The Emergency Services Support Projects

The ongoing conflict has resulted in a near collapse of the Palestinian economy, soaring unemployment and a sharp increase in poverty. The median family income has dropped by 40 percent compared to pre-2000 levels, to which the Palestinian population has responded by resorting to coping mechanisms such as reducing their consumption levels, using personal savings, selling off assets, delaying payments and incurring debt. These strategies are nearly exhausted and unsustainable.

Donors have responded by doubling annual disbursements and shifting the bulk of their assistance into emergency support. The Bank is helping choreograph this transition and advising the Palestinian Authority (PA) and donors to maintain a balance between necessary emergency financing and a continued focus on the medium-term state building agenda—a strategy which the Bank has adopted for the West Bank and Gaza.

The First and Second Emergency Services Support Projects (ESSPI & II, US$60 million from the Trust Fund for Gaza and the West Bank) are designed to address the ongoing fiscal emergency, and will supplement the PA’s reduced revenues.

Main Development Challenges

Since the advent of the Caretaker Government in June 2007, the international community has channeled substantial financial and technical assistance to the PA to reverse the impacts of the recent aid sanctions on Palestinian institutions. This, in addition to a revival of discussions towards a peace agreement by the end of 2008, led to a new momentum in Israel and the Palestinian Territories. However, these positive developments remain challenged by the isolation of almost half of the Palestinian population within the Gaza Strip and by the continued violence arising from the Israeli-Palestinian conflict, and within the Palestinian Territories. Combined with the tightening Israeli restrictions on movement and access, and continued settlement expansion, the result is a Palestinian economy that is unable to sustain itself and its population under the current circumstances.

Background

The turbulent path towards Palestinian statehood and economic development reached crisis in late January of 2006, in the aftermath of the international boycott of the PA after Hamas won a majority in the Palestinian Legislative Council (PLC) elections. Already struggling from past spending and hiring practices, the PA’s finances dropped drastically due to Israel’s freeze on Palestinian clearance revenues, aid suspension and loan service deductions by local banks. Salary payments to about 160,000 civil servants were suspended by early March, and later only partially covered through the EU’s Temporary International Mechanism (EU TIM1) and bilateral donor funds, both of which bypassed the PA through the Office of the President, or direct funding. The formation of a Unity Government by Hamas and Fatah on March 17, 2007 only marginally resolved the crisis. Despite donor efforts, a protracted freeze in salaries combined with the incarceration by Israeli forces of 46 members of the PLC brought to a virtual halt of the Palestinian policymaking and service delivery.

After Hamas attacked and took control of Government and security positions in the Strip, Palestinian President Abbas swore in a new Caretaker Government on June 17, 2007, and declared the Hamas authority in Gaza illegal. Israel and the international community endorsed the Caretaker Government and began to reinstate financial and technical assistance. Israel resumed the full transfer of Palestinian clearance revenues, and accrued interest. On June 27, 2007, the Quartet appointed former UK Prime Minister Tony Blair as Quartet Representative on economic and institutional development issues.

At the Annapolis conference on November 27, 2007, Israeli Prime Minister Olmert and President Abbas agreed to resume peace negotiations, resolving core issues before the end of 2008. This led to the formation of a joint steering committee and a commitment to immediately implement each side’s respective obligations under the Road

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1 In January, 2008 the European Commission announced the launching of the new European mechanism for the support of the PRDP, Pegase, which replaces the EU TIM that was put in place in June, 2006. Pegase covers both support of recurrent expenditures and investments in PRDP reform and development programs.
The project is financing approximately 90% of the non salary budgets of the Ministries of Health and of Education. Thus it is supporting the continuation of health and education services in 398 laboratories, 2,613 primary health care centers and 18 hospitals, and 17 Directorate offices of the MOH, 1,490 primary and secondary schools as well as the operations of the 17 Directorate offices of the MOE. It is also financing a portion of the salary budget of 9 universities whose budgets are partially financed by the Ministry of Finance. Several other ministries have been supported through financing part of their incremental operating costs (rent, utility charges, communication charges, maintenance, transportation, etc.)

The agreement to re-commence peace negotiations also set the stage for a donor conference in Paris on December 17, 2007, where representatives of 87 states and organizations pledged financial support to the PA, based on the Palestinian Reform and Development Plan for 2008-10 (PRDP), presented by Prime Minister Fayyad. Donors pledged a reported US$7.7 billion in assistance to the PA and the Palestinian people over the three years to support the implementation of the PRDP.2

Since the Annapolis and Paris conferences, however, the confidence-building momentum has been hampered by actions on both sides. Night raids by the Israeli Defence Forces (IDF) into Nablus continue, challenging the credibility of enhanced PA security control. Israeli settlement activity continues in the West Bank, and no outposts have been dismantled since. According to the UN Coordinator for Humanitarian Assistance, obstacles to movement of Palestinian goods and people within the West Bank have increased to 609 (May 2008) check points since 2005. Two-thirds of the 723.3 km Separation Barrier between Israel and the Palestinian Territories, in deviation from the Green Line, is now complete. Violence continues: scores of Palestinians have been killed, injured or detained by the IDF, and numerous civilians within Israel have been killed and injured by rockets fired by Palestinian militants in Gaza.

Modest recent economic progress achieved in the West Bank has excluded the 40% of the Palestinian population who live in Gaza. Since the Hamas takeover of Gaza in June 2007, the crossings into the Strip remain sealed to all but a limited amount of basic humanitarian goods. With very few humanitarian exceptions, most of the 1.5 million Gazans cannot exit to Israel, or to Egypt through the Rafah Crossing. The entry of critical inputs, including fuel, electricity and materials to maintain water and sanitation networks, are highly variable and subject to numerous judicial reviews within Israel courts on the acceptability and extent of sanctions. In response to these restrictions, hundreds of thousands of Palestinians streamed through large sections of the Gaza-Egypt border wall that were destroyed in January 2008, and crossed into Egypt to purchase food, fuel and other critical items. In September, the Egyptian authorities decided to open the border for a couple of days before the beginning of the Ramadan.

On May 13th 2008, the support of Quartet Representative Tony Blair, was made official through an Agreement (package) on several initiatives agreed among all sides. The agreement is now beginning to yield results but requires further support. Several aspects of the May 13th agreement with the PA and Israel have been implemented, including the tackling of a number of key roadblocks within the West Bank, the facilitation of the first phase of the North Gaza Emergency Sewage Treatment Plant, the mobilization of donor funds to complete a $500 million Mortgage Facility, and the July 28th Frequency Allocation Agreement between Israel and the PA, enabling Wataniya, the second mobile operator in the West Bank and Gaza, to begin operations. It is also noteworthy that these measures were intended as a means and not an end in the Palestinian development narrative. Despite the progress to date, most items in the May 13th package remain uninitiated or incomplete.

Macro Economic Issues

Following the 1993 Oslo Accords it was expected that the Palestinian economy would enter a period of sustained and rapid growth. While performance was not as strong as hoped, there growth was steady and by 1999 real GDP had grown to around $4,500 million. However, since 2000, when Israel instituted a strict closure regime in response to the second Intifadah, the Palestinian economy has been on a downward trend (Figure 1). GDP fell by over a quarter to an estimated $3,556 million at the height of the fighting in 2002 and then recovered slightly in 2004 and 2005. But with the continued settlement growth, closures and the cut off in direct aid after the election of the Hamas 2

2 While these pledges represent collective international support for the peace process, in some cases the actual transfer of the funds has been delayed, causing cash flow problems for the PA.
government, GDP fell again in 2006.

**Real GDP growth in 2007 was essentially flat resulting in real GDP being nearly 9% lower than its peak in 1999.** Because of the rapid population growth during the same period, per capita GDP is nearly a third lower than in 1999. The contributing effects of the closures and movement restrictions can not be overestimated. Between 1995 and 2000, the economy was growing at an average rate of 6% per year. If that trend had continued after 2000 when restrictions intensified, real GDP may have been more than double its current value.

A combination of borrowing, remittances and increased aid has propped up GDP in the past two years and has allowed both public and private consumption to remain stable. A recent Palestinian Central Bureau of Statistics (PCBS) survey estimates that despite the economic crisis, household consumption dropped by only 0.6% between 2005 and 2006. But while consumption remained stable despite the drop in GDP, investment has fallen to precariously low levels resulting in a hollowing out of the productive sectors. Public investment in the last two years has nearly ceased as almost all government funds have been used to pay salaries and cover operating costs. The IMF estimates that private investments fell by over 15% between 2005 and 2006 and there is no evidence that it significantly increased in 2007 or 2008. Claims on the private sector fell by over 6% to approximately $1.37 billion. At the same time, private sector deposits rose from $4.1 billion to $5.1 billion leading to net claims on the private sector to decline by over $1 billion. In addition, net repayment of bank debt by the PA was $38 million. This large withdrawal of liquidity from the economy offset much of the external aid and indicates that in the current environment, few investors are willing to take risks and borrow from the banking system. The lack of investment in public infrastructure and private enterprises is eroding the very limited remaining Palestinian productive base, leading to increased aid dependency and pointing to bleak future prospects unless the trend is reversed.

Despite large inflows of aid, the shrinking economy has led to increasing poverty. Unemployment in the West Bank rose from 17.7% in 2007 to 19% in the first quarter of 2008, while unemployment in Gaza has increased slightly from 29.7% to 29.8%. These figures do not give an accurate picture of the full impact of the economic crisis, because they do not take into account underemployed workers such as the large number who have turned to unpaid family labor or seasonal agriculture. The figures also do not include the many discouraged workers who have left the labor force. Labor force participation rates are low and dropping. In the West Bank it fell from 44% in 2007 to 42.3% in the first quarter of 2008 and from 38% to 37.5% in Gaza. Adding discouraged workers would increase the unemployment rate to 25.7% in the West Bank and 35.5% in Gaza.

**Because of the crisis, poverty continues to increase in Gaza where the official poverty rate rose from 47.9% in 2006 to 51.8% in 2007.** In the West Bank poverty slightly declined, falling from 22% in 2006 to about 19.1% in 2007. The percentage of Gazans in Deep Poverty also continued to rise, increasing from 33.2% in 2006 to 35% in 2007. These rates reflect actual consumption. If remittances and food aid are excluded and poverty is based only on household income, the poverty rate in Gaza and the West Bank would soar to 79.4% and 45.7% respectively and the Deep Poverty rates would increase to 34.1% and 69.9%.

This illustrates the high levels of aid dependency in the West Bank and Gaza, especially when you take into account the fact that the majority of the income of government employees is financed with foreign aid.

Poverty and the global rise in food prices have taken a heavy toll on Palestinian living conditions. The consumer price index for food rose by 28% in Gaza and 21.4% in the West Bank between June 2007 and June 2008. Despite the large inflows of aid, a recent WFP survey found that food insecurity continues to rise in WBG, and is estimated

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3 Unemployment figures also do not include the large number of “workers absent from their usual work”. In the PCBS calculations, these workers are assumed to be temporarily away from jobs due to illness, work stoppage, natural disaster or for other reasons but still receiving normal pay. UNRWA estimates that nearly 45,000 Gazans have become “absentee” workers since the first half of 2007.

4 PCBC Labor Force Survey Q1 2008

5 PCBS: Poverty and Living Conditions in the Palestinian Territory, 2007
to have increased from 34% in 2006 to 38% in 2007. Food insecurity is even more pronounced in Gaza reaching 56% of households. Almost 66% of income earned in Gaza is spent on food while in the West Bank the figure is 56%.

The economic blockade has devastated the Gaza private sector and driven almost all industrial producers out of business. Gaza businesses are not only unable to export but because the blockade only allows in humanitarian goods, they are unable to import intermediate inputs. In addition, fuel and power shortages significantly hamper production. According to recent estimates by local business associations, only about 2% of industrial establishments are still functioning. The remaining producers are mainly food processors who can obtain local inputs or who use inputs that are allowed to be imported on humanitarian grounds. Industrial employment has fallen from about 35,000 before the Israeli disengagement in 2005 to about 860 at the end of June, 2008. In addition, the business associations estimate that another 70,000 workers have been laid off from other sectors. The damage has been so severe, that it is unlikely that many establishments will be able to recover once the blockade is lifted.

The PRDP was published in December 2007 and it contained a detailed three year budget, which laid out a path towards fiscal strengthening. Though growth has been lower than projected and inflation higher than expected, the PA has implemented a number of difficult reforms and made substantial progress towards improving its fiscal position. The current budget deficit on a commitment basis is nearly 18% lower than in 2007 and within the parameters set by the PRDP. If the current trend continues, the recurrent deficit will be about 22.5% of GDP compared to 26.7% in 2007. This more than 4% reduction would be a remarkable step towards fiscal discipline given the difficult environment.

Despite the substantial reforms and the progress in reducing the deficit, the fiscal crisis persists. The PA relies on large inflows of external budget support to maintain operations and is unable to devote any internal resources for investment. In 2008, the need for external budget support is estimated at about $1.8 billion, of which only about $1.5 billion has been secured. Current projections indicate that the PA could soon have a liquidity crisis unless additional budget support is secured.

Status of Dialog

The Bank’s work in WB&G since the 1993 Oslo Accords has supported economic recovery and development as an underpinning to the peace process. Our strategy since 2000 balances medium-term development and emergency assistance to sustain Palestinian institutions and mitigate poverty.

The Bank is continuing implementation of its portfolio, which consists of 14 projects designed to tackle both immediate service delivery and medium-term reforms. Four new projects aiming to maintain urgent service delivery are expected to be approved in FY09. Three of those projects, which focus on land administration reform, food price crisis response, and waste management, are being designed as flexible operations which can be significantly scaled up with additional donor funds. A fourth one will provide budget support to the PA through a Development Policy Grant.

Projects implementation is largely on schedule, but portion of World Bank portfolio that is being implemented in Gaza is facing important logistical constraints. Despite the current cease-fire, the closure of Gaza’s crossings to exports and to all but basic humanitarian imports keeps slowing the pace of projects, including the Bank’s infrastructure work. This notwithstanding, the Bank’s portfolio is relatively balanced, with approximately 40 percent of its resources committed to Gaza and 60 percent to the West Bank.

The Bank has delivered a strong AAA program. The Bank’s analytical and policy work has, from the outset, laid the basis for our role in WB&G. Recent analytical work analyzes movement and access restrictions in the West Bank and potential alternatives for Palestinian trade corridors (specifically on developing the Rafah corridor); an Energy Sector Review focuses on the reduction of net lending and the promotion of energy security; and a Telecommunications Sector Note provides recommendations for policy
and regulatory reform. New activities will cover water resources management, the health sector, gender and social inclusion, trade facilitation, transportation, and a review of the financial sector.

Ad Hoc Liaison Committee Meeting, September 22, 2009. The Bank will actively participate in this important event. For this occasion, it has prepared the Economic Monitoring Report "Palestinian Economic Prospects: Aid, Access and Reform" which provides a critical analysis of the economic restrictions confronting the West Bank and Gaza.

All dollar figures are in US dollar equivalents.

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