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.

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. As Hamas is on the terrorism lists of several countries, the Quartet called for an aid boycott of the PA until and unless Hamas recognizes Israel, renounces violence and accepts all existing agreements. 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 and a significant increase in overall aid levels to maintain assistance to organizations and individuals while bypassing the PA, there was a sustained drop in social and security services to the population and a protracted freeze on public sector salaries and pensions, culminating in a series of strikes and violent protests by a large portion of the public sector. This, combined with Israel's incarceration of 46 members of the PLC, brought Palestinian policy-making and legislative processes and, on occasions, the delivery of basic social services, to a halt.

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. Israeli 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

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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 17 Directorate offices of the MOH, 1490 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.)

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 Map, and an agreement to form an American, Palestinian and Israeli mechanism to follow up on implementation. Negotiations formally commenced on December 12, 2007.

Several confidence-building measures had already been taken to build momentum for the Annapolis conference. With facilitation of movement and equipment by the Israeli authorities, the PA deployed 300 security forces into Nablus in a successful bid to impose law and order. And on November 19, Quartet Representative Blair, Palestinian Prime Minister Fayyad, and Israeli Defense Minister Barak presented several Quick-Impact projects that aim to have a substantial economic impact on the ground.

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 (Annex 6) in assistance to the PA and the Palestinian people over the three years to support the implementation of the PRDP.

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 580 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. On February 4, 2008, the first suicide bombing in a year took place in the southern Israeli town of Dimona, followed by a shooting attack on a Jewish Seminary in Jerusalem on March 6, with Hamas claiming responsibility for both. Factional fighting amongst Palestinians continues to resurface, particularly in Gaza where deaths and injuries are regularly reported.

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 Israeli 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. The border has since been closed.

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 $4,896 million. However, since 2000, when Israel instituted a strict closure regime in

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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.
3 Defined as a NIS 1,837, budget for a family of six for food, clothing and housing only.
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 $3,540 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 government, GDP fell again in 2006.

Real GDP in 2007 is expected to have recovered to about $4,008 million, some 18% lower than its peak in 1999. Because of the rapid population growth during the same period, per capita GDP is nearly 40% lower than its 1999 peak. 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 has significantly increased in 2007. The March 2007 World Bank Investment Climate Assessment found that less than a quarter of private sector firms made any investments in 2005/2006 and that the equipment in manufacturing enterprises was on average over 12 years old. 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 WB&G stood at nearly 23% up from only 10% before the beginning of the Intifadah in 2000. Unemployment is highest in Gaza, at nearly 33% of the active work force. Under the current closure regime and the restrictions on imports and exports for commercial activity, this rate is likely to become much higher as the layoffs in the industrial sector become permanent. The unemployment rate in the West Bank is approximately 19%. The percentage of Gazans who live in deep poverty has been steadily increasing, rising from 21.6% in 1998 to nearly 35% in 2006. With the continued economic decline in 2007 and the implementation of even stricter closures on Gaza, the current deep poverty rate is expected to be higher than 2006 levels.

Poverty levels starkly illustrate the level of aid dependency in WB&G. The previously cited rates reflect actual consumption. If remittances and food aid are excluded and poverty is based only on household income, the poverty rate in Gaza jumps to almost 67%. The increase in poverty in the West Bank is lower, but is still significant.

The situation in Gaza has widened the economic gap with the West Bank. The closure policy, most recently tightened after Hamas’ takeover of Gaza, has eroded its economic backbone in a manner that may be difficult to reverse. According to the Palestinian Federation of Industries, the restrictions have led to the suspension of 95% of Gaza’s industrial operations (Table 1) thus companies can neither access the inputs for production nor export what they produce, transforming Gaza into a consumer economy driven by public sector salaries and humanitarian assistance. The agriculture sector, with nearly 40,000 dependant workers has also been adversely affected by the closures.

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 12 projects with a net commitment amount of $128 million. The Bank plans to present an additional five projects (three of which are Additional Financing (AF) to ongoing operations) for Board approval in the last quarter of FY08.

**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 include 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 with focused on the reduction of net lending and the promotion of energy security and a Telecommunications Sector Note which provides recommendations for policy and regulatory reform.

All dollar figures are in US dollar equivalents.

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