funds goes to tertiary education, the funds available for primary and secondary education fell from 19 percent to 17 percent of GDP between 1996 to 1998, with negative implications for equity (discussed in Chapter 6). In this context, it should be noted that UNRWA currently provides health and education services and other relief and social services to many of the 1.3 million Palestine refugees in WBG. Over the medium term, health and education services to this growing population could cost in the range of US\$100 million annually.

Table 2.2: Central Government Expenditure				
(share of expenditure)	1995	1996	1997	1998
Functional classification				
Total expenditure	n/a	100	100	100
General public services	n/a	21	27	27
Public order and safety	n/a	30	31	31
Education ¹	n/a	19	17	18
Health	n/a	14	12	11
Other expenditure				
Economic classification				
Current expenditure	100	100	100	100
Wages and salaries	62	52	55	54
Civil service	39	32	32	33
Police force	22	20	23	21
Interest payments	0	0	1	1
Transfers	3	3	2	2
Other expenditure	35	45	43	43
¹ Includes higher education.				
Sources: Ministry of Finance, IMF, Budget documents (PLC)				

Public Wage Expenditure is High and Growing

The recent trends in the composition of public expenditure with respect to economic classification also indicate growing financing needs in the future. The fundamental issue lies in the very large share of central government expenditure absorbed by wages and salaries; ranging between 52 percent and 62 percent of total current spending, government wage costs in WBG far outweigh spending in other regions of the world (Figure A.2 in the Data Annex presents a comparative analysis). In 1998, some 54 percent of the PA Budget was allocated to wages and salaries. The level of expenditure on wages and salaries has increased significantly since 1995, when spending amounted to 9 percent of GDP; by 1997, wage costs were equivalent to 14 percent of GDP. In particular, the wage bill for the police force rose from 3 percent of GDP in 1995 to 6 percent in 1997, while the wage bill for central government civilian employees climbed from 6 percent of GDP in 1995 to 8 percent in 1997.

Although a certain amount of employment and wage bill growth is anticipated in the context of setting up new government functions, the recent rapid growth in public sector employment outpaced the increase in PA responsibilities and service provision. By mid-1998, central government employment consisted of 48,138 civilian employees and a police force of 40,992, for a total of 89,130 public employees (excluding local government workers and daily paid workers⁹). A breakdown of public employment growth by category is given in Table A.1 in the Data Annex. Police hiring slowed considerably from a 36 percent increase in 1996 over 1995, to a 14 percent rise in 1997, while the civilian work force grew by 18 percent in 1996 and 9 percent in 1997. The substantial government hiring observed during this period suggests that the PA relies on public sector job creation to combat unemployment; it also indicates efforts to integrate returning PLO employees into the civil service and absorb workers repatriated from other countries. Reducing unemployment represents a pressing need, with unemployment rates oscillating between 15 and 30 percent. Creating tenured civil service jobs is a costly solution, however, both financially, because of the associated recurrent charges on the budget vis-à-vis wages and pension liabilities, as well as in efficiency terms, as a result of overstaffing, congestion and potential crowding-out of the private sector. Using public employment to address temporary employment shocks creates

a medium-term fiscal burden that will constrain the PA's capacity to respond to other demands on public resources. Alternative measures to reduce unemployment directly while retaining flexibility include hiring workers on a contractual, temporary or transitional basis.

The PA Faces Increasing Demands For Fiscal Resources

High fertility rates will lead to increased demands for social services (primarily health and education services), and the resulting large increase in public employment will continue to strain the budget through rising wage costs. Although central government funds for "other" expenditure (mostly operating and maintenance expenditure) declined from 45 to 43 percent of total expenditure between 1996 and 1997, they remained constant as a share of GDP, equivalent to 10 percent. The construction of new infrastructure and delayed maintenance on older infrastructure implies that there will be a need for heightened operating and maintenance expenditure in the short to medium term. Until now, the budget's accommodating stance was facilitated by low debt service obligations (which were negligible until 1997). However, this is likely to change as donor assistance shifts over time from grants to lending that requires repayment. To date, almost all capital investment has been financed by donors, and operating and maintenance needs have been broadly overlooked by both donors and the recipient government, due to the inherent disconnect between project design and implementation that is financed by donors in the short run, and long-term operation and maintenance that is typically the responsibility of the government. Appropriately budgeting the recurrent cost implications of ongoing and future development projects will be crucial to ensure that project benefits are fully realized and sustained. More importantly, the PA's future responsibility to finance capital investment will absorb considerable public resources in the medium term if external assistance declines.

⁹ The number of daily paid workers fluctuates considerably; in 1996, they numbered 3,325 in Gaza and Jericho, the only areas for which data is available.

Donor Assistance May Decline Over Time and There is Little Scope to Increase Central Revenue

The central government faces increasing demands for resources on numerous fronts, resulting in the likely emergence of fiscal deficits in the coming years. Budget deficits can be financed through donor assistance or external borrowing. What is the outlook for continued donor assistance? Donor aid has been substantial in the past, with commitments totaling US\$3.6 billion from 1993 through September 1998, and disbursements reaching US\$2.5 billion for the same period. Although much of this was initially allocated to finance recurrent expenditures, the PA's increasing portfolio of public service provision has led to a shift in the type of projects undertaken with donor assistance, toward capital investment.

In the context of WBG, the level of aid is partly motivated by donors' objectives to facilitate the peace process through economic assistance, and there is no evidence of flagging donor commitment to WBG development. On the contrary, donors re-affirmed their support in the wake of the recent (November 1998) Wye River Memorandum. When looking at sustainable development in the long term, however, the PA should expect that "competition" from other post conflict countries and the level of Palestinian development relative to other developing countries make long-term dependence on high levels of donor assistance impractical.

Although many countries rely on foreign borrowing to finance deficits, it represents an expensive source of financing the recurrent deficits of the PA. It should be used principally to support projects that increase the long-term productive capacity of the WBG economy. Tax revenue, by contrast, has the advantage of actually reducing deficits, rather than simply financing them. What is the scope for generating greater tax revenue, either through more efficient collection or new revenue sources? The PA has established a reasonably effective tax and customs administration over a short time span; sources range from income tax, VAT, customs duties, excise taxes and non-tax revenue, and total revenues as a share of GDP rose from 16 percent in 1995 to 24 percent in 1997. This compares favorably with other lower middle-income countries, particularly in light of the difficult circumstances under which the PA is operating. The current limits on the PA's autonomy vis-à-vis its borders results in revenue leakage on tax and

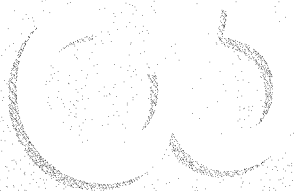
customs receipts for international trade flows.¹⁰ Within the confines of the current arrangements, there is only limited room for expanding tax revenue sources; however, some revenue gains could be realized through better tax administration, taxpayer information programs to promote taxpayer compliance, and legislative revisions of the tax code to reduce loopholes and broaden the tax base. At the local government level, there is considerable scope to increase the collection of property taxes, user charges and utility fees, thereby enabling municipalities and utilities to finance capital, operation and maintenance costs from their own sources (discussed further in Chapter 7).

Emerging Fiscal Deficits Pose a Challenge

Although measures to increase current revenue will ease fiscal pressure to some extent, a revenue gap is still likely to emerge in the medium term as a result of growing and possibly new expenditure obligations in the form of social sector expenditure, wage costs associated with a large public sector, operating and maintenance requirements, and the PA's efforts to finance a larger share of its development budget. In the near term, donor assistance remains crucial to PA fiscal sustainability. The most effective way to address the looming budget deficit at this critical junction would be to reduce the expenditure burden, which will require careful budget planning and administration, an effective freeze or slowdown in public sector hiring, cost savings from improved public expenditure management, and a more rational expenditure allocation consistent with the PA's strategic priorities to provide essential services in areas where services supplied by alternative providers (i.e. NGOs and private sector) are inadequate.

¹⁰ The *Interim Agreement* specifies that customs duties and taxes collected at Israeli ports will be transferred to the PA if the customs documentation specifically states the West Bank and Gaza Strip as the final destination. Because a very large share of WBG imports are purchased from third-party countries through Israeli agents or distributors, the PA suffers significant revenue losses. In effect, the transfer of customs revenue does not perfectly track the flow of goods as would be the case under a full-fledged final destination arrangement. In the short run, the PA is trying to overcome this by encouraging direct imports

THE PALESTINIAN CIVIL SERVICE



The Palestinian Civil Service

Compensation Levels in the PA Civil Service

We saw in Chapter 2 that there has been dramatic growth in public sector employment throughout the existence of the Palestinian Authority. It is relevant to inquire whether compensation levels and growth in these levels has also played a role in accelerating growth in the public sector wage bill.

We find, in fact, that wage levels in the Palestinian Authority are comparatively low and macroeconomic changes have caused them to become lower still in recent years. Compensation packages in the civil administration in 1998 consisted of a basic salary plus allowances, with average basic monthly salaries ranging from NIS 703 for the lowest grade civil servant to NIS 4,500 for a ministerial position. The average basic salary after taxes was about NIS 790 per month (US\$ 225), which was only 30 per cent of average monthly household expenditures for a family of 7.1 in WBG in 1997, according to household surveys carried out by the Palestinian Central Bureau of Statistics.

Low basic salary levels have led to extensive use of supplemental allowances to compensate civil servants. These allowances vary from 10-235% of basic salaries, and in some cases amount to 75% of total salary. A principal non-salary benefit is that civil servants are able to take out dollar loans in proportion to their salary. Those who made use of this facility were obviously adversely affected by the devaluation of the shekel against the dollar in 1998.

It is also worth noting that civil servants have no cost of living allowance added to their salaries, as was the case under the former Israeli Civil Administration. The absence of this inflation adjustment has led to a significant decrease in the real value of the monthly pay package.

Low compensation levels in the Palestinian Authority make it difficult to recruit qualified professionals.¹¹ The Ministry of Justice, for instance, paid contractors up to US\$3,000 a month in 1998 and was also seeking secondments of judges from

the Jordanian government. Even though qualified Palestinian expatriates are often available for employment, they are not willing to return to take up posts at the present level of compensation. Furthermore, the PA must compete for qualified personnel with numerous NGOs, particularly in the West Bank, that provide superior compensation.

The difficulty in attracting qualified professionals to work in the Palestinian Authority appears to be attributable simply to the low overall level of wages and salaries and has not been a result of compression of salaries for different skill levels within the PA bureaucracy. With allowances included, the compression ratio of salaries, or the highest total compensation relative to the lowest, is 11 to 1, which is in line with international standards.

Institutional issues: The Different Administrative and Legal Systems in WBG

The origins of the Palestinian civil service can be traced back to the period of the British Mandate. Following the 1948 war and the establishment of the State of Israel, the Gaza Strip was administered by Egypt, while the present West Bank became an integral part of the Kingdom of Jordan following a referendum in 1950. After the 1967 war, the West Bank and Gaza Strip came under Israeli military administration. The Civil Administration was established by Israel in 1981, following the Camp David Accords. The Egyptian and Jordanian law and systems were largely maintained in the West Bank and Gaza during this period of occupation.

The Palestinian Authority took over the responsibilities of the Israeli Civil Administration for all Palestinians living within the West Bank and Gaza. But the almost complete restriction on movement between the West Bank and Gaza imposed by Israel since the creation of the PA has helped perpetuate two different administrative and legal systems in the West Bank and Gaza. With respect to the civil service, these differences include two pension systems (to which a third system for police was recently added) and two institutions for civil service payroll administration.

Within the public sector there are two distinct cadres: the staff of PA ministries and institutions, and the police and security forces. A separate cadre for diplomats is currently under consideration.

¹¹ A significant number of PA officials actually have their salaries financed by donors, and several international organizations such as the UNDP and the World Bank have programs enabling qualified Palestinians living abroad to work as short-term consultants with the PA. These represent only short-term solutions to a wider problem, however.

These Palestinian civil servants come from a variety of backgrounds and bring with them different skills and approaches. The Palestinian civil service today is made up of employees who were part of the Israeli Civil Administration and were transferred to the PA in accordance with the Oslo Accords; former members of Fateh-oriented NGOs and even some of these NGOs themselves that were absorbed into the new administration; PLO officials who returned from Tunis; and members of the Palestinian Liberation Army, who have returned as police. This diversity of these backgrounds may help account for a phenomenon frequently remarked on by foreign observers—the frequent lack of communication between bureaucrats in the same ministry.

Sources of and Remedies for Uncontrolled Growth in Public Sector Employment

The Ministry of Finance has tried to implement a system of ministry-level authorization of posts based on the number of staff already recruited and the new positions for which Ministries want to recruit. The establishments so determined were reflected in the appropriations requested in the 1998 Budget.

Despite considerable efforts, however, enforcement of the number of positions authorized in the May 1998 Budget broke down in the same fiscal year. Thus, the Budget announced that new hiring would be restricted to filling 2500 additional positions in 1998. The Ministry of Finance's Report on Fiscal Developments for the third quarter of 1998 noted, however, that new hiring had already exceeded 6900 by the end of September 1998, 2300 new teaching positions still had to be filled in the remainder of the year and other hiring was continuing.

Failure to meet these public employment targets may be ascribed in the first instance to a lack of ministerial organization charts and job descriptions and overlapping responsibilities among ministries. Ministries are currently undertaking the multi-year task of preparing organizational charts and job descriptions. But ministerial organization charts have never, in fact, been formally approved at the Cabinet level. There are also numerous instances of overlapping authority between ministries. Both of these factors in turn help explain inadequate job descriptions for many posts, where these job descriptions exist at all.

To the extent that there is political pressure in the Palestinian Authority to create jobs in the public sector, of course, a lack of organization charts and

job descriptions in ministries minimizes restrictions on hiring. Organization charts would make it difficult for more people to be appointed and the absence of job descriptions may conceal the fact that for some employees actual posts do not exist at all. Similarly, the failure to clarify ministerial mandates may mean that the authorities prefer to leave ministerial responsibilities deliberately vague in order not to hinder public job creation.

Some of these increases in employment over and above what is authorized in the budget can be explained by a specific institutional weakness in the Palestinian Authority that also provides one of the most important examples of overlapping ministerial mandates in the Authority. In most countries, the GPC or its equivalent manages the recruitment, promotion, and discipline of personnel (or oversees such management by line ministries and agencies), while the Ministry of Finance or equivalent central agency typically has fiscal control over payrolls. Within the PA, in contrast, the Ministry of Finance administers the payroll in the West Bank, but the GPC is in charge of payroll administration in Gaza. This extends the responsibilities of the GPC beyond the personnel functions that are normal for a civil service ministry and at the same time impedes the Ministry of Finance's ability to implement fiscal policy.

The remedies to these problems of a lack of control of public sector employment follow from the above analysis. Fiscal control of the payroll needs to be assigned to the Ministry of Finance and civil service functions need to be assigned to the GPC. Overlap in ministerial functions needs to be resolved at the Cabinet level and Ministries must be required to have approved establishments with organization charts and job descriptions.

Inadequate Systems of Human Resource Management: Compensation, Recruitment and Promotion Policies

Responsibility for personnel is very centralized, with the GPC being responsible for human resource management across the PA. The civil service is presently divided into 20 grades (8 of which are for senior civil servants) with 28 increments for each level. The grading system is the same for the West Bank and Gaza. In general, the grading system is overly complex and gives rise to inequities. The total compensation that an employee receives is not based on functions performed but varies according to academic qualifications, the size of family, and length of time

served. There is no allowance based on evaluation of the employee's on the job performance.

There are established procedures for recruitment. A committee composed of officials of the recruiting ministry, the GPC, and a sector specialist from another ministry is required to supervise recruitment. Candidates are given points according to their qualifications and experience. Formal educational qualifications carry more weight than relevant experience, reflecting the high regard the former enjoy in Palestinian society. Written examinations were also organized in 1998 for recruitment to the Ministries of Health and Education. It appears, however, that official procedures are often bypassed in recruitment by ministries.

To receive a promotion, an employee must serve a minimum of three years in the West Bank and 4 years in Gaza at the grade, and receive at least two positive performance evaluations. The normal process is for an employee to inform his or her minister that he or she has served the minimum time in a grade required for promotion. The minister then writes to the General Personnel Council, asking for the person concerned to be promoted. The GPC usually approves regular promotions. Again, there are departures in practice from these regular channels for promotion.

There is no standard system for assessing employee performance within the PA.--evaluation practices vary throughout the civil service. Moreover, evaluations are confidential and the employee does not have access to his or her assessment.

Executive and Legislative Institutions involved in Public Administration and Human Resource Development

The picture that emerges from the above description of the PA Civil Service is that of a rather sclerotic bureaucracy in which seniority is privileged and the average civil servant lacks incentive or motivation to improve performance. There is awareness at the highest levels within the PA of the need to reform the civil service so as to improve its performance and efforts are being made to address the sources of these institutional shortcomings. As indicated subsequently, a new Civil Service Law has attempted to address many problems. Other measures have also been taken to address such issues as overlap in the mandates of ministries, the training of civil servants and other issues in public administration.

In June 1998, a decree of President Arafat established a Public Sector Reform Committee at the ministerial level. This committee is charged with reviewing government institutions' organizational structures, mission statements and objectives, and staffing patterns. The Committee has not been active since its formation, however.

A less senior but more active group in coordinating public service administration, the Core Group on Public Administration, was formed in 1997 under the auspices of the Sectoral Working Group on Institution Building established by the PA and donors. Senior civil servants represent six 'member institutions': the Cabinet Office, Ministry of Finance, General Control Institute, General Personnel Council (including the National Center for Public Administration), the Palestinian Central Bureau of Statistics, and the Ministry of Planning and International Co-operation.

The Core Group has assumed much of the responsibility for discussing and coordinating priorities for public administration across the PA. It meets regularly and its objectives include coordinating institutional development activities and donor funding for public administration, promoting human resource development, improving communication among the public administration sector's institutions and disseminating good practice in public administration. The Core Group also developed a strategy for public administration that was presented as a submission in August 1997 to the Palestinian Development Plan for 1998-2000.

The National Center for Public Administration (NCPA) was established in September 1995 with a mandate to invest in the development of public sector employees. In its first year alone, the NCPA provided training to over 2,000 public sector employees throughout the West Bank and Gaza in a wide range of management skills. The NCPA also sponsored the establishment of Training and Development Units within PA institutions. The NCPA was originally located inside MOPIC, but was transferred in 1998 to the General Personnel Council and became the Council's Directorate for Human Resource Development. Since this transfer, there appears to have been a significant decline in activities in personnel development formerly undertaken by the NCPA.

The NCPA also provided guidance to personnel units in most ministries and agencies on the identification and analysis of training needs, development of training policy and plans, and the evaluation of training. Training and Development Units and training Focal Points were established within ministries to manage and co-ordinate training activity. By being located closer to the customers for training in ministries and agencies, the Training and Development Units are intended

to be more responsive to client needs, to relate training more directly to job responsibilities, and to support and promote staff development within the public sector.

Outside the executive branch, the Palestinian Legislative Council (PLC) has been the leading force promoting civil service reform, particularly through the work of its Budget Committee. In its work on the first Report of the General Control Institute (the supreme audit institution in the PA) in 1997, the Budget Committee attributed much of the mismanagement and waste of resources reported by the GCI to defective organization of the civil service. In its 1998 report on the Palestinian Development Plan, the Budget Committee also pointed to the overlapping mandates of ministries as a cause of duplication of effort and ineffectiveness. Finally, the Budget Committee has repeatedly recommended, most recently in its report on the 1998 Budget, that fiscal control over payrolls be assigned solely to MOF.

Aborted Reform: The New Civil Service Law

On 28 May 1998, a new *Civil Service Law* was signed into law by the President that represented a determined attempt to deal with many of the problems outlined above. The new Law established a unified civil service managed by a consistent set of institutions. It clarified the functions of the GPC, bringing these functions into line with international standards by eliminating the GPC's role in determining total payroll expenditures. It defined and increased the role of individual ministries in managing their staff.

The new Law set new standards for recruitment and promotion and determined the nature and criteria for various allowances in pay. The Law revised government positions into five grades, with different steps in each. The Law called for a unified evaluation process that is more transparent, and introduced performance as an explicit factor to be taken into account in promotion. A merit allowance was also introduced that could be paid to employees rated "excellent" for two consecutive years as well as to employees who propose efficiency and cost-saving measures.

To be sure, the weight given to performance in compensation and promotion in the Law is still less than what is common in other civil services.

For instance, promotion from one step to another within grades still appears to be based disproportionately on seniority, especially in the lower grades.¹² Further, a university degree is a prerequisite for promotion to more senior grades. While this is additional evidence of the high regard accorded to formal educational qualifications within Palestinian society, the requirement may simply reward credentials rather than performance and consequently prevent the upward mobility of qualified and performing staff.

The Law revised the civil service salary scale. According to the Law, the Cabinet is responsible for proposing adjustments to salaries and forwarding the proposals to the PLC; specifying types of increment and qualifications for them in accordance with suggestions put forward by the General Personnel Council (GPC); developing human resource management systems within the PA; and specifying work days, hours, and holidays.

A major problem in implementation of the Law arose from the new salary scale it proposed. The additional annual cost of implementing the new salary scale was estimated to be from \$145-270 million, although full implementation was to take place over several years. This new salary scale raised alarms about the fiscal sustainability of additional burdens on an already strained PA treasury, however.

The procedure proposed for implementing the Law was not unusual, with the legal and administrative provisions being adopted first, and the suggested salary scale to be implemented incrementally by executive decision at later dates. The practice in most countries is that the executive thus periodically determines salary levels in the civil service.

But the salary provision of the new Law opened a Pandora's Box that proved to be its undoing. Following a strike of health workers and others dissatisfied with the selective implementation of new salary scales, the President suspended operation of the new Law in early 1999 and called for its revision. The old grading structure and pay scales remain in place until the law is revised.

Overall, however, the new Civil Service Law represented a decisive step forward. Its eventual implementation will require introduction of a number of by-laws, and probably some technical assistance to facilitate implementation. Despite Presidential approval and subsequent publication making the Law operational in August 1998,

¹² Seniority accounts for 80 percent of the decision from the 6th to the 5th grade, 50 percent from the 4th to the 3rd grade, and only 20 percent from the 2nd to the 1st grade.

preparation and drafting of the necessary implementing by-laws and regulations had barely begun by the time the Law was suspended in January 1999, although the Public Sector Reform Committee set up a Technical Committee to prepare the by-laws and a ministerial committee was also working in this area.

When the *Civil Service Law* is eventually revised, external assistance may be needed to help the General Personnel Council adjust to its new role in modern standards of personnel management; train personnel officers in line ministries; and put in place a computerized personnel management system linking payroll and ministry-level data. The Bank has provided technical assistance to include a payroll module of the type indicated as part of the Government Financial Management Information System that is being introduced in the PA, although the module has yet to be implemented.

Recommendations

As an important first step to creation of a professional civil service, the PA needs to take the necessary measures to revise and implement the *Civil Service Law* as soon as possible. Provisions in the suspended Law that are of primary importance would:

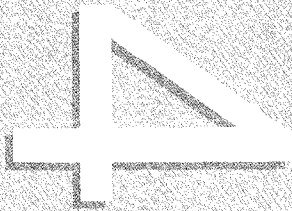
- ensure a unified control of payrolls in the Ministry of Finance and assign civil service functions to the General Personnel Council;
- unify service provisions in the West Bank and Gaza;

- and establish merit-based recruitment, advancement and remuneration.

Other recommended actions, with some suggestions on responsibility centers for carrying them out, are:

- attack the problem of overlap in ministerial mandates at the Cabinet level, where the task of the Public Sector Reform Committee in making recommendations on this issue should be re-emphasized;
- require that ministries formulate organizational charts and job descriptions for their positions. Consideration of organizational charts would be a suitable accompaniment to a re-emphasized responsibility of the Public Sector Reform Committee to make recommendations with respect to overlap in ministerial mandates. The Core Group on Public Administration might well make recommendations on the adequacy of job descriptions in Ministries;
- introduce a computerized personnel database linked with payrolls to allow checks and audits, as planned in the Government Financial Management Information System;
- mobilize the necessary resources through external assistance to help the General Personnel Council adjust to its new role and introduce and extend modern standards of personnel management; and
- provide adequate training to personnel officers in line ministries to ensure compliance with recruitment, grading and promotion policies. The Core Group on Public Administration could serve as a focal group with respect to such training.

BUDGETARY INSTITUTIONS FOR GOOD EXPENDITURE OUTCOMES AND PROPRIETY SAFEGUARDS



Budgetary Institutions for Good Expenditure Outcomes and Propriety Safeguards

The Palestinian Authority's institutional arrangements—the set of rules, norms, and procedures for formulating and implementing budgetary policy, while developing rapidly, have until recently been insufficiently formalized. Formal institutional arrangements now exist in many key areas, but more effort is needed to ensure that they are effectively enforced. As shown in the preceding chapter, the Palestinian civil service provides an example of an ineffective institutional framework governing personnel functions. In order to ensure good expenditure outcomes and guarantee high standards of propriety in the stewardship of public funds, formal institutional provisions for transparency and accountability in preparing and executing budgets, and especially their enforcement, also need to be strengthened. In the absence of a complete set of such formal institutional arrangements, over the past four years PA agencies and officials have filled in the gaps with an eclectic mix of formal and informal rules, norms and procedures derived from those that prevailed within the PLO and the pre-PA traditions of government in the West Bank and Gaza (some going back to Ottoman times), or from donor priorities and requirements. On balance, these have resulted in reasonable public expenditure outcomes and accountability for public funds over the past four years, but at times have exhibited notable deficiencies and drawn criticism.

Completing the build-up of formal institutional arrangements that are apt to promote good expenditure outcomes—fiscal discipline, strategic expenditure priority-setting, and efficient and effective use of public funds—is a task that deserves precedence on the part of the PA and donors. In general, putting such institutions in place is a key element of nation-building. More particularly, there is an urgent need to safeguard aggregate fiscal discipline in view of the uncertainty about revenue sources, potential new expenditure responsibilities, and donor assistance in the medium to long-term. The capacity to determine priorities for public expenditures within a proper strategic framework, as well as to ensure efficient and effective use of public funds at the individual ministry and agency level, is likewise vital given the combination of scarce public resources and high expectations of public service delivery among the Palestinian population.

Building the institutional arrangements needed to ensure high standards of propriety in the stewardship of public funds (which are closely related to those needed for good expenditure

outcomes) should likewise be a high priority task for the PA and donors. Aside from the broader benefits to Palestinian society of good governance, continued strengthening of propriety safeguards will be critical in motivating future donor support for the Authority's public investment and other expenditures. It will also be key to dispelling the negative perceptions that developed among the media and the Palestinian public in the wake of the first annual report in May 1997 of the General Control Institution (GCI), the PA's supreme audit body. Finally, the adoption of more comprehensive accounting principles is also an important institutional change that would serve to increase the transparency of the fiscal accounts.

Further Development Needed in Budgetary Institutions for Good Public Expenditure Outcomes

Recent Bank work advocates using three criteria to assess the extent to which central budgetary institutions are apt to foster good expenditure outcomes. Do the institutions help safeguard overall fiscal discipline? Do they ensure that budgetary allocations reflect the strategic priorities of policy makers? And do they promote efficient and effective use of resources as agencies spend their allocations?

To safeguard aggregate fiscal discipline, certain institutional arrangements in the budgetary process and associated accountability and transparency provisions are particularly important. These include incorporating a macroeconomic framework and ensuring the dominance of central ministries (notably Finance) in the budget-making process. Furthermore, budgeting needs to be comprehensive (i.e., ensuring that no major expenditure or revenue items are omitted) and requires reconciling budget allocations with actual spending, with evaluations of performance in this respect being made publicly available and with such performance being subject to sanctions for deviations. These institutional arrangements counteract the so-called "commons" problem the risk of resource hoarding by competing claims among government agencies on budget resources, the "rights" to which are ill-defined ex ante.

The PA has been gradually developing many of these institutional arrangements but, at least through the approval of the 1998 budget, further efforts were needed to formalize them and to ensure their application. The recent enactment of a new *Organic Budget Law* (which provides a framework and timetable for annual budget preparation, execution, and follow-up and defines the parameters of Palestinian Legislative Council (PLC) oversight), formalizes many of the requisite institutional arrangements. Preparation, approval, execution, and monitoring of future annual budgets within the confines of the new Law should address many of the shortcomings that have been manifest in past years. These shortcomings—many of which had already been rectified in the 1998 budget—included long delays in submitting the annual budget, failure to report on the execution of previous-year budgets for PLC review, omission of key revenue items from the budget, and only superficial integration of public investment expenditures (which to date have been almost wholly grant-funded by donors) with the Authority's annual budget.

Even with the new *Organic Budget Law*, adequately safeguarding future fiscal discipline hinges on reinforcing certain arrangements in the PA's budget preparation process. Annual budget proposals need to be systematically integrated into a medium-term macroeconomic framework so as to foster substantive cabinet-level discussions of various fiscal policy stances and their medium-term implications. Furthermore, budget coordination mechanisms such as the budget circular underpinning agency-level preparation and submission need to ensure that all planned expenditures, including those on projects directly funded by donors, are incorporated into the overall budget. Use of a medium-term framework and coordination mechanisms that comprehensively record planned expenditures in the budget are critical requirements in planning the future operations and maintenance requirements of public investments. As discussed in Chapter 2, the latter issue is gaining in importance because of the fiscal pressures associated with a large and growing wage bill.

Institutional arrangements that encourage budgetary allocations to reflect the strategic priorities of the government include the use of "forward estimates" by agencies (in effect allowing comparisons of costs of competing priorities over time), comprehensive budgeting, broad-based consultations in budget-making, and the use of objective criteria such as cost-effectiveness analysis in the process of setting priorities. They also include accountability and transparency provisions such as a requirement to report on and evaluate budget outcomes (with reports being made available and accessible to the public), adequate

technical capacity within the legislative branch to assist legislators in assessing the government's budget proposals, and enforcement of hard budget constraints on ministries and agencies. Conceptually, such arrangements and provisions will give political decision-makers access to good quality information in setting priorities (including information on how expenditure allocations translate into final policy outcomes and the key associated tradeoffs), and will ensure that priorities are in fact carried out.

Under the PA, many of the institutional arrangements and accountability/transparency provisions needed to ensure that the government's priorities are effectively reflected in use of budgetary resources are now there, but many are of very recent origin. The *Organic Budget Law* came into effect in mid-1998. The 1999 Budget Circular is the first requiring ministries and agencies to link their recurrent and capital budgets. The Ministry of Finance is about to set up and staff units to carry out medium term macroeconomic forecasting and to integrate capital and recurrent budgets. All ministries and agencies are now required to have some estimates of future budgetary requirements. The two largest ministries dealing with social welfare, the Ministries of Education and Health, will be the first required to support their requests for budgets with forward estimates of programs, such as for primary and secondary education and health care. Obviously, however, the institutional experience to make these provisions systematic has yet to be accumulated. The next few years of institutional experience will be critical to the success of these ambitious planning steps.

The use of objective criteria (such as cost-effectiveness or impact analysis) in ranking expenditure priorities, while present in some agencies and often required under donor programs, is still not systematic and lacks uniformity. Although the new *Organic Budget Law* does introduce the requirement of a summary description of the Executive Authority's objectives, programs and plans for a given fiscal year, experience in reporting on, and ex post evaluation of, program outcomes still needs to be accumulated. Finally, while there is presently no provision giving Palestinian private business or civil society the opportunity for direct input into discussions on expenditure priorities, beginning with the 1997 budget the PLC (supported by its Budget and Finance Committee) has reviewed the annual budget and formally voted it into law.

While there is an urgent need for institution-building efforts to address (or to continue addressing) all of the issues outlined above, perhaps the most pressing issue pertains to budget comprehensiveness. Annual budget preparation under MOF auspices, while gradually gaining in

structure and rigor over the past four years-as evidenced in the increasing sophistication of budget circulars-has largely excluded investment expenditures. Investment programs incorporating the latter-most recently the 1999-2001 Palestinian Development Plan-have been prepared periodically, on separate if parallel tracks, in the first instance for presentation to donor forums in order to mobilize funding commitments. Efforts which have been initiated to bridge the disconnect between the two must now be institutionalized, barring which a properly unified view for consistent and sustained expenditure priority-setting will continue to be elusive.

To foster efficient and effective spending at the agency level, relevant institutional measures are needed to attract and retain qualified and motivated managers and employees, and to ensure that agencies have managerial autonomy and face predictable access to resources. The 1998 "liquidity crisis", in which agencies were not allowed to spend budgets that had been allocated to them because the Ministry of Finance faced a shortfall in revenues, indicates that these goals still have to be achieved. Agencies must also have clear mandates and tasks, be subject to rigorous accounting and auditing standards and client surveys, and have assessments of their performance available for scrutiny in the public domain. These institutional arrangements are designed to create otherwise missing incentives for agencies to use resources efficiently and effectively, while at the same time properly fulfilling the priorities set by political decision-makers.

For the PA, the need to establish and strengthen institutional arrangements to support efficient and effective public spending remains considerable. The previous chapter examined issues associated with building a professional public service, and indicated the need to institutionalize a more rigorous system for merit-based recruitment, advancement, and remuneration in the Palestinian Authority. There is also a need, as described in the previous chapter, to clarify, and to remove residual overlap in, the mandates and tasks of line ministries and agencies. For example, many agencies still do not have formalized mandates or "mission statements". Aside from this, the restrictions now in force on the ability of ministries and agencies to use their recurrent budgets to achieve their objectives are minor, with one exception. For instance, central controls are imposed on rents and overseas travel by civil servants. The most important restriction, however, is that the composition of payrolls (as determined by appointments, promotions, etc.) is presently determined by the GPC. If and when suspension of the new *Civil Service Law* is lifted and it comes into effect, appointments and promotions of personnel will be determined by the ministries

themselves. The importance of payrolls in recurrent budgets therefore means that ministries will have substantial flexibility in altering their own budgets. Uniform automation of payrolls and other expenditures under the GFMIS will also give ministries a tool for determining their current budgetary situation by supplying data for planning purposes that is presently unavailable to them.

Perhaps most urgent is the need to institutionalize rigorous accounting and auditing procedures for all ministries and departments of the Palestinian Authority. The PA deserves credit for recognizing the importance of a strong institutional framework with respect to accounting and auditing, and for creating the requisite structures. Despite notable progress in building up accounting and auditing functions, the framework remains nascent and weak in many areas, however. For example, a detailed manual setting out a standardized chart of accounts for agency transactions has been prepared under the Government Financial Management Information System (GFMIS) project, but the GFMIS project is still under implementation. The capacity for controlling and auditing individual agencies' accounts remains uneven and fragmented, owing to a lack of uniform standards, and clear rules for placing audit results in the public domain do not yet exist. Experience with client surveys and other "voice" mechanisms is still limited. However, the service delivery surveys recently initiated in the education and health care sectors are a promising first step, and merit consideration to be institutionalized in these and other sectors so as to increase the accountability of individual ministries and agencies.

Control and audit functions themselves are still at an early stage of development. The capacity for, and intensity of, internal control and auditing within individual ministries and agencies-typically carried out by their finance departments-remains unevenly developed. Meanwhile, the "central" internal audit function is highly fragmented, with responsibilities split among the GPC (for audits of the Gaza civil service payroll), a Ministry of Finance Internal Auditing Department (for audits of most non-security agencies-excluding personnel expenditures in Gaza), and a special Ministry of Finance Department (for audits-*de facto* a combination of internal and external-of the security agencies and certain other items). The PA's external audit functions are covered by the General Control Institution (in effect an auditor-general's department), but exclude oversight of the security forces and the President's Office. The capacity of these audit bodies varies, but all have substantial unmet needs for professional training and equipment. Perhaps most significantly, the enabling environment of formal laws and regulations that define the mandates of these bodies and empower them needs to be further

developed. In the case of the GCI, where a formal authorizing framework already exists, international experience suggests that modifications in key provisions would strengthen accountability (see below).

Accounting and Auditing Institutions and Rules are Central to Stewardship of Public Funds

Solid and uniform accounting and auditing standards and capacity are critical to safeguarding propriety and regularity in the stewardship of public funds—that is, ensuring that the collection and disposition of public funds is done "cleanly"—with minimal scope for abusing public office for private gain in doing so—and with the requisite authority (typically conferred by the annual budget as approved by the legislative branch). More generally, three key questions are helpful in assessing propriety safeguards. First, how clearly defined, formalized, and disseminated are the rules concerning standards of propriety in the stewardship of public funds? Second, how adequate is the authorizing framework and capacity for detecting improper or irregular transactions? And third, are there provisions for accountability and sanctions should such improper or irregular transactions be detected?

The PA is still developing its rules concerning propriety and regularity standards, and these efforts now need to be intensified. The recent enactment of the *Organic Budget Law* and the *Civil Service Law* (although the latter has since been suspended) are important steps in formalizing standards for the authorization and execution of public revenue collection and expenditure, and for the recruitment, advancement, and remuneration of the Authority's employees. Efforts should now be directed at making sure these standards are observed. Rules and standards for government accounting, however, have not yet been fully formalized, although a chart of accounts has been developed under the GFMIS project. Another key area where until recently rules were insufficiently formalized concerns procurement. The new procurement law which came into effect in November 1998 addresses this problem, but experience in applying the new standards will now need to be accumulated.

Adequate formalization and dissemination of standards is an important prerequisite for their efficient policing and enforcement, since it provides the benchmarks for identifying improper or irregular transactions. But efficient detection and enforcement also hinges on adequate capacity to

fulfil these functions, and on the supporting institutional arrangements under which this is done. These areas still require priority attention on the part of the PA. As discussed above, several structures with control and auditing functions are in place, but many do not yet have the full capacity and mandates to fulfill these functions to high standards. In particular, the effectiveness of the Authority's external audit apparatus, the GCI, would likely be improved through institutional arrangements that better circumscribe the broad mandate accorded to it under its 1994 establishment decree, and that modify the reporting relationship provided for therein. More generally, institutional arrangements that provide for active legislative branch oversight of transactions by public agencies have proved effective in ensuring proper accountability in the stewardship of public funds. The reinforcement of such arrangements in the PA—which may, for example, call for enactment of the much-delayed Basic (or Constitutional) Law—is to be encouraged.

Finally, the Authority needs to ensure that institutional arrangements for applying sanctions in the event of improper or irregular transactions are clearly defined and in place. Ex ante rules, rather than ex post discretion, in the process leading to sanctions are needed to avoid arbitrariness and uneven application; this involves clearly specifying the roles of the PLC and the judicial branch. Until such institutions are developed, there is a risk of undermining public confidence in the transparency and accountability of government.

Comprehensive Accounting Principles are Needed for Transparency and Accountability

Part of the current thrust towards greater accountability and fiscal transparency throughout the world involves adoption of more comprehensive accounting principles or measures. In West Bank/Gaza, the Bank has provided technical assistance to introduce a uniform system of municipal accounts based on (modified) accrual accounting principles. Many countries, and the IMF in its Government Financial Statistics, are similarly moving to adopt accrual accounting principles in national accounts. Absent this change, accountability may require publishing special estimates of future obligations whose importance is not revealed in the traditional cash accounting framework. For instance, the medium term fiscal impact of the substantial expansion in public employment by the PA is only partly reflected in

the wage bill, since the latter provides no indication of the obligations for future outlays associated with pay-as-you-go (PAYG) pension plans for public servants. The latter can be substantial.¹³

The Palestinian Authority administers two pension systems for civil servants (there are separate systems in the West Bank and Gaza) and an additional system for the police forces. All three systems operate on a PAYG basis, but they differ substantially in their actuarial soundness and in the accumulated reserves backing liabilities. Of special concern is the actuarial soundness of the pension system for police, which by some estimates would require contribution rates well above 100 percent of salary to maintain the current level of benefits and be actuarially sound.

There are other complications in the pension picture—such as the desire to recognize past service in the PLO as to fulfill qualifications to receive public service pensions. This desire is understandable. Other newly created states—including the US—have similarly recognized and rewarded service prior to the state's formation. For the sake of fiscal transparency, however, compensation for past service in the PLO should be paid through clearly specified budget allocations separate from the public service pension plans.

In Sum, a Substantial Institution-Building Agenda Still Lies Ahead

While much has already been achieved, further efforts are urgently needed to improve the PA's budgetary and related institutions. These institutions define the incentive framework that governs the behavior of public officials and agencies in determining the allocation and use of public resources, and are therefore key determinants of policy outcomes. While the overlap is not perfect, many of the institution-building measures needed for good expenditure outcomes will also help provide effective propriety and regularity safeguards in the stewardship of public resources.

The Palestinian Authority is already addressing many important items on the institutional development agenda. It is recommended that special priority be given to strengthening arrangements to ensure:

- comprehensive (investment as well as recurrent) annual budgeting within a medium-term macroeconomic and public expenditure framework;
- implementation of the Government Financial Management Information System, including use of a standardized chart of accounts for recording agency transactions;
- preparation now for eventual introduction of national accounts based on accrual principles, since cash accounting does not reveal the costs of many important commitments in the public sector;
- special tabulations for the projected future costs of public sector pension plans, pending implementation of accrual principles in the public accounts;
- compensation to individuals for service prior to creation of the PA through specific budgetary allocations. The intent of this recommendation is to avoid interference with the self-financing of existing public service pension plans and to increase transparency;
- the implementation of public procurement standards and guidelines;
- systematic control and audit of agency transactions and accounts by audit agencies and departments that have adequate capacity and well-defined mandates;
- that the capacities of the supreme audit authority in the PA, the General Control Institution, are reinforced by obtaining direct assistance from donor countries or by working through INTOSAI (the international organization of supreme audit authorities);
- direct reporting by the supreme audit agency to the legislature, as in most parliamentary democracies; and
- well-defined processes for applying sanctions in the event that standards of propriety and regularity are not properly observed.

¹³ In Greece, for example, the implicit liability for unfunded civil service pension plans was calculated earlier in the 1990's as being equal to 53 percent of 1994 GDP.

PUBLIC SERVICE DELIVERY: THE ROLE OF NON-GOVERNMENTAL AND PRIVATE FOR PROFIT ORGANIZATIONS



Public Service Delivery: The Role Of Non-Governmental And Private For Profit Organizations

NGO and Private Sector Provision of Public Services is Sizable

There is significant existing capacity in the delivery of public services by non-government entities, defined here as consisting of non-governmental organizations (NGOs¹⁴) and private for-profit firms (international NGOs and UNRWA are not discussed here). Non-public service provision is most striking in the health, education and agricultural sectors; 68 percent of hospitals are owned by NGOs or private firms, and virtually all kindergartens are run by non-public agencies (see Table 5.1). The assessment provided here relies on examples drawn from the health and education sectors because they constitute the largest instances of non-government provision of public services and present interesting paradigms of competition and complementarity of services between NGOs, private and public actors.

Despite sustained donor support to the Palestinian Authority (PA) since its inception and the continued shift in external funding toward the PA and away from NGOs, the PA can not fully take over service provision in the West Bank and Gaza at this stage of its institutional development. In any event, this may not be the most efficient option, given that NGOs have developed extensive field and technical expertise over the course of three decades of Israeli occupation, from which the PA can benefit. Moreover, NGOs and private sector organizations

generally provide high quality services. The PA should therefore consider using the private sector and NGOs to deliver public services more effectively, before continuing to expand its own services, and as part of its overall effort at rationalizing its own management of public service delivery. Indeed, there is more to delivering services than running government departments efficiently: working in partnership with non-public institutions and letting them take over part of the public service provision market, where they have demonstrated a comparative advantage at delivery, is increasingly becoming part of the answer to improved service delivery worldwide.

The Bank recently undertook a Service Delivery Survey (SDS) of health and education services in WBG to assess service provision by the NGOs, private sector and the PA. As is typical in these surveys, a representative sample of beneficiaries was asked to rate the quality of services they receive and make recommendations for improvement. Institutional reviews of education and health facilities were also undertaken by specialists to evaluate the quality of the equipment and service. The findings for the SDS of health and education in WBG indicate that although the monetary cost of the service is the principal reason why beneficiaries select a particular provider, the associated opportunity cost also informs their choice, whether motivated by access to service or its quality, two areas in which NGOs and private sector providers rank more highly than the

Table 5.1: Provision of Education/Health Services by Organization, 1998

	Kindergartens		Schools		PHC Clinics		Hospitals ^a		Hospital beds	
	Share	No.	Share	No.	Share	No.	Share	No.	Share	No.
Government	0.4%	3	73%	1,175	45%	209	27%	14	58%	
NGOs/-private sector	99.6%	786	11%	171	45%	208	68%	35	39%	
UNRWA		0	16%	265	10%	41	4%	2	3%	
Total		789		1,611		458		51		3,773

^a Hospitals include maternity homes.

Sources: Palestinian Central Bureau of Statistics, World Bank, 1998

¹⁴ NGOs are organizations that have two key characteristics: they are independent and not-for-profit.

government. According to the SDS findings on health, 46 percent of users chose an NGO clinic because of its accessibility, compared to 17 percent of users who chose a governmental clinic.¹⁵ As for service quality, patients report the highest level of satisfaction with medical treatment and staff behavior for the NGO/private sector and the lowest for government hospitals. Institutional reviews conducted by health specialists also reveal that governmental clinics are the least well-equipped.¹⁶

The findings from the SDS were presented at dissemination workshops held in April 1999 in the West Bank and Gaza and attended by ministers and senior civil servants from the PA and senior representatives from NGOs and private sector organizations involved in the provision of health and education services. The reaction to the SDS of the Ministers of Health and Education was to emphasize its usefulness as a policy and planning tool to improve the quality of health and education services across the board and to foster a better division of labor between the government, the NGOs and the private sector.

Between 700 and 1000 NGOs Provide Social Services in WBG

There are between 1000 and 1500 NGOs in WBG, two-thirds of which provide social services. These can be classified into two main categories. The first and largest category, the welfare organizations, are the oldest form of association, dating back to the beginning of the century. Among these are approximately 400 charitable societies, although at least a third are presently inactive for lack of funding, as well as Islamic Zakat (tithing) committees and other religious grassroots organizations. Funding for welfare organizations traditionally came from public and private Arab sources and from local donations, until the early 1990s when both sources began to decline. The scope of their services encompasses education, health and cultural activities; they also run youth and women's centers. Welfare NGOs typically serve socially and geographically excluded communities.

The second category, specialized professional committees and development NGOs, account for

the largest share of health services provided by NGOs. Historically, these NGOs stem from political parties, whether pro-PLO factions or socialist forces in opposition to the PLO. In the mid-1980s, PLO funds were made available to organizations through their allied factions; by contrast, leftist NGOs had to resort to outside funding, turning to Western donors. While the pro-PLO NGOs were by and large integrated into the PA structure in 1994, the other NGOs continued to provide services independently. Like most NGOs, they suffer from funding shortfalls, albeit less so because of their historical links with Western donors. In the last four years, they have evolved into professionally based, foreign-funded development centers with targeted clients, rather than popular constituencies.¹⁷ While their increased professionalism is a positive development, the lack of broad-based support means less accountability to their clients.

Funding, Donor Dependency and Sustainability are Crucial Issues for NGOs

External funding to NGOs fell by more than 50 percent between 1992-the peak year for external funding-and 1995.¹⁸ Total funding in 1995 was approximately US\$60 million, 60 percent of which went to the health sector. Since 1994, external funding has also shifted away from grassroots development projects in health and education toward training programs and democracy-building initiatives. Palestinian non-governmental sources estimate that external funding has risen modestly since 1995, but is unevenly distributed across sectors. Development and research NGOs manage to secure most of the Western funding owing to their greater professionalism and Western-friendly fundraising skills. Charitable societies and women's committees, although responsible for two-thirds of pre-school services, are severely handicapped at present by the loss of external funding. As a result of tight resource constraints, cost recovery is vital for NGOs, but only a few have managed to cut coverage and increase fees to generate more revenue. These measures to address financial difficulties raise concerns that NGOs are in effect moving away from their mandate to serve the poor and marginalized

¹⁵ The choice of facility is also heavily influenced by the insurance status of the patient. Of those with Government Health Insurance (GHI), 86 percent use governmental hospitals, 9 percent use NGOs and 1 percent use the private sector.

¹⁶ "West Bank and Gaza Service Delivery Survey, Health and Basic Education Services", CIET International, PCBS and the Health, Development, Information and Policy Institute (HDIP) with World Bank funding, December 1998.

¹⁷ Leftist NGOs also face a political crisis linked to the demise of the very political parties to which they are or were affiliated.

¹⁸ Bank sources estimate that NGOs received between US\$170 and US\$240 million per year in the early 1990s. Approximately US\$70 million came from international donors, between US\$30 and US\$100 million from Arab sources, and US\$30 million from local fundraising and the Palestinian diaspora. Some US\$45-US\$50 million from all sources went to NGO-run hospitals, clinics and universities.

communities, with negative social consequences, especially in the absence of a comprehensive social security system.

Private Provision of Social Services is Increasing, Especially in the West Bank

The vast majority of private sector hospitals and clinics are located in the West Bank rather than in Gaza (11 out of the 13 privately-run hospitals are in the West Bank). The private sector has made substantial investments in health since the Oslo agreements (between US\$80-US\$100 million), particularly in the provision of advanced diagnostic testing and related health services. This reflects an effort to capture the segment of the market that would otherwise go outside WBG for specialized treatments, the value of which amounted to US\$15.7 million or 16 percent of the Ministry of Health's expenditures in 1996. The PA purchases some of these newly-provided domestic services using its out-of-country treatment budget. This may not be the most efficient option, however, because it may actually be cheaper to pay for treatment in neighboring countries. Assessments of the cost-effectiveness of providing advanced health services and investing in preventive and primary health care services (typically provided by NGOs) could lead to more effective and efficient delivery of health services to the population.¹⁹

As in the case of health, private provision of education is more common in the West Bank. For example, out of 171 private schools, 156 are located in the West Bank. Although they are referred to as "private," few of these schools were originally established as for-profit institutions. They typically have a religious affiliation (Christian) and depend on donations which have steadily declined since the 1970s. Tuition fees have increased by 50 percent on average over the past decade, rendering these schools accessible mostly to the upper-middle and upper classes. A handful of private for-profit schools have recently opened, all but one of which cater to the children of Palestinian returnees and offer an English-language curriculum; very few are profit-making.

The concentration of private and, to a lesser extent, NGO provision of social services in the West Bank

¹⁹ On the cost-effectiveness of preventive and primary health care see *The World Development Report, 1993* and "*The West Bank and Gaza Medium-Term Strategy for the Health Sector*", a 1998 World Bank country study. With respect to advanced health services, the profit incentive for the private sector to invest in lucrative high-tech equipment may give rise to escalating costs in both the private and public sectors, given the common perception that demand for such services is supplier-induced.

cannot be adequately explained by the difference in population size between the West Bank (1.6 million or 57 percent of the total population, excluding East Jerusalem) and Gaza (1 million or 36 percent of total population). Likely explanations include (i) the difference in GNP/per capita between the two regions (US\$1,855 vs. US\$1,410 in the West Bank and Gaza, respectively), and (ii) the greater prominence of an educated middle-class in the West Bank that provides impetus for the formation of non-governmental and private sector organizations.

Further Expansion of Private and NGO Services Requires Economic and Political Incentives

The economic decline since the creation of the PA described in Chapter 2 has resulted in less disposable income being available to purchase NGO/private sector services. For example, in the absence of well-developed private health insurance in WBG, most patients going to NGO and private sector facilities pay out-of-pocket, thus restricting the use of non-public facilities to those who can afford it and effectively excluding low income groups. As we shall see, lack of coordination with the public sector, whether at the delivery or the planning level, has also inhibited further development of NGO/private sector services.

PA Outsourcing to NGO/ Private Providers Needs to be Systematized

Although PA/NGO relations were initially confrontational, these relations have improved as the mutual benefits of coöperation have been recognized. The Ministry of Health (MOH) was one of the first to recognize the comparative advantage of NGO provision in areas such as rehabilitation, health promotion and some aspects of primary and secondary health care. Today, at least four NGO hospitals and seven primary health care NGOs are under contract to the MOH on a regular basis.²⁰ The Ministry of Education (MOE) also collaborates with NGOs to obtain teacher training and has incorporated NGO-designed science textbooks in the national curriculum (the education sector is discussed in detail in Chapter

²⁰ The Ministry of Health buys services such as referrals and testing, as needed, from some 22 different NGOs.

6). Outsourcing to NGO/private sector providers is limited, however, owing to the PA's constrained fiscal resources as well as inadequate contracting mechanisms. Contracting seems to take place on a case-by-case basis with no systematic link to provider performance and service costs. The purchase of expensive high-tech services from the private sector should be closely monitored and performance-based, and could benefit from a well-defined contractual framework. Finally, the uneven utilization rates among hospitals in different sub-sectors points to the need for improved efficiency in the system (e.g., bed occupancy rates in the West Bank are 64 percent in NGO hospitals vs. 84 percent in the governmental sector). Extension of insurance benefits to include NGO and private hospitals would increase their utilization rates and promote a more optimal use of available capacity. The Ministry of Health is currently moving in this direction, as indicated by its collaborative arrangements with NGOs.

The PA Can Improve Resource Allocation by Involving the NGO/Private Sector in Planning

To date, the PA's efforts to involve the NGO/private sector in strategic planning have been sporadic. National health action committees that include representation of public and NGO/private sector providers have been formed to devise effective delivery models and unify professional health standards. Workshops with the participation of all three types of providers have been held to coordinate delivery and service expansion at the primary, secondary and tertiary health care levels, with the express purpose of avoiding unnecessary duplication of effort. In education, the Ministry is discussing harmonization of kindergarten and primary school curricula with a consortium of education NGOs. Under the umbrella of the Ministry of Planning and International Cooperation, a National Action Plan for Childhood is being formulated with the participation of the Ministry of Education and selected NGOs. While these represent solid efforts to coordinate sector policy, it is still unclear to what extent non-public providers are helping to shape sectoral policy and planning. Only in the health sector does the NGO/private sector relationship with the government appear to be becoming institutionalized.

Towards an NGO Law

Five years after the establishment of the PA, there is still no law regulating the activities of NGOs. This is largely a consequence of the ongoing debate within the PA on how to deal with NGO participation in social service provision and civic life in general. The latest attempt to develop an NGO law, in early 1998, arose from a joint effort between a subcommittee of the PLC and a coalition of NGOs. Amendments to the draft law were then offered by the Executive, mainly focused on the identity of the agency responsible for registering NGOs and overseeing their activities. The law drafted by the PLC provided for the Ministry of Justice to be the responsible oversight agency, whereas the Executive favored the Ministry of the Interior for this oversight role (the latter being the ministry traditionally responsible for internal order in many states in the region). A PLC vote in favor of the former option was found to be technically illegal by the PLC Speaker in August 1999, the Speaker then declaring the Executive's amendment to make the Ministry of the Interior the oversight ministry to be accepted. Apart from the controversy surrounding the question of the oversight ministry, however, it is worth noting that no other amendment has been made to the law drafted in the PLC. As of September 1999, the law is awaiting the President's signature.

Quality and Accreditation Standards must be Enforced in the Public and NGO/Private Sectors Alike

It is the PA's responsibility to establish quality standards and monitor systems of service delivery.²¹ Although PA licensing of hospitals, schools and kindergartens is enforced across the public and NGO/private sectors, rules tend to focus on quantitative aspects of provision (e.g., the number of beds, chairs, building safety) rather than on the quality of service. Once a license is granted, there is rarely any subsequent monitoring of the services or facilities. Apart from licensing, there is no regulation of pre-school educational services since kindergartens are not part of the Ministry of Education's responsibilities.²² In health, standardization in the quality of care is

²¹ Self-regulation by professional associations and further involvement of service recipients could also be promoted, provided that the former do not engage in anti-competitive behavior.

²² It is only fair to note, however, that there is also little regulation of pre-school education in many industrialized OECD economies.

progressively being addressed. The Ministry of Health is upgrading the skills of health personnel through various training programs, and quality control systems are being piloted, albeit only in a few government hospitals. There is no national agency to regulate and monitor public, private or NGO health care provision, however. For NGOs whose activities are not overseen by any legislation, this means that accountability only occurs to those who finance them.

Recommendations

In light of the discussion of the macroeconomic outlook in Chapter 2, increases in direct service provision by the PA are likely to be unsustainable and would seem to be unnecessary where there is alternative service provision of good quality. Rather, the PA's role in public service delivery will likely develop as in other Western economies: it will progressively become that of a policy-maker, planner, facilitator and regulator of service provision by the private sector and NGOs. The PA should thus start setting in place incentive mechanisms in the legal, regulatory and financial realms to capture the advantages in service provision offered by NGO/private sector providers. Specific recommendations include the needs to:

- enact an enabling NGO law;
- systematize the process of consultation with NGO/private sector providers at the delivery and planning levels of service provision in education and health;
- introduce and enforce service quality standards in all levels of health services;
- define an effective contracting framework to facilitate outsourcing of health services;
- extend Government Health Insurance coverage to permit the use of NGO/private sector facilities, on the basis of the previous two recommendations;
- repeat the service delivery studies at regular intervals for health and education to monitor changes in public experiences and opinions of these services; and
- extend service delivery studies to other sectors such as agriculture and microenterprise credit, where provision of public services is shared between government, NGOs and private sector firms.

EDUCATION

6

PA and UNRWA Provision and Financing are complemented by the Private Sector and NGOs

Educational services to the Palestinian population are provided by the public sector, the private sector and NGOs. Private sector and NGO provision occurs at all levels of education, but dominates the pre-school and tertiary levels. The public sector, including the PA and UNRWA, focuses primarily on providing basic and secondary education, although the PA as well as UNRWA provide limited post-secondary programs. Table 2.2 above showed that expenditures on education are by far the largest of all social service expenditures in the PA budget, accounting for 18 percent of total expenditure in 1998. These characteristics indicate why education was chosen as the social service sector that would receive further detailed examination in the present public expenditure review.

There are multiple sources of funding for education: the PA, donors (directly and indirectly through UNRWA), NGOs, and families. Table 6.1 summarizes the FY1997 education budget.²³ The PA allocates most of its limited resources to the provision of basic and secondary education. Families contribute only modestly to the education of children in PA schools at these levels, but much more heavily for children enrolled in pre-schools and at the most expensive level, the tertiary level, where student fees cover more than half of university expenses.

The public sector regulates the provision of education, although regulatory frameworks for the basic and secondary levels are much better developed than for the pre-school or tertiary levels. Thus far, however, the public sector has not measured learning outcomes, which are critical to assuring public sector accountability for educational performance.

Table 6.1: Outlays on Education by Source, FY1997 (US\$ millions)

	PA	UNRWA	NGOs/Donors	Users	Total
<i>Recurrent spending:</i>					
Pre-school	0.0	0.0	2.6	14.6	17.2
Basic & Secondary	141.0	62.0	1.8	4.0 ^a	208.8
Tertiary					
Vocational	2.0	7.7 ^b	na	0.0	9.7
Community college	^c	^b	na	1.3	1.3
College/University	4.3 ^c	^b	17.6 ^d	27.0	48.9
<i>Capital spending^e:</i>					
Pre-school	0.0	na	na	na	na
Basic & Secondary	0.7	^f	36.0	^a	36.7
Tertiary	0.0	0.0	0.9	0.0	0.9

Source: Background paper for the PER, "Effective Use of Resources in the Public Sector of West Bank/Gaza; The Education Sector." Data in this table represent the best estimates from various sources. For a detailed discussion, refer to the background paper.

^a In the West Bank, municipal governments collect an education tax, which amounted to US\$3 million in FY97. The recurrent/capital breakdown of spending is unknown and is excluded from this table.

^b UNRWA's US\$7.7 million covers vocational training, community college, and university college programs.

^c The Ministry of Higher Education oversees both community colleges and colleges/universities, with a total recurrent budget of US\$4.3 million.

^d US\$7.5 million of this total is obtained by borrowing, including borrowing from the pension funds of the institutions.

^e Plant and equipment only.

^f Capital investment, including that for UNRWA, is financed by donors.

²³ FY 1997 was the last fiscal year for which expenditure data for the full year was available at the time of writing in January 1999.

The System Maintains a Fragile Fiscal Equilibrium, Except for the Universities

At this time, all levels of education except for the universities seem fiscally sustainable, although funding for public vocational training centers is insufficient to provide even minimal acceptable quality. However, this fiscal equilibrium is fragile. For example, net recurrent costs for the PA and UNRWA together increases total costs by almost half of the FY1997 costs for the PA, from US\$149 million to US\$218.7 million. These additional costs of UNRWA are equivalent to two percent of 1997 GDP, relative to a base of an additional 4.5 percent of 1997 GDP that the PA will spend on education, and 8 percent of the PA's FY1997 recurrent budget, relative to a base of 17.2 percent for PA spending on education.

Student fees covered 54 percent of university outlays in 1997-98, and the European Union's contribution of US\$8.7 million covered another 17 percent of the universities' total recurrent costs. Nevertheless, the university system ran a deficit of US\$14 million (equivalent to 28 percent of total recurrent costs) which was financed by borrowing, including loans from the pension funds for university personnel. The fiscal crisis at the university level led the PLC to insist that the PA add some funding for universities in the FY1998 budget.

The PA Education Budget Includes Increasing, but Still Limited, Funding for School Textbooks, Maintenance, and Construction

Since the PA was created, donors have covered most of the expenditures for textbooks, school maintenance and new construction in WBG. The FY1997 budget made no allowance for textbooks because donors financed their costs in this fiscal year. The PA budget for textbooks in FY 1998 was about \$US 1.8 million (NIS 7 million); equivalent to a little over half of their total cost. There are presently no commitments by donors for any textbook financing in 1999 and it is assumed that the MOE budget will be covering their total cost.

Although the FY 1997 Budget made no allowance for school maintenance, the FY1998 Budget included \$US 2.9 million (NIS 11 million) for maintenance. Expenditures of NIS 14 million are planned for 1999. Although the FY1997 and

FY1998 Budgets contained allocations for school construction, no funds were actually disbursed for this purpose. By contrast, donors' contributions for capital expenditures on schools in FY1997 alone were \$US 36 million.

The PA Budget has to steadily reduce its reliance on *ad hoc* donor financing for textbooks, school maintenance, and construction—in other words, integrate their costs into its routine budgeting for the education sector. Books, maintained schools, and the availability of school seats are visible indicators of educational inputs to communities. Their provision creates some political capital for the PA; their absence, political costs. And the issues are not just political. Analyses for other countries indicate the cost-effectiveness of routine maintenance of schools, one study estimating savings of 13 percent per school over a 21 year period. Finally, school seats are a *sine qua non* of educational access, and the very high birth rates in WBG challenge the system to maintain, let alone improve, net enrollment rates.

One option to reduce the cost burden of textbooks is to introduce a textbook rental scheme managed by school districts, schools, or parent associations. The MOE currently has a textbook re-use policy even for basic grades, but this is not a textbook rental scheme nor are the books printed so as to make them sufficiently durable to support a multi-year re-use scheme. We suggest that the feasibility of a textbook rental scheme be analyzed, taking into account the costs of printing books durable enough to weather four years of use, the rental cost to families at prices that cover the next printing of books, the means to subsidize poor families, and mechanisms to manage the rental scheme that includes collecting rents and transferring them to the Ministry.

Allocation of PA Education Resources is Equitable

Several characteristics of the public education system suggest no major differences in spending on children from different family income groups. For example, by concentrating its resources on basic and secondary schooling, the PA is spending on exactly the right levels of education from the point of view of equity. The PA spends little for tertiary education, typically a source of substantial inequities in public education spending throughout much of the world. Public financing of higher education is likely to benefit higher-income families disproportionately because unit costs for such education are much higher than for pre-tertiary education and wealthier families are more apt to have children enrolled in post-secondary educational institutions. Furthermore, most

children are enrolled in school at the basic levels, although those not enrolled are more apt to come from poor families. Finally, the Ministry of Education spends approximately equal amounts per child within levels of education. On the other hand, for education levels that depend heavily on family contributions, i.e. pre-school and universities, the lack of systematic subsidies, scholarships or loan schemes imposes an equity cost on the poor. The PA finances some scholarships, but their supply is not commensurate with demand or need.

High Birth Rates Threaten Fiscal Sustainability in Basic and Secondary Education

The high fertility rates observed in WBG threaten the fiscal sustainability of the PA's recurrent and capital budgets for basic and secondary education. By year 2005, conservative estimates of basic and secondary enrollment growth alone indicate a 14 percent increase in enrollment relative to FY1997/98, and less conservative estimates indicate an enrollment increase of 45 percent for the same period²⁴. Recurrent budget costs will rise in line with enrollments; based on unit cost estimates for FY1997, enrollment increases would result in additional annual recurrent expenditures ranging from US\$41 million to US\$66 million (1.2 to 1.9 percent of 1997 GDP) using the low and high projections, respectively. If one includes the educational services provided by UNWRA, the total public system costs by 2005 would be even greater.

In terms of the capital budget, low and high estimates of basic and secondary enrollment growth translate into 4,000 to 6,500 new classrooms by the year 2005 (a 27 to 44 percent increase over the 1997-98 PA stock of 14,729 classrooms). Based on a combined PA and UNWRA stock of 19,000 classrooms in 1997-98, the total estimated physical capacity requirements by the year 2005 will range from 5,300 up to 8,400 new classrooms.

Trends in PA Basic and Secondary Education that Need to be Reversed

Using standard indicators of system efficiency, the PA's basic and secondary educational system is relatively efficient in its quantitative use of inputs: teachers, non-teaching staff, students, teaching

materials, and physical plant. The Ministry of Education's original policy of permitting only single shifts in the use of schools was not cost-efficient in the face of high enrollment growth and limited public resources. In practice, enrollment pressures have prevented the Ministry from implementing this policy: in 1996-97 about 34 percent of PA students were enrolled in double-shift schools. The MOE's current policy is to maintain this percentage, using PA and donor resources to improve educational quality rather than reducing the percent of students being educated in double shifts.

Despite its fairly efficient use of inputs, the Ministry does not routinely analyze cost tradeoffs among alternatives, thus reducing potential efficiencies that could be attained over the long term. Already some trends may signal declining efficiency. Student/teacher ratios have slowly declined over the last four years, despite rapid enrollment growth. The 1997-98 average ratio of 28 students to one teacher is entirely reasonable; however, high unemployment rates in WBG create pressures on the PA to expand public sector employment. Furthermore, the ratio of non-teaching staff to teachers is increasing, possibly signaling incipient bureaucratic bloating. Earlier chapters noted a significant increase in general administrative personnel in the PA as a whole, and a similar pattern in education gives cause for concern.

Education's Governance Arrangements are Reasonable, but Could be Improved

Four fundamental questions can be posed to assess the appropriateness of the governance of pre-tertiary levels of education. First, who has power over decisions? In general, the central government now dominates decision-making for pre-tertiary education. At the same time, although decision-making is now fundamentally centralized, the Ministry of Education is gradually decentralizing some decision-making, using pilot initiatives to build capacity and initiative at sub-national levels.

Are functions missing? No important function of education is entirely absent in WBG. Two important functions are very poorly developed, however: standard-setting and measurement of system performance. The costs of not addressing these issues are increasing-what gets measured gets done, and quality always suffers when performance is not measured.

Although some central and district staff in the Ministry of Education are now being trained in policy analysis and formulation, heretofore the

²⁴ Actual enrollment increased by 24 percent between 1994-95 and 1997-98.

Ministry has not had standards for making policy decisions. As a result, policymaking tends to be *ad hoc*. For example, policies are not routinely based on analyses that define and set priorities or on feasibility assessments of alternative policy solutions, including assessments of comparative downstream costs. Nor has the Ministry of Education set learning standards by grade—in other words, the Ministry has not defined what students should know and know how to do by the conclusion of each grade. As a result, the Ministry does not have a basis for assessing accountability for system performance. Thus far, there has been no routine measurement of students' learning achievements. However, the Ministry has just piloted sixth grade assessments in mathematics and Arabic in 100 schools, spanning private, PA, and UNRWA schools. The committees revising the curriculum have almost completed their work. They are defining desired learning outcomes by grade, thus establishing the basis for establishing learning standards.

Construction standards for schools are also missing, an absence that affects design, tendering, and supervision and ultimately the quality of the final product. The lack of standards means that the Ministry cannot realize the lower prices that result from longer production runs that require standardized specifications to achieve economies of scale. At the same time, the Ministry recognizes this problem. With donor funding, it has started a project that will set norms and standards for school buildings. While standards exist for hiring, retaining, and promoting teachers, either they do not measure teachers' actual capabilities or they are set too low to assure competent teaching. For teaching positions, the Ministry of Education examines applicants' scores on the *taujibi*, the secondary school leaving examination that also affects entry into universities. However, hiring standards are primarily determined on the basis of "seat time" (years of education and experience), despite international experience indicating that a teacher's actual knowledge and skills predict students' learning achievements much more powerfully than years of education or experience. The standards for promoting teachers are also fairly minimal in WBG; a teacher is promoted if he or she receives at least what amounts to an "average" performance rating for the previous four years. The Ministry of Education itself acknowledges that this standard is too low.

Are functions misallocated among levels of government? Educational functions do not appear to be overly centralized. Indeed, given WBG's compact area, homogeneous ethnic composition and small population, the degree of decentralization appropriate for its educational system is less than for larger and more diverse states. Furthermore, creating a coherent Palestinian

identity would be facilitated by using centralized authority to eliminate the differences in the educational system that predate the Israeli occupation, such as the use of the Egyptian curriculum in Gaza and the Jordanian curriculum in the West Bank, with each curriculum tied to different versions of the *taujibi*. At the same time, whatever the degree of centralization in the system, some educational functions are always most appropriately handled at the level of the local school. Students' learning problems ultimately have to be solved at the level of the school and the classroom. Teachers and principals need a degree of autonomy if they are to undertake necessary problem-solving initiatives.

Are resources and responsibilities appropriately aligned? At present the answer is yes, except that the Ministry of Education needs to reduce its reliance on donors to finance textbooks, major school maintenance, and school construction.

The PA's Education System is Transparent, but Accountability is Embryonic

The Ministry of Education appears to have a deserved reputation in Palestinian civil society and among donors for transparency. All job positions, tenders, and scholarships are advertised publicly, and specific criteria are used to select candidates, contractors, and students. The Ministry uses sound procedures to protect the administration and grading of the *taujibi*. Although there is some question about the adequacy of the PA's internal audit procedures, the Ministry's accounts are audited internally at the school, district, and Ministerial levels and separately by the Ministry of Finance. In addition to standard Ministry of Finance audits, the Ministry of Education has also been subject to separate national audit by the PA's Audit Office, the GCI, and to an inquiry by a special commission appointed by the President in 1997 to examine spending in all ministries as a result of the first GCI report. The European Union and other donors also regularly audit the projects that they fund; international auditors appointed by the EU have commended the Ministry for its careful control of funds.

The story on accountability is less encouraging, although public opinion surveys reveal a substantial level of public demand for accountability and "voice". ("Voice" refers to citizens' access to ways of expressing their views of a public service and of ensuring that Government takes these views into account.) The system does provide "exit" opportunities, however, since parents in theory can enroll their children in the public schools of

their choice, although this right is somewhat constrained by district controls that are intended to prevent over-crowding and under-enrollment in schools. Only six percent of total enrollment in basic and secondary education is in private schools. Obviously, private education reduces the financial burden on public budgets, but in terms of accountability it also provides an alternative for those unhappy with public education and who are able to pay.

At present, voice is undeveloped in the education system in WBG. Neither customers of the educational system nor policymakers accountable for its performance have a basis for judging the sector's record in terms of students' learning outcomes or its cost-effectiveness. The Ministry of Education is planning an intensive consultative process with local communities around the Five Year Development Plan now being developed for pre-tertiary education. It has also directed principals to start Parent-Teacher Associations at each school, although it is not clear that these PTAs have the power to influence important decisions. As noted in the previous chapter, the Ministry is cooperating with a Bank-sponsored client service survey to assess consumer satisfaction with education, as well as with other public services. Although client service surveys constitute an important step towards public accountability, in the absence of other information, the "customers" (or their parents) can properly evaluate only the visible dimensions of the school system. Do teachers show up for work? Is the school building in reasonable physical condition? Do the children have textbooks? Is the physical equipment in the play yard in safe condition?

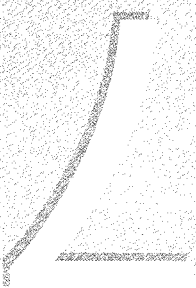
There is currently no oversight of the system by civil society, except as provided by the Palestinian Legislative Council. In particular, there is no elected body of governors to make or advise on sectoral policy-the Educational Council that has appeared on the Ministry of Education's table of organization for years has never been convened and will probably be eliminated in the next revision of the Ministry's organization chart.

Recommendations for Changes in Financing, Efficiency, and Institution-Building

Recommendations in financing, efficiency, and institution-building to create the conditions for the sector's continued improvement emerge out of this analysis:

- continue increasing the Ministry of Education's budget to cover the costs of textbooks and major school maintenance, and, as possible, to cover an increasing share of capital costs;
- analyze the feasibility of a textbook rental scheme, considering the costs of printing books durable enough to weather four years of use, the rental cost to families at prices that cover the next printing of books, the means to subsidize poor families, and mechanisms to manage the rental scheme that includes collecting rents and transferring them to the Ministry;
- move towards the objective of subjecting policy alternatives to cost tradeoff analyses and long-term fiscal sustainability analyses;
- evaluate the reasons for the recent decline in student/teacher ratios and the increase in the number of non-teaching staff, and correct these trends where desirable;
- confront the need for double-shift schools by working with communities to compensate for the disadvantages of double-shift schools;
- set and enforce transparent standards for the management of personnel, budgeting, buildings, policy planning, and learning at each grade, and ensure that performance expectations embedded in the *tawjihi* reflect the standards for learning;
- assess sector performance against benchmarks in countries which the WBG wishes to emulate, and publicize the results; and
- hold the various players in the system (e.g. Ministerial departments, districts, schools, teachers, and students) accountable for correcting and improving performance.

LOCAL GOVERNMENT AND UTILITY REFORM



Local Government And Utility Reform

Although weakened by infrequent elections (last held in 1976), local government in the West Bank and Gaza provided services throughout the Israeli occupation and continues to do so today, albeit still without elected representation. Public services provided by local governments are inferior to those in other countries with similar incomes, infrastructure needs upgrading and resources are very limited. In these circumstances, can local government effectively meet the needs of its citizens and contribute to developing a strong and viable public sector under the Palestinian Authority? The answer is yes. The role of local government is critical in achieving sustainable development, in fact, because of the importance of local governments in supplying infrastructure. But changes are necessary if local government is to function effectively, let alone attain its potential. In particular, the local property tax is a potentially significant and equitable source of local revenue. Local accountability and local representation are prerequisites for strengthening the tax authority of local governments. Utilities constitute a primary function of local governments, and a substantial revenue source for some municipalities; current initiatives to create regional self-financing water, wastewater and electricity utilities would relieve local governments of these distribution services, but may result in revenue loss for some local governments. Fiscal resources vary greatly across municipalities, such that many local governments cannot fully meet local requirements, suggesting the need for some equalization of funding for local services across the West Bank and Gaza.

Municipal Government: Utility Operations Complicate the Picture

Local governments are organized into municipalities, village councils and villages. The number of municipalities has been expanded from 28 to 106 under the PA but few of the new ones have full municipal (i.e., revenue-raising) authority. Because of data limitations, only the original 28 municipalities (covering about half of the WBG population outside Jerusalem) are discussed here. Local government differs somewhat between the West Bank and Gaza, owing to separate Jordanian and Egyptian control from 1948 to 1967, which in turn succeeded a common British mandate from 1917 to 1947.

Beyond water and electricity, local government responsibilities are narrow in scope in WBG, being limited to the core responsibilities of local governments in most countries. These include streets, fire protection, sanitation, building permits and local business regulation; local responsibilities for "people" services such as schooling are minimal. Responsibilities are closely linked to local infrastructure and local capital outlays (predominantly for utilities) account for an estimated 40 percent of total capital expenditures in WBG (i.e., local and central government). Moreover, essentially all capital financing comes from foreign donors, as discussed in Chapter 2; this situation is unsustainable and highlights the urgent need for all WBG local governments to move towards self-finance of their investments.

Local utility accounts and local general government accounts are combined and the financing of both functions is very much intertwined. Where municipal utilities exist, their gross revenues and expenditures dominate local accounts (ranging from 50 to 80 percent of total revenues). Furthermore, utility net cash flow (primarily from electricity) helps to support other municipal services; in the four municipalities examined, net utility income provided between 17 and 46 percent of total revenue. Water operation surpluses represent a fairly unreliable source of funds because many municipalities are behind in their payments to suppliers. For example, the PA's West Bank Water Department collected only 73 percent of its billings in 1997. The largest debtor, Hebron, paid only half its total bill over 1996 and 1997. Although a similar problem emerged for electricity service, the Israel Electricity Corporation interrupted supply to enforce payment. A major water supplier, the Israeli water company Mekoroth, has had its arrears paid by Israel's Ministry of Finance, which deducts the balance from the clearances of VAT and other taxes it collects and transfers to the PA Ministry of Finance. As a result, local underpayment becomes a central government burden. At present, measures to consolidate local utilities into regional operations are being implemented in order to generate technical, management and financing improvements. By successfully disentangling utility and municipal revenues and becoming self-financing, regional utilities will facilitate the rational funding of both, but at a considerable cost to some local governments whose fiscal resources will be diminished.

The nature of this joint financing problem of utilities and municipalities could be clarified through improved municipal accounting methods, and the Bank has provided technical assistance to obtain standardized municipal accounts in West Bank/Gaza. The accounting system being introduced is based on modified accrual accounting principles, in part to obtain financial data on a comparable basis to that of utilities and private sector firms. Implementation delays have emerged, however. Financial reform of municipalities and utilities are intrinsically linked, suggesting a pressing need to put the planned accounting system into effect in all municipalities.²⁵

Non-Utility Revenues are Restricted and Relatively Meager

Non-utility revenues of municipal governments come from a variety of sources, chief among them a property tax on the net rental value of land and buildings (defined as 80 percent of the total rental value). The property tax rate is 17 percent in the West Bank and 10-15 percent in Gaza. Collected by the Ministry of Finance, 90 percent of the revenue is returned to West Bank municipalities. In Gaza, by way of contrast, all property tax collections are retained at the central level. However, Gaza municipalities levy additional property-related taxes, such as Gaza City's housing/room tax.

Property taxes on net rental value would represent a potentially substantial revenue source if assessments were current and accurate; they are outdated, however, and depressed by rent controls. Moreover, inaccurate assessments create inequities among properties. Land registration, survey and titling systems are also ineffective and outdated, severely constraining financial intermediation and the development of fair and accurate property tax records, and ultimately reducing the tax base. Along with building license fees, property taxes often substitute as an unofficial record for ownership. This indirect, inaccurate and often discretionary system constrains the further development of a robust real estate market which could expand the tax base and raise collections. Not only the tax authorities but all other sectors of the economy would benefit from current and accurate land registration, surveys and titles.

²⁵ The traditional cash accounting principles utilized in government accounting do not generate data which can be used to make such financial comparisons with enterprises, because these cash accounting methods do not include all costs and they do not calculate costs for specified and identifiable accounting periods.

West Bank municipalities also levy a local education tax equivalent to 7 percent of the net rental base, with net proceeds used to finance school construction, maintenance and textbooks, areas in which central funding falls short of local needs (as discussed in Chapter 6). Administered by a separate committee, the revenues and expenditures associated with the education tax do not appear in the municipal accounts. Because it is collected locally on the same base as the property tax, administration is duplicated. There is some evidence that local authorities are more successful in collecting this essentially local tax.

The Ministry of Finance collects an occupation tax on businesses and professions in both the West Bank and Gaza and remits 90 percent of the proceeds to municipalities, retaining 10 percent to defray collection costs. Rates vary by nature, size and location of the business. Furthermore, from 1998 onward, the central government is obligated under the 1997 *Local Government Law* to share revenues from motor vehicle licenses and traffic fines with the municipalities of origin. As of August 1999, transfers for 1998 had only been made to most Gaza local governments, although it was anticipated that all Gaza local governments would have received these transfers by September 1999. As of August 1999, transfers to West Bank local governments were being delayed until an arrangement for dealing with municipal arrears to Israeli utilities was reached.

Three-quarters of local non-utility revenue comes from various charges, fees, and profits from local enterprises; the most important source being building license fees.²⁶ Because local revenues from property and occupation taxes are primarily controlled by the central government, and because there are few alternative revenue-raising options, local governments may establish commercial ventures that crowd out private activity. Local governments could enhance their revenues by more closely matching fees and charges to the cost of services, however. For instance, personnel involved in the Bank's MIDP program calculate that fees for municipal waste collection and disposal return as little as one tenth of the actual costs incurred. The same MIDP personnel point out that building licenses, which presently finance recurrent expenditures, might be restructured to make up a genuine regulatory fee. In this respect, a development charge based on the value of property is employed in many countries as a levy

²⁶ Reliance on nontax revenues to fund local expenditure is high in WBG—75 percent—compared to averages of 20 percent in OECD countries, 28 percent in a number of large cities in developing countries, and 29 percent across a number of developing countries (see Figure A5 in the Data Annex). On the other hand, local nontax revenues in WBG with respect to GDP are comparable to ratios in OECD countries.

on users that is specifically intended to finance infrastructure services related to property. Still, the lack of a major broad-based local tax and the heavy reliance upon a few specific own-revenue sources present a serious concern; the mismatch between local revenues and necessary expenditures suggests a need for revenue restructuring and greater autonomy in setting tax policy. Unfortunately, the new *Local Government Law* passed in 1997 appears to do little to relax central taxation, supervision and imposed uniformity.

Raising Local Tax Capacity through an Expanded Local Property Tax

In view of emerging fiscal pressures faced by the central government, local governments in WBG will need to rely heavily upon their own revenue sources. Is local capacity adequate to meet these needs? Local governments in WBG have some advantages over their international counterparts, owing to their relatively modest general expenditure responsibilities. In 1996, local government expenditures amounted to less than 2.3 percent of GDP, in contrast to the 12.7 percent average for OECD countries and the 4.6 percent average for reporting developing countries (see Figure A.3 in the Data Annex).

Not only are municipal expenditures low, but taxes fund relatively little of these expenditures. By international standards, the property tax is underutilized as a source of local financing in WBG. In 1996, the West Bank property tax averaged US\$38 per household, representing only 0.35 percent of average household expenditure (about US\$55 and 0.5 percent, respectively, if the education tax is included). This falls far short of average taxes in OECD countries, where property taxes are equivalent to 1.6 percent of household expenditure, and 2.8 percent in countries where the property tax represents a major local tax (see Figure A.4). As a percentage of GDP, the property tax in WBG was 0.19 percent, compared to an average 1.13 percent for 21 OECD countries (1.7 percent in property tax reliant countries and 0.83 percent elsewhere). Property taxes play a smaller role in WBG than in many other countries. As a share of total taxes raised, property taxes represented 5.4 percent of total taxes in OECD countries, but only 1.5 percent of taxes in WBG. It is striking that property tax collections in the West Bank are less than one-fifth the level of collections implied if the tax was paid on the imputed rent reported in household expenditure surveys of the Palestinian Central Bureau of Statistics.

The underutilization of the property tax in WBG forces an excessive dependence on local nontax revenue. This imbalance is exacerbated by municipalities' inability to set their own tax rates and results in misplaced property tax decision-making as well as a mismatch of revenue and expenditure. Transforming the property tax into a truly local tax (where local governments set the tax rates) may or may not raise total (i.e. consolidated) government revenue collections, but it would improve the local revenue structure and enhance local governments' fiscal flexibility and autonomy and expand their capacity to meet local needs.

Regional Utilities to Improve Efficiency and Service Quality

The effectiveness of electricity distribution, water and sewerage services is important for public well-being and for the potential impact on municipal finances and operations. Although water and electricity service coverage is high (excluding East Jerusalem, over 83 percent of households in 1997 were on water lines and 95 percent received electricity), it is of poor quality and unreliable, and delivery systems are generally old, deteriorated and inefficient. Wastewater services coverage is inadequate; only half of municipal households and one third of all households outside of East Jerusalem were connected to sewer lines in 1997 and sewerage treatment is minimal.²⁷ Moreover, the supply and consumption of electricity and water are low by regional standards, with electricity supply per capita being about half that in Egypt, Jordan, Lebanon and Syria, and water consumption only one-third that in Israel, well below that in Jordan, and below minimum amounts recommended by the World Health Organization. Limited supply is further aggravated by system losses on the order of 30 percent for electricity and 50 percent for water. Israeli utilities supply essentially all WBG electricity and 17 percent of the water. Water supply is a particular problem because of limited access negotiated with Israel and because withdrawals exceed the natural recharge of some aquifers, resulting in sea and wastewater intrusion and contamination. However, two-thirds of the water is used for irrigation free of charge for the water itself, suggesting considerable room to improve the efficiency of agricultural use and redirect water to higher value uses. Improvements in the utility services require technical and institutional change but major steps in these directions are already underway.

²⁷ All figures in this paragraph, apart from the estimate of municipal housing connected to sewer lines, are taken from the *Palestinian Population, Housing and Establishment Census, 1997* (Gaza: Palestinian Central Bureau of Statistics, 1998).

In 1995, the PA established the Palestinian Energy Authority (PEA) and the Palestinian Water Authority (PWA) to address the problems in the electricity and the water and wastewater sectors, respectively. Each authority has undertaken to consolidate municipal utilities into autonomous, self-financing regional operations in order to realize scale economies, enhanced management, and efficient and full-cost pricing. The consolidated utilities will remain publicly owned initially (though probably privately managed), because the utility environment is considered to be unattractive to private investment in the short term—perhaps for the next 5 years or so. There are plans for two new electricity and two new water and sewer regional companies on the West Bank to complement the Jerusalem District Electric Energy Company and the Jerusalem Water Undertaking as well as the electricity and water utilities in Gaza. The PEA plans to retain a separate transmission company to carry electricity to the regional distribution companies. The PA's West Bank Water Department, which sells water to West Bank municipalities, would sell to the water utilities as required.

A recent PWA study found that only 2 of 27 water utilities managed to cover operating and maintenance costs fully, and only one contributed significantly towards its capital costs. This implies that most water operations are a burden on local taxpayers even if water bills and other current costs are fully paid and even though capital costs are typically covered from other sources (e.g., donors, central government). Tariff schedules do not correspond well to recommended practices for promoting efficient use, equity or cost recovery; to address this, the PWA has outlined a best practice tariff setting methodology. In fact, technical improvements to reduce the high levels of system losses should increase revenues significantly without increasing average burdens on utility consumers. The PEA conducted a parallel study of electrical utilities; although not yet available, problems similar to those faced by the water utilities are anticipated, e.g. funding of other municipal activities is realized partly at the cost of new investment and adequate maintenance. Regional utilities will certainly reduce if not fully correct the current multi-directional cross-subsidization and help rationalize both utility and local government budgeting.

Municipalities do not uniformly support the plans to regionalize the utilities, however, owing to the negative impact on their fiscal capacity and flexibility, voice and ownership, and the higher utility prices to be borne by citizens. Removing utilities from the local domain is likely to reduce substantially the fiscal capacities of some cities. Dividends to the municipal owners may afford some compensation, and municipal franchise fees,

taxes and rents levied on utilities are other possibilities but would need to be introduced and applied uniformly across public and private operations. As a result of this opposition, regionalization has progressed more slowly than anticipated. The Gaza water system has realized the most progress to date, but it is not yet an autonomous regional authority. Nevertheless, the Gaza arrangements—a performance-based contract supported by a Bank credit—have achieved major reductions in unaccounted for water, improved water quality and increased revenues (perhaps indicating a willingness to pay for improved service), and suggest a successful blending of public ownership and private management.

Upgrading and expanding the sewerage systems throughout WBG presents a major and costly challenge. Moreover, many households not currently on a sewer line have invested in alternative systems (e.g., a septic tank) and may be hesitant to convert immediately, given the associated installation charges. This could explain the relative unwillingness to pay for sewerage services that is revealed by surveys. The timing of expansions and the introduction of user charges are therefore crucial to encourage hookup but still contribute appropriately to costs. Wastewater reuse for irrigation represents another option for cost recovery that would also ease agricultural demand for fresh water. Furthermore, charging agriculturalists for water would promote alternatives and conservation, but is likely to raise demands of compensation for lost rights.

Large Fiscal Disparities among Municipalities call for Equalization

Unless and until a local property tax is tried and proved inadequate as a source of local funding, there is no case for extending transfers from central to local governments to fill a so-called "fiscal gap". Nevertheless, fiscal disparities among local governments are large. Centrally funded equalizing transfers to moderate such differences can be justified on efficiency and equity grounds. Among the five municipalities examined, per capita expenditure in the highest spending municipality is 5 times greater than in the lowest. Fiscal capacity indicators show less variation across the group; on the basis of household rental values, the highest tax capacity is 1.85 times the lowest, but only 1.5 times the lowest when net utility income is incorporated. By equalizing up to the average fiscal capacity, transfers to two municipalities would be substantial, amounting to 45 and 10 percent of total non-utility revenues currently available. In the West Bank, it would be logical to

extend equalization to include school committees because they also tax property.

Equalizing to a representative revenue base would allocate transfers to where they are most needed. Revenue sharing, by contrast, distributes funds broadly, often to the advantage of well-off municipalities. In view of the severe limits to central government resources, any additional available funds should be distributed according to equalization criteria; this could be financed partially by the existing centrally retained property taxes or by a portion of property tax revenue growth. Furthermore, equalization is likely to ease local acceptance of regional utilities. But an effective and equitable equalization program requires reliable measures of local revenue bases. Although the required data are currently unavailable, property tax reform could move substantially towards providing quality data.

An Agenda for Local Government and Utility Reform

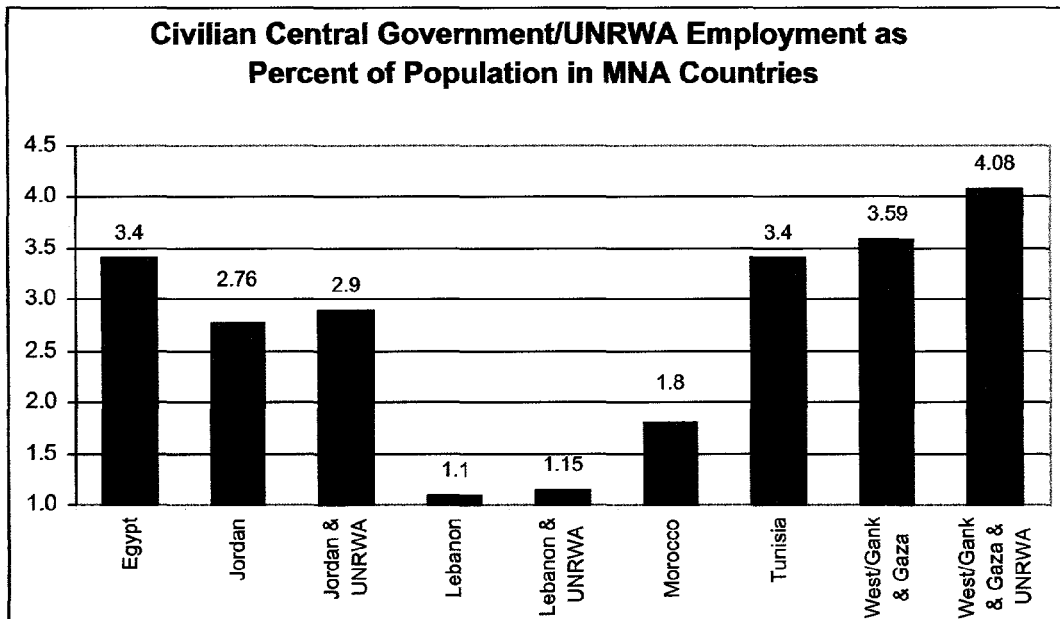
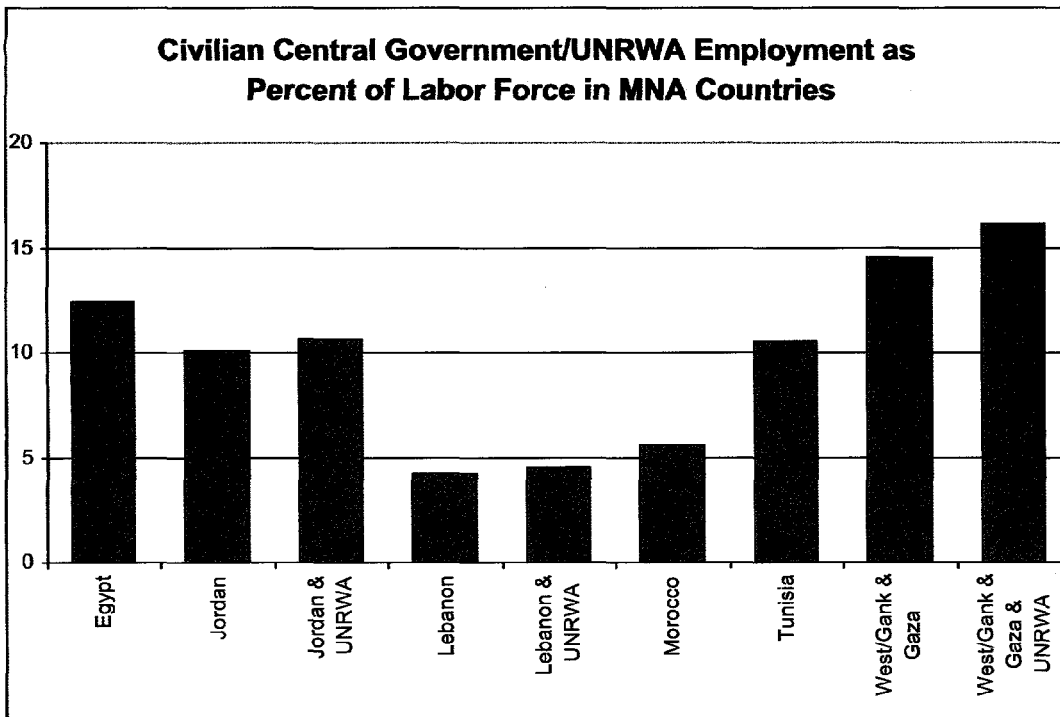
The quality of local government in WBG could be improved by making utilities more independent and more self-sufficient and by providing increased tax authority to local governments so that they become more effective and self-supporting entities with greater accountability to their residents. Several measures can be taken towards achieving this objective:

- enforce hard budget constraints to put utility and local government finance on a sound footing and to ease fiscal pressure on the Authority's central budget, which has been backstopping arrears in municipal utility payments (including those to Israel);
- arrangements need to be made to ensure that central transfers to local governments are paid regularly and promptly. The Local Government Law provides for transfers to local governments of revenues such as half of vehicle licensing fees to support local functions such as road maintenance;
- support and intensify present efforts to create consolidated regional water and electricity utilities, in order to generate efficiency, management, resource and financing gains, albeit at a cost to local government revenues;
- make these utilities into independent corporate entities as a first step and increase private sector participation in them as soon as possible;
- complete the introduction of the improved standard municipal accounting system, thereby disentangling the joint financing problems of municipalities and utilities;

- match municipal expenditures and revenues more closely by increasing user fees for such services as solid waste management;
- analyze the merits of converting building licenses into a development tax of the type used to finance related infrastructure services for property in many countries;
- revitalize the currently underutilized property tax by establishing the property tax as a truly local tax; create the potential to expand and rebalance the local government tax base by establishing local authority to set tax rates and to collect and retain revenues. Similar adjustments could be made to the occupation tax;
- update and improve the accuracy of property assessments, needed to ensure an efficient property tax; this could be undertaken in conjunction with related efforts to expand land titling and registration so as to improve financial intermediation;
- introduce a centrally-funded equalization program, when dependable measures of tax bases become available, to reduce the large disparities in local services and fiscal capacities, thus increasing equity and efficiency in the local public sector by ensuring the capacity to provide comparable services at reasonable tax rates; and
- proceed with existing plans for local elections to increase local government accountability to citizens, thereby improving the effectiveness and autonomy of local governments.

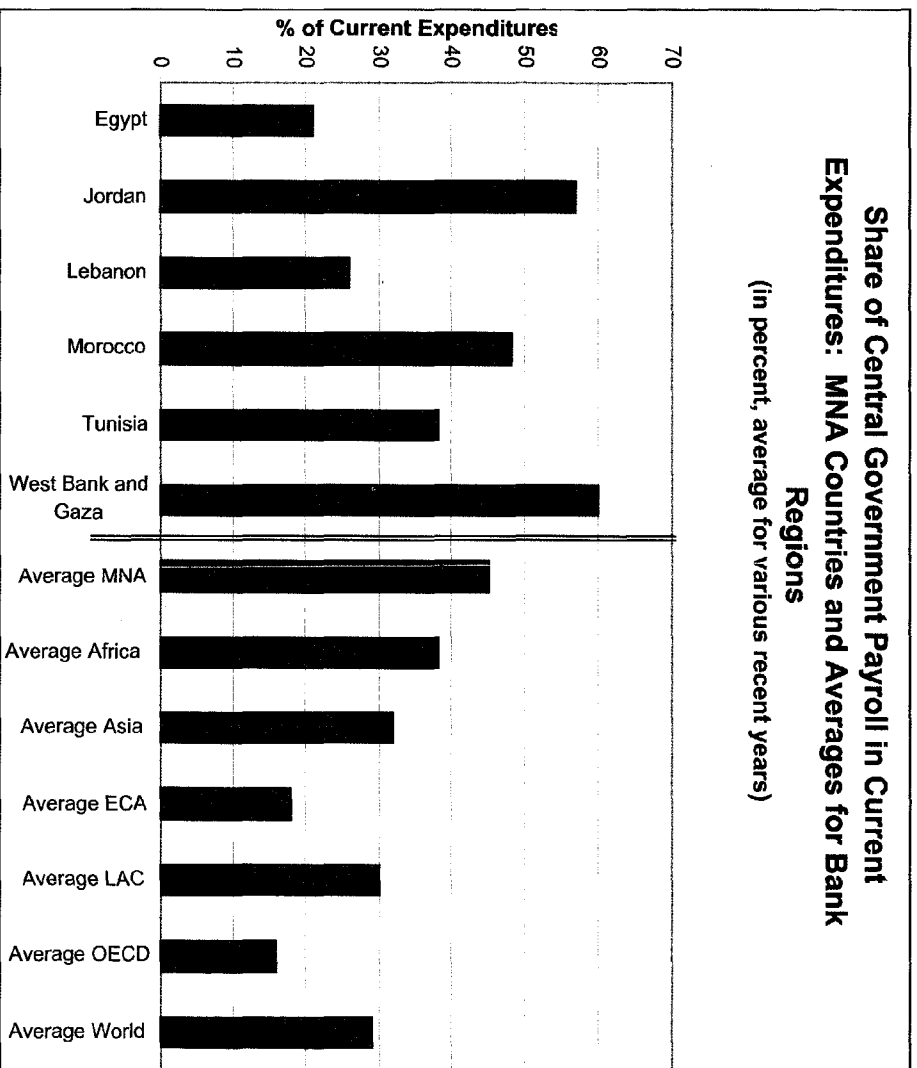
DATA ANNEX

Figure A.1.



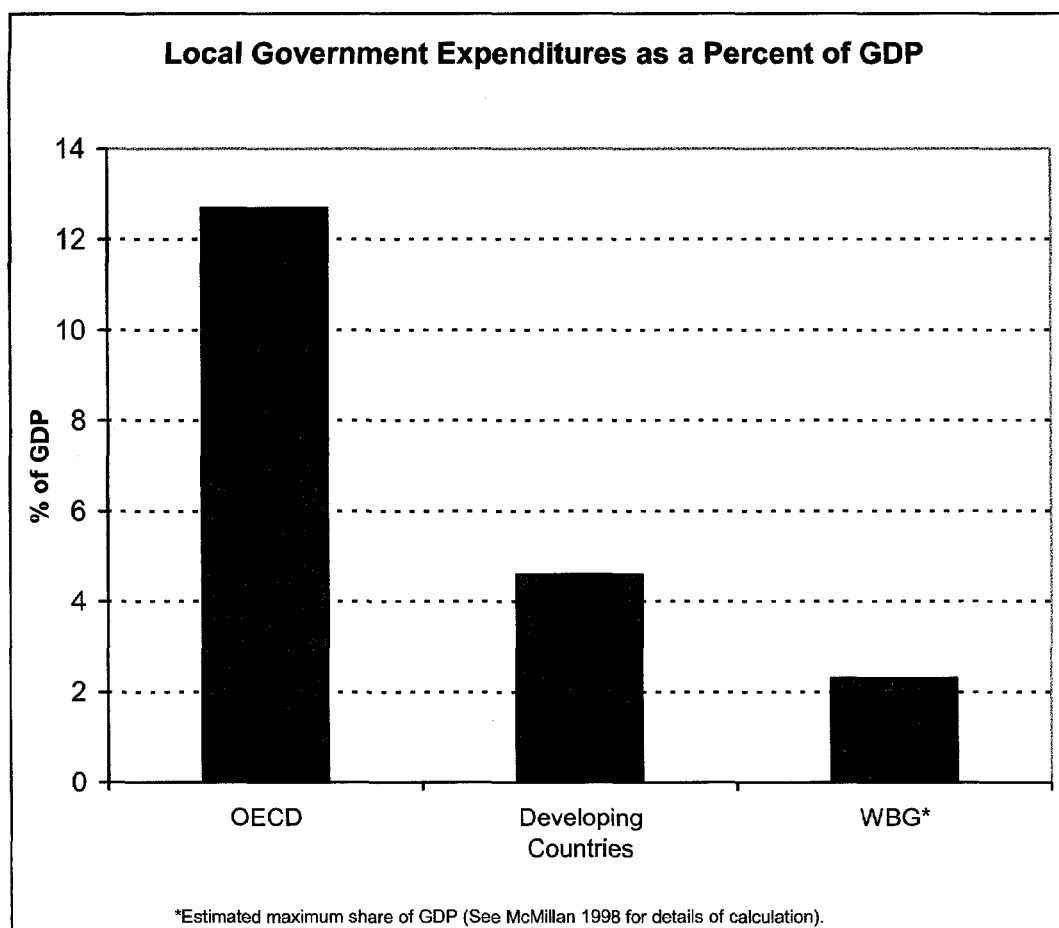
Source: Schiavo-Campo S., G. de Tommaso and A. Mukherjee, 1997. "An International Statistical Survey of Government Employment and Wages," World Bank Policy Research Paper 1806; and UNRWA.

Figure A.2.



Sources: as for Figure A.1.

Figure A.3.



Notes:

Note: The value of 12.7 percent of GDP for OECD countries is the average for the 21 OECD countries cited in McMillan (1995) and also for the 8 developed countries cited in McMillan (1997).

Sources:

For OECD:

McMillan, M.L., 1995. "A Local Perspective on Fiscal Federalism: Practices, Experiences, and Lessons from Developed Countries," The World Bank (PRDPE).

For Developing Countries

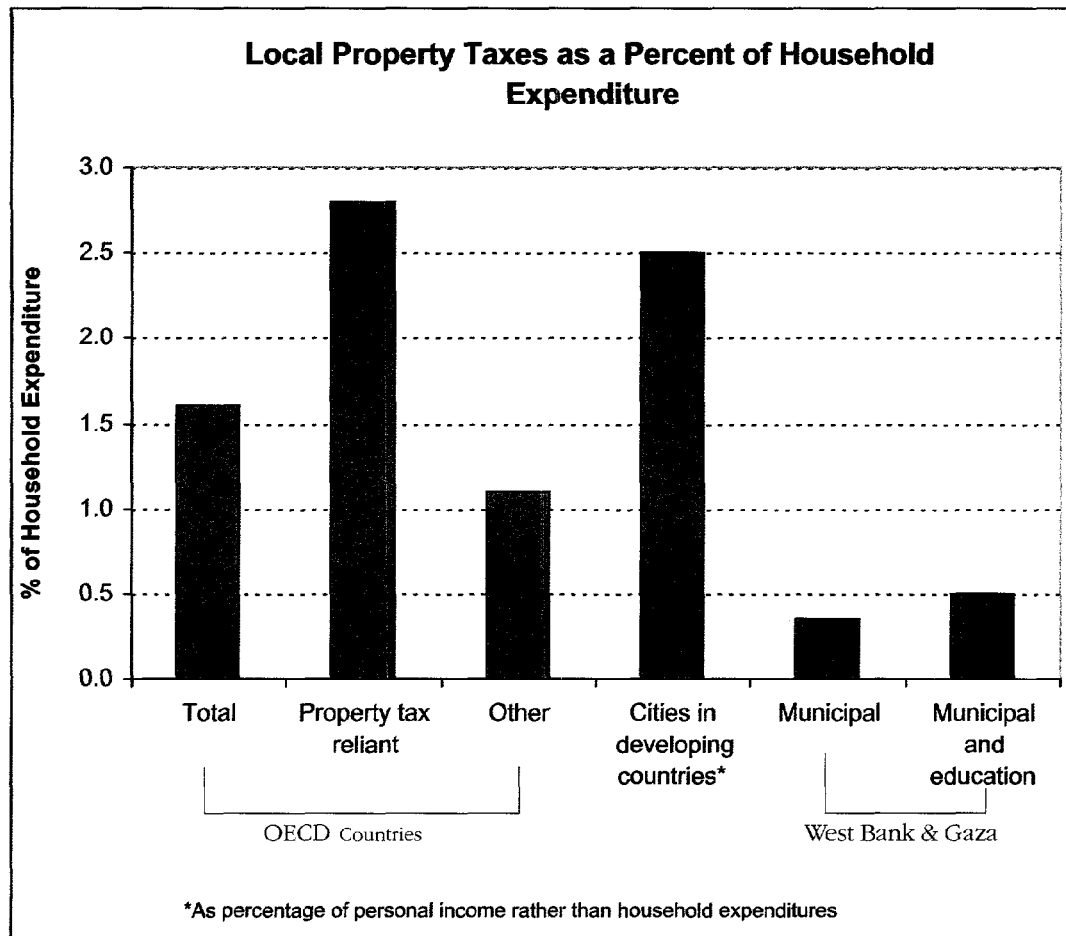
Shah, A. et al., 1994. "Intergovernmental Fiscal Relations in Indonesia: Issues and Options". World Bank Discussion Paper 239.

McMillan, M.L., 1997. "Local Governments: An International Perspective on Industrialized and Developing Countries". In F. Flatters et.al (eds), Malaysia's Public Sector in the 21st century: Planning for 2020 and Beyond. MIER, Kuala Lumpur and J. Deutsch Institute, Queens University, Canada.

For WBG:

McMillan, M.L. 1998. "Local Government Finance in the West Bank and Gaza," The World Bank (MNSD).

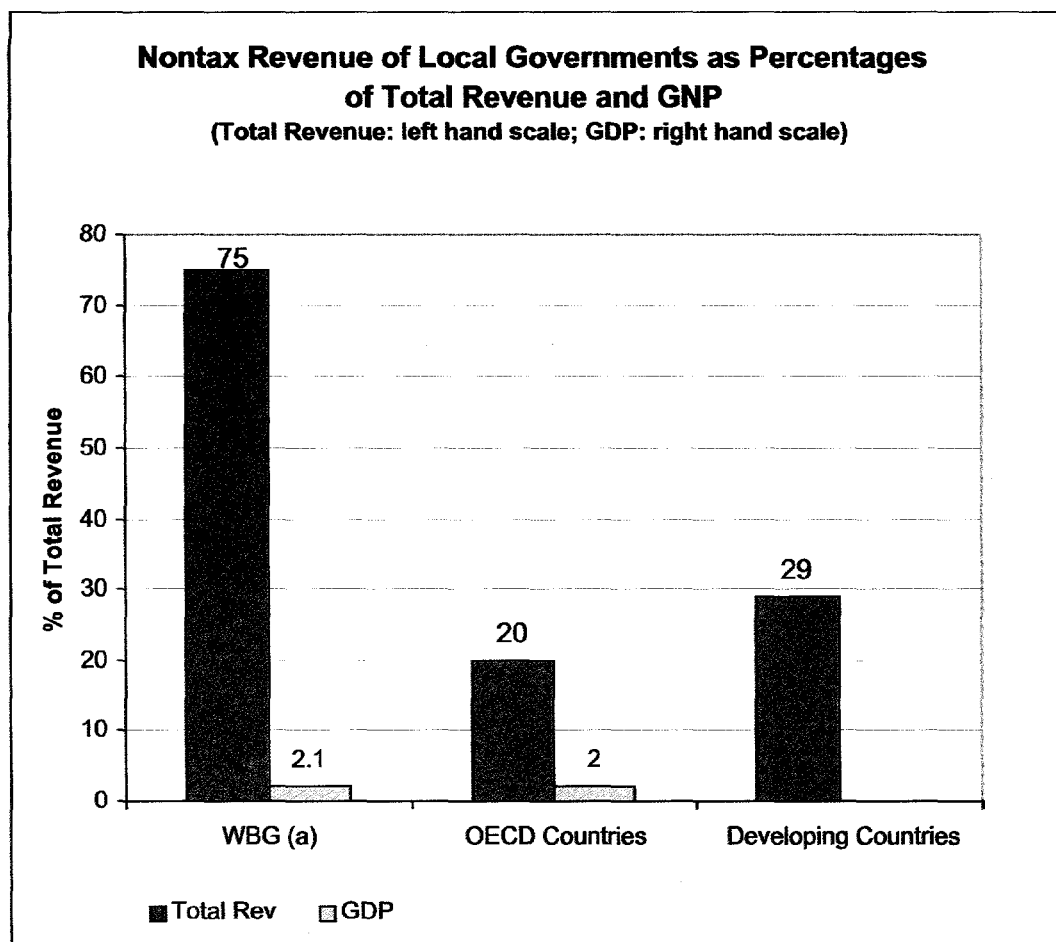
Figure A.4.



Sources: For OECD and West Bank and Gaza, same as for Figure A.3.

For cities in developing countries: Bahl, R.W. and J.F. Linn, 1992. *Urban Public Finance in Developing Countries*. The World Bank and Oxford University Press.

Figure A.5.



Note: a. Includes net utility revenues of municipalities. These are maximum estimates of the share of nontax revenues in Local Government and GDP. See McMillan (1998). Data for nontax revenue as a percent of GDP in developing countries is not available.

Sources: As for Figures A.3 and A.4

Table A.1: Growth of PA/UNWRA Employment, 1994-1997

	1994	1995	1996	1997
General Administration	8,048	15447	18684	20260
Growth in no. employed		7399	3237	1576
Growth rate		92%	21%	8%
Education	13,533	14742	16498	18258
Growth in no. employed		1,209	1,756	1,760
Growth rate		9%	12%	11%
Health	3919	4611	5838	6196
Growth in no. employed		692	1227	358
Growth rate		18%	27%	6%
Police	14,000	24000	32600	37031
Growth in no. employed		10,000	8,600	4,431
Growth rate		71%	36%	14%
TOTAL	39,500	58,800	73,620	81,745
Growth in no. employed		19,300	14,820	8,125
Growth rate		49%	25%	11%
UNRWA	8,195	8387	8838	9109
Growth in no. employed		192	451	271
Growth		2%	5%	3%
TOTAL: PA and UNRWA	47,695	67,187	82,458	90,854
Growth in no. employed		19,492	15,271	8,396
Growth rate		41%	23%	10%

Sources: Pannier, D. 1996. "Report on Palestinian Civil Service: Issues and Recommendations". The World Bank (EMTPM); PA Ministry of Education; PA Ministry of Health. Aggregate and police employment data from West Bank and Gaza-Report on Fiscal Developments. PA Ministry of Finance (quarterly). General administration is calculated as aggregate central government employment less education, health and police.



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