

*The Secretariat of the
Ad Hoc Liaison Committee*

**AID EFFECTIVENESS IN THE
WEST BANK AND GAZA**

Acknowledgments

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Acronyms

AHLC	Ad-Hoc Liaison Committee
CDF	Comprehensive Development Framework
CG	Consultative Group
CPRS	Center for Palestine Research and Studies
DAC	Development Assistance Committee (of the OECD)
EU	European Union
GDP	gross domestic product
GNP	gross national product
IFC	International Finance Corporation
IMF	International Monetary Fund
JMCC	Jerusalem Media and Communications Center
LACC	Local Aid Coordination Committee
MENA	Middle East and North Africa
MIGA	Multilateral Investment Guarantee Agency
MOPIC	Ministry of Planning and International Cooperation
NGO	non-governmental organization
ODA	official development assistance
OECD	Organization for Economic Cooperation and Development
PA	Palestinian Authority
PCBS	Palestinian Central Bureau of Statistics
PDP	Palestinian Development Plan
PLC	Palestinian Legislative Council
PRRN	Palestinian Refugee Research Net
SDS	Service Delivery Survey
SWG	Sectoral Working Group
TA	technical assistance
TAP	Tripartite Action Plan
UNDP	United Nations Development Programme
UNRWA	United Nations Relief and Works Agency
UNSCO	Office of the United Nations Special Coordinator
WBG	West Bank and Gaza

Executive Summary

Despite the attention so often devoted to numbers—to pledges, commitments, disbursements, budgets, and so forth—development assistance involves much more than simply spending money. It involves using scarce resources to alleviate poverty, promote equity, and build the foundations for sustainable development. In the case of the West Bank and Gaza, development assistance addresses the additional task of peacebuilding: creating tangible improvements in the everyday lives of Palestinians, promoting progress towards peace and the universal benefits associated with it, and laying the economic foundations to sustain a just and lasting permanent status agreement between Israelis and Palestinians. Indeed, not only is development an important contribution to peace, but without peace there can be little or no development. Both processes are inextricably linked.

Effective development assistance also requires partnership and cooperation. It involves working together to identify shortcomings, encourage innovation, and build on success. Development is not a static exercise of abstract blueprints. It requires flexible and strategic planning, careful monitoring, adaptability, commitment, and learning, all to achieve concrete results.

This report on *Aid Effectiveness in the West Bank and Gaza* reflects these factors of development. The report was undertaken jointly by Japan and the World Bank, with the financial support of the Government of Japan and UNDP. It is based on field-level consultations with donors and the Palestinian Authority, as well as discussion in the Joint Liaison Committee and Ad-Hoc Liaison Committee. The report addresses four major areas: the macroeconomic and sectoral impact of donor assistance (Section 2); Palestinian public perceptions of the aid effort (Section 3); issues of sustainable social and economic development in the WBG (Section 4); and the role of donor aid in supporting institutional and policy reform (Section 5). A concluding section (Section 6) outlines critical issues on the road ahead.

From the outset, *it is important to understand the context of development in the West Bank and Gaza, the central role of donors, and the need to assess aid effectiveness to date.* In the West Bank and Gaza, the Palestinian Authority and donors alike have faced enormous challenges: an underdeveloped economy buffeted by severe external shocks; the need to construct a functioning Palestinian public administration where none existed before; the extraordinary complexities associated with the various Israeli-Palestinian interim agreements; the involvement of more than forty donors, over two dozen multilateral organizations and UN agencies, and hundreds of local and international NGOs in the development effort; political uncertainty and a highly politicized local and international environment; and the difficulties of planning for the future amid ongoing negotiations on the permanent status of the territories.

Despite these many challenges, the overall impact of the donor effort has been very constructive. More than US\$2.7 billion has been disbursed in the West Bank and Gaza since the first donors' conference in Washington in 1993. Donor aid has helped to build and sustain a Palestinian administration that now provides a broad range of services to its population. Initial

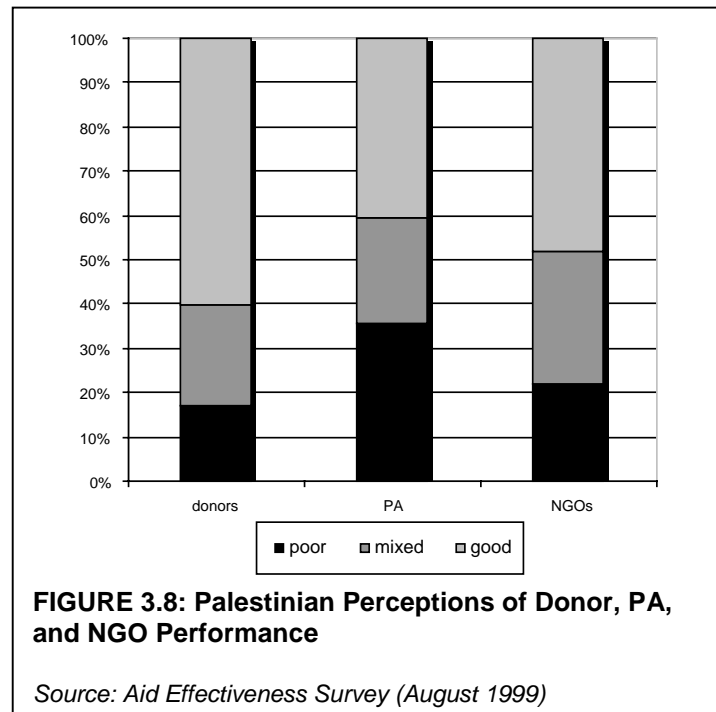
economic decline has been offset, and the infrastructure for future economic growth and social development is being put in place. Surveys confirm that Palestinians view the donor effort positively, with favorable impressions outnumbering negative ones by almost 4:1 (Figure 3.8). The Palestinian public also reports marked improvements in a broad range of services and local facilities. In short, important social and economic foundations of development have been laid, creating a conducive environment for peace.

The West Bank and Gaza has emerged from years of difficulty into the current period of real economic expansion, declining unemployment, and a balanced current budget. However, *both economic growth and the current fiscal balance are fragile*. The key to sustaining positive performance lies in restraining excessive expansion of public sector employment, implementing institutional and policy reform, and promoting a vibrant private sector as the primary engine of economic development and job creation.

Amid the various successes of the donor effort, there is certainly room for improvement, and new initiatives are needed. This report identifies past weaknesses as well as achievements. In some cases, it sounds an alarm about current trends. Most importantly, this analysis suggests how the various partners might work together in better and smarter ways, to achieve as effectively as possible the shared goals of peace and development.

Economic Performance

Overall Palestinian economic performance through 1994-97 was weak, characterized by negative growth rates, declining per capita incomes and rising unemployment (Figure 2.6). A variety of factors contributed to this—most notably closure and other restrictions on the mobility of goods and people. As a result, the initial experience of the peace process for many Palestinians was one of declining living standards.



Since 1997, the WBG economy has experienced modest economic growth, including rising per capita incomes and employment growth. The unemployment rate fell to 12.4 percent in 1999, about half its 1996 peak. With increasingly effective tax collection and economic growth, PA tax revenues now cover almost all current expenditures.

Although external assistance has not been sufficient to offset all of the decline in the Palestinian economy, donor aid has played a key macroeconomic role in cushioning the impact of mobility restrictions and other external shocks, raising annual GDP per capita growth rates by 1-2 percent. By 1999, GNP per capita was an estimated 6-7 percent higher than it would have been without donor assistance (Figure 2.41).

The relative magnitude of donor assistance has declined since the Oslo Accord, from 18 percent of Palestinian GDP in 1994 to 11 percent in 1999—highlighting the need for dynamic economic growth to take the place of diminishing aid flows. The level of private sector investment and activity has been disappointing since 1993, however. Among the key stumbling blocks have been mobility restrictions, uncertainty about the ability to import and export, political uncertainty, a complex legal system and weak judicial system, increasing reports of public sector corruption, and the murky operations of PA-linked commercial enterprises. All of this has heightened concerns about the PA's commitment to transparency and the rule of law, increased the costs and unpredictability of doing business, and weakened the competitiveness of the marketplace, thereby deterring local and foreign investment.

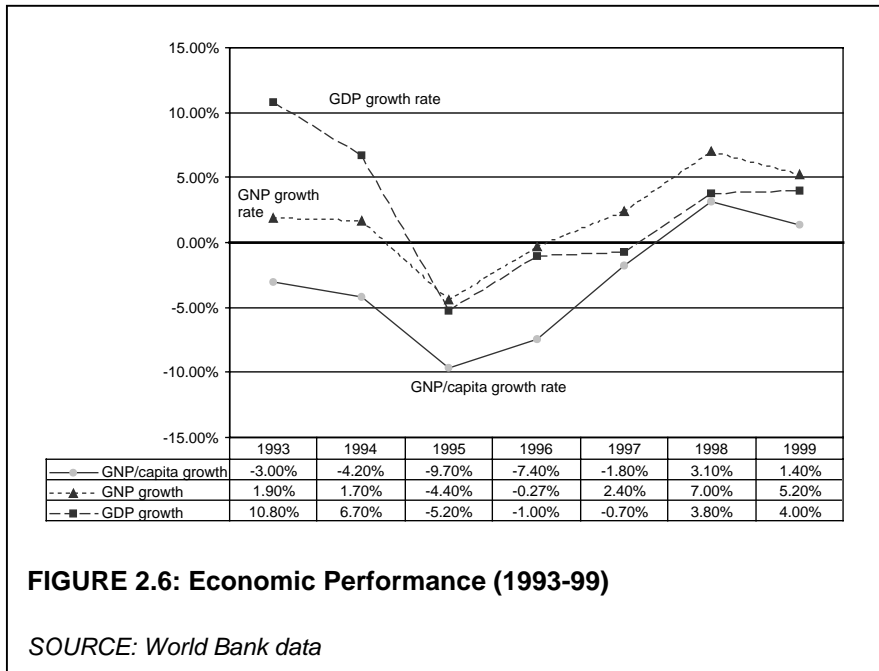


FIGURE 2.6: Economic Performance (1993-99)

SOURCE: World Bank data

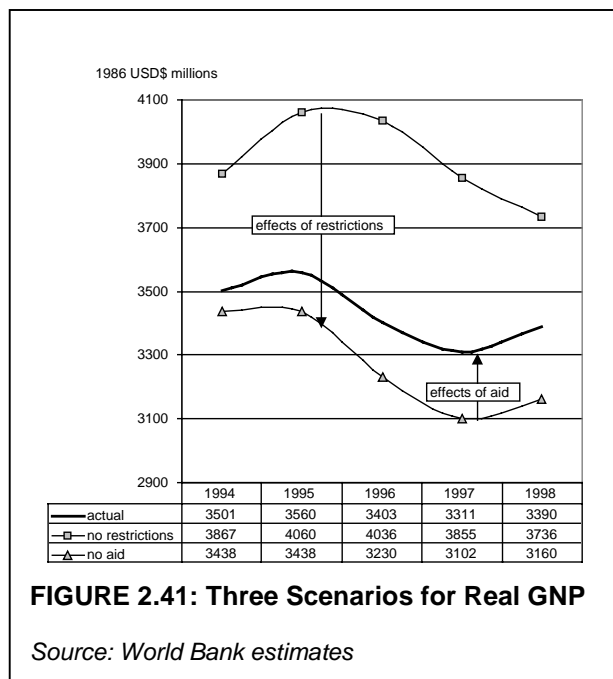


FIGURE 2.41: Three Scenarios for Real GNP

Source: World Bank estimates

Development Planning and Donor Coordination

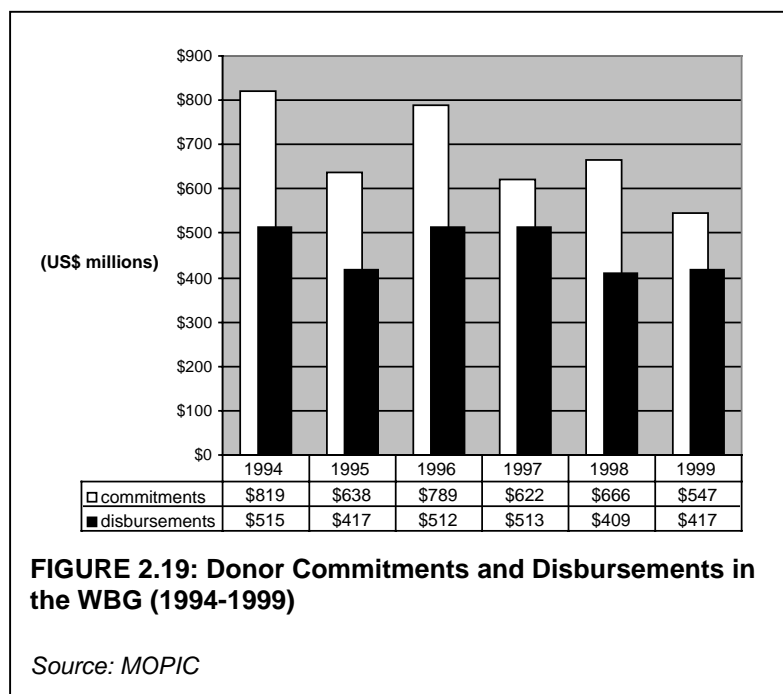
The challenges to development planning in the WBG are immense, given the complex nature of the interim agreements and the uncertainty of future political developments, including permanent status arrangements. Although development planning has grown more sophisticated over time, there remains considerable room for improvement. The PA should be encouraged in its efforts to make the process more focused, with more effective prioritization and supported by detailed information at the project and program level. Recurrent cost implications of development projects need to be accurately estimated and adequately budgeted. Donors, for their part, should work within the development priorities set by the PA.

The structures of donor coordination have evolved considerably since 1994, serving to enhance the effectiveness of donor assistance. But here, too, there is room for further improvement. Donor coordination mechanisms should be better integrated into the Palestinian development planning process, with the PA assuming the lead role in aid coordination. The documentation and transparency of managing and coordinating aid needs to be strengthened, with a bigger role for NGO participation.

Both donors and the PA would benefit from more effective knowledge management, to ensure the ready availability and distribution of information to stakeholders and the public. Possible measures include: establishing a development resource information center; continuing efforts to refine PA data-collection and analysis capabilities (including MOPIC donor matrices), and sharing donor assessments more widely. Greater use of beneficiary impact assessment and public opinion survey techniques (as used in the aid effectiveness study itself) would also contribute to more effective development initiatives.

Trends in Donor Assistance

Donor assistance has undergone important changes since 1993. There has been a relative shift away from budgetary and transitional support toward infrastructure investment—but with no absolute increase in the latter. Loans account for a growing share of donor commitments. And aid levels in 1998-99 were down markedly from 1996-97 (Figure 2.19). This last trend is particularly worrisome, not only because fewer resources are available to support peacebuilding and economic development, but it also hampers



PA economic planning and erodes donor credibility.

There are several important implications associated with these trends.

- ◆ Given the importance of donor assistance in the WBG, *continued donor delay in fulfilling pledges and commitments diminishes the PA's ability to finance necessary investments and plan for the future.*
- ◆ *The PA needs to be realistic in its expectations of future donor assistance.* Although agreement on permanent status negotiations may bring another increase in donor interest, it seems unlikely that disbursement levels will permanently rebound to previous levels. Palestinian decision-makers should not rely on long-term aid dependence.
- ◆ *The PA must assume a larger share of capital expenditures and maintenance costs.* At present, public investment is almost entirely donor-financed, and PA capital expenditures are not even adequate to offset the depreciation of existing assets.
- ◆ *The PA needs to develop effective procedures for setting national priorities for donor assistance and especially for borrowing,* in order to ensure that future borrowing is integrated into a broader strategy of social and economic development. An important element of this effort will be *better mechanisms to monitor and manage all loan- and credit-based assistance.* Donor pledges should specify the terms of any loans offered, and MOPIC donor matrices need to track information on loan terms and concessional components, to obtain accurate estimates of available donor assistance.

The recent creation of a Higher Council for Development and General Directorate for Loans represent important steps in the right direction. Donors and the PA need to work together to ensure the effective implementation of the measures announced by the PA in January 2000.

Sectoral Achievements and Challenges

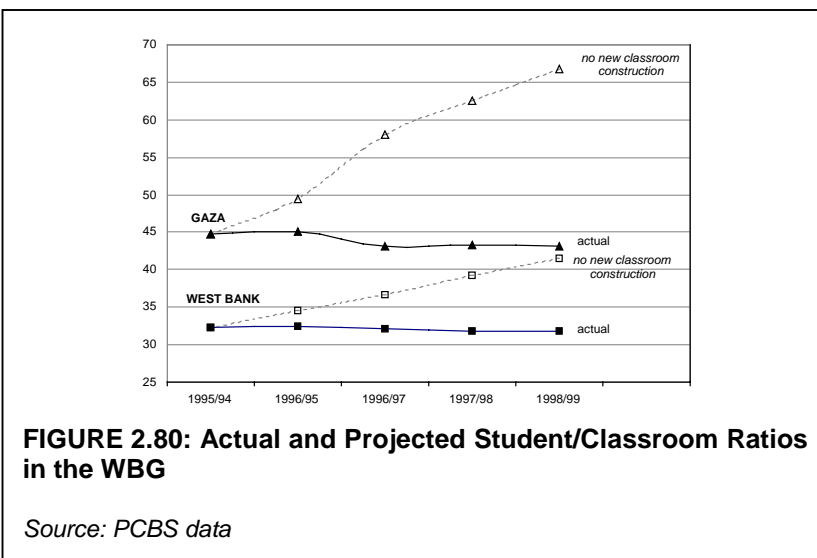
Sector-by-sector analysis of donor assistance shows substantial tangible improvements in most areas of infrastructure and services. Electrical consumption has grown sharply. More than 264 km of new roads, 1,755 km of water pipes, 393 km of new sewage lines, 3,764 classrooms, and scores of new clinics have been constructed with donor assistance since 1994. Donors, the PA, and NGOs have undertaken a variety of measures to facilitate private sector growth. Donors have also played a key role in supporting institutional development in the public sector.

Donor support for infrastructure has increased as a proportion of total assistance, but is lower in absolute terms, implying that *the anticipated shift from transitional and budgetary support to infrastructure projects has not occurred.* Instead, donors have tended to terminate transitional support without a corresponding increase in long-term public investment.

The key sectoral findings are summarized below.

- ◆ In the *energy sector*, donor support facilitated a marked increase in per capita electricity consumption. However, the extension of electrical supply to rural areas of the West Bank has been slower than hoped. Further progress in this area can be fostered through: clearer delineation and separation of policy-making functions and operations/management functions; rehabilitation of existing networks; and increasing technical efficiency by consolidating transmission networks, greater energy conservation, and better load management.
- ◆ *Solid waste disposal* has not received adequate support to date. While there have been big improvements in some urban areas and refugee camps, progress has lagged in rural areas of the West Bank.
- ◆ The *transportation sector* has benefited from substantial donor support, and road construction and repair projects are well distributed across the various regions of the WBG. Although some projects have had striking benefits, in general there has been little post-project evaluation. Recommendations for further progress in this area include: reducing restrictions and delays on regional trucking and trade at border crossings; improving transportation access between the West Bank and Gaza; clarifying the role and responsibilities of various ministries/agencies; strengthening the capacity of the Ministry of Public Works to use current plant and equipment; improving major road networks and the quality of regional and village access roads; increasing funding for road maintenance; and improving road safety through better road standards, vehicle maintenance standards, and enforcing traffic regulations.
- ◆ The *water sector* has received large amounts of donor assistance, resulting in improvements in per capita supply and water quality. However, the proliferation of donors has sometimes inhibited the development of a coherent national water strategy. Institutional reform of the West Bank's system of municipal supply is needed. Progress to date in the water sector has been slowed by challenges associated with drought, limited supply, environmental degradation, complex local patterns of water ownership/usage, and a host of political and territorial issues. Future development efforts should include improved water quality through disinfection, better aquifer management, addressing problems of low water pressure and limited hours of service in some locales, identifying leaks and illegal connections to reduce water losses, improved technical codes and national standards, a new national water law to strengthen the regulatory environment, and establishing regional water and wastewater utilities owned by (and accountable to) local governments.
- ◆ With regard to *sanitation*, Palestinians report marked improvements in sewage facilities in urban areas and refugee camps, especially in Gaza. Rural areas of the West Bank report little change. Specific initiatives to strengthen performance include developing integrated environmental and solid waste management programs, monitoring fertilizer usage, and modifying the tariff structure to achieve cost recovery.

- ◆ In the *education sector*, Palestinians report substantial improvements in educational facilities since 1994, and more modest gains in education quality. Student/teacher and student/classroom ratios have remained stable or improved since 1994 despite rapid expansion of the school-aged population, suggesting that without donor-financing of new schools, educational conditions would have deteriorated sharply (Figure 2.80). The Ministry of Education has made significant efforts to increase education quality through curriculum reform and improvements in teacher qualifications. The Ministry of Education currently allocates too few resources to capital investment or maintenance, depending on donors for the former and deferring the latter, thereby creating an unsustainable situation. A number of initiatives—many of them partly underway—could strengthen basic and secondary education in the WBG, for example by increasing enrollment and completion rates in higher grades through appropriate dropout, remedial, re-entry and continuing education programs, improving the foundation skills of students and higher-order cognitive skills through curricula reform and better school facilities (e.g., labs, libraries), developing more sophisticated procedures for assessing students' learning achievements, better integrating local communities into school planning and activities, and ensuring adequate provision for recurrent costs such as textbooks, consumables, and school maintenance.



- ◆ Donor assistance to the *health sector* has declined in recent years. The expansion in the number of PA primary health care centers since 1994 has been offset by a decline in the number of NGO-operated clinics, implying little net asset creation. The secondary and tertiary health care sectors have seen minor improvements in the ratio of hospital beds to population, but serious problems remain, including high operating costs, uneven or inappropriate geographic distribution of new and existing beds, large gaps in health insurance coverage, and limited access to facilities in East Jerusalem. Further progress could be achieved through: revising existing health care legislation and developing new legislation to address public health, environmental health, drug and food safety, and professional qualifications; strengthening the quality and availability of health indicators to allow evidence-based health planning; improving recurrent budget management, human resource planning, health systems management and capital investment planning within the Ministry of Health; increasing coordination within the PA and among the PA, UNRWA, and NGO health care providers, especially to develop a comprehensive plan for the coordinated and cost-

effective delivery of UNRWA, PA, and NGO health services to the refugee population; and upgrading and rationalizing the health care infrastructure.

- ◆ Support for *private sector development* has taken many forms, and its effectiveness is hard to gauge. Improvement in the business climate has brought an increased rate of disbursement. Microcredit programs, although small, have performed a useful role. And regulatory reform has made good strides toward promoting a positive environment for private sector activities. Nevertheless, weaknesses remain, notably in the judicial and other institutions.
- ◆ *Institution-building* is an area of key concern. Despite substantial progress, major (and perhaps growing) challenges remain with respect to fostering an effective, transparent, and accountable public sector. In particular, there is an urgent need to: clarify the mandates of government agencies and the division of labor between them; unify the legal systems, regulations, and administrative systems of the Palestinian civil service; clarify organizational structures and job descriptions within ministries and agencies; improve the transparency and fairness of recruitment policies; develop systems of performance-based management; improve the structure of civil service compensation and the pension system; and more effectively link training to institutional needs.

An examination of aid effectiveness across all sectors points to the same conclusion, namely that accountable, transparent, and effective public institutions are fundamentally important. There have been many successes in this area, often supported with donor assistance, but there are also grounds for concern. Of particular importance is the need to establish a solid fiscal foundation for public services and public investment. The situation remains fragile, with the PA's balanced recurrent budget (and its future contributions to expanded public investment) threatened by continued expansion of public sector employment, as well as failure to centralize all government revenue and expenditure accounts. Recent reforms announced by the PA may address some of this. However, the reform process must also address the unhealthy relationship between some commercial enterprises and the PA, a relationship that undermines accountability, obscures transparency, and erodes private sector confidence.

Public Attitudes

Ultimately, the primary intended beneficiaries of the donor effort in the West Bank and Gaza are ordinary Palestinians. To measure the impact of aid as it affects people "on the ground", this study took a step not heretofore attempted on this scale in the context of multilateral peacebuilding efforts: it asked a random sample of Palestinians *what they thought* about the aid effort. Specifically, this study commissioned a national public opinion survey of some 1,253 persons in 120 locales in the West Bank and Gaza, conducted by the Center for Palestine Research and Studies. The results provide an extremely valuable popular perspective on aid effectiveness through their eyes of Palestinians, and also highlight the value of undertaking beneficiary impact assessment.

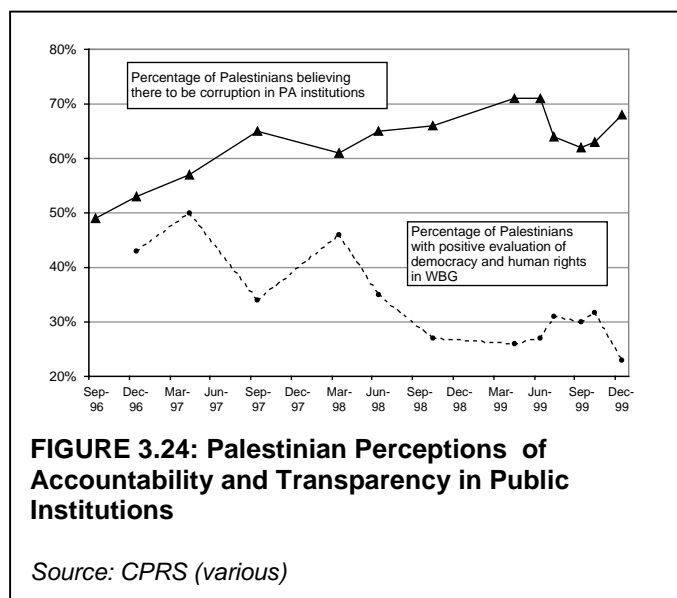
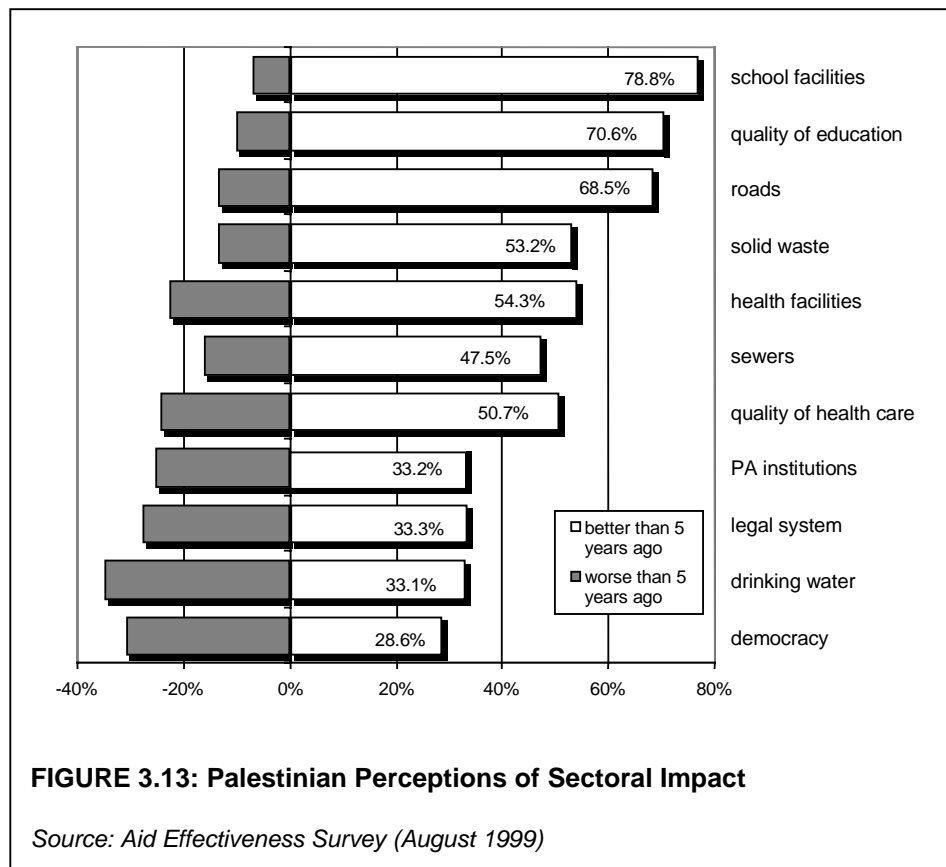
Not surprisingly, most people report a significant decline in their economic condition since 1993. However, *a large and growing proportion of Palestinians are now optimistic about their*

future, suggesting that the recent up-turn in Palestinian economic performance has been felt at the local level.

The survey also found that a sizeable majority (60 percent) of Palestinians has a positive view of donor performance in the WBG, while relatively few (17 percent) have negative views. NGO performance is also rated positively. Public evaluations of PA performance are more mixed, but with more positive than negative assessments being offered.

Palestinians report significant improvements in the education and transportation sectors since 1994, and mixed but generally positive performance with regard to health, solid waste and sewage. Only in the areas of drinking water and public institutions (including democracy and the rule of law) are evaluations negative overall (Figure 3.13).

Over time, a significant deterioration can be seen in public appraisals of the transparency and accountability of the Palestinian Authority. This threatens to have a corrosive effect not only on the legitimacy of public institutions, but also on support for the PA itself (Figure 3.24).



Education and health are rated by the general public as the most important areas for future donor assistance, followed by water and electricity. Support for gender programs, vocational training, democracy (in the West Bank) and solid waste (in Gaza) are rated as relatively low priorities.

Disaggregating the survey results by region, Palestinians in the West Bank (and especially those in rural villages) have seen less improvement in services and infrastructure—notably in the sectors of health, roads, and solid waste—compared to those in Gaza. However, objective need (as measured by regional poverty rates) remains higher in almost all areas of Gaza. Palestinians living in refugee camps report slightly greater than average improvements in these same sectors. Lower-income Palestinians and those residing in high poverty areas offer slightly more positive evaluations of donor efforts than others. Women also tend to be more positive; this gender gap is particularly evident with respect to drinking water and health services, perhaps reflecting women’s greater everyday use of these facilities in their traditional roles as family care-givers.

Public opinion leaders tend to be much more negative in their appraisal of development efforts compared to members of the general public. This may be due to greater familiarity with donor programs, residence in less needy communities (which naturally have not been the focus of donor efforts), or less familiarity with typical living conditions. In any case, this finding is very important, since elite perceptions or misperceptions may be disproportionately represented in the media’s coverage of the development effort.

Finally, a number of important warning signals emerge vis-à-vis the state of Palestinian civil society. These include a declining level of resources available for NGO activities since 1993 and the diminishing ability of NGOs to organize and operate freely. In view of the flexibility, innovation, and cost-effectiveness typical of the NGO sector—as well as its broader contribution to Palestinian pluralism and democracy—this represents a worrying trend.

Sustainability

The sustainability of development efforts in the WBG must be assessed against a backdrop of fiscal stability, demographic change, and possible shifts in donor assistance. Despite success in mobilizing fiscal revenues and balancing the recurrent budget, the medium-term fiscal outlook for the PA remains fragile. Population growth rates are high, and expanding social need can only be met through overall economic growth. As noted above, donor disbursements declined in 1998-99, and there may be a future shift toward greater use of loan-based assistance, with important fiscal implications.

Continued growth of public sector employment presents a serious threat to the sustainability of development efforts. Public employment and the associated public sector wage bill (Figure 4.6) continue to expand faster than either fiscal revenues or the underlying rate of population growth. In 1998-99, 58 percent of the PA’s current expenditures were devoted to salary, well above the 45 percent average for the Middle East and North Africa region, and over twice the world average. In the draft PA budget for the year 2000, this proportion is slated to grow further, to almost 60 percent.

It is essential for both the PA budget and the development planning process to address more effectively the recurrent (wage and non-wage) implications of donor investments. The PA needs to assume greater responsibility for capital investments, particularly those required on an ongoing basis (such as school construction). In brief, *the PA is presently unable to sustain the level of capital expenditure required simply to maintain the developmental status quo, let alone invest for the future.*

A more systematic approach is needed for tracking, prioritizing, and managing loan-based development assistance, particularly in light of the shift in donor assistance from grants to concessional and non-concessional credit. Some US\$309 million in donor loans had been disbursed in the WBG by end-1999, most connected with private rather than public sector investments. However, an additional US\$408 million in loans has been committed by donors but has not yet been disbursed (Figure 4.22). While these levels are still relatively modest, it is important that the PA not squander its “debt-free beginning” by taking on unsustainable levels of future borrowing.

Permanent status arrangements will have profound implications for the sustainability of development efforts in the WBG. The future political status of a Palestinian entity, the extent and nature of its physical borders, the nature of trade and tax regimes, mobility and access issues, the sharing of regional water supplies, and demographic changes related to the peace process will all have profound effects on the potential for, and character of, future growth. While recognizing the political sensitivity to these matters, donors and the PA should undertake economic planning

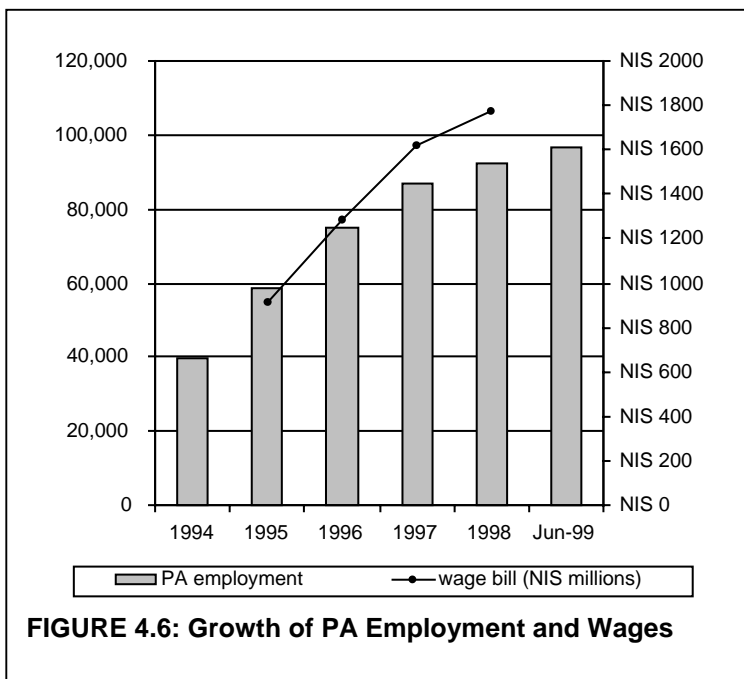


FIGURE 4.6: Growth of PA Employment and Wages

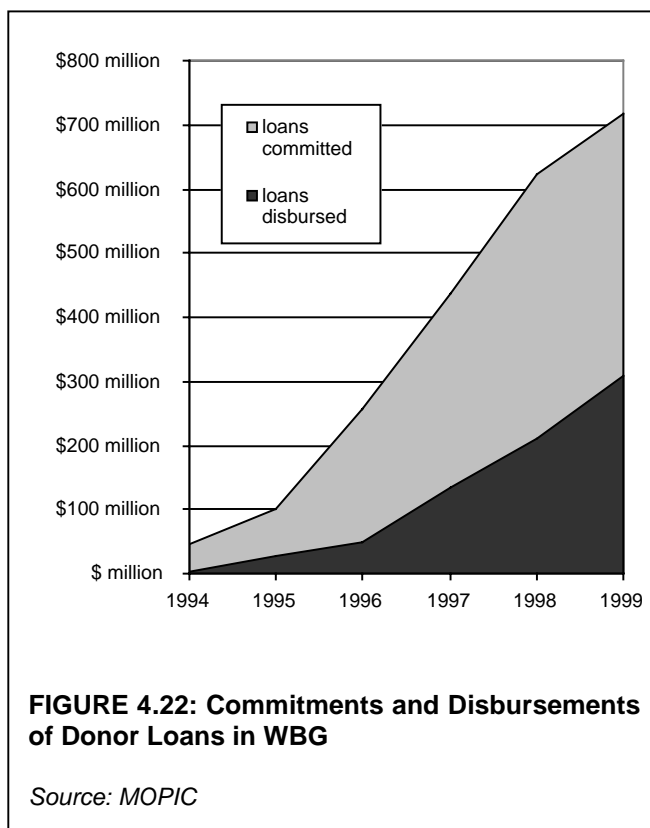


FIGURE 4.22: Commitments and Disbursements of Donor Loans in WBG

Source: MOPIC

today to ensure a smooth transition to permanent status arrangements in the future.

Donors, Aid, and Policy Reform

Comparative evidence from developing countries underscores that effective institutions and good policies matter; without them, aid is rarely effective in the long term. In the WBG, there have been notable successes in the areas of institutional and policy reform, but serious challenges remain and need to be addressed.

As emphasized in the assessment of economic and sectoral performance, there are convincing reasons why the pace of institutional and policy reform in the WBG should be accelerated. Despite a number of institutional obstacles to change—especially the growth and consolidation of constituencies that benefit from the status quo—other factors can facilitate reform. In particular, the public opinion survey data presented in this study highlights the political imperatives for change: declining Palestinian confidence in public institutions is strongly related to perceived weaknesses in institutional performance, concern over growing corruption, and fear of eroding civil liberties. Institutional reform is therefore likely to strengthen, rather than weaken, the PA.

In pressing forward an agenda of institutional and policy reform, Palestinian leadership and ownership of the reform process is essential. Donors also have an important supporting role to play, however.

The simple provision of assistance—*money*—can have both positive and negative effects on institutional development. Some donor practices have served to fragment, rather than reinforce, Palestinian capacities. *Conditionality* is not likely to be a major, or effective, component of encouraging institutional development and policy reform. *Technical assistance* (TA) can play a useful role, but only if provided in appropriate ways; the findings of the aid effectiveness study point to the need for greater attention to the *quality* rather than *quantity* of technical assistance.

Donor support for institution-building and policy reform must focus not only on structures but also on underlying political dynamics. It should include frank policy dialogue with the PA built on the principles of genuine partnership, and backed by positive incentives for progress in these areas.

Moving Ahead

The overall impression that emerges from the aid effectiveness study is positive: donor support slowed the overall economic decline, contributed to economic growth, and strengthened key institutions and local capacities. In doing so, donors have contributed to political stability, thus helping to sustain continued Israeli-Palestinian negotiation.

The aid effort in the WBG stands at a critical juncture. Donors and the PA currently face a shift from emergency assistance to supporting sustainable development. Their actions need to recognize that the structural dynamics of measures taken today will have lasting repercussions

for Palestinian social, political and economic development in the long run. Finally, it is essential to prepare for the challenges posed by future permanent status arrangements. Both donors and the PA need to undertake policy analysis *now* that will help them address the outcomes of permanent status arrangements. Failure to do so may increase the costs and uncertainties of transition.

The challenges faced at this juncture are compounded by a number of current trends: shifts in the size and composition of donor assistance; the fragility of the current fiscal balance; declining public confidence in Palestinian public institutions; and rapid population growth.

In responding to these challenges, it is crucial to foster an enabling environment for private sector activity and promote further institutional and policy reform within the PA. *In the absence of a clear and unequivocal commitment to reform at the highest levels of the PA, there is little prospect for progress in these areas.* And without reform, donor assistance will not be as effective as it otherwise might be. Indeed, *without such reform, there is little likelihood of real, sustained economic growth.* In many ways this is the central finding of the aid effectiveness study, and its fundamental importance cannot be overemphasized.

Donors have an important role in promoting reform, and hence increasing the effectiveness of their assistance programs. However, reform cannot and should not be imposed from outside. Rather, it must be founded on partnership, dialogue, and—perhaps most importantly—Palestinian ownership and leadership of the reform process.

