

OVERVIEW OF THE AID EFFORT

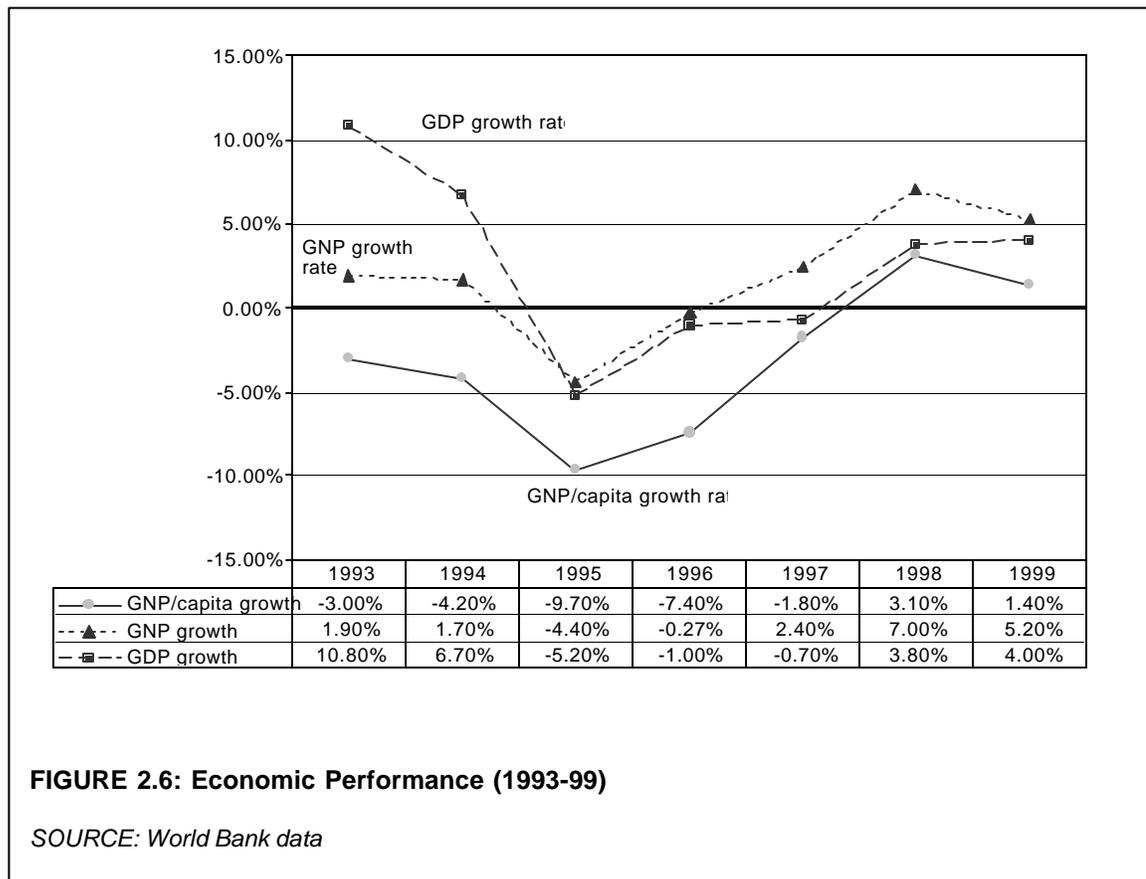
- 2.1. This section provides an overview of political and economic developments in the West Bank and Gaza since 1993. It includes a brief description of the evolution of economic policy, development planning, and donor coordination during this period, as well as an examination of changing patterns of donor assistance.
- 2.2. This section also offers an assessment of the economic and social impact of development assistance in the WBG. This is done in two ways. First, estimates are made of the aggregate macroeconomic effects of donor assistance on national income, employment, and public investment. Second, the sectoral outputs of donor-financed investments in infrastructure, health, and education are examined. Although less amenable to quantitative measurement, effort is also made to identify the effects of donor programs intended to foster an enabling environment for private sector investment, as well as those designed to promote institutional development and capacity-building in the public sector. The amount of detail that can be offered in a report of this sort is, of course, limited. Any one of these sectors or subsectors could easily sustain a lengthy study in its own right, and several have already been the subject of more detailed World Bank analysis. Therefore, rather than offering in-depth treatment, this analysis provides a broader sense of the effects that development assistance is having.

Political and Economic Developments

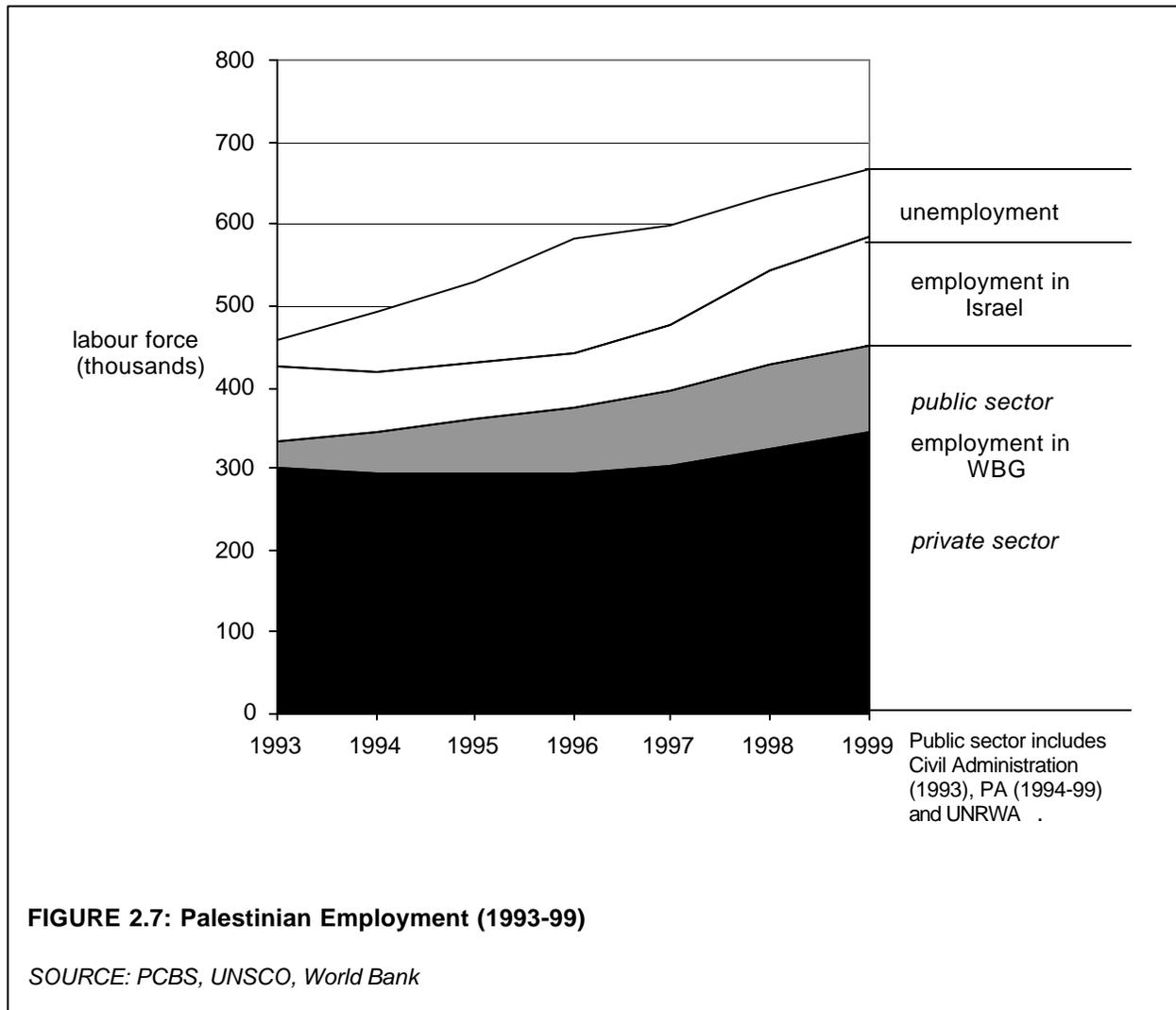
- 2.3. Shortly after the signing of the Israeli-Palestinian Declaration of Principles in September 1993, the international donor community met in Washington to mobilize support for the peace process. The US\$2.4 billion pledged at that first donor meeting has since grown to almost US\$4.7 billion (as of the end of 1999), of which more than US\$2.7 billion has been disbursed to support social and economic development in the West Bank and Gaza.
- 2.4. The May 1994 Agreement on the Gaza Strip and Jericho Area was a critical milestone, setting the stage for the establishment of the Palestinian Authority later that year. In September 1994 and again in August 1995, agreement was reached on the transfer of further powers and responsibilities to the PA. In September 1995, the Interim Agreement set the stage for additional Israeli troop redeployments, an expansion of the area under PA administration, and elections in the West Bank and Gaza. The issue of Hebron was dealt with in a separate protocol in January 1997. The Wye River Memorandum of

October 1998 and the Sharm el-Sheikh Memorandum of September 1999 saw the parties renew their commitment to cooperation, negotiation, and the implementation of existing agreements. The Palestinian and Israeli sides also committed themselves to resume permanent status negotiations on an accelerated schedule, in a determined effort to achieve their mutual goal of reaching a permanent status agreement.

- 2.5. During this same period, and with the financial and technical assistance of donors, the Palestinian Authority constructed an extensive array of political, administrative, economic and service institutions. In contrast to many other cases of war-to-peace transitions, where there may be a weakened but existing state structure to build upon, this institutional development has taken place in a context where few bureaucratic structures were inherited (with the partial exception of the health and education sectors). Thus, while significant tasks of capacity-building and institutional reform remain, the achievements to date should not be underestimated.
- 2.6. Economic performance in the WBG was, until relatively recently, poor. While underlying GDP growth was very weak, population growth remained high. GNP per capita declined significantly through 1993-1997, before showing a modest increase in 1998 (Figure 2.6).



- 2.7. During this period, unemployment rates trebled, from an average of 5.6 percent of the labor force in 1990-93 to an average of 18.3 percent in 1994-98 (Figure 2.7). In 1997 an estimated 15.6 percent of persons in the West Bank, and 38.2 percent in Gaza, fell below the poverty line (NPEC 1998, 50).¹ Poverty rates in Gaza are highest in the south (50.8 percent) and in refugee camps (41.7 percent). Poverty rates in the West Bank are highest in the north (18.1 percent) and south (24.4 percent), and in rural villages (18.2 percent).



- 2.8. Poor economic performance in these years was the product of many factors.

- Despite prior economic growth, many aspects of infrastructure and of the productive sectors of the economy remained underdeveloped under occupation. Public investment was at very low levels.

- The late 1980s and early 1990s saw a contraction of the regional MENA economy, characterized by a decline in workers' remittances from the Gulf and elsewhere. Following the Gulf war this decline accelerated, compounded by a weakening of regional support for Palestinian NGOs.
 - This was aggravated by the effects of Israeli closures, permits policies, and other complex restrictions on the movement of people and goods. These restrictions reduced employment opportunities, constrained internal mobility and external trade, and deterred investment. The average number of Palestinians holding work permits for Israel and the settlements fell from 70,000 in 1992 to a low of around 25,000 in 1996. While the actual number of Palestinians working in Israel was larger than the number holding valid permits, it too dropped sharply, from around 116,000 in 1992 to 66,000 in 1996.
- 2.9. Since 1997, there has been a reduction in the use of closure policy, and a concurrent increase in the number of Palestinians employed in Israel and Israeli settlements. By 1998-99, the number of permit holders rebounded to an average of over 45,000, and the number actually employed reached 125,000. This employment growth was accompanied by an expansion of the West Bank and Gaza economy: GDP grew by an estimated 3.8 percent in 1998 and 4.0 percent in 1999, and unemployment fell to 12.4 percent in 1999, almost half its 1996 peak.
- 2.10. Despite this recently positive performance, however, the Palestinian economy continues to face major challenges. Even if current rates of growth are sustained, it will take a decade before real Palestinian GNP/capita returns to its 1993 levels. The social and economic needs of the West Bank and Gaza remain substantial. Underlying population growth rates are very high, estimated at around 4 percent per year in 1997. Despite a reduction in the imposition of comprehensive closure, the present political and economic arrangements in the territories continue to represent a major constraint to economic development. For example, a recent study concludes that permit requirements, security procedures and overlapping bureaucracies increase the transaction costs for Palestinian exporters by 30 percent, and increase shipping delays by 45 percent (CMECS 1998). The agenda remains large with respect to improving the physical (i.e., infrastructure) and policy environment for private sector activity. Problems of accountability, transparency, alleged corruption, and inefficiency afflict some Palestinian institutions. Compounding these factors will be the inevitable challenges associated with the transition to whatever permanent status arrangements are agreed by the parties.

Development Planning and Economic Policy

- 2.11. Development planning has always been complicated by the highly dynamic political and economic context in the West Bank and Gaza, including a series of Israeli-Palestinian interim agreements that continuously redefined the territorial authority, fiscal foundations, and policy responsibilities of the PA. An initial impetus for development

planning came with the publication in 1993 of the six-volume World Bank study *Developing the Occupied Territories: An Investment in Peace*. This was followed in 1994 by the *Emergency Assistance Program*, which outlined US\$1.2 billion in urgent short-to-medium term donor investments. In 1995, donors were presented with a US\$550 million *Core Investment Program*, followed in 1996-97 by the *Palestinian Public Investment Program* which outlined US\$1.3 billion in priority investments. Although each of these various development plans involved an increasing degree of Palestinian participation in setting the development agenda for the West Bank and Gaza, donors continued to play a leading role in shaping their content. Moreover, many of these plans essentially represented short-term “shopping lists” of projects, prepared for presentation at Consultative Group or other donor meetings, rather than comprehensive national development strategies.

- 2.12. Qualitatively, Palestinian development planning entered a new phase with the first *Palestinian Development Plan* for 1998-2000, which involved a much greater degree of host ownership and a longer-term vision of development priorities. The subsequent 1999-2003 PDP extended the timeframe for planning, and introduced a macroeconomic framework for medium-term development planning. Four key national goals were set: economic growth and employment generation; rural development; improving social conditions and human resource development; and the development of financial institutions and policies. More attention was devoted to developing strategies and priorities at the sectoral level. The prioritization process for PDP projects was further refined, including greater public participation through a process of local consultation. Finally, the PDP has been made available on-line, facilitating access by both donors and the general public.
- 2.13. Despite these developments, room for improvement remains in the development planning process. The overall macroeconomic strategy of the PA remains sketchy in some important aspects. Planning has been undercut by weaknesses in the budgetary process and the failure to regularize all fiscal accounts. The recurrent cost implications of development initiatives must be addressed in a more sophisticated manner, as will be discussed in Section 4 of this study. Donors continue to finance virtually all Palestinian capital investments, with the 1999-2003 PDP calling for US\$141 million in development financing from the PA, US\$200 million in concessional borrowing, and the remaining US\$4.3 billion (or 93 percent) to be contributed by the international donor community. Consequently, at the level of line ministries, the selection of investment priorities continues to be heavily shaped by perceptions of potential donor interest, and donors thus continue to have an indirect, often unintended, but still powerful influence in shaping Palestinian development priorities. This is compounded by the fact that some donors still pursue project opportunities outside the framework of the PDP. On the donor side, some donor officials suggest that the PDP—if it is to be a genuine development plan rather than a “wish list”—should become more focused and more effectively prioritized. Moreover, it could usefully include information on specific details, costing and components of proposed projects and programs.

- 2.14. As will be highlighted in Section 4, there is a need for the Palestinian development policy process to address more effectively the recurrent cost implications of donor investments, as well as the utilization of concessional loans in financing certain strategic development initiatives. However, it is important to underscore that the PDP continues to evolve, that progress is underway in these and other areas, and that further improvements are planned. It is also important to emphasize that—given the sheer number of donors and volume of donor assistance—effective development planning requires cooperation from donors themselves, and willingness by donor agencies to accept the overall principles of host country ownership of the development process.

Donor Coordination

- 2.15. In the WBG some fifty or more donors have worked in a variety of ways and at a variety of levels, including directly with the PA and its various ministries and agencies, with municipalities and other local governments, and with local and international NGOs. Since 1993, a complex architecture for donor coordination has been put in place in an effort to facilitate agenda-setting, reduce duplication, and foster synergies. Periodic international meetings of the Ad Hoc Liaison Committee (AHLC) and Consultative Group (CG) were complemented by the establishment in late 1994/early 1995 of local aid coordination bodies: the Joint Liaison Committee (JLC), the Local Aid Coordination Committee (LACC), and the various Sectoral Working Groups (SWGs). Within the UN system, the establishment of the office of the United Nations Special Coordinator (UNSCO) facilitated coordination and agenda-setting. The World Bank has performed the role of secretariat to the AHLC, and has also facilitated local aid coordination. The appointment of a World Bank resident representative, and the subsequent devolution of greater decision-making authority to the field, enhanced the responsiveness and efficacy of Bank operations. Indeed, these measures are seen as a model for other Bank operations in post-conflict areas (World Bank 1998b, 30-31). Beginning with the “Understanding on Revenues, Expenditures and Donor Funding” in 1994, and the first Tripartite Action Plan (TAP) in 1995, periodic trilateral agreements have committed the PA, donors and Israel to specific actions and targets.
- 2.16. This architecture has evolved over time. Changes include a restructuring of the SWGs and an increasingly important role for MOPIC and other Palestinian institutions in the aid coordination process. As part of their broader analysis of aid effectiveness in the WBG, Japan and the World Bank presented an external review of the aid coordination process to the Ad Hoc Liaison Committee in October 1999 (Box 2.16). This study finds that “the existing aid coordination structure provides a strong platform to build on,” but concluded that this needed to become “less dominated by the donors and less biased to the short term” (Japan and World Bank 1999b). Another external evaluation also offers a mixed assessment of coordination mechanisms, suggesting that while mechanisms proved inclusive and facilitated information-sharing, they were generally less successful at strategizing and were not always effectively linked to Palestinian policy-making processes (Brynen 2000). Incentives still exist for individual ministries or municipalities

BOX 2.16: Improving Aid Coordination

As part of broader research on aid effectiveness in the West Bank and Gaza undertaken by Japan and the World Bank, a study on the *Improvement of Aid Coordination for West Bank and Gaza* was conducted by a team of consultants and presented to the AHLC in October 1999. While the overall assessment of donor coordination mechanisms was positive, both donor and the PA officials interviewed for the report expressed a number of concerns:

- Donors expressed concern at the workload implied by the coordination structure; the lack of a more focused dialogue in some meetings; inadequate preparation for some meetings; uncertainty as to PA responsibilities in aid management; duplication of project requests from the PA and the risk of donor overlap; implementation problems arising from both PA and Israeli action or inaction on certain issues; overall weaknesses in PA capacity and performance; potential problems of sustainability of PA services; and the lack of a well articulated connection between overall Palestinian development strategy and particular projects.
- PA officials expressed concern that donors tended to follow their own priorities and utilize their own channels; placed too much emphasis on technical assistance; and spent too much money on donor country contractors and consultants. There was also concern that donors were poor at sharing information, took too long in project preparation and implementation, and had procedures that imposed an excessive administrative burden on the PA.

The study makes a number of recommendations for improving the donor coordination process. Key among these are:

1. Strengthening the PDP process by linking it to the PA's financial calendar, giving more weight to sectoral analysis and strategy, and enhancing the role of the SWGs in PDP preparation.
2. Reviewing donor aid procedures in the context of a more explicit understanding of donor and PA responsibilities.
3. Improving the documentation and transparency of the aid management and coordination system.

Central to these recommendations is the need to strengthen the Palestinian development planning system as a way to ensure a leading Palestinian role in aid coordination.

Source: Japan and World Bank 1999b.

to deal directly with selected donors, or for donors to by-pass bottlenecks in the development planning process by working bilaterally with local recipients. Finally, it has proven difficult to find a mechanism to include the NGO sector in the coordination process. Additional efforts are needed to promote effective donor-PA coordination across the broad range of sectors and levels of donor assistance, and to identify mechanisms that enable NGO participation.

- 2.17. In order to facilitate more effective coordination and greater developmental effectiveness by the host government, donors, and other key stakeholders, in January 1999 the World Bank launched a program to develop a Comprehensive Development Framework (CDF). The West Bank and Gaza is one of thirteen developing economies in which the pilot CDF

concept is being tested, evaluated, and refined. The CDF is not a blueprint to be applied to all countries in a uniform manner. It represents a new way of doing business, a tool to achieve greater development effectiveness in a world challenged by poverty. In the short run, the CDF acts to establish mechanisms to bring people together and build consensus, forge stronger partnerships that allow for strategic selectivity, reduce wasteful competition, and emphasize the achievement of concrete results. It will help donors become more selective in their activities. In the long run, the CDF enhances development effectiveness and contributes toward the central goal of poverty reduction and other agreed targets. In the WBG, the CDF process has been rooted in collaboration among the World Bank, the Palestinian Authority, the donor community, multilateral agencies, the private sector, and NGOs.

- 2.18. The CDF pilot period is slated to end in September 2000. To date, a development framework has been or is being developed in a number of areas, including social protection, health and population, education, water and sanitation, energy, transportation, communications, the environment, private sector development, rural development, governance/public administration, finance, and justice. These identify the sectoral issues, including key constraints and shortcomings, actions that are needed to address these weaknesses, indicators for progress, and a list of the relevant initiatives undertaken by each partner.

Patterns of Donor Assistance

- 2.19. By the end of 1999, donors had pledged almost US\$5.7 billion in assistance for the West Bank and Gaza, of which US\$4.1 billion was committed against specific projects, and over US\$2.7 billion was disbursed. During this period, donor disbursements averaged US\$464 million per year, ranging from a high of US\$537 million in 1996 to a low of US\$409 million in 1998 (Figure 2.19).
- 2.20. This level of assistance reflects the great importance that donors place on supporting the Middle East peace process. Indeed, at almost US\$175 per capita (1997), aid to the West Bank and Gaza represents one of the highest levels of per capita official development assistance anywhere in the world (Figure 2.20).²
- 2.21. The rate of aid implementation in the WBG—that is, the proportion of aid commitments that have been disbursed—averaged 67 percent between 1994 and 1999. This appears to be better than in many other cases of peacebuilding assistance. In Bosnia-Herzegovina, for example, aid implementation averaged 53 percent in 1996-98 (Dahrendorf and Ballan 1999, 64; see also Forman and Patrick 2000).
- 2.22. Overall analysis of donor assistance is provided by MOPIC in its *Quarterly Monitoring Report*, and will not be repeated here. It is nevertheless worth noting a number of significant shifts in the composition of donor assistance over time (Figure 2.22). Sectoral analysis of aid disbursements indicates a marked decline in the proportion of donor

resources allocated to human resources and social development, from 33 percent (1994-95) to 21 percent (1998-99 QII). Over the same period, support for institutional development declined from 20 percent to 13 percent of disbursements, while support for infrastructure development increased from 19 percent to 39 percent of donor support.³

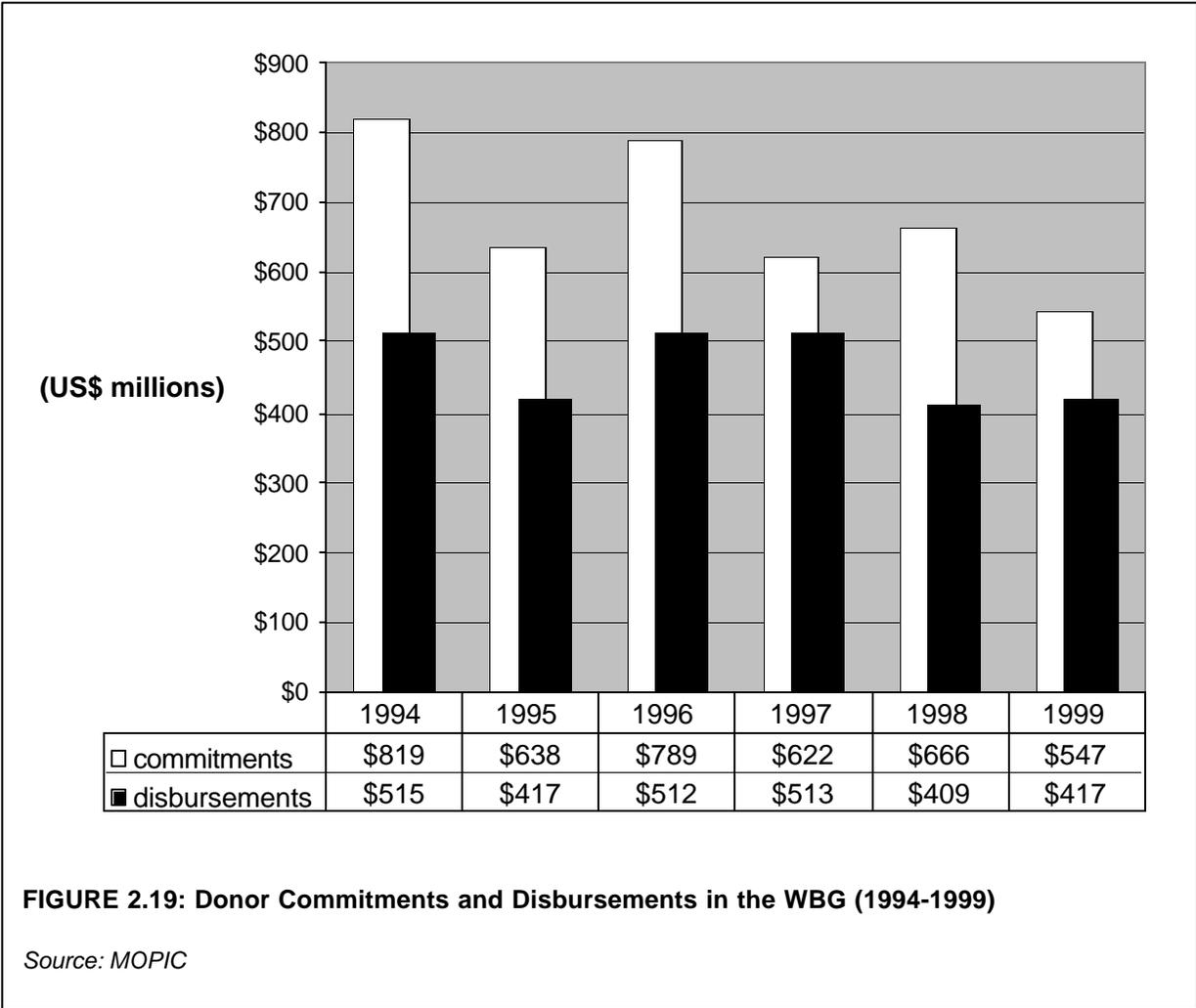


FIGURE 2.19: Donor Commitments and Disbursements in the WBG (1994-1999)

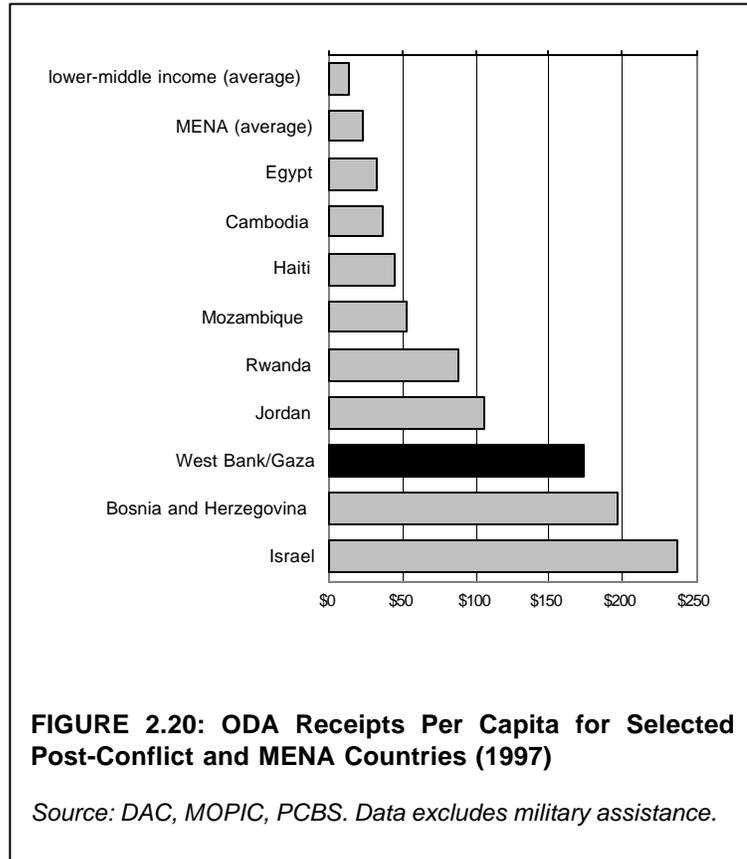
Source: MOPIC

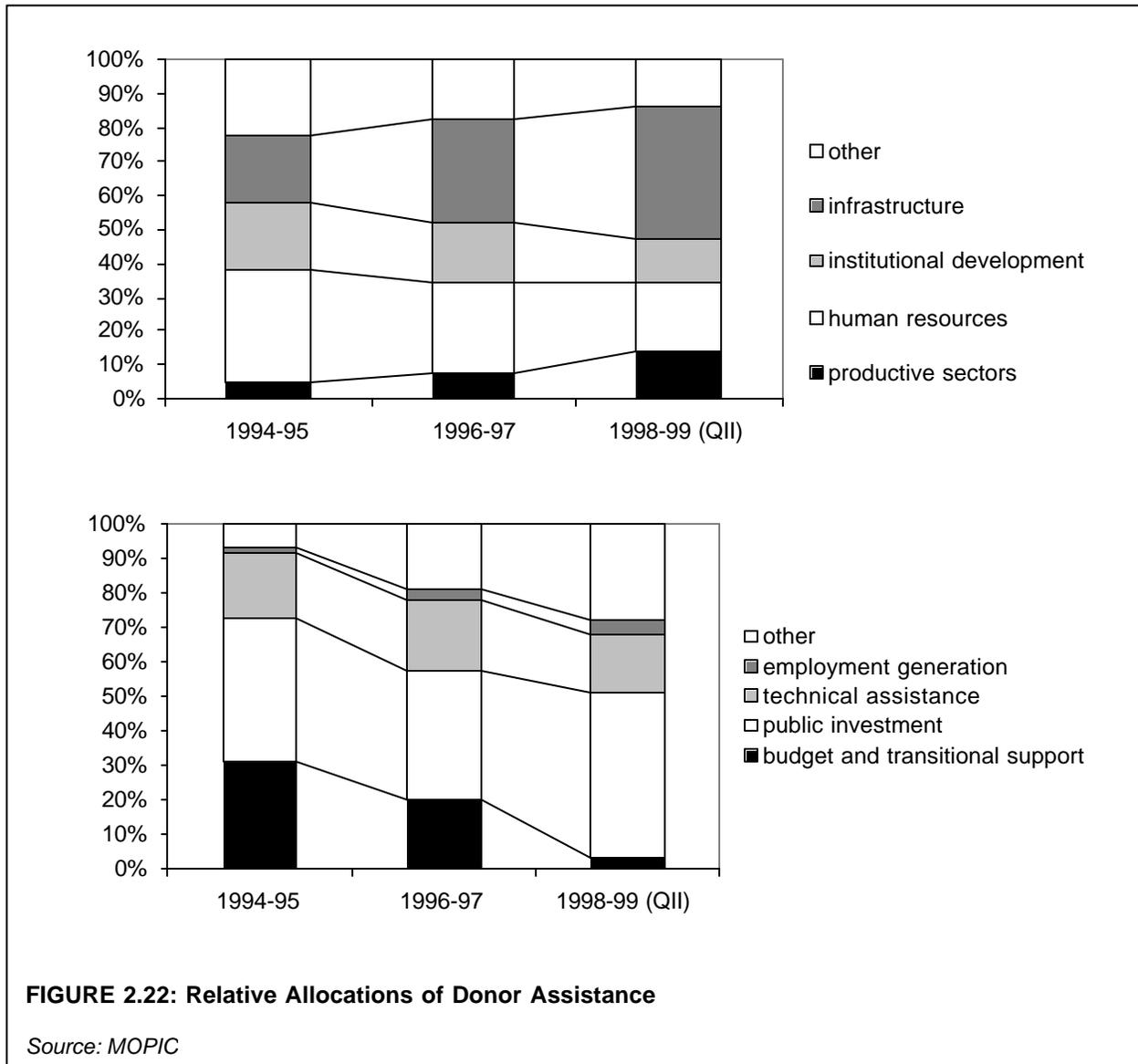
- 2.23. Among the various types (“categories” in MOPIC terminology) of assistance, a dramatic reduction is evident in transitional and budget support for the PA, from 31 percent of all assistance in 1994-95, to 20 percent in 1996-97, to less than 4 percent in 1998-99 QII. The proportion of donor support for public investment increased slightly over the same period, while the proportion of technical assistance has remained relatively constant at around one-fifth of donor disbursements.
- 2.24. As of the end of 1999, loans accounted for 17 percent (\$698 million) of cumulative total donor commitments and 10 percent (\$289 million) of cumulative donor disbursements.

There has been a gradual but steady shift in the ratio of grants to loans over time. In 1995, for instance, loans accounted for only 6 percent of donor disbursements, while in 1999, loans accounted for almost one quarter of all donor disbursements that year. Part of this trend may reflect the delayed initial pick-up in loans and investment guarantee funds due to an uncertain investment climate in the WBG. However, this data may also signal a gradual shift in the mix of assistance actually available to the WBG.

2.25. Changes in the level of support available to Palestinian NGOs also

represents an important issue. Previous World Bank estimates suggest that by the early 1990s Palestinian NGOs were receiving somewhere between US\$140-220 million each year from outside sources. By 1994, with the establishment of the Palestinian Authority, external support contracted to about US\$90 million, and in 1995 and 1996 stabilized at about US\$60 million per annum (World Bank 1997). MOPIC data reports donor support for NGOs at over US\$60 million in 1994, falling to around US\$45-50 million per year during 1995-98.



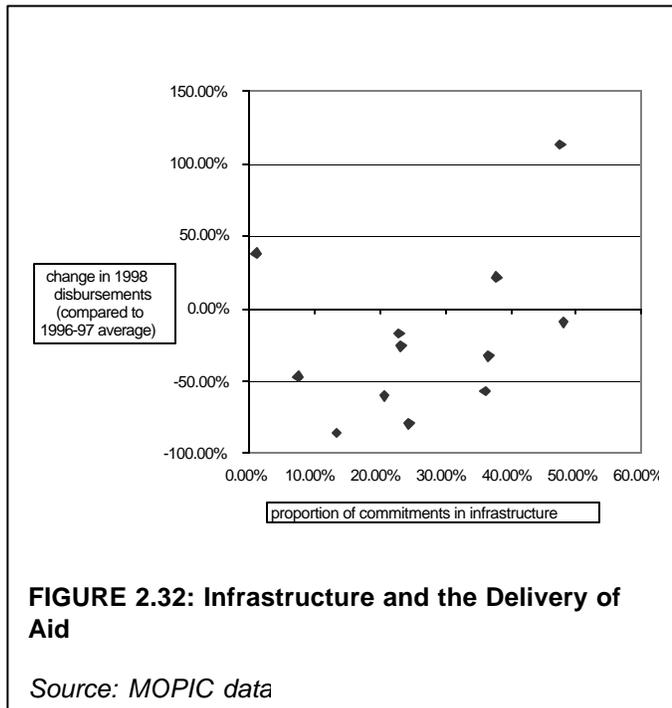


Possible Explanations for Declining Donor Disbursements

2.26. According to data provided by MOPIC, donor disbursements have fallen almost twenty percent, from an average of US\$512 million per year in 1996-97 to an average of \$413 million in 1998-99. The level of aid commitments has also fallen substantially, from an average of \$706 million in 1996-97 to \$606 million in 1998-99. Of course, any conclusions that might be drawn from these figures depend heavily on the reliability of MOPIC data. At times, such data has proven to be problematic.⁴ Nevertheless, there appears to be a significant reduction in 1998-99 levels of assistance.

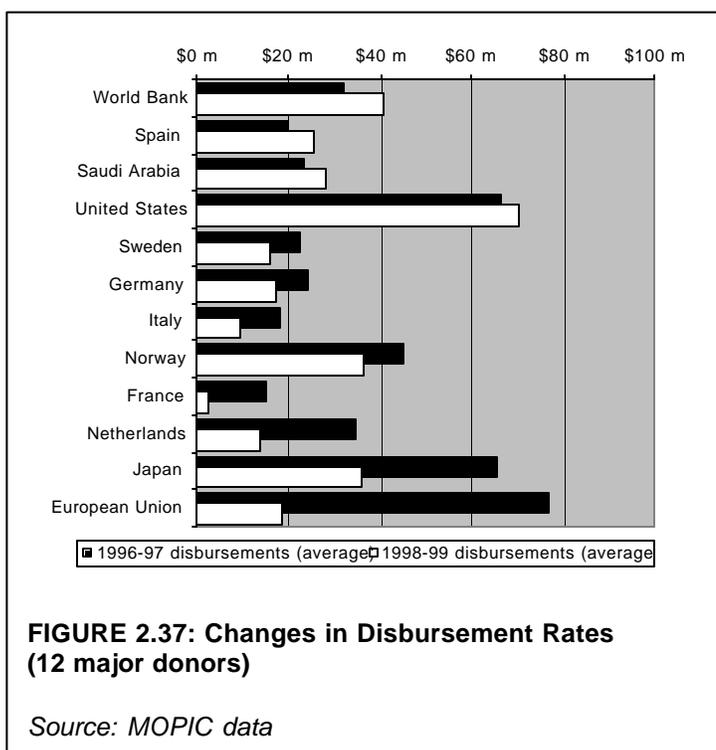
- 2.27. Although some year-to-year fluctuations in aggregate levels of donor assistance are to be expected, the overall magnitude of the decline in disbursements is simply too large to be attributed to normal year-to-year variance. Indeed, it is important to note that the 1998-99 decline in donor disbursements was not a universal phenomenon. Of 42 active bilateral and multilateral donors in 1997-98, two-thirds (28) showed a decline in disbursements in 1998 compared to their 1997 levels, while one-third (14) showed an increase.
- 2.28. Currency fluctuations may also create swings in the level of apparent donor assistance. However, this would require a significant appreciation of the US dollar (the currency in which aid is reported) against the national currencies of major donors (the currency in which pledges and commitments are usually made), or a significant appreciation of both of these currencies against the local currencies used in the WBG (which would reduce disbursements by decreasing local costs). However, this effect has not been great, and is certainly inadequate to explain the apparent decline from 1997-98 levels.
- 2.29. Another possible explanation for the decline in donor assistance might be a shift in the composition of external assistance from budgetary support and quick-disbursing employment generation programs to longer-term infrastructure and other public investment programs (Figure 2.22). Because these typically involve longer planning and implementation cycles, such a shift might be expected to slow the disbursement of donor funds.
- 2.30. Specifically, transitional and budget support for the PA has declined sharply since 1996, concurrent with a greater proportion of donor resources allocated to support infrastructure improvements and other public investments. Moreover, this explanation is consistent with the observed deteriorating rate of aid implementation due to the longer period required to implement infrastructure projects. Analysis of comparative rates of aid implementation among different donors indicates a slight correlation between higher levels of donor involvement in infrastructure projects and lower rates of aid implementation in the WBG.
- 2.31. It is critical to note, however, that donor investment in infrastructure and public investment—while increasing in *relative* proportion—has not increased in *absolute* terms in 1998-99. On the contrary, actual disbursements for infrastructure and public investment peaked in 1996-97. The effective termination of budgetary support did not translate into substantial increases in donor support for public investment. This important point has not yet been fully recognized by the donor community.
- 2.32. There appears to be no statistically-significant correlation between the degree of donor involvement in the infrastructure sector and the deceleration of aid, as shown in Figure 2.32.⁵ Clearly, the apparent decline in 1998-99 donor disbursements cannot be fully explained by reference to infrastructure investments.

2.33. Another possible explanation for declining disbursements concerns local bottlenecks and obstacles, especially those arising from actions or inaction on the part of Israel or the Palestinian Authority. In the *Improvement of Aid Coordination for the West Bank and Gaza* study previously prepared for the AHLC, donor officials pointed to both of these as sources of delay. The most recent Tripartite Action Plan, signed in Tokyo in October 1999, identified a number of efforts that the local parties could make to expedite the development effort. Although these constraints are significant, they have not worsened in a way that would explain the deceleration of donor disbursements.



- With regard to Israeli policy, improved security procedures and reduced use of comprehensive closure should have lessened rather than increased the constraints on development activities in the West Bank and Gaza.
 - With regards to the Palestinian Authority, there is little basis for believing that the current situation is worse than in 1994-95 or 1996-97. On the contrary, the PA has made major strides in building its policy and administrative capacity since it was established in 1994.
- 2.34. Regardless of whether the real context for development efforts has improved or deteriorated, it is possible that growing concerns about institutional capacity, accountability and transparency may have heightened the caution of donor agencies, or weakened domestic support for the assistance program within donor countries. At least one major donor encountered temporary difficulties in securing legislative approval of its previous aid pledges. This problem might be accentuated by changes in media reporting, which have devoted increasing attention to the negative aspects of the development effort. Finally, it is not unreasonable that donor expectations increase over time, and that donor tolerance for obstacles declines. The result may be increasing conditionality—often implicit or unspoken—between the provision of assistance and acceptable levels of accountability, transparency, project preparation, and implementation.

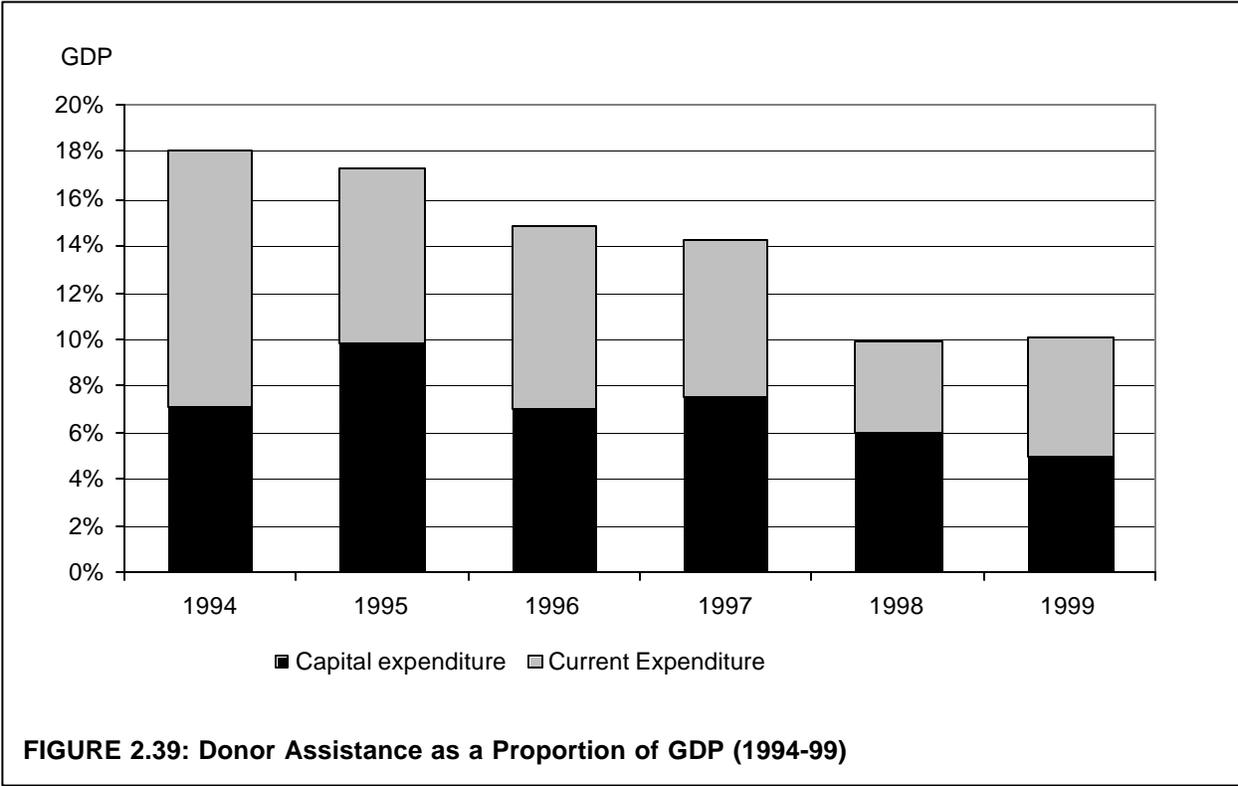
- 2.35. All of these effects may be further compounded by both a general reduction in official development assistance levels and increased competition among recipients for scarce aid resources. Total global ODA fell 18 percent in nominal terms and 21 percent in real terms between 1994 and 1997 (the most recent year for which data is available). During that same period, the proportion of global ODA provided to the WBG actually increased significantly, from 0.78 percent to 1.24 percent according to OECD data.⁶ Further declines in global ODA is certain to affect negatively the availability of future resources for the WBG. This may be further aggravated by competing needs from humanitarian emergencies elsewhere in the world, such as peacebuilding efforts in Kosovo and East Timor, for example.
- 2.36. Declining donor disbursements might also be the result of increasing “routinization” of the aid effort in the WBG, marked by the lack of pressing political crisis, and possible public, legislative, and/or donor fatigue. The data suggests that donor disbursements are highest when there is pressing need (such as the establishment of the PA in 1994) or political or economic emergency (such as the crisis wrought by violence and mobility restrictions in 1996). The decline in donor disbursements from 1996 to 1997 to 1998 might also suggest that political uncertainty and delays in the peace process during this period negatively affected aid flows. If so, it will be important to see whether aid commitment and disbursement figures increase in 2000, as political momentum builds.
- 2.37. The most powerful explanation for the decline in donor disbursements in 1998-99, however, focuses on a few key donors, rather than all. Among these key donors, special circumstances—many of them unconnected, and some of them extraneous to the West Bank and Gaza or even the peace process—affected the pace at which they are able to commit and deliver aid resources. There is substantial evidence for this idiosyncratic explanation from MOPIC disbursement data: three or four major donor countries account for almost all of the decline in 1998-99 disbursements relative to 1996-97 average levels (see Figure 2.37). The shortfall in European Union disbursements is particularly noteworthy.⁷



- 2.38. Overall, *developments in 1998-99 suggest a trend towards lower levels of donor disbursement in the WBG*. Current PA budget forecasts which project donor assistance to rebound to 1996-97 levels thus appear to be unrealistic. It is important to recognize that changes in donor assistance flows have implications not only for the level of development resources available, but also for the efficacy of the development process. At a time when donors are encouraging the PA to improve the linkage between macroeconomic forecasting and development planning, unanticipated fluctuations in aid (representing a drop equivalent to 2.3 percent of WBG GNP in 1998-99) complicate both. Similarly, any slippage in aid implementation rates will do little to enhance donor credibility at a time when they are pressing for more transparent, streamlined, and efficient systems of project identification and implementation on the Palestinian side.

The Macroeconomic Effects of Donor Assistance

- 2.39. The level of donor assistance to the West Bank and Gaza fell from a high of 18 percent of GDP in 1994 to around 10 percent by 1999 (Figure 2.39). There can be no doubt that donor assistance has had a substantial positive effect on the domestic economy of the WBG since 1994. Most immediately, the inflow of donor resources stimulated local economic activity and contributed to household incomes. In the longer term, it enhanced the productive potential of the economy by supporting investments that expand the underlying economic productive capacity. However, the decline in donor assistance relative to domestic production also highlights the extent to which Palestinian economic growth is not, and cannot be, predominantly rooted in the flow of external aid.
- 2.40. Estimating the precise macroeconomic effects of aid is a challenging task. The exact relationship depends, among other things, on the characteristics (labor intensity, import content, and so forth) of the individual sectors in which donor assistance is channeled, the type of assistance (budget support, technical assistance, infrastructure investments), and the degree to which donor funds are actually disbursed and spent within the WBG (as opposed to donor countries). Moreover, the relationship is likely to be characterized by a long and complex lag structure. The particular disarticulations of, and economic shocks experienced by, the Palestinian economy introduce further complications in quantifying the macroeconomic impact of aid. Finally, weaknesses remain in the quality and comparability of existing data.⁸



2.41. Despite the positive contribution of donor assistance to macroeconomic development in the WBG since 1994, real output levels have changed little. In real terms, actual GNP in 1998 was at more-or-less the same level as in 1994 (Figure 2.41), and GNP per capita was correspondingly lower. An important factor behind this disappointing fact was the restriction of mobility of goods and persons in and out of the WBG, especially during the years 1995-97 when mobility restrictions were imposed much more frequently. These restrictions not only affected the income of Palestinians working in Israel, but also disrupted trade flows (resulting in a possibly permanent loss of market share). It can be estimated that, in the absence of restrictions, Palestinian employment in Israeli could have been some 50,000 persons higher in 1998 compared to its actual levels.⁹ This suggests that restrictions on Palestinian labor mobility led to earnings losses equivalent to 15-20 percent of potential WBG GNP during the years 1995-97, and considerably less in 1998-99, when restrictions were less severe.

2.42. Comparative analysis suggests that donor aid since 1993 has increased the GDP growth rate by 1-2 percent over what it would have been in the absence of aid. This calculation assumes that donor-financed capital expenditures in the WBG directly augment the domestic stock of productive capital. Translated into levels of potential GNP per capita, the production capacity of the WBG economy in 1998 was 6-7 percent higher than would have been the case without donor-financed capital expenditures (Figure 2.41). This implies that the positive effects of donor assistance in 1994-97 were offset by the

cumulative negative effects of closure and other restrictions. Yet, without such assistance, the Palestinian economy would have certainly experienced a much more precipitous—and politically destabilizing—decline. Since 1997, the economic effects of mobility restrictions have lessened significantly, and donor aid has played an important role in the modest growth experienced by the WBG economy.

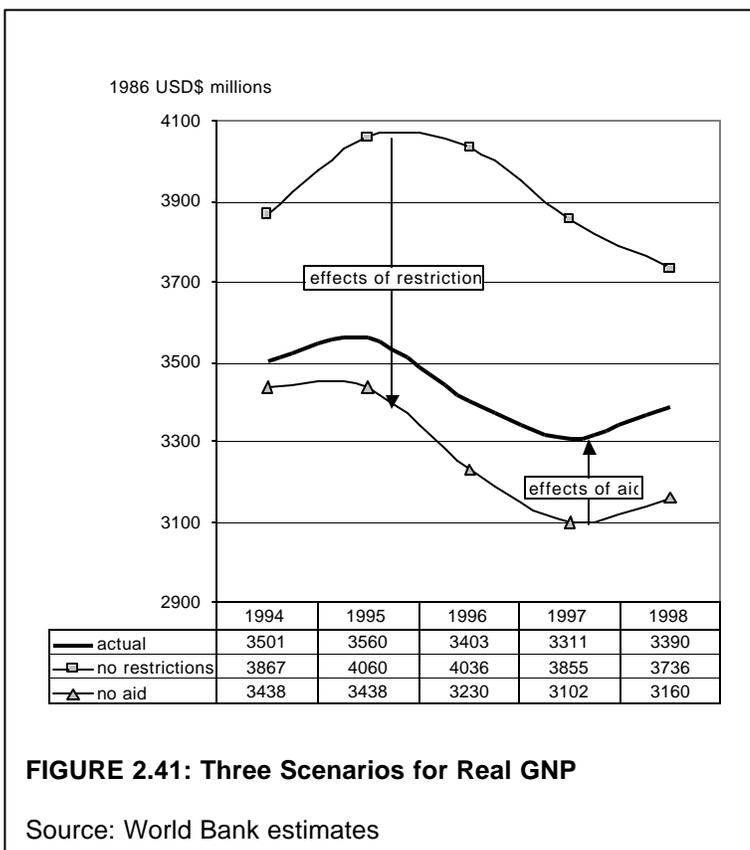
Fiscal Developments

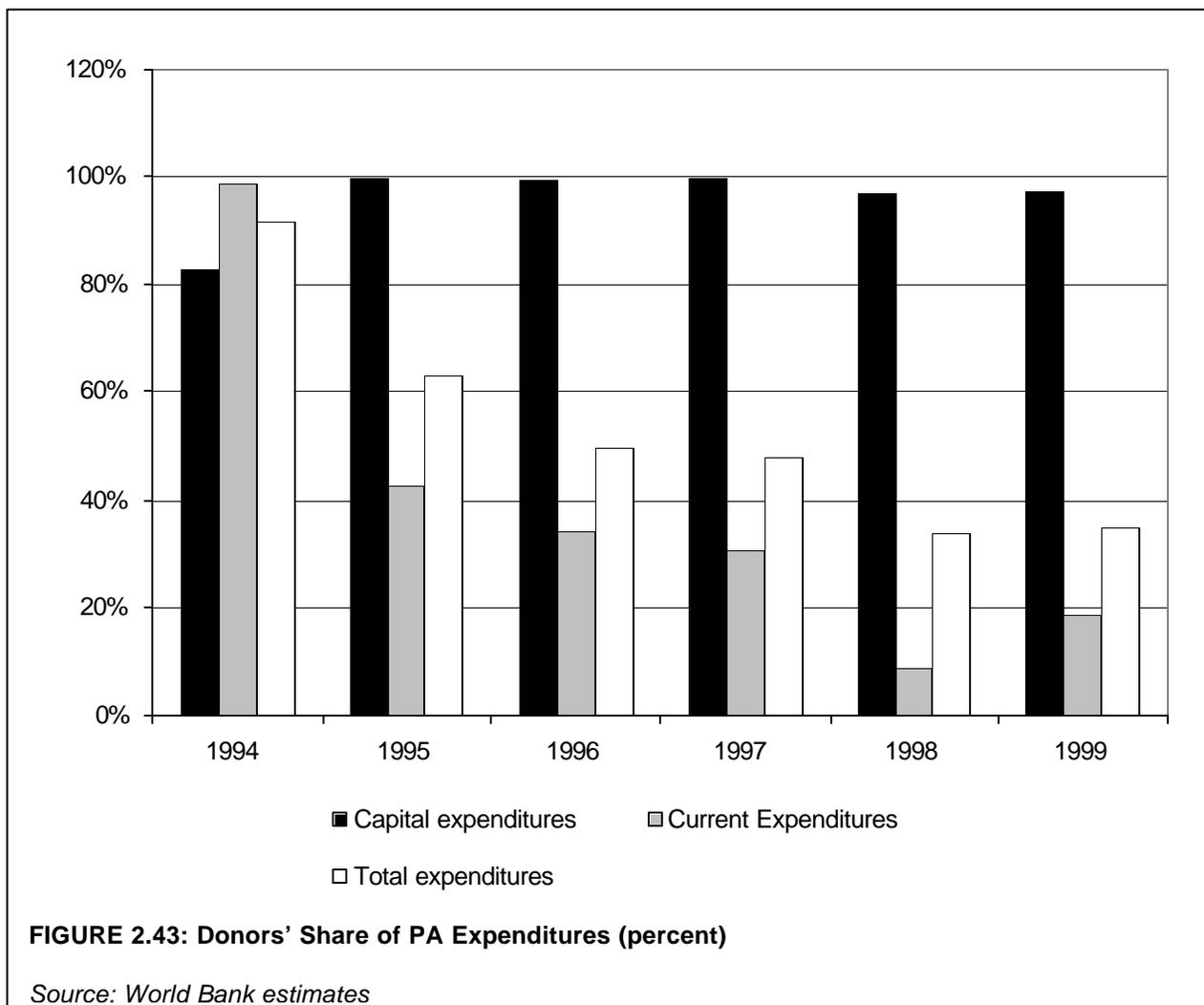
2.43. By far the largest effect of donor assistance on the PA’s fiscal situation has been on the expenditure side. Donor support for current expenditures has declined sharply since 1994 (Figure 2.43).

The initially high degree of budget support provided by donors helped the PA to establish operations and avoid potentially destabilizing fiscal deficits at a critical stage. However, recurrent budget support also facilitated an expansion of public sector employment that—whatever its immediate political utility—was in excess of that needed to carry out the new responsibilities of the PA.

2.44. Public expenditures grew sharply relative to GDP until 1997. This pattern was reversed in 1998, due to GDP growth and declining donor disbursements. The PA’s 2000 budget anticipates that current expenditures will drop from 24.4 percent of GDP in 2000 to 23.5 percent by 2002, with this decline resulting from a relative decline in wage and salary expenditures. It is not clear, however, how realistic these estimates are.

2.45. Public investment—almost exclusively financed by donors—nearly doubled from an average of 2.9 percent of GDP in 1990-92 to 5.7 percent in 1997-98. This still represents a relatively low ratio, however, compared to Jordan, Egypt, or other economies at similar income levels, in part because of an unavoidable donor focus on transitional costs, recurrent budget support and emergency employment programs. The current Palestinian Development Plan projects public investment to rise to between 9 and 10 percent of GDP by 2003. PDP estimates, however, assume donor support equal to US\$800-900 million per year. While this reflects historical pledging levels, actual disbursements over 1993-99





have been significantly less. The PA's 2000 budget offers rather more modest predictions, suggesting expansion in public investment to 6-7 percent by 2002, supported in part by an expansion of the PA's contribution from 0.5 percent to 1.5 percent of GDP.

- 2.46. With respect to the fiscal impact of donor assistance at the local level, both the structure of public utilities and the system of local government would benefit from reforms to assure the efficient delivery of services and use of revenues. A number of donor programs in the water, electricity, fiscal, and local government sectors have encouraged such reform.
- 2.47. On the expenditure side, donors have supported PA efforts to improve the system of budgetary management and expenditure control. Further progress is needed, however, notably in implementing many of the reforms already enacted. Moreover, donors have expressed particular concern about the growth of public sector employment and the recurrent wage bill of the PA, an issue discussed more fully in Section 4 of this report.

- 2.48. The Palestinian Authority has made major progress—with the assistance of the IMF and donors—in strengthening its revenue capacity. Total fiscal revenue as a percentage of GDP has risen from just 9 percent in 1994 to 24 percent in 1998. This compares favorably with many other lower-middle income countries, especially those emerging from conflict. Continuing efforts are underway to increase the collection efficiency and improve tax compliance rates. However, as the World Bank has previously noted (1999g, 8), the major gains from improved tax administration have already been captured. Consequently, the 2000 budget estimates that PA revenue will increase only slightly, to a ceiling of around 25 percent of GDP in 2000-02. Thus, there is relatively little scope for greater fiscal performance on the revenue side, other than through broader growth in the WBG economy. However, the short-term liquidity position and budgetary planning capacity of the PA would be enhanced by centralizing all revenues into a single treasury account. Important efforts in this direction were announced in January 2000, with the formation of the Higher Council for Development to oversee most PA revenues (but excluding the commercial and investment operations of the PA).
- 2.49. The overall fiscal picture remains fragile. Although the PA is presently able to finance recurrent costs from its own revenues (including clearances from Israeli-collected taxes), there are serious risks associated with a failure to deal with current fiscal challenges in a timely budget. Continued growth of the public sector wage bill could not only eliminate any prospect of PA support for public investment, but also may require expensive and burdensome borrowing to cover shortfalls in the recurrent budget.

Sectoral Impacts of Donor Assistance

- 2.50. In assessing the sectoral effects of donor assistance, several important considerations should be kept in mind. The first—discussed in Section 1 of this study—concerns the absence of appropriate baseline data against which comparisons might be made. Second, any fair assessment of aid effectiveness must recognize the sizable challenges to, and constraints on, development efforts in the WBG. In many sectors, a variety of factors beyond the control of donors—such as requirements of the interim agreements, permit policies, closure, political uncertainty, or other aspects of the transitional period—have severely inhibited project implementation. Third, it is important to recognize that some types of projects may require substantial planning, and may not show results for several years. While the time that has transpired since the signing of the Declaration of Principles in September 1993 may seem long for those anxious to see the achievement of a just and lasting peace, it remains a relatively short frame against which to measure the dynamics of sustained development.
- 2.51. Ideally, analysis of donors' various sectoral disbursements would be tied to a more sophisticated analysis of sectoral contributions to GDP and employment growth. However, the present data—and the particular circumstances of the WBG economy—make this extremely difficult. It should also be noted that the broad scope of the aid effectiveness report does not lend itself to detailed sectoral recommendations. These

require—as in the case of the World Bank’s previous work on the health sector (1998d) or public sector management (1999g)—much more focused efforts around a narrow analytical mandate. However, it is possible to identify a series of empirical indicators of donor activities in various sectors (see Annex II for data collected for the aid effectiveness study). In many cases these can be very revealing, but in other cases, the available indicators tell little about the appropriateness or quality of the initiatives undertaken, or the opportunity cost of development decisions. In a context of ongoing peacebuilding, how development initiatives are felt by the intended beneficiary population is of particular importance. This aspect of aid effectiveness will be explored in some detail in Section 3 below.

Infrastructure

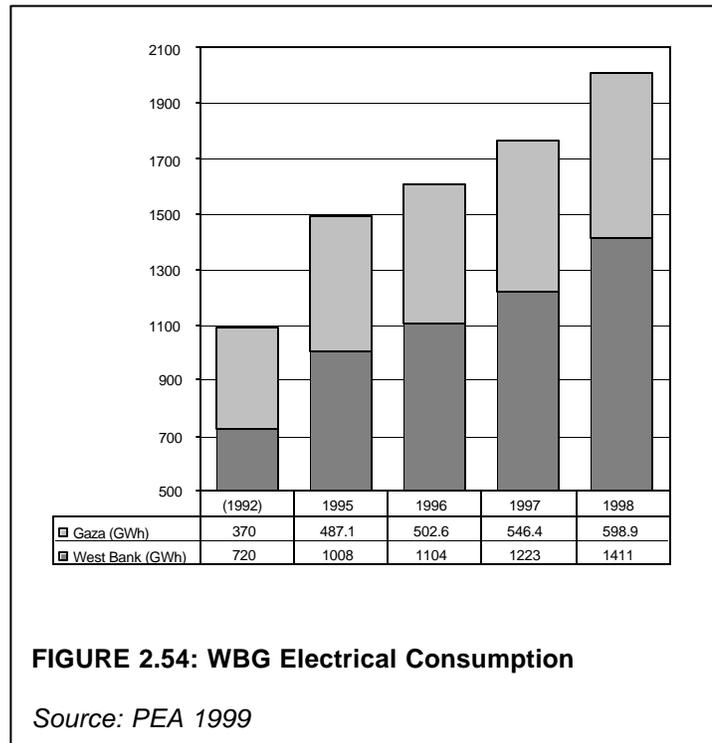
- 2.52. Since 1993, donor-supported infrastructure investment has involved a range of projects in the energy, solid waste, transportation, and water and sanitation sectors. In almost all of these areas, the Palestinian Authority inherited infrastructure that was relatively underdeveloped, lagging behind that of other comparable countries. The improvement of physical infrastructure is key to improving conditions for the Palestinian population, attracting private sector investment, and laying the groundwork for future development. Consequently, it has been a major Palestinian priority, constituting almost half (49 percent) of all proposed investments under the 1999-2003 Palestinian Development Plan.
- 2.53. In the *energy* sector, the situation in the early 1990s was characterized by low electricity consumption, high load factors, and high transmission losses. Approximately 138 rural villages in the West Bank were without full-time supply. Per capita electricity consumption stood at about 540 kWh in 1992, compared to 1054 kWh in Jordan, and 815 kWh in Egypt (World Bank 1993e, 26). The system of local municipal utilities was fragmented, inefficient, and unable to sustain expansion or modernization.
- 2.54. Between 1994 and mid-1999 donors committed some US\$134 million to the energy sector, of which US\$54 million was disbursed. About half of these funds were used to rehabilitate the electrical distribution network in Gaza, and about half for both rehabilitation and the more gradual extension of the electrical grid to rural villages in the West Bank. Such improvements and extensions have led to sharp increases in aggregate demand (PEA 1999); between 1995 and 1998, Palestinian electricity consumption increased by 34 percent—over twice the rate of population increase—to 681 kWh (Figure 2.54).

2.55. Extending reliable electrical supply to rural villages in the West Bank has had dramatically positive effects on both local living conditions and improving the environment for private sector activity. It has been achieved, moreover, at a very impressive cost/beneficiary ratio of US\$67 per person, according to estimates derived from the aid effectiveness project database (Annex II).

2.56. Challenges remain, however. Extending electrical supply to rural villages involves a host of territorial issues that slow project implementation. Also, donor disbursements to this sector remain low at under half the US\$108 million envisaged

under the World Bank's original Emergency Assistance Program (for 1994-96). Energy continues to be a relatively undersubscribed subsector of the PDP. Consequently, a significant population in the northern governorates is only now being connected to the electrical grid. Also, the process of institutional and policy reform in this sector—marked by the establishment of the Southern Electric (SELCo) and the pending establishment of the Hebron Electric Power Company (HEPCo)—remains at a relatively early stage. Specifically, further progress in this area can be fostered through the following measures.

- Clearly delineating policy-making functions (vested in a strengthened and reorganized Palestinian Energy Authority) and operations/management functions (vested in autonomous and commercially-oriented regional distribution utilities).
- Further rehabilitation of existing networks and extension of services, while at the same time increasing technical efficiency through consolidation of transmission networks (within regional utilities), as well as greater energy conservation and better load management.
- Laying the foundations for sustainable development through increased planning capacity, encouraging private sector participation, reducing non-technical losses, improving staff productivity, and other measures intended to strengthen economic viability.

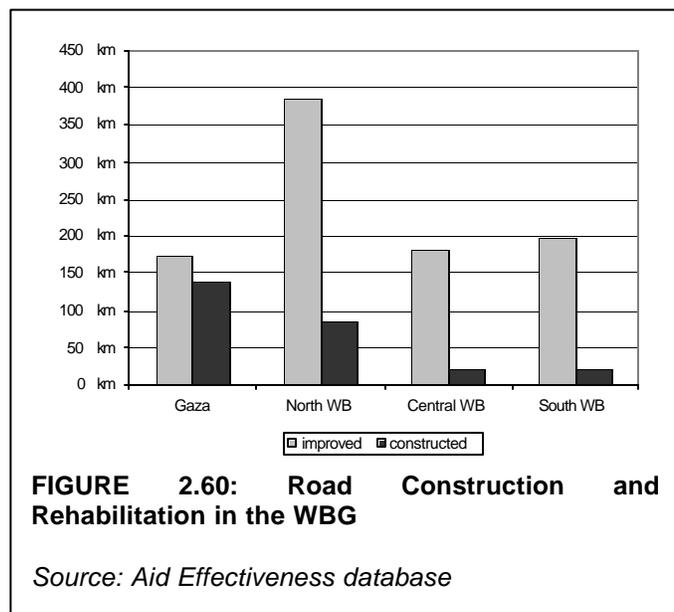


- 2.57. With regard to *solid waste*, donors committed some US\$38 million as of mid-1999, of which nearly US\$19 million has been disbursed. This too represents significantly less than the US\$57 million envisaged by the Emergency Assistance Program (for 1994-96), and solid waste is also a relatively undersubscribed subsector of the PDP.
- 2.58. At present, 25 percent of the West Bank population are not served by a solid waste collection system, and 30 percent of the population have no access to a nearby dump site (MOPIC 1998c, 47-49). Progress has been made in addressing these needs, however, particularly in the urban areas of the West Bank and Gaza. While time-series data is not available, progress is evident from survey findings that a majority of Palestinians report improved facilities in this sector (see Section 3).
- 2.59. In the *transportation* sector, donors committed some US\$128 million between 1994 and mid-1999, of which US\$55 million has been disbursed. This is close to the level envisaged in the EAP (\$73 million), although below the levels called for in the PDP. Such support has allowed the establishment of an airport in Gaza, and a number of donors have committed resources to construct a port in Gaza. However, the bulk of investment in transportation has been, and will continue to be, in the rehabilitation and expansion of the WBG road network.

2.60. According to data collected by the aid effectiveness study, donor-supported projects have been responsible for the construction of at least 264 km of new roads and the improvement of 939 km of existing roads in the WBG (Figure 2.60).

2.61. It is more difficult, however, to assess the social or economic value of these projects. There is little substantial post-project impact assessment, even for major road projects such as the Salah al-Din Road in Gaza. While the substantial benefits of major road improvement are probably clear to anyone who drove the poor, slow, often-flooded main road to Gaza prior to the peace process, in other cases the picture may be more complex.

A World Bank rapid assessment report on its Community Development Project, for example, found that road improvement did not always figure among the top priorities of local communities (World Bank 1998c). But the fear of losing potential funds could lead community leaders to accept such projects nevertheless. Israeli road construction within the West Bank, and any future arrangements that might be agreed to in permanent status



negotiations, make it difficult to develop a strategic plan for the transportation sector, although the PA has attempted to do so (MOPIC 1998). Data collected by the aid effectiveness project shows that 77 percent of road construction or rehabilitation in the West Bank has occurred in the northern or southern governorates where need is greatest, suggesting a fairly efficient matching of donor investments to regional transport needs.

2.62. Further progress in the transportation sector can be fostered in a number of different areas, notably through efforts to:

- reduce restrictions on regional trucking and trade, including delays at border crossings and due to security inspections, and improve transportation access between the West Bank and Gaza;
- clarify responsibility for road infrastructure by defining the role of various ministries/agencies, establish a Central Roads Administration, and strengthen the capacity of the Ministry of Public Works to use current plant and equipment;
- improve major road networks, particularly in the West Bank, enhance the quality of regional and village access roads, increase funding for road maintenance (possibly through a system of user charges), and establish procedures and safeguards to ensure the protection of both the environment and cultural heritage sites during new road construction;
- reform the regulatory arrangements for public transportation, strengthen planning, and improve public transportation service in rural areas;
- improve road safety, through better road standards, vehicle maintenance standards, and enforcement of traffic regulations;
- establish a Gaza port, including agreement on a suitable protocol for its effective operation, and establish a suitable institutional and regulatory context for management of port facilities.

2.63. *The water and sanitation* sector has been a primary area of donor support for public infrastructure investment in the WBG. Between 1994 and mid-1999, donors committed US\$634 million, and disbursed US\$293 million. As evidenced from the relatively high proportion of PDP projects funded, it has been comparatively easy to mobilize donor resources in this area, reflecting widespread recognition that the water sector is of critical economic and social importance. Palestinian water resources are extremely limited—on a per capita basis among the lowest in the developing world—and must be shared with neighboring countries. Most recently, local droughts in the summers of 1998 and 1999 highlighted the importance of this critical resource. Furthermore, Palestinian demand will continue to increase at a substantial rate for the foreseeable future, fueled both by economic development and demographic pressures.

- 2.64. In Gaza, the primary challenge is water quality, due in large part to over-exploitation of the coastal aquifer. PCBS census data indicates that 92 percent of Gazan households had access to a public piped water in 1997 (PCBS 1997). In the West Bank, water scarcity is compounded by limited and outdated water distribution networks. Water network losses in the West Bank range from less than 10 percent in some locations to over 60 percent in others. Loss rates—and hence aggregate wastage—are particularly high in urban areas (45 percent in Hebron, 45 percent in Jenin, 50 percent in Jericho). Overall, 88 percent of the West Bank population has access to piped water, leaving some 193,000 persons in 282 localities without access. In the northern West Bank the problem is particularly severe, with 37 percent of the population of Jenin governorate and 22 percent of Nablus governorate lacking access to piped water. The price of water varies up to nine-fold across different locations in the West Bank, in large part because of variations in local supply and the absence of a national supply system (MOPIC 1998c).
- 2.65. According to data supplied by the Palestinian Water Authority, total water production in Gaza increased by 20.4 percent between 1995 and 1998, from 44 million m³ to 54 million m³. This led to a modest increase in per capita consumption from 84 liters per day to 88 liters per day, but actual improvement may be even better, given the reduction in leakage rates and improvements in water quality. In the West Bank, where data is less reliable and time series comparisons are more difficult, per capita water consumption also increased by around 20 percent between 1995 and 1998, to around 63 liters per day (excluding Jerusalem).
- 2.66. With regard to wastewater, PCBS census data shows that 24 percent of West Bank homes are connected to a public sewage system, while 73 percent utilize some form of cesspit (PCBS 1997). In urban areas, sewage connection rates average around 65 percent, ranging from a high of 85 percent in Bethlehem to a low of 50-55 percent in Hebron and Qalqilya. Connection rates in West Bank refugee camps average around 24 percent (MOPIC 1998c). In Gaza, just over half of all households were connected to a public sewer system in 1997. Throughout the WBG, many localities with sewage systems do not yet have waste treatment facilities.
- 2.67. Ultimately, developments in the water sector will be profoundly shaped by the outcome of permanent status negotiations between Israel and the Palestinians, including agreements on the allocation and exploitation of regional water supplies. But in the interim, much can be done to improve water distribution networks, extend piped water services to communities that lack them, improve water quality, reduce water loss through leakage and unauthorized connections, improve national planning and data capacities, strengthen water management systems, and improve the financial sustainability of local water utilities. Donor programs have been active in all of these areas. Donors also have actively supported waste water projects to improve local health and sanitation conditions, and to reduce the risk of cross-contamination.

- 2.68. According to data collected for the aid effectiveness study, between 1994 and mid-1999 donors supported more than 308 projects in the water and sanitation sector, resulting in more than 1,755 km of new water pipes, 70 new reservoirs, 35 new water pumping stations, 393 km of new sewage lines, and 22 new sewage pumping stations. While the impact of such activities varies from project to project, the World Bank's Gaza Water and Sanitation Services Project (Box 2.68) provides one example of very positive effects.

BOX 2.68: The Gaza Water and Sanitation Services Project

The Gaza Water and Sanitation Services Project is supported by US\$25 million from the World Bank and US\$50 million in parallel financing from EIB/EU. The project consists of: (a) the provision of an international operator under a four-year management contract to implement a service improvement program; (b) the provision of operating investment funds for the operator built into the management contract, essential to fund goods, equipment, works and services required for improving services and attainment of performance targets; and (c) the provision of technical assistance to strengthen the newly created Palestinian Water Authority (PWA), to support implementation and monitoring of the project, and to provide independent auditors to monitor the operator's technical and financial performance. The implementing agency is the PWA.

The main achievements of the project after three years of implementation are:

1. 3,700 km of pipe surveyed for leaks and 11,000 illegal connections identified
2. almost 14,000 service connections replaced, 7,000 meters repaired, and more than 27,000 meters replaced
3. unaccounted for water reduced in year one from 48 percent to 44 percent, and is currently about 38 percent
4. reliable disinfection of the water supply
5. increased revenue.

The work of creating the legal entity of the Coastal Water Utility in Gaza started in January 1999 and is due to be completed by the end of December 2000.

- 2.69. Several challenges face donor efforts in the water and sanitation sector. The large number of donors involved—at least twenty one—raises the risk that initiatives may be poorly coordinated, thus negating potential synergies and undercutting efforts to develop a national water strategy. Some donor and PA officials already complain that this is a significant problem. In several areas, different donor-supported water projects are in very close proximity, but with little attention to integration or synergy. Greater sectoral coordination, including a leading role for MOPIC, the PWA, and the PDP, is therefore essential.
- 2.70. The water sector has nevertheless encountered significant practical obstacles to project implementation. In 1993, the Bank estimated that two hundred unconnected West Bank communities could be connected to piped water supplies at a cost of US\$22 million. Six years later, however, only a fraction of this has occurred. Overall, the implementation rate in the water and sanitation sector is lower than the general average for the aid effort, with only 46 percent of committed funds disbursed as of mid-1999. A major factor in these delays appears to be the fragmented system of territorial authority in the West

Bank, coupled with the present system requiring new water and sewage projects to be approved by the Israeli-Palestinian Joint Water Committee. The multiplicity of local Palestinian actors involved in the water sector—ranging from the Palestinian Water Authority to municipalities to shared village springs or the collective owners of individual wells—further slows progress (Trottier 1999). As shown in Section 3, these factors—coupled with drought and major water shortages—have contributed to widespread public perception that little has been achieved in the water sector during the past five years. Public evaluations of progress in sewage facilities, however, are rather more positive.

2.71. An essential part of the problem is the underlying need to reform the institutional foundations of the water management system. The PA is reorganizing the current system of municipal water utilities into consolidated regional utilities. Unlike the current system, these would have the technical expertise and capital resources to maintain and improve the water distribution infrastructure. The water sector must also be linked to other aspects of development strategy. A significant proportion of Palestinian water resources, for example, are used for agriculture. The costs and benefits of such usage—and the opportunity costs of inadequate supply for other purposes—may not be adequately accounted for in current rural development planning. Among the specific initiatives that would strengthen performance in this area are:

- more effective strategic planning, backed by coordinated donor support;
- preparation of regional plans to extend services in the West Bank where households lack water and/or sewage connections, and incremental improvements in cistern and latrine facilities in areas where service is not expected within a reasonable time;
- improved water quality through disinfection, aquifer management, integrated environmental and solid waste management programs, and monitoring of fertilizer usage;
- increased levels of service and operational efficiency by addressing problems of low water pressure and limited hours of service in some locales, reduced water losses by identifying leaks and illegal connections, appropriate staffing levels, improved level of staff training, and higher technical codes and national standards;
- stronger regulatory environment through a new national water law, registration and licensing of all wells, regional water and wastewater utilities owned by and accountable to local governments, and a strategy to attract private investment;
- modified tariff structure to achieve cost recovery, clarification of water assets and ownership, and strengthened financial accounting.

In the longer term, of course, future development of the Palestinian water sector will be fundamentally shaped by the outcome of permanent status negotiations, and by the nature of any water regime agreed by Israel and the Palestinians.

- 2.72. Water and sanitation issues discussed above also point to the broader importance of the *environment*. Here, the West Bank and Gaza face serious challenges, including mismanagement and over-utilization of limited natural resources (e.g., the depletion and declining quality of water supplies), rapid population growth and urban development, and the expansion of industry and road networks. Little attention has been paid to environmental issues in the past, and public awareness is low. Emphasis on the social and political imperatives of economic growth may come at the cost of environmental protection, despite the importance of the latter to the sustainability of the former. Finally, the complexities of the interim period and the implication of future permanent status arrangements for territorial and resource control severely complicate environmental management and planning.
- 2.73. According to MOPIC data, donors disbursed some US\$9 million in the environmental sector between 1994 and 1998. However, since almost all infrastructure projects (and a great many others besides) have environmental consequences, this data understates the donor role in this area. The most effective development planning integrates and mainstreams environmental concerns into program and project cycles under a broader framework provided by the host country. In the WBG, the previously fragmented institutional structure of Palestinian environmental policy has in fact coalesced within the Palestinian Ministry of Environmental Affairs. The establishment of the Ministry and its National Environmental Strategy and Action Plan provides a focus for future donor efforts. However, there are a number of areas where action is required to strengthen this process:
- The Ministry of Environmental Affairs requires an adequate budget, staff training, and greater ability to collect and assess environmental data.
 - The appropriate policy context must be put in place, including preparation of an Environmental Law and other relevant regulation.

Effective collaboration on environmental issues must be established across PA ministries and agencies, and among the Palestinian Authority, NGOs, the private sector, and other stakeholders.

Education

- 2.74. The education sector in the WBG is characterized by very rapid growth in the number of school-age children, and hence in the demand for schools, classrooms and teachers. Between the 1994/95 and 1998/99 school years, the number of students enrolled in schools and educational institutions rose from 654,697 to 889,895—a 36 percent increase, with the rate of increase larger for girls (38 percent) than boys (34 percent). The

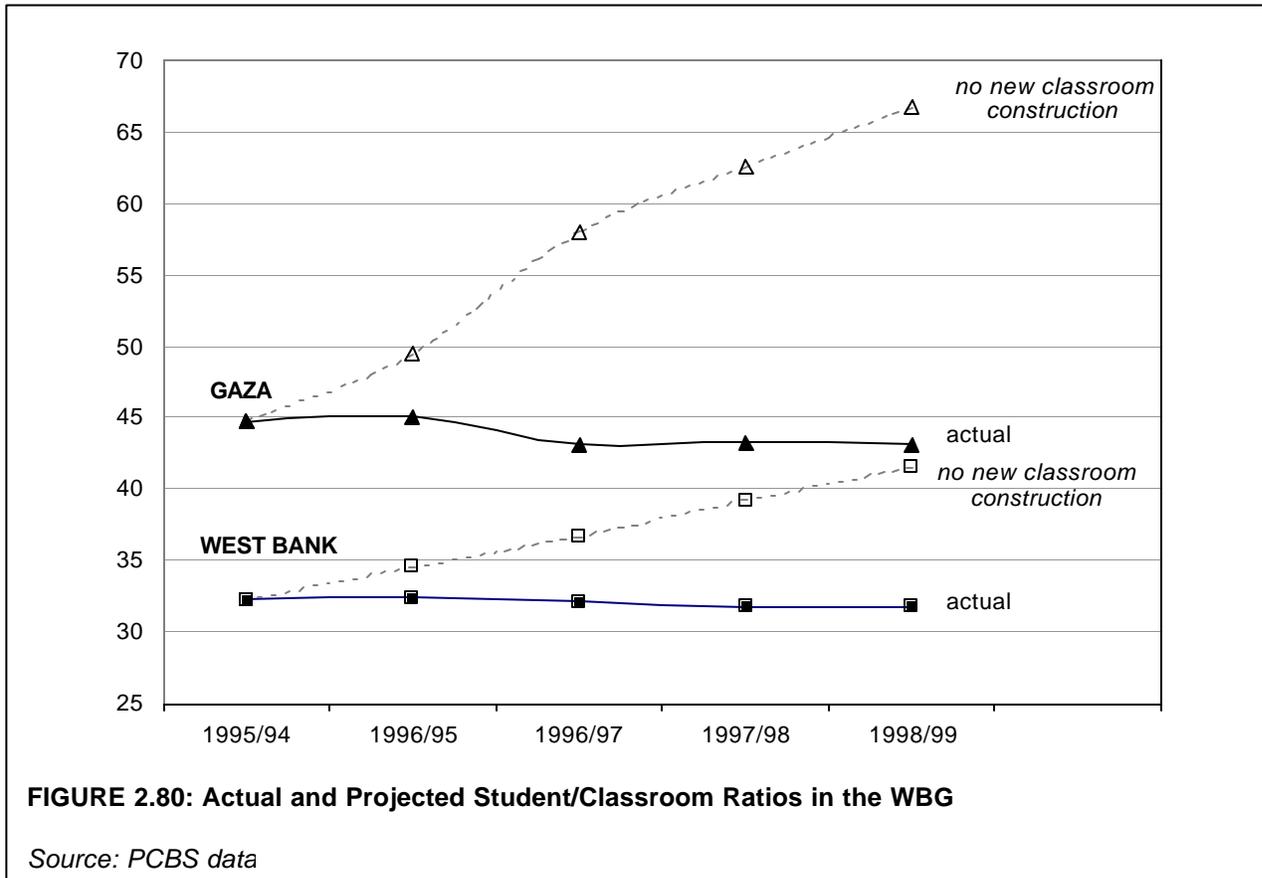
sharpest enrollment increases occurred among kindergarten students; the number of pupils grew by 110 percent (to 77,173) over five years. The education sector is also characterized by multiple service providers: the PA, UNRWA, NGOs, and the private sector. In 1998/99, 68 percent of primary and secondary school pupils were enrolled in PA schools, 26 percent in UNRWA schools, and 6 percent in private schools.

- 2.75. Year-on-year enrollment increases peaked at 10 percent in 1996/97, before dropping to 6 percent in 1998/99. The rate of growth was particularly high in Gaza, where the total number of students grew by 49 percent between 1994/95 and 1998/99. There was also a shift in the distribution of students among different types of schools; while government and UNRWA school enrollments increased by 31 percent over this period, the number of students attending private schools fell by 42 percent. Gross enrollment rates are high (98 percent in grades 1-10), but drop significantly in higher grades (56 percent in grades 11-12).
- 2.76. Between 1994 and mid-1999, donors committed some US\$406 million to the education sector, and disbursed US\$314 million. A steady decline in donor support for education is noticeable, however, with assistance dropping from US\$92 million in 1996 to only US\$15 million in 1998. This is explained in large part by a sharp decline in the level of donor support for recurrent education expenditures and higher education. Donors and the NGO/private sector currently finance the overwhelming majority of public investment in the education sector, providing 96 percent of all capital spending in the 1997 education budget (World Bank 1999g, 43). According to data collected for the aid effectiveness study, more than US\$97 million in donor assistance was devoted to constructing 152 new schools in the WBG and renovating 374 others, resulting in the addition of at least 3,764 new classrooms during this period.
- 2.77. In the early 1990s, total outlays on education were estimated at US\$170-175 million per year, equivalent to about 5.3 percent of GNP (World Bank 1993f, 37). By 1997, total public outlays had increased to US\$277 million (World Bank 1999g, 43), or nearly 6 percent of GNP. This is slightly higher than the 5.3 percent average for low and middle income MENA countries. In 1997-98, annual recurrent spending on education stood at approximately US\$310 per student in UNRWA schools and US\$270 in government schools.
- 2.78. In general, student/teacher ratios have improved slightly. In 1998/99, the overall student/teacher ratio stood at 29.5, compared to 31.5 in 1994/95. The ratio was highest in kindergartens (63.7), UNRWA schools (39.4) and in Gaza (34.7). The number of teachers at government schools increased by more than 42 percent between 1994/95 and 1998/99, a rate of growth higher than the rate of student increase (31 percent). It should also be noted that, due to new employment guidelines, the PA Ministry of Education increased the proportion of teachers with a university degree from less than 36 percent in 1994/95, to over 47 percent in 1998/99. In UNRWA schools, however, the number of teachers

increased at a much lower rate of 22 percent over the same period, resulting in a slight deterioration in pupil/teacher ratios.

- 2.79. Indicators of classroom availability have remained constant or improved marginally since 1994. The overall student/classroom ratio stood at 35.4 in 1998/99, compared to 35.9 in 1994/95. The student/classroom ratios in Gaza (43.1) were significantly higher than those in the West Bank (31.7). In Gaza, the average amount of classroom area per student rose from 1.1 m² in 1996/97 to 1.19 m² in 1998/99. In the West Bank, classroom area per student has increased slightly from 1.0 m² in 1996/96 to 1.05 m² in 1998/99 at the elementary level, and from 1.3 m² to 1.52 m² at the secondary level. It is notable that the growth in the number of classrooms for female or coed classes has occurred at a faster rate (55 percent and 36 percent respectively over five years) than growth in the number of male classes (28 percent over the same period). Because the distance, crowding or unavailability of girls' classes sometimes represent obstacles to attendance, this may explain why there has been a greater rate of increase in female enrollments since 1994/95.
- 2.80. The contribution of donors to stabilizing and improving educational facilities has been extremely important. This is dramatically illustrated by Figure 2.80, which shows the actual trend in student/classroom ratios, and the projected ratios had there been no donor-financed capital investment in school construction and rehabilitation. In the latter case, the absence of donor support would have led to a projected increase in the average number of students per classroom to 43.1 in the West Bank, and 66.7 students per class in Gaza.
- 2.81. Several patterns emerge from these statistics.
- First, there has been modest but perceptible improvement in most physical indicators of primary and secondary education: teacher/pupil ratios, the availability of classroom space, and in other aspects of education infrastructure. This is confirmed by survey data (discussed in Section 3) which shows that most Palestinians perceive an improvement in education facilities. However problems of overcrowding remain, particularly in Gaza. A significant proportion of schools are double-shifted to deal with this. Although double-shifting optimizes the utilization of physical space, it has some disadvantages.
 - Second, improvements in physical indicators have been greater for PA than for UNRWA schools. This underscores the impact of budget constraints on UNRWA's ability to maintain existing levels of service to refugees.
 - Third, there have been some underlying shifts in enrollment patterns. One component of this has been rapid growth in the number of kindergarten students, reflecting not only demographic factors but also a growing trend of enrolling children in preschool institutions. This suggests a growing need to develop early childhood education policies. Another substantial element of change has been the marked decline in

private school enrollments, which may be a consequence of deteriorating family incomes in recent years.



- 2.82. In reviewing these quantitative physical indicators, it is important to emphasize that they only partially illuminate education quality (as opposed to quantity and circumstances) in the WBG. In 1993, the World Bank's review of the educational sector noted that "the education now being provided to children living in the occupied territories does not meet reasonable quality standards," due in large part to an outdated and outmoded curriculum as well as weaknesses in teacher training and qualifications (World Bank 1993f, 41-42). While donors have supported curriculum reform, teacher training, and the production of instructional material, the remaining agenda is large, including enhancing the Ministry of Education's ability to monitor and assess student and teacher performance. A useful step in this direction was provided by the Ministry of Education's participation in the "Education for All" program of UNESCO (Box 2.82). Not only has this helped to establish benchmarks and targets for the Ministry, but it has also identified significant weaknesses in primary school achievement levels.

BOX 2.82: Education for All

During the 1998/99 school year, the PA Ministry of Education took part in the UNESCO “Education for All” program. This inter-agency program is a global assessment of primary school education, using both quantitative and qualitative indicators. Because this was the first time that the WBG participated in the program, there are no earlier benchmarks against which to measure progress, and methodological differences render it difficult to make precise international comparisons. Nevertheless, the results are revealing in many respects.

In quantitative terms, the WBG fared well, and in many instances outperformed its regional neighbors. The figures for enrollment rates (especially for females) and student/teacher ratios were notable in this regard. The Palestinian system also scored relatively high in efficiency, signifying relatively low repetition and drop-out rates. The quality of teacher training, however, remains relatively low, despite efforts to increase the level of teacher qualification.

In qualitative terms the system fared less well, although it was generally on par with other Arab countries. Student competencies in three sets of basic skills were disappointingly low, and in many cases less than half of students were able to meet national targets. Students in UNRWA schools outperformed students in PA schools in Arabic (57 percent versus 50 percent), mathematics (42 percent versus 35 percent) and sciences (42 percent versus 38 percent) alike. Students in private schools outperformed students in the public sector.

- 2.83. A further set of issues concerns the fiscal sustainability of this sector in light of the rapid growth of both students and teachers, as well as the future recurrent cost implications of school construction (World Bank 1999g, 43-47). This issue is further discussed in Section 4 below.
- 2.84. On the positive side, the Ministry of Education has a “deserved reputation in Palestinian civil society and among donors for transparency” (World Bank 1999g, 46), administrative efficiency is relatively high, and the education SWG is regarded as one of the most productive of all Sectoral Working Groups (Japan and World Bank 1999b, 63-67). Ministry officials indicate an awareness of problems in the quality of the current education system, and emphasize the need to press forward—in partnership with donors—to strengthen curriculum development, texts and teaching materials, teacher training, and assessment and monitoring capacity. All of this provides a firm base upon which to build further progress in the education sector.
- 2.85. Over the next five years, there are a number of important initiatives—many of them partly underway already—which would strengthen basic and secondary education in the WBG. Such measures would include:
- increasing enrollment and completion rates in higher grades by studying existing participation rates and designing appropriate dropout, remedial, re-entry and continuing education programs;
 - improving the foundation and higher-order cognitive skills of students through curricula reform, the development of appropriate school facilities (labs, libraries, etc.), and improvements in the quality of teachers and teaching, and increasing the

system's sophistication in assessing students' learning achievements to respond better to specific needs;

- raising the quality and quantity of information available to the public and key stakeholders, and better integrating local communities into school planning and activities;
- completing a law governing basic and secondary education;
- establishing stronger, empirically-based, policy planning capacities at the central and district levels, strengthening budget management and financial planning capacities, undertaking cost/benefit analyses of potential educational investments, establishing stronger monitoring mechanisms, decentralizing some functions to the district and school levels and developing appropriate regulations and networks to facilitate this, and sub-contracting some goods and services;
- assuring that future trends and needs in the educational sector are fully accounted for in Ministry of Finance and MOPIC planning, and aligning donor support around the Ministry of Education's development plans and priorities;
- ensuring adequate provision for recurrent costs such as textbook provision, consumables, and school maintenance.

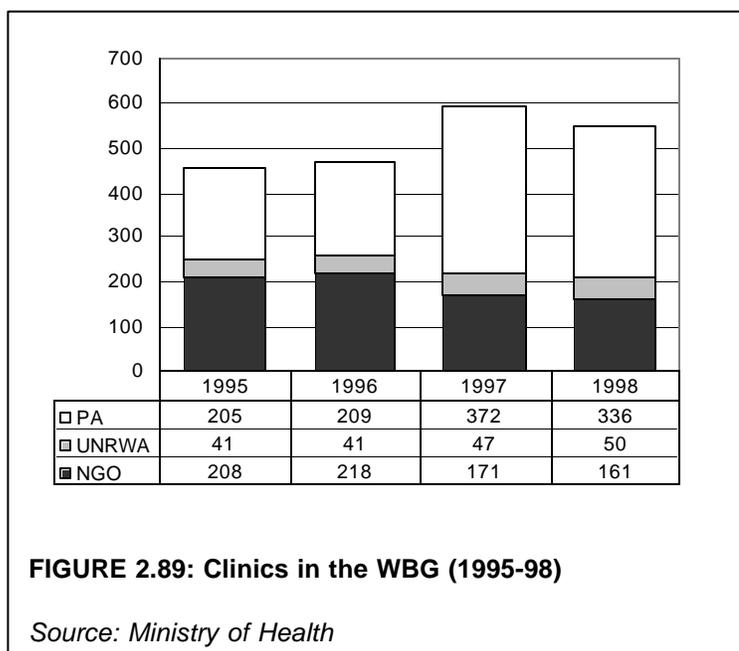
2.86. The post-secondary education system consists of 12 universities and colleges supervised by the Ministry of Higher Education. Higher education has largely been funded by external grants and tuition fees, with little central government support. Declining external support for university operating costs, however, have posed a significant challenge to post-secondary education, necessitating increased fees and other adjustments. In addition, there has been pressure from students, educators and the PLC to increase government support for universities. In many countries, state support for post-secondary education can be a significant source of bias towards higher-income groups due to their greater use of these educational resources (World Bank 1999g, 44-45). However, it is unclear how rising tuition fees might affect post-secondary educational access by lower-income Palestinians in the absence of any comprehensive system of financial support for needy students.

Health

2.87. Like the education sector, the health sector is characterized by the twin challenges of a rapidly growing population and a fragmented system of service delivery. The World Bank estimates that in 1996-97 the government sector (including health insurance outlays) and private sectors each accounted for around one-third of all health expenditures, while UNRWA, NGOs and donors each accounted for roughly one-tenth (World Bank 1998d, 11). Over the period in question, the NGO sector declined

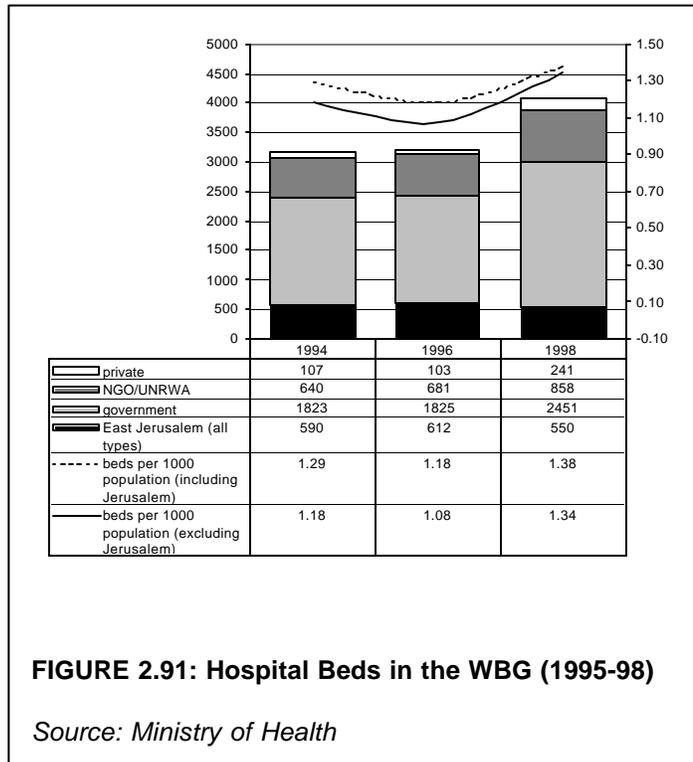
significantly as a source of health care expenditures. Total public expenditure on health averaged around 4.1 percent of GDP (3.7 percent of GNP) in 1995-97, significantly above the average of 2.3 percent for low and middle income MENA countries. However, in real terms, Ministry of Health expenditures declined by 9 percent between 1996 and 1999 (Jillison et al. 1999).

- 2.88. Between 1994 and mid-1999, donors committed some US\$353 million to the health sector, and disbursed US\$181 million in actual assistance. This pattern of support was marked by a particularly rapid drop-off in annual levels of donor disbursements, from an average of US\$42 million per year in 1994-96 to only US\$16 million in 1998.
- 2.89. In the area of *primary health care*, Ministry of Health data suggests that the number of primary health care clinics in the West Bank and Gaza (including government run clinics, non-governmental clinics and UNRWA clinics) increased by 21 percent from 454 in 1995 to 547 in 1998. The greatest increase was in the number of government clinics, which increased by 52 percent from 205 in 1995 to 336 in 1998. However, the number of non-government clinics fell by 26 percent, with this drop occurring entirely within the West Bank. NGO clinics were closed largely as a result of lack of financing (reflecting the shift in donor resources from the NGO sector to the PA) and in line with the transfer of responsibility for health services delivery from NGOs to the Ministry of Health. Overall, therefore, there was relatively little creation of new primary health care assets. During the same period, UNRWA clinics grew only slightly (see Figure 2.89). The number of clinics in the Gaza Strip rose from 70 in 1995 to 109 in 1998, while West Banks clinics increased from 384 to 438. Within the West Bank itself, growth was most notable in the districts of Jenin, Salfit and Qalqilya.
- 2.90. With regard to *secondary and tertiary health care*, the Ministry of Health's Strategic Health Plan indicates that, at the beginning of 1999, there were 38 secondary health care facilities in the West Bank (including Jerusalem facilities and the Said-Kamal Psychiatric Hospital in Bethlehem) and 13 in the Gaza Strip. During the past three years, four new governmental hospitals were built—two in the West Bank (the Jericho Hospital and the New Tulkarem Hospital) and



two in Gaza (the Gaza European Hospital and the Husni Mubarak Hospital). Together, these new facilities provide an additional 483 beds. However, the opening of the European Gaza Hospital was delayed until 2000, and not all of the beds in other facilities are operational yet. Two more hospitals are currently under construction – community-based hospitals in Yatta (Hebron) and the mid-zone of Gaza – and will add an extra 100 beds to the total.

- 2.91. During the period 1994-1998, Ministry of Health data shows that the total number of hospital beds in the WBG (excluding East Jerusalem) grew by 38 percent, from 2,570 in 1994 to 3,550 in 1998 (see Figure 2.91).¹⁰ While the rate of expansion was largest in the private sector, growth in government beds (from 1,823 to 2,451) accounted for the largest share of the aggregate increase. This has resulted in a modest improvement in the ratio of hospital beds per 1,000 population from 1.18 (1.29 including East Jerusalem) to 1.34 (1.38 including East Jerusalem). These figures, however, include the substantial number of beds that are not yet fully operational. Donors funds have provided virtually all capital investment in the government hospital sector, and hence are responsible for well over half of all new beds in the WBG.



- 2.92. In the West Bank, the total number of hospital beds grew by 15 percent from 1,645 in 1994 to 1,898 in 1998. Facilities operated by the Ministry of Health account for 61 percent of this total, down from 63 percent in 1994. The largest proportional increases in the number of hospital beds took place in Jericho, Hebron and Jenin. In Gaza, the total number of hospital beds grew by 79 percent, from 925 in 1994 to 1652 in 1998 (including non-operational beds at the Husni Mubarak and Gaza European Hospitals). Facilities operated by the Ministry of Health account for 78 percent of all beds in the WBG, down from 85 percent in 1994.
- 2.93. In examining available empirical health care indicators, several caveats are in order. First, there may be significant variation in the data, depending on the types of facilities that are counted, and whether data for East Jerusalem is included in aggregate totals. This makes

time-series analysis difficult. Second, data on the expansion of facilities may obscure underlying problems of accessibility. In some rural areas, for example, clinics are open only 1-2 days per week. And there is an over-supply of hospital facilities in some areas, and an under-supply in other areas. This is compounded by restrictions on the access to Jerusalem for most Palestinians, which constrains the contribution of East Jerusalem facilities to the overall health care system and threatens the financial viability of some of these institutions. Overall access is also constrained by the decline in Palestinian disposable incomes as well as major gaps in the current system of health insurance coverage. The marked variation in hospital bed occupancy rates points to these issues: although most government hospitals report occupancy rates of 80 percent or more, the occupancy rate in Jericho stood at 55 percent in 1998 (suggesting a oversupply of local facilities), around 60 percent in East Jerusalem (suggesting the impact of mobility restrictions), and less than 50 percent for most private/NGO hospitals (perhaps because these are not covered by government health insurance benefits) (World Bank 1998d; Jillison et al. 1999). Finally, there are a number of important issues regarding the sustainability of present capital investments. The delays in opening the Gaza European Hospital highlight the problem, with the PA Ministry of Health reluctant to assume the high operational costs of the facility .

- 2.94. The empirical data presented here on healthcare infrastructure says little about the quality of human resources in the health care sector, the appropriateness of health care provided, the allocation of PA and donor resources within the health sector, or the sustainability of current services and capital investments. Of particular note is the difference between UNRWA's model of service delivery, with its heavy emphasis on primary and preventative care, and relatively greater focus by the PA on the provision of acute care hospital facilities. This results from divergent approaches rather than any planned division-of-labor, and suggests the need for further development of a national health care strategy in the WBG which addresses the inter-relationship between different types of service and the existence of different categories of health care providers.
- 2.95. In order to achieve further progress in the health sector, it will be important to:
- review, update and redraft existing health care legislation, and develop legislation to address areas such as public health, environmental health, drug and food safety, and professional qualifications;
 - strengthen the quality and availability of health indicators so as to allow evidence-based health planning, strengthen the ability of the Ministry of Health to plan future capital investments, and improve recurrent budget management, human resource planning, and health systems management within the Ministry of Health;
 - improve coordination within the PA and among the PA, UNRWA, and NGO health care providers, and develop a comprehensive plan for the coordinated and cost-

effective delivery of UNRWA, PA, and NGO health services to the refugee population;

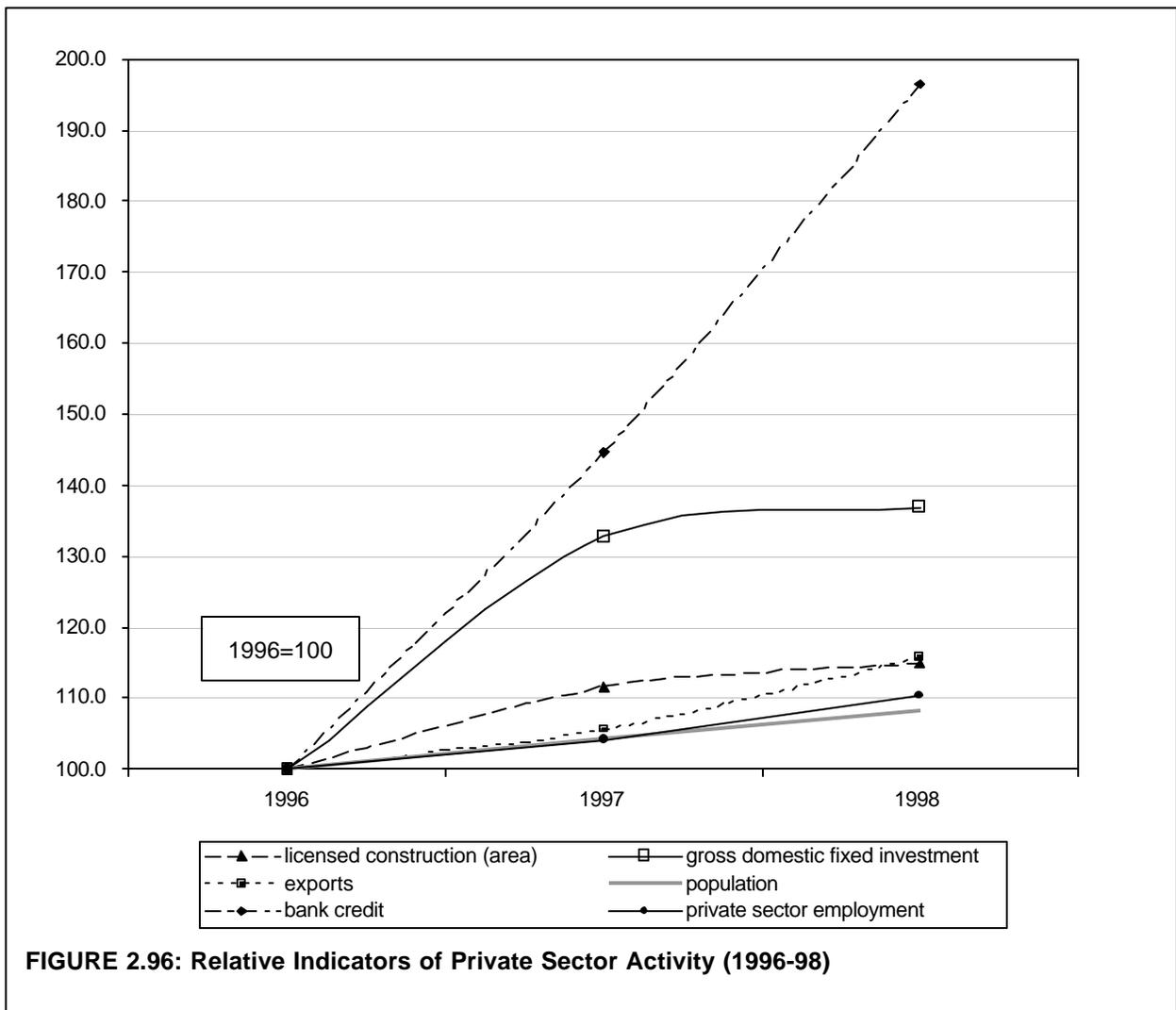
- upgrade and rationalize health care infrastructure based on national and regional planning and improved coordination among public, private, and NGO health care providers, with particular attention to strengthening public health, primary health care, women's health, and family planning programs, and develop critical ancillary services including a national blood supply system, emergency services, and high-quality laboratory facilities;
- strengthen quality controls as they relate to personnel, facilities, and service delivery, and address potential problems of pharmaceutical overuse and patient compliance.

Some further discussion of these issues is offered in Section 3 of the aid effectiveness study, which reports the views of health care consumers on the existing health care system. Section 4 of the aid effectiveness also highlights some key issues of sustainability. A much fuller analysis of the sector, however, can be found in the World Bank study *West Bank and Gaza: Medium-Term Development Strategy for the Health Sector* (1998d).

Encouraging Private Sector Growth

- 2.96. Private sector investment and strong private sector growth are fundamental requirements of sustainable development in the WBG. In their absence, there will be inadequate employment for the rapidly expanding labor force (resulting in declining household incomes) and insufficient growth in fiscal revenues to sustain the current level of government services. Since 1994, the Palestinian private sector has faced a number of external shocks and restrictions that have undercut both profitability and competitiveness. Some of these conditions have eased since 1996, however, creating somewhat more favorable economic conditions for investment and business expansion (Figure 2.96). Preliminary analysis of key indicators for 1999 suggests a stagnation of Palestinian exports and construction activity. However, modest growth is evident in bank credit, the registration of new (generally small) companies, and the value of projects approved under the Palestinian Law for the Encouragement of Investment (UNSCO 1999d, 8-9).
- 2.97. Donor support for private sector growth has taken a variety of forms, including: infrastructure programs intended to provide a more attractive environment for private sector activity; risk insurance, loan guarantees, credits, and other forms of donor financing for investment activities; support for local microcredit programs; technical support for reform of the financial services sector; technical assistance in legal and regulatory reform; and the provision of equipment, technical assistance and policy advice to Palestinian ministries and other economic institutions. Growing donor recognition of the importance of encouraging private sector growth is evidenced by the level of

disbursements in this area, which (unlike the social sectors) have grown rather than declined over time, from US\$31 million in 1996 to US\$49 million in 1998.¹¹



2.98. It is difficult to quantify progress in this area for several reasons. First, while donor support is substantial, it is small relative to the much larger fluctuations experienced by the Palestinian economy since 1993. This fact, and the relatively short time frame, make it impossible to separate the aggregate (positive) effects of donor assistance from the (negative) effects of other political and economic developments. Second, because donor programs to support private sector activity vary so much in focus and format, it is difficult to assess their effects other than through detailed case studies, for example.

2.99. It is possible, however, to point to areas where close cooperation between donors and the Palestinian Authority has enabled major activities to be undertaken. One example is the

Gaza Industrial Estate (Box 2.99). Another case is the Bethlehem 2000 project, in which multiple donors have contributed to the renovation of Bethlehem and its transport and tourist facilities in anticipation of millennial celebrations in the city. Both projects illustrate the many elements that must be put into place to establish an environment to foster private sector activity. In the case of the Gaza Industrial Estate, implementation was long delayed by the need for PA and Israeli agreement on security and site access. There was also a need to establish an appropriate regulatory setting, as well as to construct the required local infrastructure (in partnership with the private sector). And in the case of Bethlehem 2000, highly politicized issues of access emerged. Experience to date points to the need to coordinate the activities of multiple donors, various ministries, local government units, private sector interests and religious authorities.

BOX 2.99: Gaza Industrial Estate

The establishment of the Gaza Industrial Estate, on a 50 hectare site at al-Muntar, is the first largely export-oriented industrial zone or "estate", established as a means of generating sustainable employment and stimulating industrial development in Gaza. The legal and regulatory regime for industrial and free zones in the WBG is designed to attract investors, and the investment law was revised to enhance the protection afforded to investors and strengthen the incentive package. The GIE Project is expected to play a key role in attracting foreign and local investment, and to facilitate joint ventures and other models of cooperation and confidence building.

The GIE, managed and operated by a private sector company, Palestine Industrial Estate Development and Management Company (PIEDCO) is being developed in three phases. Some 34 firms had leased space at the GIE by the end of 1999, filling all space available under phase I. Of these, 14 firms are already operating, and currently employ some 500 people, plus another 200 or so occasional workers. PIEDCO is planning to launch Phase II construction shortly to double the number of available industrial sites. At full capacity, the GIE could create up to 20,000 permanent jobs on about 110 industrial plots, with a further 30,000 jobs created indirectly for services and associated manufacturing operations.

GIE has been supported by the World Bank, IFC, EIB and USAID, together with a long-term lease on the land from the PA.

- 2.100. Donors have supported a number of large external investment, loan guarantee, and risk insurance funds, whether to support local Palestinian investment or encourage outside investment. Many of these programs, however, were initially hampered by institutional procedures and commercial standards that were poorly suited to the uncertain economic environment of the WBG. According to MOPIC data, despite approximately half a billion dollars in offered support, virtually none of these monies were disbursed in support of private sector investment in 1994, 1995 or 1996. Thereafter, however, improvements in commercial circumstances in the WBG resulted in greater donor activity. Aggregate loan disbursements of these types (including initiatives by the European Investment Bank, the International Finance Corporation, the Multilateral Investment Guarantee Agency, and the Overseas Private Investment Corporation) grew to US\$3.7 million in 1997, US\$9.4 million in 1998, and US\$8.4 million in the first half of 1999.

- 2.101. At the other end of the spectrum, more than a half dozen micro-credit and other small business programs operated by UNRWA and various NGOs have “continued to play an important role in the Palestinian credit market” (UNSCO 1999d, 12-13). In the first half of 1999, these disbursed some US\$15 million in loans. Although this represents less than 2 percent of commercial Bank loans in the same period, these programs typically focus on the poor, who otherwise have little access to credit and the entrepreneurial prospects it represents. Somewhat larger loan programs, such as that operated by the Palestinian Development Fund (Box 2.101), aim to meet some of the needs of small and medium enterprises for consultancy services and financing. In all of these areas, the NGO sector has an important role to play alongside initiatives to facilitate private sector development.

BOX 2.101: Supporting Small and Medium Scale Business

The Palestinian Development Fund (PDF) is an example of the role that non-profit and NGO initiatives can play in promoting private sector development. The PDF was established in August 1996 following the merger of three existing small-scale credit agencies—the Arab Development and Credit Company, the Economic Development Group, and the Arab Technical and Development Corporation. PDF’s activities support the small-scale private sector in the WBG—a category applicable to more than 90 percent of all industrial establishments—through advice, services, and the provision of medium-term loans which are not generally available from the commercial banking system. To date, the PDF has provided 1,824 loans with an average value of US\$15,653, through which approximately 5,000 new jobs have been created. The PDF has succeeded in overcoming the historical problem in small-scale lending—low repayment rates as a result of the perception of small-scale credit as a charitable donation rather than a commercial loan. Repayment rates at the three founding institutions were historically low, but the PDF is now achieving dramatically improved rates of around 97 percent.

Not only does the PDF fill a vacuum in the financial market, but it also sets a precedent in small-scale finance and aims to establish the first development bank in Palestine. It has signed a memorandum of understanding with the Cyprus Development Bank to work together in developing the PDF’s human resources and joint lending and investment activities. It has also applied for a banking license from the Palestine Monetary Authority.

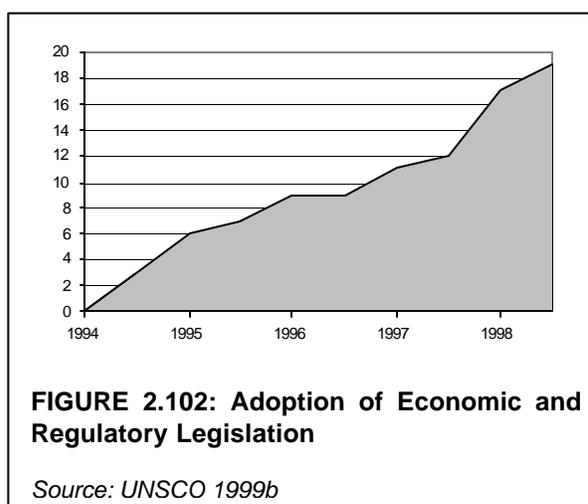
The PDF operates as a non-profit private sector entity with a transparent corporate structure and professional management procedures. The funding of PDF’s three founding credit agencies was provided by various donors, the majority from the European Union in the form of grants. Part of the funding provided by the EU was recently converted to equity in a foundation to form part of the PDF’s initial capital. The Euro-Palestinian Foundation is a Cyprus-registered offshore charitable foundation which holds 98.8 percent of the PDF’s US\$20 million of paid-up capital. The remainder is held by the 40 trustees of the three original credit agencies. The PDF recently signed an agreement with the European Investment Bank under which the EIB will take a euro 2 million direct equity participation in the PDF’s share capital once it gains fully approved ‘bank’ status.

- 2.102. One particularly important area where it is easier to measure progress is that of legal and regulatory reform. An appropriate legal environment—characterized by modern commercial legislation, a transparent and appropriate regulatory regime, and the rule of law—is essential for encouraging both local and external investment. The challenge in this area has been severe, given the complex legal legacy in the West Bank and Gaza, comprising a mix of Israeli, Egyptian, Jordanian, British, and Ottoman regulations. One indication of progress is illustrated by Figure 2.102, which shows the cumulative number

of economic laws and regulatory instruments adopted between mid-1994 and mid-1999. As the recent Council on Foreign Relations study on *Strengthening Palestinian Institutions* notes:

[T]he relevant [economic] ministries have made a significant contribution to drafting new laws and revising existing ones to modernize and stimulate the Palestinian economy. Already in effect are the Laws for the Monetary Authority, Encouragement of Investment, and Condominiums. Others in draft form or awaiting promulgation, with the assistance of international institutions and donors, include laws on income tax, company registration, banking, insurance, investment, offshore companies, securities, secured lending and leasing, arbitration, industrial zones, commercial agency, accounting and auditing, pensions, labor, and intellectual property. Many of these are in advanced stages of preparation, and some are ready for promulgation (CFR 1999).

Of even greater importance is the effectiveness, rather than the number, of these new laws. Donors have been central in providing policy advice and technical assistance, helping the PA to identify regulatory shortcomings and redress these through new or revised legal instruments. Donor input, for example, led the PA to redress weaknesses in its initial Law for the Encouragement of Investment. However, persistent weaknesses in the judicial system may undermine much of this progress if enforcement is haphazard or if perceptions of bias or irregularity in legal proceedings are widespread.



2.103. The tasks facing the donor community in fostering an improved climate for Palestinian private sector development remain significant.

- It is essential to improve the clarity, transparency, and predictability of the legal environment. This will require further improvement in the quality of commercial law; eventual harmonization of the legal system across the West Bank and Gaza; building the efficacy and capacity of the judicial system; and initiating efforts to assure the neutrality of judicial and enforcement institutions. Furthermore, several new regulatory institutions (e.g., a securities and exchange commission and an insurance controller) must be established or strengthened to protect the integrity of market transactions.

- One key measure to make donor assistance more effective would be to develop, in partnership with the PA and Palestinian private sector, a suitable strategic framework for activities in support of private sector development. The PA's ability to do this is still hampered by an unclear allocation of responsibility across ministries, however (see Box 2.103). The absence of such a framework creates a risk that individual donor initiatives are poorly coordinated, fail to build on potential synergies, or even work at cross purposes. In the financial services sector, for example, donor-supported credit programs might compete with—and undercut—concurrent efforts to strengthen and modify the behavior of existing lending institutions.
- Finally, the murky, privileged relationship between some (quasi-public, quasi-private) commercial enterprises and the Palestinian Authority may prove to be the most dangerous long-term challenge to private sector development in the West Bank and Gaza. While these enterprises are often referred to as the “monopolies,” the underlying concern is not one of classic monopoly behavior *per se*, but rather that their special status results in unfair competition, market distortion, restrictions on trade, and lack of transparency. This is further compounded by weaknesses in the judicial system and security services, giving rise to perceptions of corruption, coercion, and official bias. The result may be an increasingly widespread perception of the private sector as an “uneven playing-field” favoring some economic actors over others. In light of the natural unwillingness of the private sector to risk resources in an uncertain and unfair business environment, as well as competing investment opportunities elsewhere in the regional and global marketplace, a consolidation of this situation would diminish the amount of private capital invested in the Palestinian economy, thereby precluding future growth.

BOX 2.103: Public Institutions and Private Sector Development

In its discussion of commercial regulation, development planning and economic policy-making, the report on *Strengthening Palestinian Institutions* places considerable emphasis on increasing the coherence of Palestinian institutions in this area. Specifically, it reports:

Industrial and foreign investment, export promotion, and employment policies are fragmented among various ministries, to mention a few examples. The problem is compounded by the absence of effective, formal mechanisms for consultation, coordination, and collaboration. Similarly, sectoral working groups or strategies are also either absent or inadequate, and clustering of ministries and agencies is urgently needed.

Duplication, fragmentation, and inadequate coordination also lead to unproductive competition, conflict, and waste of resources. This is additionally worrisome in light of the shortage of qualified personnel in certain categories, leading to a mismatch of staff and jobs in some cases and to overstaffing and understaffing in others.

To exemplify the extent of duplication, at present the Ministry of Economy and Trade and the Ministry of Supply both regulate internal markets, while the Ministry of Economy and Trade and the Ministry of Justice both register companies. There is also considerable overlap between the Ministry of Economy and Trade and the Ministry of Planning and International Cooperation with respect to planning.

Source: CFR 1999

The need for continuing reform in all of these areas underscores that policy dialogue—specifically, the provision of ideas, and not simply a supply of donor money—is centrally important to effective development assistance in the WBG, as elsewhere. These issues are explored in more detail in Section 5 of this study.

Institutional Development

2.104. Development of Palestinian institutions of self-governance has benefited from several factors: an educated and literate labor force, a rich and vibrant network of associational groups within civil society, and substantial donor engagement and support. The Palestinian Authority, however, has also faced the monumental task of transforming a nationalist movement into a functioning political administration. It has done so, moreover, amidst a highly variable and complex economic and political environment in which both Palestinian territorial authority and the nature of policy instruments available to the PA have been defined and redefined by a series of transitional agreements with Israel. Territorial fragmentation and mobility restrictions represent further constraints to smooth institutional development. Any attempt to measure progress in this area must fairly reflect the constraints as well as the opportunities. As noted in the *Strengthening Palestinian Institutions* report (CFR 1999):

The Palestinian Authority should be measured against performance in the real world, not an ideal one. It has achieved levels of service delivery, revenue mobilization, financial accountability, and utilization of international assistance that are at least commensurate with, and in some aspects exceed, those in countries of comparable development and income. Recent data show an upward trend in key social and economic indicators. Because these important achievements tend to be overlooked in reports such as ours that focus on remedial action, they deserve special emphasis.

2.105. At the same time—as the *Strengthening Palestinian Institutions* report also notes—“much remains to be done.” A number of reforms can be undertaken to improve the accountability, transparency and efficacy of key Palestinian public institutions (CFR 1999). Internal coordination within the PA could be strengthened, replacing the competition that currently exists (Box 2.105). Moreover, as the World Bank’s report on *Strengthening Public Sector Management* (World Bank 1999g) makes clear, rapid growth of Palestinian public sector employment, the need to develop more effective systems of budget management and service delivery, and the importance of reform in the system of local government and utilities pose additional challenges. Discussions around the Comprehensive Development Framework have highlighted the 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;

BOX 2.105: Promoting Institutional Synergy—Not Competition

Rural infrastructure development is just one area where institutional cooperation and synergy is important. Ideally, MOPIC would play the central role in developing Palestinian priorities (in conjunction with, and with input from, the relevant ministries) and presenting these to the donor community. The Palestinian Development Plan and Comprehensive Development Framework would be used to assure strategic direction and to guarantee horizontal linkages with other development initiatives. The Ministry of Finance would be the conduit through which donor assistance would flow, and would monitor financial transparency. The Ministry of Local Government would facilitate the involvement of local government units, assuming a role in zoning and planning, but not acting as an implementor. Sectoral ministries and agencies (such as the Palestinian Water Authority or the Ministry of Agriculture) would play a key role in the identification and technical appraisal of needs, defining the technical content of programs and projects, and providing similar specialized inputs. In many projects, PECDAR might act as a tendering, supervision and financial management institution, but would neither be the initial recipient of donor funds (the role of the Ministry of Finance) nor play a role in setting priorities (the function of the Ministries and specialized agencies).

In practice, however, it usually does not work like this. Ministries wish to implement; PECDAR wishes to be a ministry; MOPIC faces challenges in securing input and coordinating the PA; line ministries and specialized agencies wish to be coordinator but have less desire to be coordinated. Program and project leadership is unclear, and control over project finance may then become the lever used to influence policy and project design. Compounding all of this, donors may act in ways that exacerbate rather than reduce these bureaucratic frictions and inefficiencies. In these areas as in so many others, increasing the effectiveness of donor aid requires appropriate reform of the institutional setting in which Palestinian development decisions are made and implemented.

- 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;
- more effectively link training to institutional needs.

2.106. Within the PA, the Higher National Committee for Institutional Development has identified, and pledges to address, some of these issues. Failure to do so will have serious long-term consequences for both economic development and public confidence in government. As shown in Section 3 of this study, opinion surveys suggest that ordinary Palestinians already expect higher degrees of accountability, transparency, and performance from key public institutions.

2.107. Donors have played a key role in supporting Palestinian institution-building. Donor assistance for transitional costs and budget support was of fundamental importance during 1994-96. Without such support, it is difficult to see how a functioning administration could have been established in this early, critical period. The mechanism used to transmit such assistance, the Johan Jørgen Holst Peace Fund, disbursed some US\$254 million between 1994 and mid-1999, and is now widely seen as a model for

other peacebuilding contexts. According to MOPIC data, donors also committed some US\$611 million for institution-building between 1994 and mid-1999, and disbursed US\$257 million (Box 2.107). Focusing solely on projects that support legal reform and the rule of law, a May 1999 UNSCO survey found that more than US\$100 million in donor support had been committed to 322 past, current, or planned activities, involving no less than twenty-four donors and thirteen multilateral agencies, together with a broad range of Palestinian and international NGOs (UNSCO 1999b, 11).

BOX 2.107: UN Contributions to Palestinian Institution-Building

At least fourteen UN agencies have programs that contribute to Palestinian institution-building. The largest of these is the United Nations Development Programme and its Programme of Assistance to the Palestinian People. The Governance and Public Sector Unit at UNDP/PAPP was established in 1995 with a focus on providing technical and capital assistance to the fledgling Palestinian Authority. At the time, basic infrastructure needs, such as equipment, vehicles and rehabilitating facilities, were in demand by every ministry, a unique situation in which UNDP/PAPP was able to respond and provide assistance.

In late 1996, the Governance and Public Administration Support Programme was launched to improve managerial and administrative capacities of the Palestinian Authority. Financed by a \$2 million grant from Japan and \$750,000 from UNDP resources, the initiative focused on providing support to core institutions working in the area of public administration and building the capacity of line ministries. Today, UNDP/PAPP continues its capacity building efforts in the area of public administration as well as supporting the institutional development of the Palestinian Legislative Council and the judiciary.

UNDP's TOKTEN (Transfer of Knowledge Through Expatriate Nationals) program supports short- and medium-term assignments by Palestinian expatriates to Palestinian ministries. By April 1999, TOKTEN had enabled some 147 persons with specialist knowledge to join more than thirty PA ministries, agencies, municipalities, and research institutions on assignments ranging from one month to a year (UNDP 1999).

2.108. Clearly, reform requires political will, technical expertise, and donor support. In assessing the effectiveness of the latter, however, it is important not to view the aggregate level of disbursements or projects as an indicator of success in and of itself. Donor support may serve to aggravate, as well as ameliorate, problems of institutional weakness. Inappropriate forms of support may divert resources from other important areas. Poorly conceived projects may create short-term donor-supported institutions, capacities and staff positions that are unsustainable in the long term. Poor coordination among a multitude of donors may encourage institutional fragmentation. Finally, institutional development strategies may be shaped by the lure of donor resources rather than by objective institutional needs of recipient organizations. To date, most reports have focused almost entirely on what the Palestinian Authority needs to do to promote further, and more effective, institutional development. While this is certainly an appropriate concern, it is important to identify what donors can (or should not) do to facilitate this. Consequently, in Section 5 of this study, issues of policy dialogue, partnership, and the role of technical assistance are explored in greater detail, with particular attention to the interaction between donors and the PA, the focus and direction of reform efforts, and the future role of donor assistance.

2.109. Lastly, any assessment of institutional development must also devote suitable attention to the NGO sector. Comparative research suggests that the vibrancy of civil society and civil liberties has a strong positive relationship to the success of development projects, especially when beneficiaries are actively engaged in project design and implementation (World Bank 1998a, 87). Historically, NGOs have been an important component of the development effort in the WBG. They continue to be central, despite a general reduction in levels of donor support since the early 1990s. As noted earlier, NGOs provide a significant share of education, health, and other social services, and are active in a range of other key areas, from private sector development (through technical advice and small-scale credit) to human rights advocacy. In many cases—such as that of the Women’s Affairs Technical Committee—they play an important and energetic role in facilitating new ideas, analysis, networking, and social advocacy (Box 2.109). It is therefore crucial that the NGO sector attract suitable levels of donor assistance. It is equally important that a political and regulatory environment be established in the WBG that is conducive to NGO activities. There are some worrying signs in this area, however (discussed in Section 3), especially with regard to the public “space” within which NGOs can freely operate.

BOX 2.109: The Women’s Affairs Technical Committee

The Women’s Affairs Technical Committee (WATC) represents an excellent example of an NGO that, through its activities, enhances the range of information and analysis available to public institutions in the WBG. WATC was established in 1992 as a semi-official coalition of affiliated women’s organizations, institutions, and independent professional women, with the aim of providing input on women’s issues into Palestinian policy planning. At the outset it operated on a voluntary basis, but now employs a director and administrative staff. In 1998, WATC’s total expenditure amounted to US\$846,589 and was drawn from 23 different funding sources.

Since 1992, the organization has gained greater independence. It has also achieved some success in lobbying for more rights for Palestinian women, training women in various skills, networking with other (local, regional and international) women’s institutions, and undertaking public education on gender issues. The WATC monitors the drafting of new laws and regulations to ensure that women’s concerns are accounted for, and is currently working on the draft of the Family Law. The WATC also promotes women’s political participation, both as voters and candidates. Most notably, the WATC has been successful in pushing for gender-aware changes in emerging national regulations. In 1997, the WATC lobbied the PLC to modify newly-issued legislation that required all Palestinian women applying for a passport to obtain the permission of a male relative. At the grassroots level, its female education sponsorship scheme assists low income families in educating female household members.

WATC’s strength lies in its resource base. The nature of the coalition—which combines a group of already well-established political and community bodies with broad-reaching mandates, representation, and popular credibility—allows the organization to build on existing networks and resources. Since most board members represent an organization, the meetings serve to exchange information and engage in strategic planning.

WATC has established itself as a major force in protecting and promoting women’s rights, notably among the national legislative institutions where men predominate. WATC unites experienced professional Palestinian women who have established track records in policy advocacy, and targets the collective goals of its member organizations. WATC has also strengthened its institutional presence—increasingly important in what is a highly politicized environment—by creating a network with other international NGOs with similar mandates.

Conclusions

- 2.110. *Despite many challenges*—a highly dynamic political environment, complex legal and territorial arrangements, underdeveloped local infrastructure, severe external economic shocks, the need to establish many Palestinian public institutions from scratch, and the difficulties of coordinating the efforts of scores of donors and international organizations—*the development effort in the West Bank and Gaza has had many substantial positive effects*. Donor assistance played a key role both in establishing the PA and in offsetting economic decline in the WBG in the first few years of the peace process. Today, it makes a significant contribution to the modest economic growth that the territories have experienced. Moreover, the various improvements associated with donor assistance—whether improvements in electricity supply, the quality of piped water, rehabilitation of the road network, extension of liquid and solid waste facilities, or other activities—have touched the daily lives of most Palestinians, despite the general difficulties of the WBG economy.
- 2.111. In spite of the successes, however, many tasks remain. As donors and the PA look to the economic future, several areas emerge as development priorities.
- 2.112. There is still room for improvement in donor aid coordination and Palestinian development planning. This is not to say, of course, that there hasn't been substantial progress; there has, and several mechanisms used to guide the development process in the WBG may prove to be models for other peacebuilding efforts. Nevertheless, donor coordination could be improved by assuming a more strategic character. More robust and sophisticated development planning by the PA would provide a comprehensive vision around which donors could organize their efforts. Local ownership of the development process is a key to good development programming, in the WBG as elsewhere.
- 2.113. On the Palestinian side, accountable, transparent, and effective public institutions emerge as fundamentally important. There have been many successes here, often supported with donor assistance. There are also grounds for concern, however, and certainly room for continued improvement. 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 will address some of this. However, the reform process must also address the unhealthy relationship that exists between some commercial enterprises and the PA, a relationship which undermines accountability, obscures transparency, and erodes private sector confidence.
- 2.114. On the donor side, the observed slow-down in donor assistance in 1998-99 raises concerns. Any growth in the gap between donor pledges, commitments, and disbursements undermines the credibility of the donor community even as it presses the PA to undertake reform of its own policy processes. It also severely complicates the

process of Palestinian economic planning and hampers development efforts on the ground.

- 2.115. The importance of a vibrant NGO sector to Palestinian development is also underscored by this report. Both the PA and donors have important roles to play in assuring a supportive political-regulatory environment and an adequate level of funding for NGO initiatives.
- 2.116. Finally, Section 2 of this study underscores the need to examine “aid effectiveness” not only from the perspective of macroeconomic effects, donor disbursement levels, or the facilities and other physical assets established. Since the laying of another kilometer of road, water pipe, or electrical transmission line is not a large achievement in and of itself, but only insofar as it positively affects the lives and economic prospects of Palestinians, it is also important to determine how beneficiaries themselves view the impact of donor assistance. The benefits of donor assistance, moreover, will prove to be transitory if inadequate attention is paid to the sustainability of development initiatives. Finally, as stressed in the preceding sectoral examination, progress requires not only physical infrastructure but also the appropriate policy environment. Each of these topics—beneficiary assessments, sustainability, and policy dialogue—are examined in greater detail in the remaining sections of the report.

SECTION 2: NOTES

¹ The National Commission for Poverty Alleviation (1998) defined the poverty line in 1997 at a monthly income of NIS418 for an individual, or NIS1390 for a family of 6.

² Figure 2.20 uses PCBS estimates of mid-year 1997 WBG population, and MOPIC data on 1997 donor disbursements. DAC data shows a lower (1996) population and a higher (1997) level of disbursements, resulting in a figure of US\$289 for per capita WBG ODA receipts. Data does not include military assistance.

³ The category “productive sectors” includes MOPIC’s agriculture, industrial development, private sector, productive sector, and tourism sectors; “human resources” includes health, education, detainees, social development and humanitarian aid; “institutional development” includes institutional development, democracy, legal affairs and police; and “infrastructure” includes energy, environment, housing, infrastructure, solid waste, telecommunications, transport, and water and sanitation.

⁴ Periodically, MOPIC data has been subject to substantial revision: whereas the August 1999 donor matrices showed 1998 donor disbursements at \$330 million, this number had been changed to \$409 million by February 2000. Such unreliability weakens the credibility of the Palestinian Authority when it raises the issue of donor disbursements, and undercuts efforts to examine trends in donor support. Of course, part of the reason for errors in MOPIC data lies with donors who fail to review and correct information contained in previous matrices or to update MOPIC on the status of projects.

⁵ Figure 2.32 is based on the MOPIC donor matrices of August 23, 1999.

⁶ Data is derived from DAC 1999, adjusted using the deflators for DAC members. MOPIC disbursement figures differ from those provided by DAC. Using MOPIC data, aid to the WBG increased from 0.84 percent (1994) to 0.97 percent (1997) of global ODA.

⁷ The decline in EU disbursements in 1998-99 has been partially offset by an increase in European Investment Bank disbursements, which increased from zero disbursements in 1996-97 to \$33.6 million in 1998-99. EIB assistance is loan- rather than grant-based, however, and its concessional component is much smaller.

⁸ MOPIC data on donor disbursements is subject to ongoing historical revision (most notably the 1998 donor disbursements), and at times there are minor discrepancies in the aggregate totals provided in MOPIC donor matrices. There is also a lack of clear definitions and consistency between MOPIC data and other data released by the PA, notably budget figures. MOPIC data cannot be easily disaggregated into current and capital expenditures. Capital expenditures could be taken to be the sum of disbursements for public investment, equipment and in-kind (the same definition used by the IMF and Palestinian Monetary Authority). However, the figures obtained this way do not match those in the PA’s fiscal accounts. In 1998, for example, the Ministry of Finance reported donor-financed capital expenditures equal to US\$330 million, whereas the MOPIC classification yields US\$290 million. In 1999 the MOPIC figures actually exceed the fiscal account figures, such that the donor share of PA capital expenditure is over 100 percent.

Since donors finance practically all public investments in the WBG, the solution adopted in Figures 2.39 and 2.43 is to use the fiscal account figures for capital expenditures and determine current expenditures as the residual (i.e., the difference between MOPIC’s data for total disbursements and the fiscal account data for capital expenditures). It should be noted, however, that weaknesses in the fiscal accounts data arise as well.

⁹ The “no closure” scenario illustrates the *immediate impact on WBG’s GNP through lost labor income* on the part of Palestinians working in Israel. The calculations take as a starting point the situation in 1992, before the closure policy was brought into use. For the years 1993-98, it is assumed that Palestinian employment in Israel, in the absence of closures, would have evolved according to Israeli demand for labor in the sectors that employ Palestinian workers, notably the construction sector, which absorbed about 70 percent of Palestinians working in Israel in 1992. The resulting “counter-factual” number of Palestinians working in Israel is then used, together with average daily

wages (from PCBS Labor Force Surveys) in the relevant sectors, to calculate the total income Palestinian workers would have earned in the absence of closures.

For a number of reasons the figures in the “no closure” scenario most likely *underestimate* the losses due to closures. First, the calculations consider only the direct income effect but ignore the “multiplier effect”, i.e., the effect arising from reduced demand within the Palestinian economy due to lower incomes from Israel. Second, the impact on WBG trade vis-à-vis Israel is not taken into account. If closures lead to permanent loss in Palestinian market share in Israeli markets, the long-term effect can be significant. Third, closures reduce the expected return on investments and create a general sense of uncertainty which undoubtedly has reduced private investment.

The “no aid” scenario is constructed using a somewhat different methodology than the “no closures” scenario, recognizing that a major aim of donor assistance is to *augment the productive capacity* of the WBG economy. The calculation takes as a starting point a standard Cobb-Douglas production function in which output is produced using a combination of labor and capital inputs. Given this macro production function, it can be shown that annual growth in output is determined by the investment rate as well as population and productivity growth and the rate of depreciation of capital, as long as the economy has not yet reached its long-run equilibrium. Since donor assistance directly increases the investment rate of the WBG economy (almost all public investment in the WBG since 1993 has been donor-financed), the relationship between the growth rate and the investment rate can be used to derive the growth rate in the absence of donor assistance.

The methodology used in the “no aid” scenario implicitly assumes that private and public capital are equally productive and that all donor assistance would have augmented the stock of productive capital in the WBG economy, the latter probably being an optimistic assumption. The growth estimates in the “no aid” scenario undoubtedly *underestimate* the impact of donor assistance on GNP.

Because the methodology used to construct the two counterfactual scenarios is quite different, comparing the two requires caution.

¹⁰ UNRWA beds are counted together with NGO beds in the data supplied by the Ministry of Health.

¹¹ This total includes MOPIC’s agriculture, industrial development, private sector, productive sector, and tourism sectors.