

In This Issue

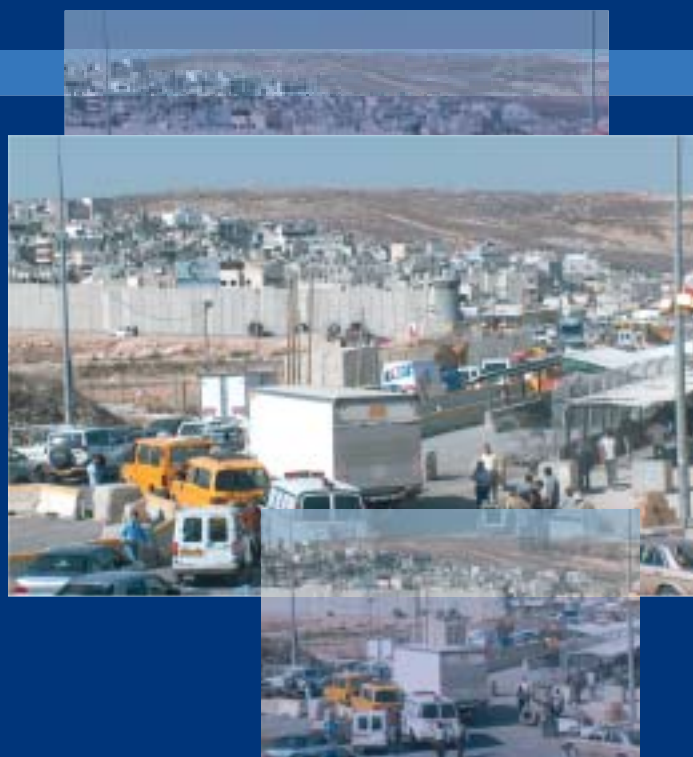
1. Stagnation or Revival?
Israeli Disengagement and Palestinian Economic Prospects /3
2. 4 Years - Intifada, Closures and Palestinian Economic Crisis /5
3. Infrastructure Assessment in the West Bank and Gaza /11
4. Poverty in the West Bank and Gaza after Three Years of
Economic Crisis /15
5. Recent Economic Developments /17
6. Program Portfolio Update /29
7. Community Study Series in the West Bank and Gaza /37
8. Country Financial Accountability Assessment /39



The World Bank Group

A Quarterly Publication of the West Bank and Gaza Office

WEST BANK AND GAZA UPDATE



November 2004

Contact Numbers

West Bank Office Numbers:

Switchboard 02-2366500
Fax: 02-2366543

Country Director
Nigel Roberts
Tel. 02-2366506

**Deputy Head of Office/
Civil Society/Portfolio**
Sima Kanaan
Tel. 02-2366541

Economics
John Wetter
Tel. 02-2366549

**Health, Education, Social
Protection**
Anne Johansen
Tel. 02-2366514

**LACC Secretariat(Head)
External Affairs**
Stefano Mocchi
Tel. 02-2366535

Infrastructure Development
Ibrahim Dajani
Tel. 02-2366553

Community Studies
Tanja Hohe
Nithya Nagarajan
Tel. 02-2366511/61

Projects Disbursements
Adel Odeh
Tel. 02-2366515
Samira Hillis
Tel. 08-2823422

Public Information
Mary Koussa
Tel. 02-2366529

Gaza Office:

Coordinator
Husam Abu Dagga
Tel. 08-2823422/2824746
Fax: 08-2824296

International Finance Corporation

Investment Officer
Youssef Habesch
Tel. 02-2366517
Fax: 02-2366521

West Bank and Gaza Update editorial team

Mary Koussa
John Wetter

Email for free subscription: mkoussa@worldbank.org
Newsletter at Internet: <http://www.worldbank.org/we>

Stagnation or Revival? Israeli Disengagement and Palestinian Economic Prospects

"If the PA shows firm commitment to security and economic reform and if Israel seriously addresses closure, another major donor effort definitely would be justified. Under these circumstances an additional US\$500 million each year could help the Palestinian economy to turn the corner."

*James D. Wolfensohn, President,
the World Bank, June 23, 2004*

The World Bank's June 23 report, *Disengagement, the Palestinian Economy and the Settlements*, warns of the potential disintegration of the Palestinian economy under the sustained pressures of conflict and Israeli closure policies.

The report describes a society which has, in the space of four years, lost all economic dynamism and experienced a recession of historic proportions. As a result, the strong social cohesion that characterizes Palestinian life has begun to crack, while the Palestinian Authority has lost credibility and effective control in several parts of Gaza and the West Bank. This is a situation which is potentially ruinous for both Palestinians and Israelis.

Today there is hope that the Israeli and Palestinian governments are once again ready to discuss their shared future. They would do so at a time when Israel is preparing, for the first time, to evacuate settlements established in Gaza and the West Bank after the 1967 war, and when President Bush has just reminded the world of his wish to see the emergence of a "truly free" and democratic Palestinian state before the end of his second term. The PA's decision to hold presidential elections in line with the provisions of the Basic Law and to follow them in May with parliamentary elections are very encouraging steps; and so too are indications

from the Government of Israel of a new interest in holding direct discussions with the Palestinian Authority.

No state can be truly free with its economy in chaos and with the majority of its population living below the poverty line. While prosperity is no guarantee of tranquility, history teaches that the opposite is too often true – that destitution, political instability and violence are constant companions.

At this juncture, it is vital that policy-makers focus on stabilizing and reviving the economy as part of any new political process. For the PA to play an effective political role, it must preside over a period in which the Palestinian population experiences positive change in their daily lives – in their the ability to move freely, to trade, to find work, to earn a living for their families.

While money, and in particular donor money, has an important role to play in reviving the economy, it is not the determining factor. The last four years exemplify how little donor assistance can achieve in the absence of a positive policy environment – while donor disbursements doubled to almost US\$1 billion per annum, real personal incomes fell by almost 40 percent in the same period.

To change this frustrating dynamic, the underlying causes of economic decline need to be addressed.

It is important to emphasize this at a time of new hope, since it would be a mistake to respond to today's potential opening by efforts to raise large sums of money without addressing the root causes of today's economic crisis.

For a recovery to take place, the Government of Israel needs to roll back the system of restrictions on the movement of people and goods imposed since the beginning of the *intifada* – it is these various closure measures that are the proximate cause of four years of Palestinian economic distress. Accordingly, much of the work of the Bank and donor team over the course of this summer focused on the various facets of closure, with the team benefiting from intensive, professional interaction with both parties. The Government of Israel's willingness to engage with the donors on these issues spoke of a strategic reappraisal of the importance of Palestinian economic stability to Israel's own security – while the work of the Bank and its partners shows that there are solutions that permit a significant dismantling of closure measures without endangering Israeli security.

The Government of Israel has given encouraging signs of a willingness to reform the management of border gateways, to enable a much faster and more reliable throughput of cargo and people. Unless a number of other key areas of the closure system are addressed, however, these improvements will have only limited impact. Of particular concern are the likely persistence of the back-to-back cargo handling system, the continuation of internal closures throughout the West Bank, the lack of adequate connections between Gaza and the West Bank, and Israel's stated intention to terminate Palestinian labor permits by 2008 and to abrogate the Customs Union in Gaza after withdrawal from Philadelphi.

For its part, the Palestinian Authority faces two sets of challenges if it is to play its part in bringing about revival. First is the need to demonstrate strong commitment to security reform, politically risky though this may be. Without a visible and

effective effort, the case for persisting with certain closure measures is hard to refute.

The PA also needs to re-invigorate its program of governance reforms in order to create an internal environment more attractive to private investors.

Doing this will require that the PA complete the cycle of popular elections it has embarked on, control lawlessness, develop a solid judicial system and address concerns about transparency and corruption. The acquisition of the settlement areas offers the PA an opportunity to demonstrate a new spirit of openness in planning the disposal of these assets.

On the basis of what is on offer today, economic revival is a distant prospect, and it would be hard to justify a major new donor financing drive – the challenge, rather, will be to preserve existing aid levels of c. US\$900 million per annum and thereby ensure that basic budget support, humanitarian and infrastructure development needs continue to be met.

Chapter Six lays out an agenda of actions that the Bank believes would lay the basis for economic regeneration. It is suggested that this agenda be further refined after the AHLC meeting in December, if possible through direct discussion between GOI and the PA.

It is further proposed that the donor community track progress by the parties in tackling these key preconditions for economic revival. If significant progress is made against a set of agreed indicators, a major new donor effort would then be justified – and a donor pledging conference should be called. Calling such a conference in the absence of adequate progress would be counterproductive, however, and should not be considered.

4 Years Intifada, Closures and Palestinian Economic Crisis

In 2003, the Palestinian economy stabilized after two years of sharp contraction. The World Bank estimates that per capita Gross Domestic Product increased about one percent in 2003. The stabilization occurred against a backdrop of a modest decline in violence. Moreover, there were fewer curfews (the most extreme form of closure) and the Government of Israel's transfer of previously withheld tax revenues produced a short-acting fiscal stimulus. However, neither of these stimuli was continued into 2004; the economy is stagnant once again. After almost four years of the conflict, average Palestinian incomes have declined by more than one third and one-quarter of the workforce is unemployed. Nearly one-half of all Palestinians live below the poverty line. More than 600,000 people (16 percent of the population) cannot afford even the basic necessities for subsistence. The precipitator of this economic crisis has been 'closure,' a multi-faceted system of restrictions on the movement of Palestinian people and goods, which the Government of Israel argues is essential to protect Israelis in Israel and in the settlements. Closures, including the Separation Barrier, prevent the free flow of Palestinian economic transactions; they raise the cost of doing business and disrupt the predictability needed for orderly economic life. Without major changes in the closure regime and significant progress in the Palestinian reform program to improve the climate for private investors, there is no prospect of a sustained recovery of the Palestinian economy.

The Palestinian economy recovered slightly in 2003, but is now stagnant

Precipitated by several one-off factors, the Bank estimates that Palestinian Gross Domestic Product (GDP) grew by six percent in real terms in 2003. Positive growth in 2003 is a significant improvement, compared with the two previous years during when the economy shrank by more than 25 percent. Several factors underlie the stabilization of the Palestinian economy in 2003. Fewer curfews and reduced violence in the period, which followed the launch of the Road Map in April 2003, enabled a "catch-up" in private sector activity

and household spending. The resumption of revenue transfers and a modest rebound of the Israeli economy also helped. However, the resumption of growth has delivered only marginal improvements in per capita incomes. Given the growth in population in the West Bank and Gaza, real GDP rose by around one percent in 2003. As a result, average incomes in 2003 were some 36 percent lower than their pre-*intifada* levels.

Labor market indicators for the first half of 2004 suggest that the recovery is coming to an end. Some 104,000 jobs were created for Palestinian workers in 2003, equivalent to a 21 percent increase in employment compared with 2002. Job growth was particularly strong in Gaza, where employment increased by 32 percent in 2003. Unemployment rates fell from an average of 31.4 percent in 2002 to 25.7

percent in 2003. More recently, however, these trends reversed, particularly in Gaza. During the first half of 2004, the Palestinian economy lost more than 22,000 jobs. Gaza experienced the lion's share of this loss (20,000 people lost jobs). Employment in the West Bank held up only because of a sharp increase in part-time jobs, compared with full-time jobs, which declined by almost 17,000 in the first half of 2004. Moreover, at less than 1,000, the number of Palestinians working in Israel was the lowest ever reported by the PCBS.

The Palestinian economy remains severely depressed compared with the pre-intifada period.

The World Bank estimates that GDP is 23 percent lower than in 1999. After accounting for population growth, real GDP per capita is some 35 percent below its pre-*intifada* level. An unemployment rate of about 25 percent in 2003 (compared with 10 percent at the eve of the *intifada*) underscores the fact that the Palestinian economy operates well below its potential. Young people are particularly hard hit by unemployment: 37 percent of young people were unemployed at the end of 2003 compared with 14 percent on the eve of the *intifada* in September 2000.

The PA's fiscal situation eased somewhat in 2003, but remained difficult. The PA's fiscal situation has been severely constrained by the *intifada*. Fiscal revenues increased in 2003 due to improved tax collection, the resumption of withheld revenue transfers and macroeconomic stabilization. Clearance revenues amounted to US\$442 million in 2003 compared with US\$150 million in 2002. The GoI also rebated a total of US\$294 million in previously-withheld clearance revenues to the PA; these revenues allowed the PA to pay off some of its arrears to suppliers which had accumulated during 2002. These revenues also boosted private sector liquidity. Revenues also got a boost from reform of the Petroleum Commission. The commission has operated under the direct control of the Ministry of Finance since July 2003. However, PA expenditures, driven in particular by an expanding public sector wage bill, exceeded limits set by the 2003 Budget. While civil service recruitment remained within limits set by the 2003 Budget, security sector employment grew by 3,443 in 2003 compared with a budget-stipulated freeze in recruitment. The total increase in

the public sector payroll came to about 5,300 – almost twice the level allowed for in the budget. At the same time, public sector salaries went up 15 percent in 2003 because the PLC forced through implementation of the 1998 Civil Service Law. The PA's budget was further strained by the burden of paying outstanding municipal bills to Israeli suppliers. As a result, the PA's financing gap in 2003 totaled US\$561 million (19 percent of GDP). To cover this gap, the PA squeezed non-wage expenditures, deferred payments to the public sector pension system, and borrowed from commercial banks. At US\$229 million, external budget support in 2003 was less than one-half of the amount anticipated in the 2003 Budget. In response, the PA squeezed non-wage expenditures to 78 percent of 2003's budgeted amount; the PA also increased borrowing from commercial banks (PA debt to commercial banks stood at US\$176 million at the end of the year).

Closures remain the defining characteristic of Palestinian economic life

The economic space of the West Bank and Gaza remains highly fragmented; economic activity has significantly declined. Closures and curfews continue to disrupt business, commerce and routine social exchange; they have raised transport and production costs and severed vital economic links between villages and urban areas. West Bank businessmen report difficulties in obtaining necessary productive inputs from suppliers, and in shipping finished goods to market. The movement of commercial goods between the West Bank and Israel declined by 50 percent during 2003 compared with the level prior to the launch of Operation 'Defensive Shield' in March 2002; Defensive Shield severely restricted Palestinian traders' ability to engage in business outside the West Bank. Closures and permit cancellations reduced the number of Palestinians working in Israel and in the Israeli settlements (ISI) to 8 percent of employed Palestinians, according to the latest figures from PCBS compared with 22 percent on the eve of the *intifada*.

The frequency of curfews – the most extreme form of closure – occurred less often in 2003 than in 2002, but construction of the Separation Barrier accelerated. The intensity of curfews gradually declined from their peak during operation Defensive Shield in the spring of 2002, when more than one-third of the West Bank population was under curfew for extended periods of time. The decline continued in 2003; when the share of curfew-hours in most urban centers dropped to around 10 percent from over 40 percent in the second half of 2002. The Government of Israel continued the construction of the Separation Barrier in 2003. To date, a total of 185 kilometers of the Separation Barrier has been constructed. If constructed according to GoI plans, approximately 157,800 acres or 11.2 percent of West Bank land (excluding East Jerusalem) will lie between the Barrier and the Green Line.¹ These areas are home to some 93,000 Palestinians. The Palestinians are likely to be separated from their agricultural lands, irrigation networks and water resources, as well as from West Bank workplaces, schools and health clinics. Commercial establishments in Palestinian communities affected by the Barrier will face reductions in their customer base, as the ability of Israeli Arabs to frequent Palestinian shops is restricted.

To date, the Separation Barrier's direct economic impact has been modest although especially agriculture has been negatively affected; closures have dwarfed its effect. In terms of unemployment, data collected by PCBS show that so far there has not been a significant divergence in unemployment rates between communities located on either side of the Barrier. Labor movements were severely constrained before construction began, limiting the additional negative impact of the barrier. However, there are signs that the percentage of workers commuting to Israel and to the Israeli settlements from those governorates in which the Barrier was built declined more rapidly than in those where the Barrier has yet to be constructed.

¹ These numbers derive from projections based on the revised barrier route published by the IDF's Seam Zone Authority. The routing of the Separation Barrier is still subject to uncertainty, partly because of pending lawsuits.

² The economic effects of the Separation Barrier are analyzed in depth in the forthcoming Separation Barrier Report.

The separation barrier has, however, led to destruction of agricultural lands, infrastructure and water resources, and appreciably reduced access to farmland in the seam-zone, which has had a particular negative effect in Jenin and Tulkarem districts that together account for more than 20 percent of Palestinian agricultural production².

Palestinian living standards have been severely compromised

Despite economic stabilization in 2003, some 47 percent of Palestinians live below the official poverty line. Three years of economic crises have severely compromised Palestinian living standards. Job creation in 2003 made a dent in the poverty rates, but some 47 percent of Palestinians (around 1.7 million people) still live below the official poverty line of US\$2.1 daily per person (down from 51 percent in 2002). Joint analysis by the Bank and PCBS suggests that every segment of the Palestinian population (except for the richest 10 percent) has seen deterioration in their financial situations.

Economic hardship is most acute for the 600,000 Palestinians living under the minimum level for subsistence. –That 16 percent of the population, who live below the subsistence poverty line, merely survive, despite significant amounts of humanitarian assistance. Families living in subsistence poverty display characteristics of long-term poverty: they are generally large with many non-working dependents (children and elderly) and limited, if any, savings. The working poor have low levels of education (20 percent of the working poor have not even completed primary school, compared with 9 percent of other workers); the Working poor are employed in sporadic, part-time or unpaid jobs (e.g. family labor). These characteristics limit their ability to withstand the economic crisis. They hovered close to the subsistence poverty line prior to the *intifada*; a modest decline in average incomes was enough to push them into subsistence poverty.

The coping strategies for the poorest segment of the Palestinian population are being increasingly stretched thin.

By 2003, the ability of the subsistence poor to continue coping with a prolonged economic crisis by reducing consumption, drawing down savings and selling liquid assets became increasingly strained. Consumption has been drastically reduced; there is limited opportunity for further cuts. In 2001, 94 percent of the population reported cutting consumption; in 2003, only 46 percent reported they were able to do so. Family savings are being depleted. In 2001, 70 percent of the poorest families drew down their savings, compared with 13 percent who continued to do so in 2003. Social networks provide an important safety net for poor households; 60 percent of the poor reports borrowing from individuals while 34 percent rely on borrowing from friends and relatives in 2003.

The protracted conflict is taking a heavy toll on the mental health of children and youth.

Continued violence has increased levels of psychological trauma and stress among children and young people. Almost one-half (48 percent) of children report having personally experienced conflict-related violence or witnessed violence affecting an immediate family member. Around 40 percent of parents report *intifada*-related psychological problems among children (aggressive behavior, nightmares, etc.) according to a study by the University of Geneva. Schoolteachers and parents also report diminished attention spans and difficulty in concentrating among school-age children. The well being of children and youth is problematic and worrisome; so too are the future cohesiveness and development prospects of Palestinian society.

Delivery of basic social services continues, due to significant donor assistance. But law and order are disintegrating

Despite commendable efforts, the quality and coverage of basic social services are severely under stress. To their credit, the PA, municipalities and a variety of NGOs (assisted by donors) have maintained delivery

of core services – education, health, water and electricity, sewage and solid waste – on a regular basis. Inevitably, however, service standards have declined; closures and the sustained fiscal crisis have taken their toll. For example, school enrollment rates have declined four years in a row. Moreover, the capacity of the education system is seriously constrained by the PA's deteriorating financial situation, a dramatic drop in payment of student tuition fees, and a lack of planning and management capacity. Despite these constraints, generally, the quality of basic education has been sustained at pre-*intifada* levels; the average student/teacher and student/classroom ratios have remained constant over the past five years. However, the quality of higher education is deteriorating; recruitment of teaching staff and expansion of facilities have not kept pace with expanding enrollment. The quality of municipal services has also deteriorated since the onset of the *intifada*. Closures have had a particularly negative impact on solid waste collection; there was also limited access to landfills; (the IDF has closed many municipal landfill sites). Increasing transport costs have led to a proliferation of temporary dumpsites that present environmental and health hazards. Donors doubled the level of emergency municipal support in 2003, thus playing a key role in sustaining municipal services.

The PA's legitimacy and ability to enforce law and order has gradually decayed.

In recent months, there have been increasing signs of a collapse of law and order in the West Bank and Gaza, with several kidnappings, mass protests and attacks on PA offices. When Prime Minister Qurei'a submitted his resignation on July 17 (later withdrawn) he warned that the West Bank was on the verge of "unprecedented chaos." Challenges to the authority of the PA have come from officials within the PLO and from a younger generation of political activists. Many of the latter are affiliated with militant groups like the Al-Aqsa Brigade and other groups associated with Fatah. Undoubtedly, the Israeli disengagement plan has fuelled internal Palestinian tensions; various political factions have sought to position themselves for the "day after" an Israeli military withdrawal.

Donor-financed emergency assistance has played an important role in sustaining social service delivery and supporting the poor. Donors disbursed US\$883 million in 2003 – a slight decline from 2002. But at US\$258 per capita, the level of donor support remains high by international standards. Despite a steep decline in budget support, donors nevertheless covered some 25 percent of the PA's recurrent expenditures in 2003. Therefore, they played a significant role in helping the PA continue basic social services. Donors also disbursed US\$264 million in emergency and humanitarian aid; US\$119 million of that was for food aid, job creation programs and cash assistance for the poorest. Without these programs, the Bank estimates an additional 250,000 persons (a 35 percent increase above the current level) would have fallen under the subsistence poverty line in 2003. Donor-financed emergency assistance has been relatively effective in targeting the poorest segments of the Palestinian society. Over 40 percent of food aid and about 55 percent of cash assistance goes to the 16 percent of Palestinians live below the subsistence poverty line. Inevitably, relatively affluent households receive some emergency assistance; however, the largest share of emergency assistance (some 70 percent) reach families living below the official poverty line.

A radical easing of closures and facilitation of trade is needed to restore Palestinian economic vigor

A radical easing of internal closures would bring growth to the Palestinian economy, but unemployment rates would still increase. Although short-lived, the modest economic recovery that accompanied the brief easing of closure and violence in 2003, and the brightened prospects for stability, illustrates the importance of closures for the health of the Palestinian economy. The World Bank estimates that an immediate easing of internal closures could lead to real GDP growth of 3.6 percent by 2005. Despite these economic gains, easing internal closure alone would not be enough to spur economic activity

to reduce unemployment and poverty. GDP per capita would remain 40 percent below its 1999 level by end-2006; poverty levels would reach 51 percent by 2006 (68 percent in Gaza). Unemployment rates would still reach about 30 percent by 2006 (35 percent in Gaza), slightly lower than under the *status quo* scenario (34 percent and 38 percent, respectively)¹.

Ending the Palestinian economic crisis depends on the ability of the private sector to trade in international markets. That means the opening of external borders. A small developing economy cannot rely on domestic demand for long-term sustainable growth. Palestinian (and Israeli) businesses need international markets to sell their products and to acquire inputs and production technologies at competitive prices. Bank projections indicate that a facilitating Palestinian external trade would raise real GDP growth to 9.2 percent by 2006 (compared with a negative 2006 growth rate under a *status quo* scenario). Exports would grow at a rate of 30 percent per annum by 2006 (significantly higher than the 3.4 percent under the *status quo* scenario); exports would spur job-creation and reduce unemployment to 23 percent by 2006, compared with 34 percent if the current *status quo* continues. As a result, the poverty level would fall from 56 percent under the *status quo* scenario (72 percent in Gaza) to 46 percent by 2006, which still, however, represents only a negligible improvement compared to the poverty level today. Bank projections indicate that were donors to provide generous additional assistance, concurrently with a radical easing of closures, a significant dent in poverty could be made: an extra US\$1.5 billion (for a total of US\$4.3 billion during 2004-2006) could reduce poverty to 37 percent by 2006.

¹ The scenarios presented in this report are identical to those of the June 23 World Bank report “*Disengagement, the Palestinian Economy and the Settlements*”.

PA reform and fiscal discipline are essential to create an investor-friendly climate

Rejuvenating the reform program is essential to create a growth-oriented economic environment and boost PA legitimacy with Palestinians and donors. Two years after the PA reform program began momentum has stalled. In 2003, reform achievements were limited to the area of public financial accountability. There is a serious need to bring the reform program up to speed again, even if a continuation of the conflict and the absence of a negotiated final settlement would compromise the effectiveness of these reforms.

Reforms to improve public accountability, transparency and stability, all vital element for economic recovery, require particular attention. The PA should press ahead with the establishment of legal and institutional frameworks for elections and complete the long-delayed voter registration process. Moreover, further measures to improve PA transparency - including the creation of an independent audit function, the privatization of public enterprises, and observing existing laws on public procurement - are essential to create investor confidence. In addition, legal and regulatory reform to ensure the orderly conduct of commercial activity must be speeded up; in particular, there is an urgent need to improve the infrastructure

of the court system and give priority to training judges and lawyers. And, though this paper does not discuss the specifics of Palestinian security, it is clear that the PA needs to establish control over law and order as a precursor to economic recovery. Finally, expanding access to credit will be needed to fuel any recovery; a major land-titling program, the expansion of leasing and adopting more creative methods for assessing credit risk would all help expand credit opportunities. There is no reason to delay these important reform measures. At the same time, it should be underscored that the economic impact of any reform will remain limited unless the GoI addresses restrictions on internal movement and external trade.

It is essential that the PA brings the wage bill under control. Unrestrained growth in the PA's wage bill in past years has severely undermined fiscal stability and sustainability. That has put the PA in a situation of unhealthy reliance on unsure donor support. The PA needs to press ahead with ongoing measures to tackle the escalating wage bill and reform the pension system. In particular, a continued increase in security sector staff is unjustified; it is essential that the PA restricts any increases in public expenditures to the social sectors. However, it should be noted that reducing the wage bill, by reducing the payroll or cutting salaries, could prove to be highly destabilizing; the PA derives its legitimacy from its ability to provide jobs in a context of economic crisis.

Infrastructure Assessment in the West Bank and Gaza

A World Bank team led by Mohammad A. Mustafa have recently carried out an assessment of the performance and condition of electricity, water and wastewater, transport, and telecommunications services in the West Bank and Gaza. The assessment report describes the efforts of the Palestinian Authority (PA) to manage and modernize WBG infrastructure over the past ten years. The report identifies the major issues-many of which center on problems of access to areas or resources controlled by Israel-facing these core infrastructure sectors. Taking account of the current social, economic and political situation, it sets out short- and medium-term options for development and investment needs that vary according to whether political conflict continues or abates.

Those needs could range from a little under US\$500 million in the short term (2005-2008), assuming continued political stalemate, to as much as US\$900 million in the same period if progress is made in resolving the Israeli-Palestinian conflict. In such favorable circumstances, medium-term (2008-15) investments required to upgrade the four core sectors could total over US\$2 billion.

In the next three years-assuming political progress-and in the seven that follow, *transport* would account for more than half of all projected funding needs. Of special importance is the need to rebuild existing roads that have sustained damage (estimated at some US\$94 million) from military action. In addition, damage at the Gaza International Airport estimated at about US\$22 million needs repair. In the medium-term, a Jenin-Hebron highway on the West Bank ranks as a priority. A 20-year plan to improve *water and wastewater* facilities to ensure Palestinians minimum WHO-recommended water consumption standards is estimated to cost over US\$5 billion, almost three times the annual level of average investment in the sector over the past eight years.

2005-08 investment needs for *electricity*, of which 95 percent of the supply comes from Israel and system losses run to an estimated 20 percent, are only about one-third of those projected for water systems, with the bulk of the outlays needed to build a West-Bank electricity transmission system and other funds required to diversify sources of supply. The report sees a degree of promise in the concept of regional electric interconnection facilities to help share power among Israel, Jordan, WBG and Egypt at peak load times. In *telecommunications*, a field dominated by a private company, modest annual investments could bring significant returns if the sector strategy focuses, as the PA has mandated, on marrying growth in information technology and high-quality infrastructure and on creating supporting regulatory environment for effective competition in the sector.

Strategy Adopted by the PA in the infrastructure sector

That strategy adopted by the PA aims at modernizing and expanding infrastructure services and at the same time building efficient structures and institutions in order to facilitate the achievement of its infrastructure services' objectives. Its key pillars are:

- Increasing the access of citizens to infrastructure services at affordable prices by rehabilitating existing networks and expanding them to reach a greater number of users;
- Establishing autonomous and commercially oriented regional utilities by consolidating the utility departments in municipalities and villages;
- Increasing private participation in infrastructure operations to leverage private financing and management expertise; and
- Separating regulatory from commercial functions and establishing regulatory institutions that will ensure a level playing field for all stakeholders.

PA's development efforts over the last ten years have faced enormous challenges:

- Territorial fragmentation and mobility restrictions imposed by the Government of Israel across borders and within WBG (especially in the last four years);
- Political uncertainty that confounds the public and private sectors amid interrupted negotiations on the permanent status of the Palestinian areas;
- Limited access of Palestinians to resources critical to the improvement of infrastructure services – water supply, seashore, airspace, radio-spectrum, and right-of-way;
- An underdeveloped and fiscally fragile economy subject to severe economic shocks;
- The large number of donors supporting infrastructure and their impact on deciding developmental priorities; and
- The need to build functioning national public institutions where none existed before.

Performance of infrastructure sector

Work on providing infrastructure services in WBG has made considerable progress since the PA assumed responsibility for them, but the Palestinians have had to build from a low base, including a huge backlog of rehabilitation and development work, few institutions, and very little funding. They have had to work, moreover, in very difficult physical, social, political, economic, and institutional circumstances. When these realities are factored in, the progress in water and wastewater, electricity, and telecommunications appears very creditable. For a number of reasons, progress in transport has not been as impressive, fundamentally because of the PA's failure to establish a coherent institutional and policy framework.

Good progress has been made in extending services and rehabilitating distribution networks, but more focus is needed on developing new sources of supply and backbone networks:

- **Access to and consumption of services have improved.** The majority of the population (84 percent) and the communities (62 percent) in WBG have access to piped water. Gross per capita water supply has also increased to about 106 liters per capita per day (l/c/d), although the net per capita consumption—an average of 65 l/c/d—remains low due to very high system losses. About 98 percent of the Palestinian population has access to electricity services. The number of villages still not connected to the electricity transmission grid was reduced from 138 in 1993 to less than 75 now, and work is underway to connect remaining villages. The paved-road network has been expanded by about 30 percent (nearly 700 km) since 1993 to bring the total paved network to about 2870 km. The agriculture roads network has also significantly expanded, as has access to telecommunications services. About 9 percent of the population (about 30 percent of households) has access to fixed telephones, mobile telephones, or Internet services.
- Long-term, sustainable development of infrastructure, however, will require a strategic

look at **the development of supply sources and backbone networks**. Despite the overall improvement in service provision, the distribution networks and the transmission networks remain inadequate. Water and electricity transmission networks are still at a very early stage. The supply of electricity is still greatly dependent on the Israeli Electricity Company (IEC), with only about 5 percent of Palestinian demand met from a Palestinian power plant built recently by an independent power producer (IPP). Only 45 percent of the available water supply in the West Bank is obtained from locally owned sources, mostly wells. Access to water aquifers and riparian rights is constrained by the political arrangements. The development of key transport facilities—West Bank-Gaza link, Gaza seaport, Gaza airport, West Bank airport, the North-South highway in the West Bank; and the North-south highway in Gaza is still to be undertaken.

Considerable progress has been made on the institutional development and sector reform fronts:

- Despite all the problems, internal and external, **the Palestinians have been able in a relatively short time to build several, very creditable public and private-sector institutions:** the Palestinian Water Authority and Palestinian Energy Authority; and the Palestine Telecommunications Company, its mobile subsidiary Jawwal, and the Palestine Electricity Company. Paltel and PEC have established themselves as strong national institutions, major employers, and key contributors to the national economy. Long-term strategies have been developed for electricity and water. A similar attempt is now underway in telecommunications. The establishment of bulk utility companies for water and electricity is planned. New laws were enacted for telecommunications and water, and a draft law for electricity has been prepared and is under discussion. These developments augur well for the future.
- **WBG is still in the early stages of establishing regulatory institutions for its infrastructure.** Sector ministries currently play the role as regulators of telecommunications and transport, although the PA Cabinet has recently decided to establish a separate regulator for telecommunications. Electricity and water are regulated by two separate public authorities. Despite the progress made on the legislative side, none of the regulatory

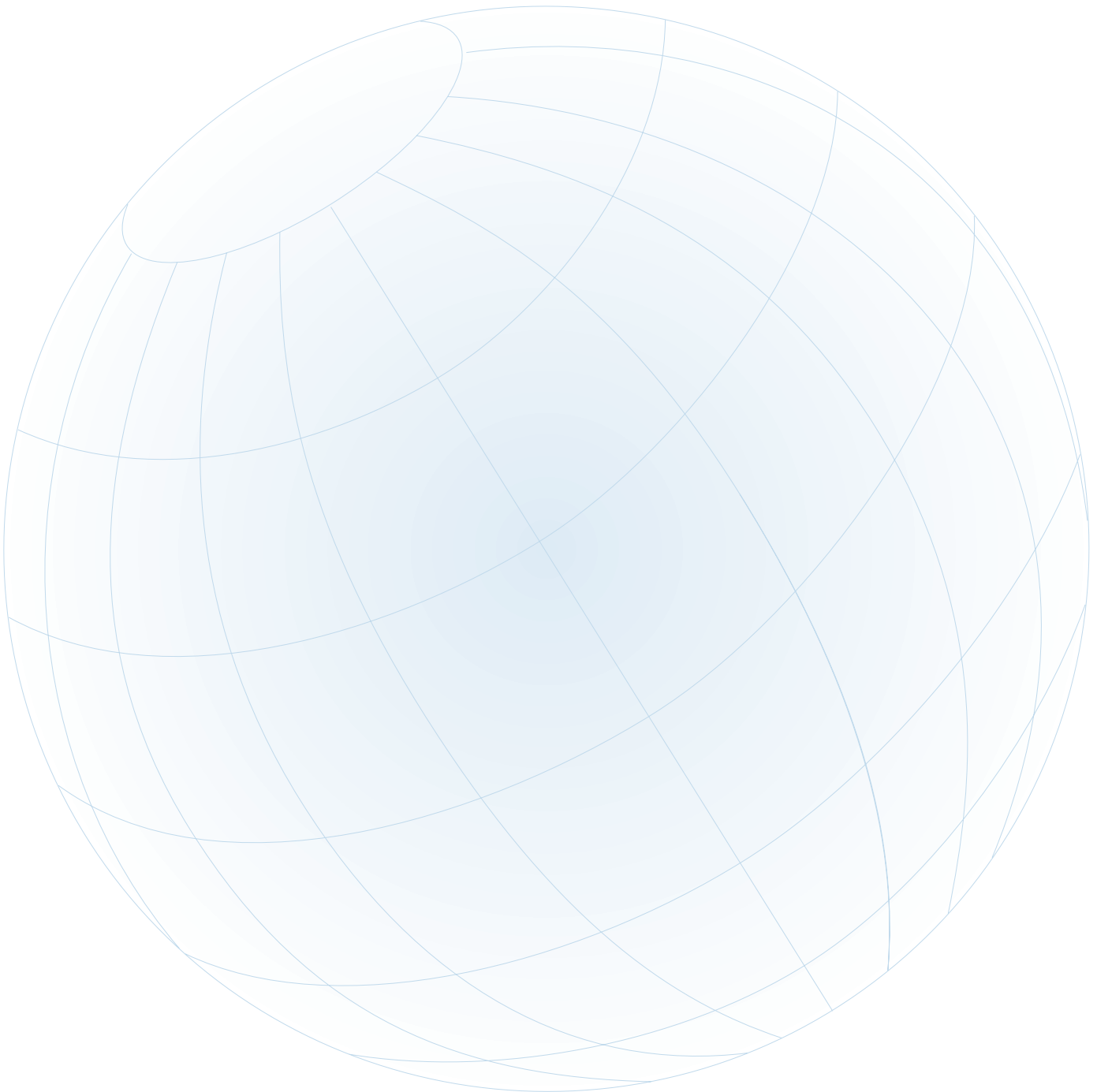
institutions has developed a detailed regulatory framework and the instruments required to enable effective regulation. Rather, they continue to perform several policy, developmental, and some times, service-provision functions.

- **PA's effort to consolidate and commercialize the entities (mostly municipalities and village councils) in charge of providing services is still in progress.** One of the key features of the PA's strategy in the area of infrastructure-services provision has been to set up regional utility shareholder-owned companies for electricity and water. While four (out of five planned) regional, electric utilities have been established since the PA took over, three more are still to be established. The Jerusalem District Electricity Company, which was founded in 1927, and the Jerusalem Water Undertaking are the leaders in terms of commercialization and institutional capacity in their respective sectors. However, municipalities and joint service councils continue to play an important role in providing infrastructure services to their populations despite increasing evidence indicating that municipalities served through regional utilities have better services, lower costs, and better network conditions.
- **Although the involvement of the private sector has been limited to few market segments, in many respects, private interventions in the sector highlight the potential for private participation in the infrastructure sector development.** As mentioned earlier, Paltel, Jawwal, and PEC have established themselves as strong national institutions and key players in the infrastructure sector. The management contract in the water sector in Gaza was another pragmatic approach to involving private operators in infrastructure. Since political risk was often cited as the main reason for this lack of success, it is evident that with a modicum of political stability and an efficient regulatory environment, much progress can be made in developing the sector.

Self-financing in infrastructure has been limited; the need for a sustainable financing strategy cannot be overstated. Given the PA's fiscal constraints, donors provided most of the funding—about US\$1.3 billion—that went into infrastructure. The shares of the key beneficiary sectors are: US\$730 million for water, US\$473 million for transport, and US\$140 million for

electricity. A strategy of continuing dependence on donor financing for infrastructure investments as well as for recurrent expenditure is neither healthy nor sustainable. The PA therefore needs to be realistic in its expectations of future donor funding and needs to do a much better job in developing effective procedures and setting national priorities for donor assistance. Inappropriate tariff regulation regimes,

inefficient billing and collection systems, and weak sector governance have contributed to the limited cost recovery and self financing. Innovative approaches are also needed to increase private involvement. If strong revenues cannot be generated by operators through cost-covering prices, especially from services provided to poor consumers, targeted subsidies provided by the government can be used to cover the gap.



Poverty in the West Bank and Gaza after Three Years of Economic Crisis

Three years of *Intifada* and closures have plunged the Palestinian economy into deep crisis, causing dramatic declines in living standards. This report – and indeed much of the attention of the donor community – focuses on the situation of the poorest of the poor. We have chosen this focus because the resources available for poverty reduction are insufficient to meet the needs of all individuals below the official poverty line. In the current context, donors and policy makers are naturally concerned that the resources available reach those who are most dependent on emergency assistance. Their concern is reinforced by two perceptions: (i) that the poorest have exhausted their savings and are increasingly vulnerable to malnutrition and permanent poverty traps should they face further economic shocks and (ii) the poorest will be unable to benefit from economic recovery because they tend to be unskilled or unable to work. Throughout the report, we use a subsistence definition of poverty, which includes individuals whose expenditures are less than 205 NIS per person per month. Using this definition of poverty, we find that 16 percent of the Palestinian population of the West Bank and Gaza cannot afford to consume the minimum caloric intake as established by the FAO and WHO.

Who are the poor?

A variety of factors are strongly related with poverty. As other studies have found, we find that the poor tend to have larger families and relatively low levels of education and that poverty is particularly common in Gaza. We also find that poverty is strongly related to unemployment and sporadic (as opposed to regular, permanent) jobs. Interestingly, we find that refugees and those in female-headed households are not significantly more likely to be poor than are others.

Has the crisis affected the poor disproportionately?

The poorest segments of the population do not appear to have suffered disproportionately from the crisis. Although the poor have become increasingly vulnerable and liquidity-constrained, they have also benefited more than other groups from emergency assistance.

In the early months of the crisis, the vast majority of the poor reduced their expenditures and also relied heavily on drawing down savings and selling jewelry as strategies to partially compensate for their reduced income. By the end of 2003, the savings of the poor seem to have been exhausted: the majority of the poor were no longer relying on these strategies, while the non-poor continued to do so.

While the exhaustion of savings and the resulting vulnerability has disproportionately affected the poor, emergency assistance has been reasonably successful in preventing widespread malnutrition and other types of humanitarian crises among the poorest. When we subtract out the value of emergency assistance received, we find that 22 percent of the population would fall below the (subsistence) poverty line. In other words, emergency assistance has served to lower the poverty rate from 22 percent to 16 percent – a reduction of almost a third.

Those who are poor or would be poor in the absence of emergency assistance – a group we refer to as the “needy” – have benefited disproportionately from emergency assistance. Whereas only 23% of the non-needy receive assistance, fully 68% of the needy receive assistance. Moreover, 55% of the total value of emergency assistance distributed is received by needy individuals.

How much of emergency assistance go to the non-needy?

How concerned should we be that some of the emergency assistance goes to the non-needy? Although some of the non-needy who receive assistance have consumption levels well above the poverty line, the majority has very low consumption levels. Because most of the non-needy who receive assistance are close to being needy, there is little cause for concern that they receive a portion of the assistance. Moreover, an examination of the observable characteristics of non-needy recipients of assistance, does not suggest any simple way to exclude them from benefits.

How serious is under-coverage of emergency assistance?

Whereas 68% of the needy receive assistance, a significant portion of the needy – 32% -- do not. What are the characteristics of these 32% of needy who are not covered? Needy individuals living in rural areas and in Gaza are much less likely to receive assistance than needy individuals living in other areas. In addition, controlling for other factors, the unemployed and the less educated tend to receive less aid than the employed and better educated. Interestingly, needy refugees and individuals in female headed-households are more likely to receive assistance than are other needy individuals. This may reflect agencies using refugee status and the gender of the household head as a proxy for need. This is ill advised however, as these households do not have exceptionally high rates of poverty.

What can be done to reduce poverty?

Because economic hardship has increased with the crisis, it may be hoped that a resolution of the crisis would reduce poverty. Unfortunately, even lifting of closures and a return to pre-*Intifada* levels of unemployment would do little to reduce poverty¹. By contrast, structural policies aimed at lowering dependency ratios and improving labor productivity could have much larger impacts on poverty rates. In the short term, a significant portion of the Palestinian population is likely to remain poor – and increasingly vulnerable to further shocks as their savings are exhausted. Direct assistance will remain a crucial component of the consumption of the poor. While reducing leakage would be difficult and have limited benefits, increasing the volume of emergency assistance could be an effective solution to fight poverty, if it can reduce under-coverage and systematic biases. This would, in particular, require implementing new programs designed to reach people from Gaza and rural areas, as well as the inactive, unemployed and less educated.

¹ More precisely, lifting of closures and a return to pre-*Intifada* levels of unemployment would do little to reduce subsistence poverty, which is the focus of this report. Lifting of closures and a return to pre-*Intifada* levels of unemployment may, however, have a larger impact on rates of poverty defined on the basis of the official poverty line.

Recent Economic Developments

Economic Output

Most recent economic data available (Palestinian imports from / exports to Israel for the first six months of 2004; Palestinian employment data through the third quarter of 2004 and in Israel through August; banking sector data through end-August; PA fiscal data through September) continue to provide evidence that the modest economic recovery witnessed in 2003 is extending into this year, but at a reduced rate of growth in the West Bank. In Gaza, due to closures imposed on Palestinian workers during the second and third quarter, growth has stalled and, possibly, declined.

Underlying the economic stabilization of 2003 were diminished levels of violence, fewer curfews, and more predictable (albeit intense) closures, as well as adaptation by Palestinian businesses to the contours of a constrained West Bank economy. Looking forward, the extent to which this admittedly fragile growth path can be sustained depends greatly upon the political/security situation and the extent to which travel and transit restrictions within the West Bank and Gaza, and whether closures of Israeli labor markets to Palestinian workers are eased or tightened (as recent Government of Israel policy statements suggest).

Table 1. Macroeconomic Projections 2003-2006

	2003	2004	2005	2006
GDP (US\$ million)	3,144	3,336	3,390	3,405
real growth rate	6.1%	2.7%	1.8%	-0.6%
GDP per capita (US\$)	925	934	904	867
real growth rate	0.6%	-2.3%	-2.9%	-5.1%
GDI per capita (US\$)	\$1,467	\$1,393	\$1,307	\$1,231
real growth rate	5.7%	-8.1%	-6.0%	-6.8%
Unemployment Rate	26%	27%	28%	32%
Poverty Rate	47%	48%	50%	54%

World Bank staff projections, November 2004, "Status Quo" scenario. Gross Domestic Product (GDP) measures productive activity within the West Bank and Gaza; Gross Disposable Income (GDI) measures total income, including workers' remittances and foreign aid (current transfers).

Under a political "status quo" scenario, economic performance in the West Bank and Gaza will continue to be considerably below its previous (and potential) levels, with the domestic economy unable to generate the employment necessary to absorb the increasing number of new entrants to the labor force. Private investment will continue to be depressed and increased foreign investment unlikely (*Table 1*).

Foreign Trade

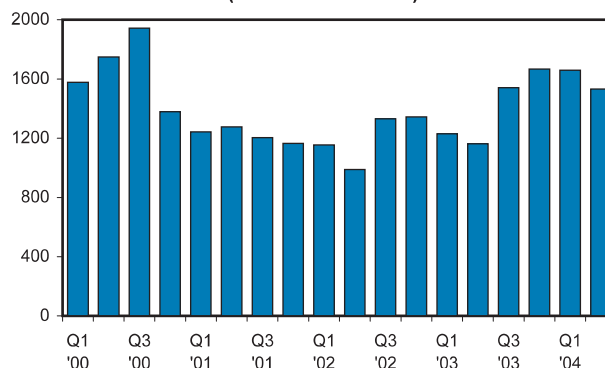
Trade traditionally played an important role in the small and open Palestinian economy. Throughout the past five years, imports of final goods, services, equipment and intermediate inputs represented approximately 70 percent of GDP, while exports of goods and services represented less than 20 percent of GDP.

Unfortunately trade is badly registered, as most of it takes place between the West Bank and Israel, where no custom stations exist (unlike trade between Gaza and Israel). The Israeli Central Bureau of Statistics nevertheless estimates such flows, and we rely on their data to depict the evolution of trade since 1998. This only covers Palestinian trade with Israel, and not with the rest of the world. However, trade with Israel represents the bulk of total Palestinian trade.¹ Furthermore, a significant share of imported goods from Israel are actually originating from third countries – “indirect imports”. In addition, it does not appear that these relationships are considerably impacted by exchange rate movements; neither the depreciation of the New Israeli Shekel in the first half of 2002 nor its subsequent appreciation during 2003 are thought to have significantly altered the composition of Palestinian imports in terms of trading partners. (See Figure 13 for shekel-dollar exchange rate movements.)

The impact of closures following the outbreak of the *Intifada* and their progressive tightening through summer 2002 were clearly reflected in the reduction of Palestinian imports from Israel. While both first and second quarter 2003 again witnessed reduction from the levels seen in the second half of 2002 (which, in turn, represented a rebound from the depressed second quarter 2002, the height of Israeli military operations in the West Bank), third and fourth quarter 2003 imports were at levels not seen since the outbreak of the *Intifada*. Second quarter 2004 (NIS 1532 million; USD 336 million equivalent) declined slightly from first quarter 2004 (virtually unchanged from fourth quarter 2003); compared to the pre-*Intifada* third quarter of 2000, the decline in imports is 21.1 percent (Figure 1).

¹ In 2000, imports from and via Israel represented 73 percent of total imports, while exports to Israel represented 92 percent of total exports.

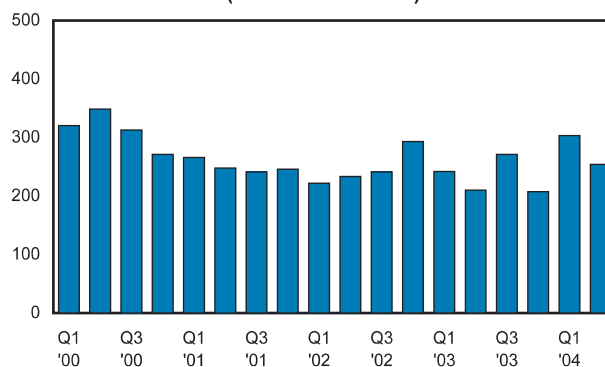
Figure 1. Merchandise Imports from Israel (million NI shekels)



Source : Israeli Central Bureau of Statistics.

Trends in merchandise exports to Israel have followed a similar pattern: decline through summer 2002; some rebound in the second half of that year; two consecutive quarters of decline in 2003, followed by an uptick in the third quarter. Unlike imports, fourth quarter 2003 saw a decline, while first quarter 2004 (NIS 303 million, US\$68 million equivalent) demonstrated strength, only to fall again in second quarter 2004 (NIS 254 million, US\$56 million equivalent). This represents a 18.8 percent decline from third quarter 2000 (Figure 2).

Figure 2. Merchandise Exports to Israel (million NI Shekels)



Source : Israeli Central Bureau of Statistics.

At least three factors explain the reduction in exports witnessed during the past three years: increased costs in transportation resulting from closure making Palestinian products less competitive (see Figure 14); foreign purchasers switching to more reliable alternative sources of supply in the face of production and shipping interruptions; and Palestinian producers switching to service domestic markets.

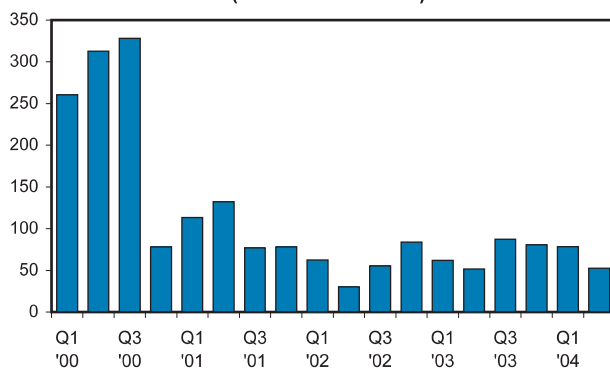
Labor Markets

As a result of external closures nearly 100,000 Palestinian workers have lost their jobs in Israel since September 2000. According to Palestinian Central Bureau of Statistics (PCBS) data, 146,000 Palestinians (116,000 from the West Bank, incl. East Jerusalem, and 30,000 from Gaza) were working in Israel and Israeli industrial estates and settlements during the third quarter 2000.

At its low point during the second quarter of 2002 the number had fallen to 33,000 before rebounding in the following quarter to 53,000; since then, the number of Palestinian workers in Israel and settlements has been roughly stable, fluctuating in accordance with the extent of closure imposed in the wake of specific terror incidents. In third quarter 2004, the number of workers stood at 57,200 (56,600 from the West Bank and only 650 from Gaza).

Fewer jobs in Israel translates directly into a decline in workers remittances. According to the Israeli Central Bureau of Statistics, third quarter 2000 remittances totaled US\$328 million; in second quarter 2004, only \$53million – a 84.0 percent decline (see Figure 3) – was remitted.

Figure 3. Workers' Remittances from Israel
(million US Dollars)



Source : Israeli Central Bureau of Statistics.

This decrease has had direct consequence on the income of Palestinian households, as workers' remittances from Israel represented some 18 percent of their total disposable incomes in 1999. In turn, lower incomes inevitably affected the demand for Palestinian

goods and services and hence, labor demand for Palestinian workers producing such goods and services within the West Bank and Gaza.

The negative impact that job losses in Israel has had on domestic employment was aggravated by the difficulties in conducting business within the West Bank and Gaza as a result of internal closures and curfews, particularly in 2002, which resulted in significant increases in transaction costs, disruptions in production cycles, losses of perishable output, and lower economies of scale.

By second quarter 2002 domestic employment had recovered to the extent that the number of Palestinians employed within the West Bank and Gaza surpassed the levels prior to the *Intifada* (see Table 2). At the same time, however, the number of unemployed has continued to grow, from 73,000 in the pre-*Intifada* third quarter 2000 to 226,000 currently.

In third quarter 2004 the number of West Bank Palestinians working inside the West Bank was 395,000 compared to 352,000 just before the *Intifada*. At its low point in second and third quarter 2002, their number had fallen to 287,000 and 288,000 respectively. Fourth quarter 2002 saw an increase in jobs in the West Bank to 334,000, but this growth was short-lived, concentrated in agriculture (related to the olive harvest and reversed in the first quarter of 2003) and some one-off infrastructure repair generating employment in construction.

From a first quarter 2003 decline to 300,000, second quarter 2003 saw strong growth (371,000), continued expansion in the third (377,000) and fourth quarter (386,000) last year, followed by decline (368,000) in the first quarter 2004. That decline largely reflected seasonal factors in agriculture and construction, sectors responsible for the growth witnessed in the latter half of 2003 and the pick up in employment noted in the second and third quarters of 2004.

In the Gaza Strip 163,000 Gazans were domestically employed during third quarter 2000. By third quarter 2002, the low point during the *Intifada*, this number had fallen to 111,000 (a 32 percent decline). Four quarters of continuous job growth found 180,000

Gazans employed domestically, before the decline registered during the fourth quarter of 2003 reduced the number of employed to 173,000. First quarter 2004 again witnessed domestic job growth in Gaza, to 177,000. The increase in tension and deteriorating security environment in Gaza during spring 2004, coupled with the loss of income from closing Israel and Erez Industrial Estate to Gazan worker, was reflected in the worsening employment numbers witnessed in the second quarter (156,000) and only partial recovery in third quarter 2004 (165,000).

Despite the recent increases in employment, with population growing at approximately 4.3 percent per year, dependency ratios – the total population divided by the number of employed persons – have increased significantly over the *Intifada* period. Whereas in the third quarter of 2000 each job holder in the West Bank was supporting 4.3 persons, by the third quarter of 2004 each employed person was supporting 5.4 persons. In Gaza the dependency ratio increased more dramatically, from 5.9 to 8.6.

Growing population and labor force, declining levels of Palestinian employment in Israel and Israeli settlements, and a lack of domestic job creation during the first two years of the *Intifada*, led to dramatic increases in unemployment and unemployment rates. Despite the job growth in recent quarters, the number of unemployed remains far in excess of pre-*Intifada* levels. (Under International Labor Organization (ILO) standard definitions, a person must be actively seeking work in order to be considered “unemployed”.)

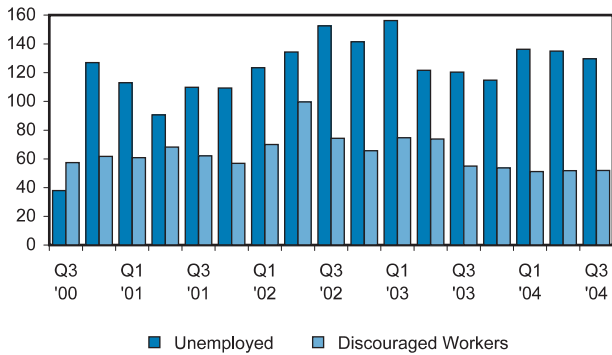
Following a decline in the unemployment rate in the West Bank in the fourth quarter of 2003 to 20.7 percent (down from its *Intifada* peak of 31.4 percent in first quarter 2003) first quarter 2004 again saw an increase, to 24.6 percent with 136,000 persons unemployed. Second and third quarters noted slight improvement, but by end-September 130,000 remained without jobs – an unemployment rate of 22.3 percent (see Figure 4). (By contrast, during the third quarter of 2000 the number of West Bank unemployed was 38,000 and the unemployment rate stood at 7.5 percent.)

Table 2. Number of Palestinians Employed and Unemployed (thousands)

	Q-3 2000	Q-3 2001	Q-4 2001	Q-1 2002	Q-2 2002	Q-3 2002	Q-4 2002	Q-1 2003	Q-2 2003	Q-3 2003	Q-4 2003	Q-1 2004	Q-2 2004	Q-3 2004
Working in West Bank	352	314	316	304	287	288	334	300	371	377	386	368	387	395
Working in Gaza	163	129	134	138	131	111	150	169	175	180	173	177	156	165
Working in Israel – from West Bank	116	60	66	56	30	50	49	43	50	59	54	49	48	56
Working in Israel – from Gaza Strip	30	3	2	2	2	2	7	6	4	8	4	6	0	1
Total Employed	662	506	518	501	451	452	540	518	600	624	617	602	594	619
Unemployed (ILO)	74	172	184	203	229	250	203	226	193	193	198	214	238	226
"Discouraged Workers"	94	119	101	111	137	119	112	109	110	78	76	72	71	73
Total, Unemployed and Discouraged	167	291	285	315	365	370	315	335	302	271	274	286	309	299

Source: PCBS. Note: Israel includes employment in Israeli settlements and industrial estates. West Bank includes East Jerusalem.

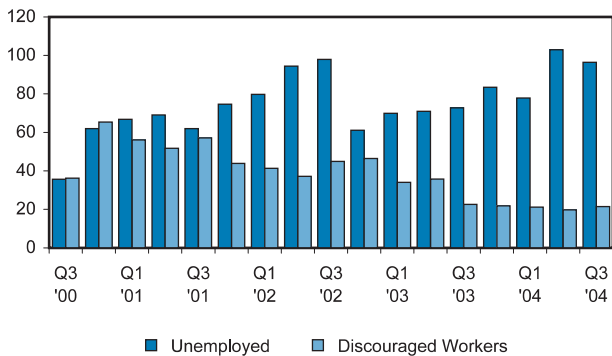
Figure 4. West Bank Unemployment (thousands of persons)



Source: PCBS. Data for West Bank includes East Jerusalem.

In Gaza, third quarter 2004 unemployment stood at 36.8 percent (96,000 individuals); only a modest improvement over second quarter 2004, when the unemployment rate stood at 39.7 percent, 103,000 persons – the highest number of unemployed ever recorded in Gaza). Prior to the *Intifada* the unemployment rate in Gaza was 15.4 percent (35,000 persons). (Figure 5.)

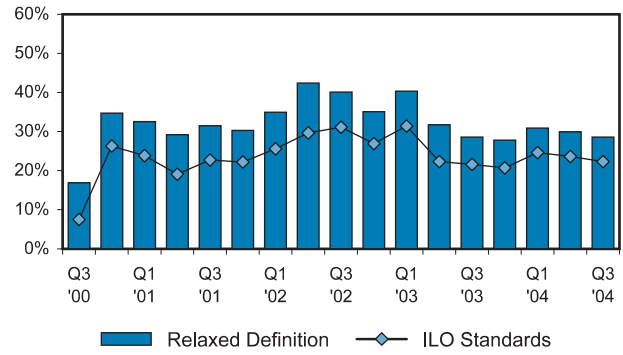
Figure 5. Gaza Strip Unemployment (thousands of persons)



Source: PCBS.

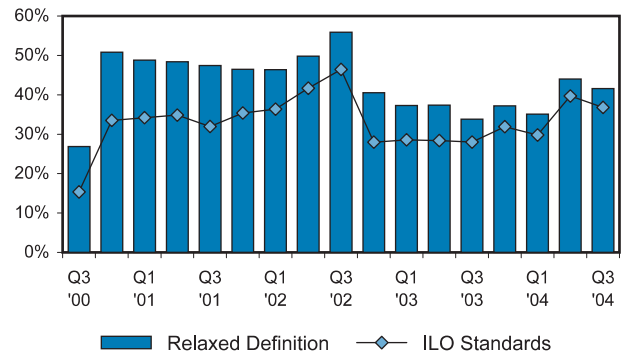
When the definition of the labor force is broadened to include "discouraged workers" – persons without jobs who, because of their pessimism regarding the prospect of actually finding work, have stopped looking – the “relaxed definition” of unemployment shows similar trends. In this case, the relaxed definition unemployment rate in the West Bank has increased from 16.9 percent (95,000 individuals) in third quarter 2000 to 28.6 percent (182,000) in third quarter 2004; in Gaza, from 26.9 percent (71,000 individuals) to 41.6 percent (118,000) over the same period (see Figures 6 and 7).

Figure 6. West Bank Unemployment Rates



Source: PCBS. Data for West Bank includes East Jerusalem.

Figure 7. Gaza Strip Unemployment Rates

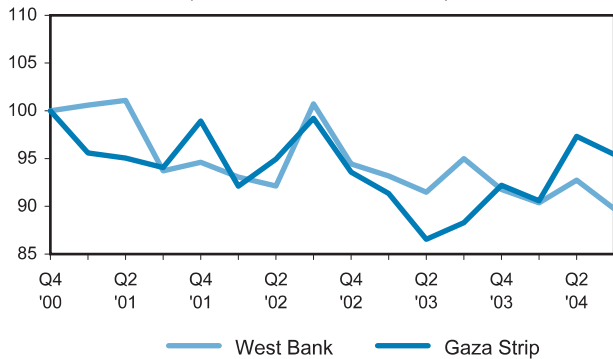


Source: PCBS.

For wage earners continuing to be employed, the impact of the increase in dependency ratios during the course of the *Intifada* (and the implied obligation of working Palestinians to support greater numbers of extended family member) is exacerbated by the decline in average real wages over much of the period of the *Intifada*, fairly consistently in both the West Bank and in Gaza. In the West Bank, real wages have declined 10.3 percent since fourth quarter 2000; in Gaza, they have decreased 4.6 percent (see Figure 8).

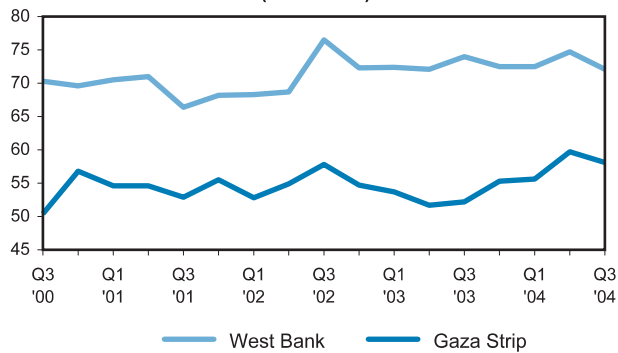
Average nominal wages have actually increased (3.2 percent in the West Bank and 10.3 percent in Gaza) over the 48 months since third quarter 2000 (Figure 9). The average daily wage in the West Bank stood at NIS 72.1 in third quarter 2004, and NIS 58.1 in Gaza; these compare with an average daily wage of NIS 125.3 received by Palestinians working in Israel and Israeli settlements.

Figure 8. Real Wage Indices
(Fourth Quarter 2000 = 100)



Source: PCBS average wage data; World Bank staff calculations. West Bank includes East Jerusalem. Data are deflated by consumer price indices for West Bank and Gaza, re-based to Fourth Quarter 2000 = 100.

Figure 9. Average Daily Wages
(NI shekels)



Source: PCBS. West Bank includes East Jerusalem.

One explanation for the stickiness of nominal wages may be the physical partitioning of the labor market – the result of travel restrictions associated with internal closure – which has resulted in increased mis-matches between supply and demand for various types of labor in the local labor market. Unemployed workers – even those willing to work for less than the prevailing wage – who cannot reach potential jobs remain jobless; at the same time, firms that face a shortage of labor are, therefore, not inclined to reduce workers' compensation.

Such behavior helps explain why the decline in labor demand witnessed during the *Intifada* has resulted primarily in higher unemployment and only to a lesser extent in lower real wages. Indeed the decline in real wages has mostly been the result of increase consumer prices and not decreased nominal wages. Even so, the decline in real wages during the *Intifada* period is

much less than experienced in the 1995-96 period of external closure, when real wages declined more than 20 percent in response to a reduction in the number of Palestinians working in Israel – a reduction much smaller than that of the current *Intifada*

Monthly labor force data from the Israeli Central Bureau of Statistics showed a decrease in (“legal”) Palestinian employment in Israel in August, the second monthly decrease following two months of growth from the low point reached in May, when the monthly average stood at 2,600 – the lowest level recorded since June 2002. August's monthly average of 9,500 workers compares with 15,200 in January 2004 and 16,900 in January 2003 (the highest level during the *Intifada*).¹

Of the 5,700 decrease recorded since January, the majority – 3,300 – were in construction, and may reflect seasonal considerations as well as security concerns. Currently 18 percent (1,700) are employed in agriculture; 62 percent (5,900) in construction; 20 percent (1,900) in other sectors. It is in these “other sectors” – primarily manufacturing and commerce – where the falloff since pre-*Intifada* employment levels has been greatest. According to ICBS data in September 2000 29,500 Palestinians were legally employed in Israel – 5,000 in agriculture; 15,200 in construction; and 9,300 in other sectors.

¹ PCBS Quarterly Labor Surveys consistently report higher levels of Palestinian employment in Israel than does ICBS, the result of two factors: first, PCBS data includes Palestinians who hold Israeli identity cards (primarily East Jerusalem residents) or foreign passports as well as persons who hold Palestinian identity – presumably ICBS considers foreign passport holders as foreigners and Israeli identity card holders as Israelis; second, PCBS data includes “illegal” (non-permit holding) workers, whereas these undocumented workers are likely to be under-counted by ICBS, as ICBS reports foreigners' employment on the basis of employers reporting to the National Insurance Institute.

Fiscal Developments

Ministry of Finance data through September continues to show that PA revenue collection remains on target with budgetary expectations. Domestic revenue has averaged NIS 122.8 million (US\$27.2 million equivalent) compared to the budgeted NIS 122.0 million. Gross clearance revenue (i.e., before deductions taken by the Government of Israel, primarily for municipalities' obligations due Israeli utility companies and accounted for in the budget as "net lending") have averaged NIS 252.3 million (US\$56 million equivalent), approximately 25 percent above budgetary expectations of NIS

199.3 monthly. After payments of tax refunds and "net lending" to municipalities, thus far in 2004 a monthly average of NIS 316.2 million (US\$70.2 million equivalent) was available to meet PA expenditure (Table 3).

While revenue has been on target, budgetary support from the international donor community over the first nine months of the year has fallen well below expectations. Anticipating US\$650 million in foreign financing to cover recurrent expenditure (US\$54.2 million monthly), through end-September only US\$289 million has been received, an average of US\$32.1 million per month.

Table 3: PA revenue and expenditure – January-September 2004 (million NIS and million US\$)

	Budget 2004 Monthly Average		Year to Date (January-September) Monthly Average		Percent
	NIS	US\$	NIS	US\$	
Total Gross Revenue	321.3	68.4	375.1	83.3	116.8%
Domestic Revenue	122.00	26.0	122.8	27.3	100.7%
Domestic tax revenue	73.3	15.6	71.7	15.9	97.8%
Domestic non-tax revenue	48.7	10.4	51.1	11.3	105.0%
Clearance Revenue	199.3	42.4	252.3	56.0	126.6%
Less: Tax Refunds	5.6	1.2	6.8	1.5	120.8%
Total Net Revenue	315.7	67.2	368.4	81.8	116.7%
Less: Deductions for "Net Lending"	38.7	8.2	52.2	11.6	135.1%
Total Available Net Revenue	277.0	58.9	316.2	70.2	114.1%
Total Current Expenditure	520.1	110.7	483.9	107.6	93.0%
Wages and Salaries	324.5	69.1	324.7	72.2	100.1%
Non-Wage Current Expenditure	195.6	41.6	159.2	35.4	81.4%
Current Deficit Before Financing	243.1	51.7	167.7	30.4	

Source: Ministry of Finance. September data preliminary.

Note: Budget 2004 projected an average exchange rate of NIS 4.7 / US\$ 1 for the year 2004; actual average exchange rate for period January-September was 4.51. US dollar equivalent of NIS revenue and expenditure year-to-date shown in above table calculated at actual average exchange rates each month, summed, and then averaged for nine months. Percentage comparisons with budget forecasts are calculated in NIS to avoid impact of different exchange rates. Before transferring monthly clearance revenue to the PA, the Government of Israel deducts payments due Israeli utilities by Palestinian municipalities. These deductions are considered as "Net Lending" and have the effect of reducing revenue available to the PA to meet other expenditures

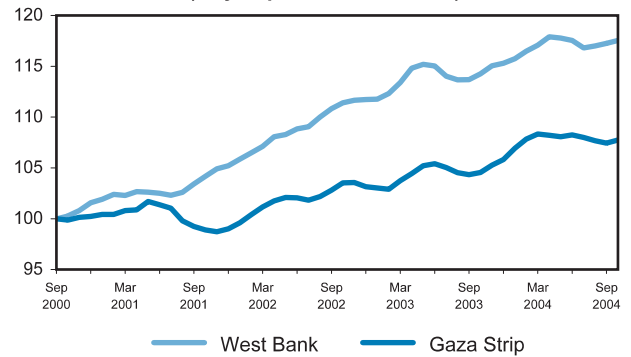
US\$107 million has come through the multi-donor “Budget Trust Fund” established by the World Bank (US\$55.8 million from the European Commission (EC); US\$20.0 million from the World Bank; US\$12.3 million from the United Kingdom; US\$12.0 million from Norway; and US\$7.0 million from Canada); US\$50 million from the EC prior to the establishment of the BTF; US\$77.3 million from Arab states (primarily Saudi Arabia, US\$61.6 million); and \$52.3 million through the World Bank’s Emergency Services Support Program (ESSP), designed to safeguard critical non-wage current expenditures in the Ministries of Health, Education, and Social Affairs.

As a consequence of the shortfall in donor support (and the inability of the PA to increase its borrowing from Palestinian commercial banks), current expenditures have been constrained. This tightening, however, has been limited to non-wage expenditures; wages and salaries, averaging NIS 324.7 million (US\$72.0 million equivalent), are running exactly at the level projected in the 2004 budget. Among the non-wage current expenditures, transfers – which have averaged NIS 92.0 million (US\$20.5 million equivalent) – are being funded at 92.9 percent of budgetary expectation thus far; operating expenditures have averaged NIS 67.2 million (US\$14.9 million equivalent) – 69.7 percent of the forecast level.

Prices

Consumer prices, measured in NI shekels, increased in both the West Bank and Gaza in the twelve month period January-December 2003, by 4.3 percent in the West Bank and 2.5 percent in Gaza. For the West Bank, this represents a reduction from 2002’s inflation rate of 6.1 percent, and a slight increase over the 2.2 percent recorded last year in Gaza. During the first ten months of 2004, inflation in the West Bank has slowed, to 2.8 percent (compared to the January-October 2003 level), while in Gaza it has accelerated, to 3.3 percent (*Figure 10*).

Figure 10. Consumer Price Indices
(July-September 2000 = 100)



Source: World Bank calculations based on PCBS data. Figure shows three-month moving averages, re-based to Third Quarter (July-September) 2000 = 100.

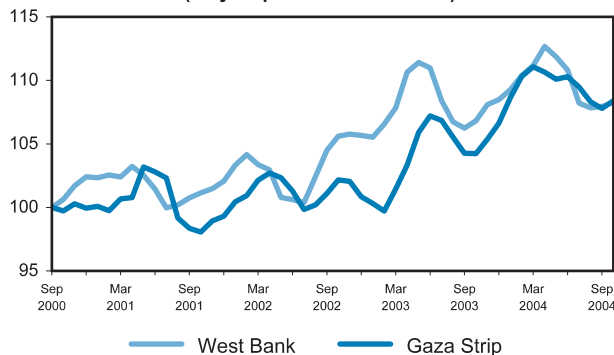
Leading the increase in 2003 in the West Bank was the Transport and Communications price index, up 7.9% last year (compared to 21.7 percent in 2002) and, somewhat surprisingly, Medical Care, up 8.0 percent. (In 2002, the West Bank Medical Care index fell 1.0 percent; in the period from the beginning of the *Intifada* through December 2002, medical care prices rose only 0.5 percent.) For the January-October 2004 period Medical Care and Transport and Communications have again driven West Bank inflation, rising 5.7 percent and 5.6 percent respectively compared to the similar period in 2003.

Cost of medical care in Gaza represented the second largest increase in the components of the consumer price index in 2003, rising 4.9 percent (compared to a 1.2 percent fall in 2002 in the Medical Care index for Gaza.) Medical care costs continued to increase in 2004, with October’s level 4.0 percent above the January-October period one year ago. Three other components, however, have had larger increases in prices so far this year: Transport and Communications, up 5.5 percent (*see also Figure 14*); Food, up 5.1 percent; and Education, up 5.0 percent. Of all components, it was the Education price index that rose the most in 2003 – up 7.3 percent. This represents a significant change from 2002, when education prices rose 2.1 percent. (Education in the West Bank rose 5.8 percent in 2003, a rate less than in Gaza, but above the overall West Bank Consumer Price Index increase for the year.)

As Figure 10 indicates, much of 2003's increase in overall consumer prices occurred during the first six months of 2003, with price declines in the third quarter offset by price increases in the fourth. The price increases during the first two quarters was driven by increases in food prices. A similar pattern can be observed in 2004: strong increases in prices in the first quarter, followed by decline in the second, increase to first quarter levels in the West Bank during the third quarter of 2004 while declining in Gaza over the third quarter.

Food prices generally exhibit strong seasonality effects, peaking during the second quarter (see Figure 11). Usually, food prices then decline in the third quarter before rising modestly in the fourth quarter of the year, a pattern likely to continue through the remainder of 2004 and into 2005.. Over the course of 2003, the Food price index increased 4.7 percent in the West Bank and 3.5 percent in Gaza – in both areas above the increase in the overall price index; comparing January-October 2004 to the first ten months of 2003, food prices have increase 5.1 percent in Gaza but only 1.3 percent in the West Bank.

Figure 11. Food Price Indices
(July-September 2000 = 100)



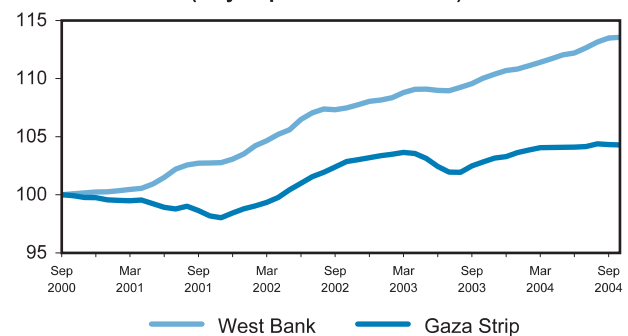
Source: World Bank calculations based on PCBS data. Figure shows three-month moving averages, re-based to Third Quarter (July-September) 2000 = 100.

Excluding food, the consumer price index in the West Bank has risen by 3.6 percent in the first ten months of 2004; in Gaza, the non-food CPI increased 2.1 percent so far this year – rates similar to those in 2003, but below what were witnessed in previous years. (In 2001, non-food prices rose 4.6 percent in the West Bank and fell 0.3 percent in Gaza; in 2002, non-food prices rose 8.7 percent in the West Bank and by 2.8

percent in Gaza; in 2003, 2.7 percent in the West Bank and 1.8 percent in Gaza.)

When the Transportation and Communication price index is also excluded – transportation prices being most affected by changes in the closure regime, but also by changes in world energy prices, which can be quite erratic (see Figure 14) – a clearer portrait of general price changes emerges. Non-food, non-transportation prices in the West Bank increased 4.1 percent in 2003, and by 1.5 percent in Gaza (Figure 12). (During 2002, non-food, non-transportation prices rose 4.6 percent in the West Bank and 2.6 percent in Gaza. In 2001, these prices rose 2.0 percent in the West Bank and fell 1.6 percent in Gaza.) Over the first ten months of 2004, this measure of “core inflation” increased 3.0 percent in the West Bank and 1.3 percent in Gaza.

Figure 12. Consumer Price Indices, excluding Food and Transportation
(July-September 2000 = 100)



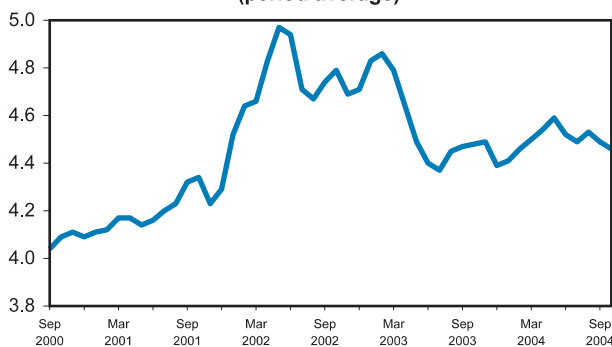
Source: World Bank calculations based on PCBS data. Figure shows three-month moving averages, re-based to Third Quarter (July-September) 2000 = 100.

There is also a relationship between price movements in the West Bank and Gaza and changes in the shekel-dollar exchange rate. The depreciation of the Israeli shekel in 2001 and early 2002 (particularly strong in the period November 2001-April 2002; depreciation is represented as an upward movement in Figure 13) and its subsequent appreciation, especially in the period February-July 2003 (downward movement in the figure) explains to a large extent the acceleration of inflation: during the 2002 and its subsequent slowing down in 2003.

From December 2000 to December 2001 the Shekel lost 4.9 percent of its value with respect to the US dollar; from December 2001 until May 2002 the Shekel

weakened a further 15.9 percent. As a result, prices of goods, expressed in shekels, imported into Israel from overseas – and by extension, into the West Bank and Gaza – mechanically increased and the overall consumer price index, also measured in shekels, increased – not by the same amount, but to the extent that the CPI market basket consists of imported goods and of services priced in dollars (such as rents). With an appreciating shekel – from February 2003 through December 2003 the shekel has strengthened 9.7 percent against the dollar (11.7 percent since the shekel's weakest point in May 2002) – imports become cheaper, and inflation measured in shekels lessens (to the extent that importers actually pass on these reductions to consumers). In the ten months through October 2004, the shekel first weakened against the dollar, depreciating by 4.6 percent through May, and then strengthened; depreciation since December 2003 totaling 1.3 percent. Should NIS depreciation again accelerate, inflation tendencies might be expected to pick up.

Figure 13. NI Shekel-US Dollar Exchange Rate (period average)



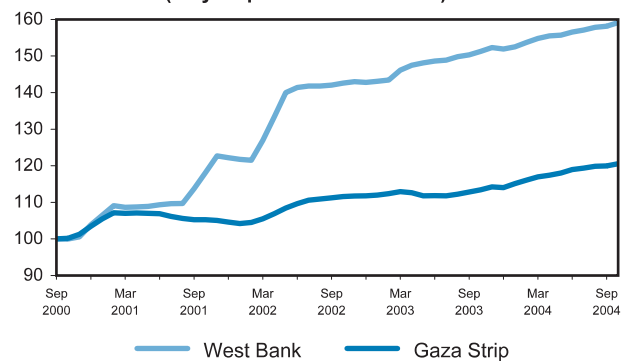
Source: Central Bank of Israel..

While exchange rate movements help explain basic trends in tradeable consumer goods prices (particularly in non-food prices, which are less affected by seasonality) tightened closure during the *Intifada* period also impacted consumer prices overall. This effect comes through both direct and indirect channels: changes in the transportation component of the consumer price index (which measures transportation prices that have increased directly as a result of heightened closure) and indirectly through increased costs of shipping for producers and distributors, which

are in turn passed on as increases in the final price of all goods faced by consumers in the market place.

Thus the tightening of closure associated with the outbreak of the *Intifada* in fall 2000 affected both Gaza and the West Bank, while Israeli military interventions in the West Bank in autumn 2001 and spring 2002 explain the difference in movement in the transportation price index in the West Bank and Gaza. In effect, these are negative shocks that raise the level of the transportation price index (seen as upward steps in *Figure 14*). In 2003, transportation prices increased in the West Bank 7.9 percent; in Gaza, transportation costs have increased 3.1 percent. January-October 2004 has again seen increases in the transportation index – since December, it has risen 5.5 percent in both the West Bank and in Gaza compared to the first ten months of 2003.

Figure 14. Transportation Price Indices, (July-September 2000 = 100)



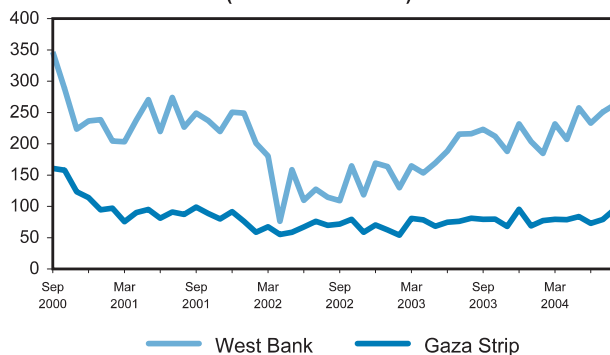
Source: World Bank calculations based on PCBS data. Figure shows three-month moving averages, re-based to Third Quarter (July-September) 2000 = 100.

Banking Sector

The decline in overall economic activity in the West Bank and Gaza since the beginning of the *Intifada* is clearly evident in the total value of checks cleared by banks operating in the West Bank and Gaza Strip, particularly in the periods of increased Israeli military operations. During the first nine months of 2000, i.e., prior to the *Intifada*, the value of checks presented for clearing averaged US\$449 million (US\$301 million in the West Bank, \$148 million in Gaza) per month. During the twelve months of 2002, monthly values averaged less than half the pre-*Intifada* levels: US\$148 million in the West Bank; \$67 million in Gaza; total, US\$216 million.

August 2004 saw US\$262 million cleared in the West Bank and US\$95 million in Gaza. Compared to the first eight months of 2003, the total value of checks cleared has increased 24.7 percent (30.6 percent in the West Bank and 10.3 percent in Gaza). However, this apparently strong increase in the West Bank is deceptive, reflecting the depressed volume in the January-April 2003 period. Indeed, the average monthly value cleared in the West Bank during the first four months of 2004 (\$207 million) is below the monthly average for the July-December 2003 period (\$214 million). Comparing the monthly average thus far in 2004 for Gaza with the average monthly level recorded during the second half of 2003 shows no change (\$80 million).

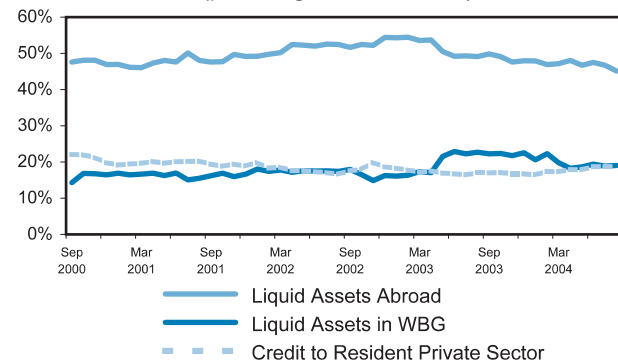
Figure 15. Total Value of Checks Cleared (million US Dollars)



Source: Palestinian Monetary Authority (PMA).

The Palestinian banking sector continues to try to weather the current economic crisis by maintaining the very conservative investment positions taken over the years. Banks remain very liquid, with placements in the West Bank and Gaza and, more significantly, overseas and have continued to increase their liquidity ratios since September 2000 at the expense of lending to the resident private sector.

Figure 16. Composition of Bank Assets (percentage of Total Assets)



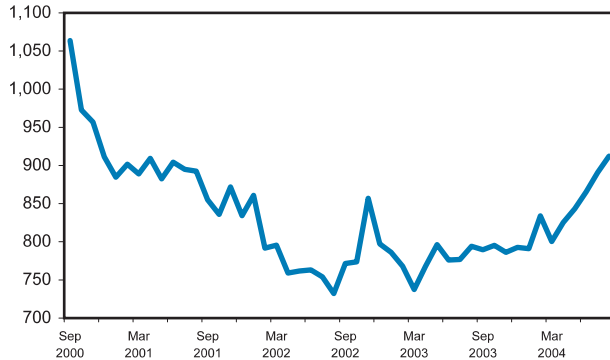
Source: Palestinian Monetary Authority (PMA).

By end-August 2004, 19.1 percent of the combined assets of commercial banks operating in the West Bank and Gaza were held in cash or deposits with other Banks; a further 45.1 percent of assets were held as deposits in foreign banks. Lending to the private sector represented 18.7 percent of total assets. These represent significant changes in asset allocation compared to September 2000 when 14.3 percent of total assets were maintained in cash and local bank deposits, 47.6 percent were in deposits with foreign banks, and 22.1 percent in private sector loans (*Figure 16*).

Along with this increase in liquid assets is the decline in Bank's lending activity. Throughout the first two years of the *Intifada*, the volume of credit extended to the private sector declined steadily, reflecting both lower demand on the part of borrowers and greater risk aversion on the part of bankers during a period of economic downturn and political uncertainty. In such a climate, the granting of new credits is scaled back and existing lending and overdraft facilities are rolled-over less automatically. Over the past seventeen months some increase in lending to the resident private sector has been noted. From its low point in March 2003,

when the stock of credit outstanding was US\$737 million, lending has increased; at end-August 2004, the stock amounted to US\$912 million. Nevertheless this still represents a 14.2 percent decline from pre-*Intifada* September 2000, when US\$1.06 billion in credit was outstanding (*Figure 17*).

**Figure 17. Credit to Private Sector
(million US Dollars equivalent)**



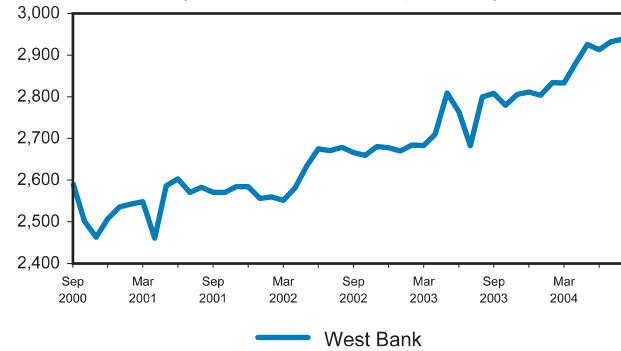
Source: Palestinian Monetary Authority (PMA).

Expressed as a share of total bank assets, private sector credit has declined from 22.1 percent in September 2000 percent to 18.7 percent end-August 2004 (*see Figure 16*). Although it is quite probable that the quality of bank's loan portfolios has suffered (non-performing loans have increased and some collateral destroyed as the result of military operations) as well, the low percentage of loans to total assets mitigates solvency concerns thus far for most banks.

Resident private sector deposits witnessed a considerable decline in the first two months of the *Intifada* in both the West Bank and Gaza; however in subsequent months different patterns emerged.

In the West Bank, deposits levels recovered; from May 2001 to April 2002 their level was essentially as in September 2000. Further growth in the second quarter of 2002 was followed by another period of stability until April 2003; over the next seventeen months deposits again increased, reaching \$2.94 billion end-August 2004, 13.2% above September 2000 (*Figure 18*).

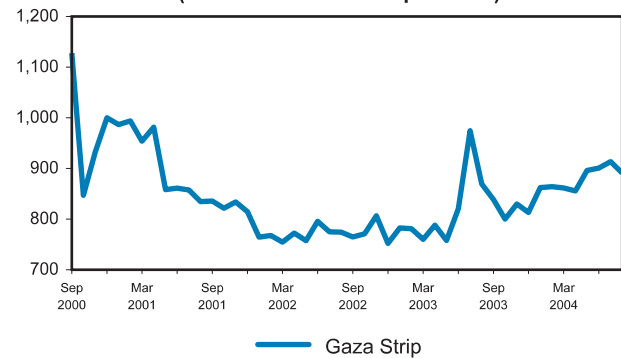
**Figure 18. Total Deposits -- West Bank
(million US Dollars equivalent)**



Source: Palestinian Monetary Authority (PMA).

In Gaza, deposits stood at \$1.13 billion prior to the *Intifada*, declining to \$1.0 billion at end-2000. In 2001, they fell an additional 18.5 percent to end the year at \$814 million; 2002 saw additional decline in the first quarter followed by relative stability, ending the year at \$752 million. 2003 witnessed a return to deposit growth, continuing into the first quarter of 2004; August 2004's level of \$891 million has brought deposits back to the level of May 2001 (*Figure 19*).

**Figure 19. Total Deposits -- Gaza Strip
(million US Dollars equivalent)**



Source: Palestinian Monetary Authority (PMA).

The difference in deposit behavior between Gaza and the West Bank likely reflects the higher rates of unemployment and poverty, and hence lower savings, in Gaza as well as the fact that West Bank residents have greater family ties abroad (primarily Jordan), a source of financial transfers and support.

Update on World Bank Portfolio in the West Bank and Gaza

(Information as of November, 2004)

the Public Financial Management Reform Trust Fund, the Social Safety Net Reform Project (SSNRP) and the North Gaza Emergency Sewage Treatment Project.

The Bank continues to work with the Ministry of Finance and other stakeholders on preparing a Pension Reform Project aimed at improving the sustainability and management of the PA's civil service pension system. Other projects expected to be approved in the course of 2005 include a Phase II Emergency Water Project, a Land Administration Project, a Higher Education Project, a Phase II Emergency Municipal Rehabilitation Project, and a follow-up operation to the Health Systems Development Project.

As of November, the Public Financial Management Reform Trust Fund has disbursed US\$118.45 million to the Ministry of Finance Single Treasury Account: Norway (US\$12 million), Canada (US\$7 million), DFID (US\$12.3 million), EC (US\$55.8 million), Japan (US\$10 million), Korea (US\$570,000), Australia (US\$780,000) and the World Bank (US\$20 million). The third tranche of the ECs contribution (US\$25 million) is the only outstanding commitment to the Reform Fund, and can only be disbursed upon fulfillment of the end-

1 These are Emergency Response Program (ERP), which financed over 200 labor-intensive micro-projects, two Emergency Services Support Projects (ESSP I and II), which provide operating cost support to the main social service ministries (Education, Health, and Social Affairs), the Emergency Municipal Services Rehabilitation Project (EMSRP), which helps municipalities sustain basic services (solid waste, electricity, water & sanitation) as well as strengthen budget and planning processes, and the Emergency Water Project (EWP), which alleviates severe water shortage in the southern West Bank.

World Bank assistance since September 2000 has aimed to strike a balance between maintaining medium-term developmental activity where feasible and providing emergency assistance designed to sustain Palestinian institutions and mitigate poverty.

In response to economic hardship and fiscal crisis, the Bank – like other donors – has placed increasing emphasis on emergency operations. In total, the Bank has committed US\$138 million to various emergency projects since the beginning of the current *Intifada*¹.

Initially, consistent with the Bank's emergency support during periods of closure in the 1990s, priority was given to job creation. From 2001 onwards the Bank's emergency strategy shifted towards sustaining basic services, largely through support for non-wage expenditures in the ministries of Health, Education and Social Affairs, as well as in municipalities. An additional element in the Bank's emergency response was a reallocation in August 2002 of US\$10.3 million from six projects public infrastructure repair.

The World Bank has currently 18 ongoing projects in the West Bank and Gaza (Table 1), for a total commitment of US\$237 million, of which US\$180 million has been disbursed to-date. More than 50 per cent of the World Bank current commitments are made towards emergency projects, while the remaining commitments are being channeled toward more traditional developments projects in a wide array of sectors.

Since the March 2004 edition of the *West Bank and Gaza Update*, three new projects have become operational;

2004 benchmarks. Total contributions to the Reform Program thus amount to approximately US\$143 million. Other donors are considering a contribution, including Belgium, Germany, France and Italy.

The Bank also performs analytical sector work on various policy issues and subjects of topical concern. Studies completed over the course of 2004 include the

Country Financial Accountability Assessment and an infrastructure assessment. The Bank is finalizing the Country Procurement Assessment Review and expects to issue the third in the series of Assessment Reports, Forty Two Months – *Intifada, Closures and Palestinian Economic Crisis* and a Poverty Update by the end of November, 2004.

On-going Bank Group Operations	
Project Name & Details	Description
<p>Education Action Project (EAP). World Bank: US\$7 million. Borrower (PA): US\$0.63 million. Approval Date: July 18, 2001. Closing Date: September 30, 2005. Task Team Leader: Arun Joshi.</p>	<p>The Education Action Project (EAP) supports the work already undertaken by the Ministry of Education in the development of its Five Year Plan (2001-2005) and long-term education strategy. The EAP primarily aims to strengthen the capacity of the Ministry of Education (MOE) to manage the education system more effectively through improving policy-making, planning and budgeting at central and district levels. It supports the implementation of activities in targeted domains included in agreed annual departmental work plans derived from the Five-Year Education Plan. This should lead to improved utilization of funding from the budget and international donors. The Project has two components. The first provides assistance to develop strategies that facilitate planning across the departments, whereas the second supports specific investments in education domains including a program for school improvement through staff review, a school development program, the development of professional standards for school principals, and support to Vocational Education.</p>
<p>Health System Development Project (HSDP). World Bank: US\$7.9 million. Approval Date: December 9, 1999. Closing Date: April 30, 2005. Task Team Leader: Anne Johansen.</p>	<p>The objectives of HSDP are to enhance the management capacity of the Ministry of Health (MOH) and improve access to high-quality and affordable Primary Health Care (PHC) services, especially in rural and underserved areas. The Project has three components. The first supports the upgrading of the PHC network by replacing 40 substandard PHC facilities, including equipment and furniture, and developing their functional standards. The second component supports the establishment of a Health Management Information System. The third component supports improvement of the quality and efficiency of health care.</p>
<p>Second Municipal Infrastructure Project (MIDP II). World Bank: US\$7.5 million. Approval date: June 20, 2000. Closing Date: June 30, 2005 Task Team Leader: Ibrahim Dajani.</p>	<p>The main objective of MIDP II is to improve infrastructure services (roads, water, and drainage), including high priority sections of the regional road network and rehabilitation of village and municipal water networks in WBG. The project is also to support rehabilitation and repair of key PA institutions, essential health and education service providers as well as infrastructure which were damaged during the <i>Intifada</i>. The Ministry of Public Works (MPW), Ministry of Local Government (MLG), and the Palestinian Water Authority (PWA) are the implementing agencies for this Project. In addition, the Project will continue to provide support to the MLG for an accounting system and institutional reform.</p>
<p>Solid Waste and Environmental Management Project (SWEMP). World Bank: US\$9.5 million EC: EURO 4 million Approval Date: October 10, 2000. Closing Date: December 31, 2005. Task Team Leader: Allan Rotman.</p>	<p>The Project is financing interventions in solid waste collection, transfer, and disposal of waste for the District of Jenin. The Project is managed by the Joint Services Council for Solid Waste Management (JSU) and is being executed through a Project Implementation Unit (JSC-PIU). The Project is assisting in strengthening capacity building of the Environmental Quality Authority. The EC component is financing the supply of collection vehicles and transfer stations relation set-ups.</p>

Project Name & Details	Description
<p>Southern Area Water and Sanitation Improvement Project (SAWSIP). World Bank: US\$21 million. Approval Date: June 5, 1999. Closing Date: December 31, 2004. Task Team Leader: Suhail Jme'An.</p>	<p>The original objective of SAWSIP was to improve sufficiency and efficiency of water and wastewater services in the southern West Bank. This would be achieved through the preparation and implementation of an appropriate institutional framework for water and wastewater service provision, including the implementation of four-year performance-based management contract and the strengthening of the institutional capacity of PWA to become a sector regulator. The Project is currently going through a restructuring to be better aligned with current circumstances on the ground.</p>
<p>Palestinian Expatriate Professional Program (PEPP). World Bank: US\$3 million. Netherlands: US\$0.3 million. Approval Date: May 22, 1998. Closing Date: December 31, 2004. Task Team Leader: Husam Abu Dagga</p>	<p>The PEPP supports the recruitment of expatriate Palestinians to key management and senior technical positions in PA institutions as an institution-building measure. Since the program started in late 1997, 17 persons have been successfully recruited for positions at 11 PA Ministries and Agencies, including the Ministries of Finance, Health, Higher Education, Housing, the Palestine Broadcasting Corporation, the Palestine Monetary Authority, and the Bethlehem 2000 Committee.</p>
<p>Palestinian NGO Project (PNGO II). World Bank: US\$8 million. UK/DFID: US\$7.8 million. Italy: US\$2.4 million. Approval Date: June 21, 2001. Closing Date: August 31, 2005. Task Team Leader: Sima Kanaan.</p>	<p>The Project is aimed at strengthening the capacity of NGOs to deliver sustainable services to the poor and marginalized, while supporting the overall professional and strategic development of the Palestinian NGO sector. The Project has three main components: A Partnership Grants Program, A Development Grants Program and a Sector Support Program which is aimed at supporting information exchange and capacity building support to umbrella NGO networks. A sub-component of the Project involves the establishment of a Center for Women in Difficult Circumstances. The Project is being implemented by the Welfare Association Consortium, consisting of the Welfare Association, the British Council, and the Charities Aid Foundation (CAF).</p>
<p>Electric Sector Investment and Management Project (ESIMP). World Bank: US\$15 million. EIB: US\$38 million. Italy: US\$35 million. PA: US\$3 million. Approval Date: August 31, 1999. Closing Date: December 31, 2005. Task Team Leader: Somin Mukherji</p>	<p>The objectives of this US\$91 million Project are to rehabilitate the power distribution systems in the central and southern West Bank, and to address the institutional structure for longer-term sector management.</p>
<p>Emergency Services Support Project (ESSP). Total Financing: US\$ 57.9 million. World Bank: US\$20 million. UK/DFID: US\$7.8 million. Netherlands: US\$5.9 million. EU: US\$9.6 million. Sweden: US\$ 4.7 million; Finland: US\$ 1.2 million; Denmark: US\$2.7 million; Italy: US\$ 5.3 million. Approval Date: February 28, 2002. Closing Date: June 30, 2004. Task Team Leader: Sima Kanaan</p>	<p>The ESSP aims at enabling Social Service Delivery Ministries and Municipalities at sustaining the provision of basic social services, thereby ameliorating further deterioration in the standard of living of the Palestinian population. The Project focuses on supporting health, education, social welfare, and basic municipal services (solid waste, water, and electricity supply). The Ministry of Finance manages the ESSP, with direct implementation handled by the Ministries of Health, Education, Social Affairs, and Local Government.</p>

Project Name & Details	Description
<p>Second Emergency Services Support Project - Phase II (ESSP II) Total Financing: US\$105 million World Bank: US\$40 million; EC: US\$51 million; Sweden: US\$5.9 million; DFID: US\$3.4 million; Switzerland: US\$3 million; Finland: US\$1.9 million Approval Date: December 17, 2002. Closing Date: December 31, 2004. Task Team Leader: Sima Kanaan.</p>	<p>A follow-up Project to ESSP I, ESSP II supports the financing of the operating budgets of the social ministries thereby helping sustain public services delivery to the Palestinian population. Unlike ESSP I, ESSP II does not provide budgetary support to Municipalities since that is being done through the Bank's Emergency Municipal Services Rehabilitation Project.</p>
<p>Emergency Water Project (EWP). World Bank: US\$12.5 million Approval Date: February 2004 Closing Date: June 30, 2006 Task Team Leader: Suhail Jme'An.</p>	<p>The main objective of the project is to support investments that would help alleviate the chronic shortages of safe water supplies; reduce water costs and health risks; and conserve scarce water resources by reducing system losses. The Project includes the following components: (a) emergency water supply repair and rehabilitation in remote rural areas of the southern West Bank; (b) repair and rehabilitation necessary to maintain water and sanitation service levels in the Gaza Strip at the high levels achieved under the Gaza Water and Sanitation Project despite the deteriorating economic and security conditions; and (c) Technical Assistance and Capacity Building provided to the Palestinian Water Authority and the recently established Coastal Municipal Water Utility in the Gaza Strip and to form pilot joint services councils for smaller towns in the southern West Bank.</p>
<p>Social Safety Net Reform Project (SSNRP) World Bank: US\$10.0 million Approval Date: July 19, 2004 Closing Date: December 31, 2008 Task Team Leader: Sima Kanaan</p>	<p>The objectives of the Project are to mitigate the impact of the present social and economic crisis on the most vulnerable, and to protect the human capital of poor children in the West Bank and Gaza. This objective will be achieved through enhancing and modifying the existing Special Hardship Case (SHC) program of MOSA to include a component that will make eligible households' receipt of assistance conditional upon their compliance with a set of pre-determined criteria related to school attendance, attendance at scheduled health check-ups, and attendance at awareness session on pertinent social issues. The Project also aims to strengthen the institutional capacity of the PA agencies involved in the implementation of the proposed project, in particular in Ministry of Social Affairs.</p>
<p>The Integrated Community Development Project (ICDP). World Bank: US\$10 million. Approval Date: May 23, 2002. Closing Date: June 30, 2006. Task Team Leader: Husam Abu Dagga</p>	<p>The Project seeks to improve the quality and availability of basic social and economic services in poor and marginalized communities of West Bank and Gaza. It succeeds previous community development operations financed through the Bank under Community Development Projects I and II. Investments will finance the rehabilitation of roads, water supply and sanitation systems, schools, clinics, thereby preserving and extending the capital stock of villages and small municipalities. It will also finance agricultural activities, including the rehabilitation of wells, roads, and terraces. Lastly, it will pilot new Information and Communication Technology (ICT) initiatives by funding the creation of Multipurpose Tele-centers thereby improving access to information and training for the poor and marginalized</p>

Project Name & Details	Description
<p>Emergency Municipal Services Rehabilitation Project (EMSRP). Total estimated cost: US\$70 million. World Bank: US\$20 million. EU: US\$30.5 million. Belgium: US\$7.2 million. PA: US\$3 million. Effectiveness Date: January 22, 2003. Closing Date: June 30, 2005. Task Team Leader: Ibrahim Dajani.</p>	<p>The Project objectives are to: (i) mitigate further deterioration in the quality and coverage of municipal services, particularly solid waste collection, electricity, water, and sanitation services; (ii) generate temporary employment opportunities for unemployed workers who have lost jobs inside Israel, or due to the economic contraction in WBG; and (iii) introduce a mechanism – a Municipal Fund – to link central and local government budgetary planning processes to strengthen Palestinian emergency response capacity, enhance mobilization of donor assistance, and improve the efficiency and equity of resource transfers to local governments.</p>
<p>Housing Project (jointly with IFC). World Bank: US\$25 million. IFC: Up to US\$4 million in equity investment. Approval Date: April 14, 1998. Closing Date: March 31, 2005. Task Team Leader: Lawrence Hannah.</p>	<p>The Project's major component is the Palestine Mortgage and Housing Corporation (PMHC) that facilitates the flow of private capital into housing. PMHC commenced operations in September 2000. Although the present situation has significantly slowed PMHC's operations, both affiliates, the Liquidity Facility, providing long-term funds for lending by banks and other primary mortgage lenders in WBG; and the Mortgage Insurance Fund, providing partial risk coverage for primary lenders, continue to increase their respective portfolios. Canada Mortgage and Housing Corporation is the technical partner for the PMHC providing technical assistance and capacity building support. The Project also includes a component for policy and institutional development in the sector that is implemented by the Ministry of Public Works and Housing.</p>
<p>Gaza Industrial Estate (GIE) (jointly with IFC). World Bank: US\$10 million. IFC: US\$9 million; US\$7 million syndicated loans. Approval Date: March 24, 1998. Closing Date: June 30, 2005. Task Team Leader: Josephine Bassinette</p>	<p>The GIE is located on a 50-hectare site at Al-Muntar in the northeast of Gaza (adjacent to the Israeli border) and is the first largely export-oriented industrial estate established to generate sustainable employment and stimulate industrial development in Gaza. The Project has attracted foreign and local investment, and has facilitated joint ventures between Palestinians and other investors. The GIE is managed and operated by PIEDCO, a private sector company; regulatory oversight and some offsite infrastructure services are provided by the PIEFZA. The World Bank and USAID are providing financing for off-site infrastructure and institutional development, while IFC and EIB are financing the developer/operator of the Project.</p>
<p>North Gaza Emergency Sewage Treatment Project. World Bank: US\$7.5 million Approval Date: September 9, 2004 Task Team Leader: : Suhail Jme'An.</p>	<p>The North Gaza Emergency Sewage Treatment project is the fourth in a series of water and sanitation projects supported by the World Bank Trust Fund for Gaza and West Bank since 1993. The Project will help in addressing the immediate and impending health, environmental and safety hazards to the communities near the poorly-treated and rapidly growing sewage lake in the Beit Lahia area of North Gaza. The project will also be part of a long-term solution for the adequate treatment and disposal of wastewater in North Gaza, which entails the construction of a new wastewater treatment plant expected to be financed by various donors. Approximately 300,000 people living in North Gaza will benefit from this project.</p>

Multi-Donor Trust Fund Administration

Project Name & Details	Description
<p>Palestinian Economic Assistance and Cooperation Expansion (PEACE) Facility. Canada: US\$3.3 million Denmark US\$3.5 million UK: US\$2.2 million Islamic Development Bank: US\$7.0 million Italy: US\$9.0 million Task Team Leader: Markus Kostner</p>	<p>The PEACE Facility, a multi-donor successor to the Holst Fund, was set up in response to the need expressed by a number of donors for a multilateral umbrella facility to support targeted activities in the West Bank and Gaza (WBG), ranging from technical assistance to projects. The objective of the PEACE Facility is to help relieve the economic and social hardship caused by the current crisis in WBG and the resultant Israeli border closures. The current PEACE Facility donors have focused on projects designed to create short-term employment opportunities for those most affected by the ongoing political crisis.</p>
<p>Public Financial Management Reform Trust Fund World Bank:\$20 million EC: \$80 million Norway: \$10 million United Kingdom: \$12.3 million Canada: \$7 million Japan: \$10 million Australia:\$0.7 million Korea: \$0.6 million</p> <p>Approval Date: April 22, 2004 Closing Date: December 31, 2005 Task Team Leader: Claus Astrup</p>	<p>In response to the perilous fiscal situation facing the Palestinian Authority, the Bank was asked by the PA and the donors to create a new mechanism through which donors would be encouraged to provide pooled contributions, to be disbursed into the Single Treasury Account (STA) of the Ministry of Finance (MOF). The Fund's main focus is to support improved PA financial management within a broader national reform agenda. Disbursements from the eform Fund are made based upon the achievement of certain benchmarks, a number of which have been derived from the Bank's June 2004 Country Financial Accountability Assessment (CFAA). As of November, the Reform Fund has disbursed US\$118.45 million to MOF's Single Treasury Account</p>

World Bank Projects Under Preparation

Project Name & Details	Description
<p>Second Health System Development Project (HSDP II). World Bank: US\$10 million.</p>	<p>The Project objectives are to improve the quality, access, and cost-effectiveness of essential secondary and tertiary care health services for populations in the northern Gaza and West Bank regions. In the original plan, the Project intended to replace and upgrade two hospital systems: Al Shifa Hospital in Gaza and Al Watani Hospital in Nablus, and to also build upon the experience of the First Health System Development Project to extend the development of integrated information and management systems to improve the productivity and quality of health care services in the targeted hospitals.</p> <p>Due to the current political situation, the preparation work for the Second Health System Development Project (HSDP II) has been considerably delayed. In addition, the amount of financing available, both from the Bank and from co-financing sources, has been significantly reduced as a result of the crisis. Consequently, the scope of the Project has been reduced. The following components from the original plan will be retained in the revised plan for the HSDP II: (a) a regional Hospital Rationalization Plan for the Northern West Bank; (b) hospital master plans for Shifa Hospital in Gaza City and New Watani Hospital in Nablus; (c) a waste management pilot program; (d) a management information system; and (e) quality improvement.</p>

<p>Proposed Gaza Water and Sanitation Services Project (GWSSP II). World Bank: US\$25 million.</p>	<p>This Project is a follow-up to the ongoing GWSSP. The development objectives of this Project are: (a) to develop a sustainable institutional structure of the water and wastewater sector in Gaza by supporting the functional establishment of a Coastal Municipalities Water Utility, as well as by enhancing and deepening the involvement of the private sector through an eight-year operating contract and strengthening the regulatory and institutional capacity of the Palestinian Water Authority; and (b) to continue improving the water and sanitation services by rehabilitation, upgrading and expansion of existing systems and facilities. Like the GWSSP, this Project is part of a larger parallel capital program to improve water and sanitation services in Gaza. The Project includes substantial investments in the establishment of a bulk water supply network connecting the various municipalities in Gaza, in the sewerage network, and in wastewater treatment plants. These investments, totaling about US\$340 million for 2000-2005, will be financed by soft loans and grants from EIB, USAID, and KfW.</p>
<p>Higher Education Project</p>	<p>The project development objectives are: 1) to improve the regulatory environment for tertiary education management, relevance and quality assurance; 2) increase internal and external efficiency of the tertiary education system, as a first step towards seeking sustainability; and 3) to create incentives and provide the basis for improvements in efficiency, quality and relevance of tertiary education institutions in order to meet the socioeconomic needs of the Palestinian population. The project will provide technical assistance on the definition of policies consistent with increasing the financial sustainability of the sector, and improving the capacity to respond to labor market needs. It will also provide incentive mechanisms to improve quality and relevance of the programs offered. On a competitive basis, Institutions will apply for quality and management grants, administered by a Fund mechanism. In addition the project will provide technical assistance to improve the management of the current student loans program managed by the MOEHE, and will set the basis for expansion of the financial resources available for funding the student aid programs. Co-financing from the EC is expected. The project is scheduled for Board presentation in April 2005.</p>
<p>Land Administration Project</p>	<p>The objective of this project is to assess/learn the extent of commitment and readiness of the PA to reforming land administration by introducing policy, legal and institutional changes to achieve efficient procedures for the issuance of land titles and registration of property transactions, and transparent processes for the management and disposal of public land. The idea is that this project would be the first phase of a long-term Land Administration Program, which aims at enhancing economic growth by improving land tenure security and facilitating the development of efficient land and property markets in rural and urban areas through the development of an efficient system of land titling and registration based on clear, transparent and coherent policies and laws and supported by an appropriate institutional structure.</p>

IFC Projects

Including the two joint-projects above, IFC has committed US\$25.89 million to three projects under the Mainstream Program. Under the Extended Reach Initiative, which supported projects in the US\$0.25-5 million range, seven projects were committed for US\$7.42 million, out of which US\$4.92 million was disbursed. The Extended Reach Initiative was discontinued in mid-2000.

All IFC-financed projects have been affected by the ongoing political crisis. Most private sector activity has been noticeably reduced, and most WBG companies are facing liquidity and severe operational difficulties due to the internal border closure.

IFC Technical Assistance

IFC's technical assistance efforts have been aimed at supporting the Palestinian Authority's efforts to further broaden and deepen the Palestinian financial sector. IFC has also worked closely with the Palestinian Authority and the private sector to encourage the emergence of new instruments and players in the financial sector and capital markets through the development of framework laws and institutions. IFC was involved with the preparation of draft laws for Insurance, Securities, Capital Markets Authority, Mutual Funds, Mortgage, Tax, and Competition.

West Bank and Gaza Portfolio, November 2004

	Allocated Amounts		Disbursed		Total
	TFGWB	Joint	TFGWB	Joint	Disbursed
Current Projects					
97 Palestinian Housing Project	17.40		12.46		12.46
97 Palestinian Expatriate Professional Program	3.00	0.32	2.31	0.32	2.63
98 Gaza Industrial Estate	10.00		6.23		6.23
99 Southern Area Water and Sanitation Project	21.00		19.48		19.48
00 Electricity Sector Management Project	15.00		12.17		12.17
00 Health System Development Project	7.90		7.82		7.82
01 Municipal Infrastructure and Development Project II	7.50		5.79		5.79
01 Solid Waste and Environmental Management Project	9.50		3.78		3.78
01 Education Action Project	7.00		5.46		5.46
01 Palestinian NGO II Project	8.00	11.62	6.98	1.07	8.05
02 Emergency Services Support Project	20.00	36.87	20.00	37.46	57.46
02 Integrated Community Development Project	10.00		4.22		4.22
03 Emergency Services Support Project II	40.00	38.76	39.31	37.65	76.96
03 Emergency Municipal Services Rehabilitation Project	20.00		11.13		11.13
03 Emergency Water Project	12.50		1.89		
04 Public Financial Reform SAO	20.00		20.00		20.00
04 Social Safety Net Project	10.00		1.00		
05 North Gaza Emergency Sewage Treatment Project	7.80				
Total	246.60	87.57	180.03	76.50	253.64
Completed Projects					
95 Emergency Rehabilitation Project	30.00	63.94	30.00	63.48	93.48
97 MIGA Fund	10.00		10.00		10.00
96 Emergency Rehabilitation Project II	20.00	3.50	20.00	3.50	23.50
97 Community Development Project	10.00	2.81	10.00	2.81	12.81
97 Microenterprise Project	2.19		2.19		2.19
01 Emergency Response Program*	12.00				
99 Community Development Project II	8.00		18.50		18.50
95 Education and Health and Rehabilitation Project	20.00	29.10	20.00	20.00	40.00
97 Gaza Water and Sanitation Project	31.00		31.00		31.00
98 Palestinian NGO Project	10.00	4.60	10.00	4.96	14.96
96 Municipal Infrastructure and Development Project	40.00	5.41	40.00	5.51	45.51
97 Legal Development Program	2.79		2.49		2.49
99 Bethlehem 2000	25.00	3.61	24.85	3.41	28.27
TOTAL (Current & Completed)	467.58	200.54	399.06	180.18	576.35

Multi Donor Trust Funds

	Amount Allocated	Total Disbursed
The Holst Fund (closed)	285.72	285.72
Technical Assistance Trust Fund (closed)	22.77	23.60
PEACE Facility	24.78	20.53
Public Financial Management Reform Fund	123.00	98.45
TOTAL	456.27	428.29

Community Study Series in the West Bank and Gaza

Socio-Political Structures, Development and State- Building

The significant size of donor aid flows to the West Bank and Gaza have raised questions about sustainability of flows and their impacts on Palestinian communities. While project impact analyses have been undertaken, few studies have examined the effectiveness of donor development approaches vis-à-vis micro-level socio-political structures.

Realities of people are heavily influenced by the social and political structures in which they live, their history, and cultural concepts. Social and political structures refer to the major institutions such as family, political parties, religion, and government, and also to the power relations that exist between different groups in society. Cultural concepts refer to the way that individuals and communities perceive the world around them. These structures and cultural concepts, which are shaped through history, affect peoples' lives in two important ways:

- 1) Cultural or ideological concepts inform people's action, and affect their beliefs. For example, it affects their views on who is a legitimate power holder in society, or on how conflicts in society are to be resolved
- 2) Social and political structures and power relations explicitly affect people's material outcomes. Depending on how they are positioned within

the class or power structure of society, different groups have different levels of access to economic resources.

If donor interventions are not undertaken based on an understanding of these socio-political and cultural dynamics, interventions may fail altogether or may have unintended effects. For example, without an understanding of local power dynamics that affect distribution of economic resources, donor funding may not reach the intended beneficiaries. Furthermore, models of governance that are not based on an understanding of the local political structures and concepts may not be credible to the local population. Understanding these local structures can challenge traditional assistance strategies on state-building and can expand analytics on the dynamics of marginalization and exclusion. New approaches to address power imbalances in society and to enhance local participation in development initiatives may be required.

The community study series commenced in November 2003 in order to understand local socio-political structures in Palestinian communities from a historical and contemporary perspective. Specifically, the study aims to understand the following: 1) the local social and political alliances and networks that affect access to economic resources. 2) power dynamics between community based institutions and who these organizations represent. 3) the relation of local political concepts and decision-making mechanisms to governance. 4) Informal conflict resolution methods and the rule of law.

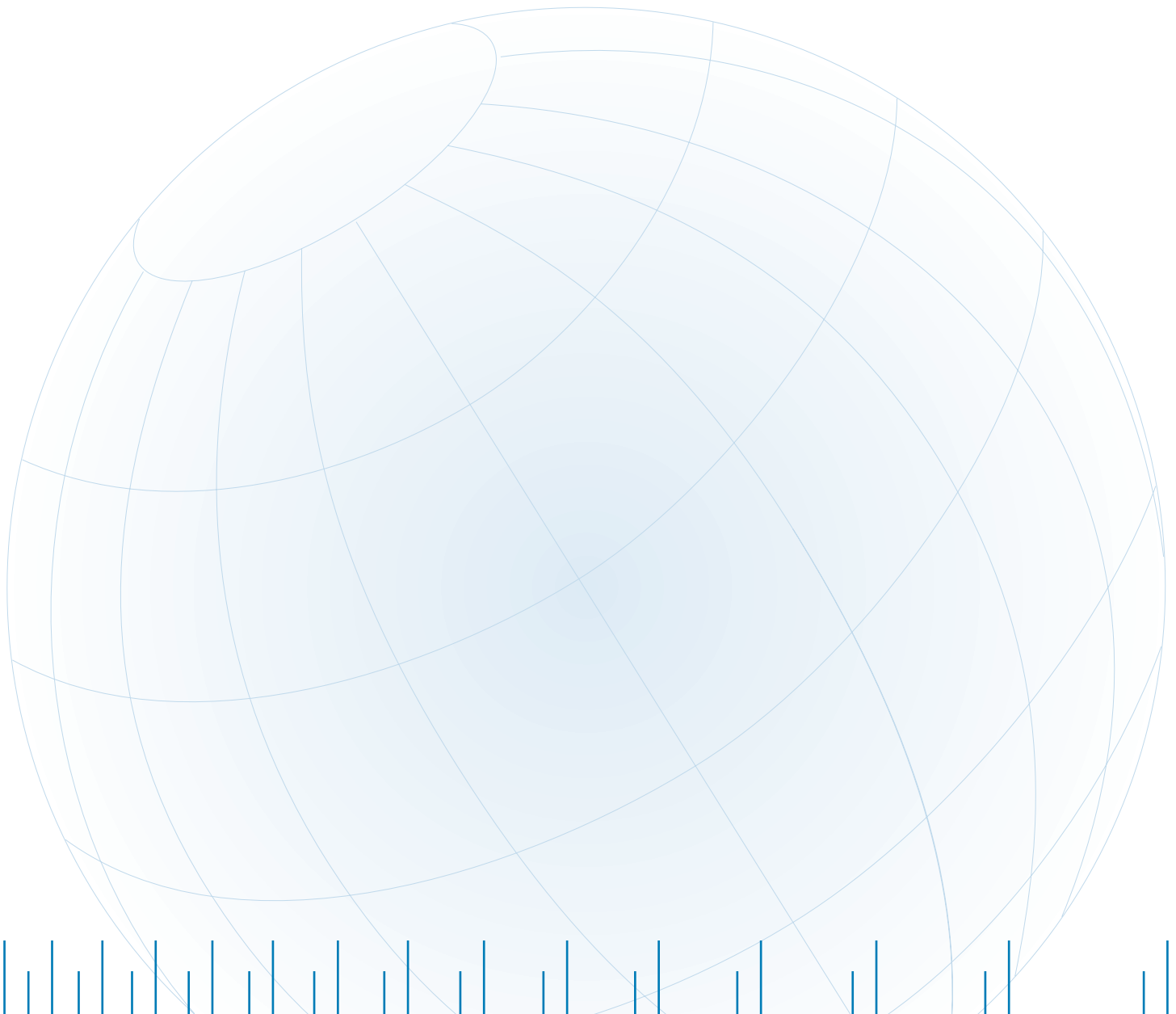
The research is an inter-disciplinary project, conducted by an economist and social anthropologist, combining both perspectives to reach a more holistic view on grassroots realities. In-depth studies are mainly undertaken in three West Bank and one Gaza location, covering rural and semi-urban communities, and refugee camps. Qualitative methodology, based on interviews, participant observation and focus group discussions, is combined with a quantitative survey approach in each location.

A pilot study in the village of Wadi Fuqeen, West Bethlehem, and a study in Duma, a rural community near Nablus, have been completed. Currently, studies are underway in Kalandia refugee camp and Hebron

city. The study series is planned to be completed in spring 2005.

This study series is being undertaken in order to inform the content and design of future Bank programs in the region, and to develop operational recommendations to donors.

It is based on an innovative method to evaluate and design donor interventions, taking into account communities' socio-economic histories' and socio-political institutions. It establishes a knowledge-base on local communities and covers development issues in a more holistic way so as to extend the boundaries of traditional development approaches and assessments.



Country Financial Accountability Assessment for West Bank and Gaza

A Country Financial Accountability Assessment (CFAA) for West Bank and Gaza was conducted jointly between the Bank and DFID. The CFAA is a diagnostic tool developed by the Bank in the recent years to assess the accountability arrangements of client countries. The scope of diagnosis covers the areas of budget formulation and execution, treasury operations, accounting and reporting, internal auditing, and external auditing. The CFAA includes key recommendations to strengthen the system in general and avoids inclusion an action plan and leaves this responsibility to the government. The CFAA is not an audit. So far, the Bank had conducted over 80 CFAAs.

Areas of Strength

The WB&G CFAA had recognized the significant improvements achieved in the public financial management (PFM) system of the Palestinian Authority (PA) in last two years as part of the PFM reforms. Main improvements are:

1. The use of Central Treasury Account (CTA) for all PA revenues. The exclusive use of the CTA enabled the Ministry of Finance (MOF) to exercise full control on all cash revenues made by all PA ministries and agencies. The CFAA team had reviewed large sample of revenue transactions and ensured all funds were transferred into the CTA. It should be noted that even foreign loan and grant accounts are also established under the CTA. The CFAA recommended all donors to exclusively channel their funds through the CTA.
2. The establishment of Palestine Investment Fund (PIF). The bundling of PA commercial investments under one body that operates according to transparent policies and procedures is a turning point in the PA management of its scattered investments. All PIF assets were valued by international firm. The PIF board is chaired by H.E. the minister of finance and membership of H.E minister of trade and a number of well-known business stakeholders form private and public sector. The PIF accounts are maintained in accordance with international accounting standards. Also, PIF prepares annual financial statements including balance sheet, profit and loss statement, and cash flow statement. These annual financial statements are subject to auditing by qualified international auditor. The PIF assets and its financial statements are published on the PIF website.
3. The improvement in the budgeting process. The MOF has submitted for 2003 and 2004 comprehensive budgets to the Palestine Legislative Council (PLC). The improvement in the Budget department is highly commended by the CFAA. It is a raw model to other departments in the MOF to follow and reflects the significant efforts exerted by Budget department management and staff.
4. The Payment of security staff salaries through individual bank accounts. The MOF had finally agreed with the all security departments in the PA to pay the salaries of all security staff through individual bank accounts and cease the cash payments. This is critical step to enhance the accountability of the PFM system.
5. Enhanced reporting system. One of the main improvements in the PFM system of the PA is the enhanced reporting and the introduction of transparency measures. Since early 2003, the MOF publishes its monthly accounts within one week of the following month. Although these accounts are

still preliminary and subject to several adjustments, they are considered major progress in terms of transparency and moving toward full disclosure. Needless to say that the various weaknesses in the accounting system such as lack of accounting policies and procedures have major impact on the integrity of these monthly reports. Especially, if each month accounts are published within the first week of the following month, why then the 2003 accounts are not closed and finalized till November 2004.

6. The PLC continuous involvement in fiscal issues of the PA. The PLC not only discusses and approves the annual budgets, but also requires quarterly reports on the budget execution and requires detailed reports on the fiscal situation of the PA. This is major progress and is highly encouraged by the CFAA and the donors.

Areas requiring strengthening

On the other hand, the CFAA had pointed out the following areas as required major improvement:

1. Strengthening the Treasury Operations. The CFAA noted the significant weaknesses in the Treasury department in MOF in terms of systems and personnel. It is unfortunate that the significant progress in the Budget department was not matched with similar progress in the Treasury department, which executes the budget. The risk of ignoring the Treasury department is that it may render all the improvements in the PFM unsustainable.
2. Strengthening the Accounting department. The accounting department employs enough number of qualified personnel. However, it lacks modern accounting system as well as accounting policies and procedures which are necessary for proper accounting managements and reports preparation.
3. Strengthen the internal auditing and financial controllership units. It is noted that the operational framework for the two units have been put in place, however, the actual operation of the two units is still to be put in motion.
4. Strength the PA external auditor. The apparent weaknesses in the General Control Institute (GCI) make the introduction of new audit law as well as establishment of new supreme audit institution an urgent need to provide independent reviews of PFM functions.

Recommendations

CFAA had provided the following main recommendations to strengthen the PFM:

1. Appointment of qualified personnel to the treasury department and establishment of adequate treasury system.
2. Modernization of the MOF accounting system and establishment of accounting policies and procedures in line with acceptable standards to allow production of reliable monthly and annual financial statements in lieu of the current preliminary and questionable ones.
3. Full operation of the internal audit function in the MOF and line ministries as well as the financial controllership function. This implies appointment of necessary qualified staff.
4. Issuance of the new audit law and establishment of modern supreme audit agency.
5. Start cooperation with the Palestine Monetary Authority for better PFM strategy.

