

## DONORS, AID, AND POLICY REFORM

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- 5.1. Thus far, the aid effectiveness report has examined the flow of financial resources from the international donor community to the West Bank and Gaza, and the various sectoral impacts associated with this assistance. These outcomes suggest that there have been both serious challenges and significant gains since 1993-94. In some areas, donor assistance has had many beneficial effects—in terms of measurable outputs and supported by perceptions of improved quality of life. In other areas, immediate effects are less evident, either because the assistance program is still relatively young, or because of the various political, economic and operational challenges of supporting development in the WBG. But in still other areas, there are clear warning signs that more needs to be done, or that efforts need to be undertaken in new ways.
- 5.2. This type of assessment of the development effort—while important—paints only part of the picture, however. Promoting economic development is not a mechanistic process whereby disbursements automatically result in positive achievements, or wherein the cumulative result of individual, short-term donor initiatives is long-term social progress. Promoting development requires more than simply setting up new facilities and programs; it also requires putting in place the policies, institutions, and human resources that can sustain long-term economic growth and social development.
- 5.3. Establishing an appropriate institutional setting for development efforts is now widely recognized to be fundamental to effective and sustainable economic growth. On average, economic growth rates are twice as high in countries with effective government institutions as in those with weak institutions. Moreover, the particular impact of donor assistance is heavily dependent on having appropriate economic policies and effective administrative institutions in place. In the presence of such policies and institutions, development assistance equal to 1 percent of GDP typically produces a sustained increase of 0.5 percent in GDP growth rates, reduces poverty by 1 percent, and increases private investment by 1.9 percent. By contrast, in the absence of good policies and effective institutions, aid has little or no effect on long-term economic growth, and negative effects on private investment (World Bank 1998a). Moreover, large amounts of aid in this context can serve to insulate governments from the costs of their own shortcomings, in effect slowing rather than facilitating the pace of needed reforms.
- 5.4. In short, getting policies and institutions “right” is essential, for the Palestinian Authority as for any other government around the world. For donors, promoting policy and

institutional reform is equally important, for it largely determines whether assistance efforts will be successful in the long term. For both the PA and donors, the evidence of institutional weakness, continuing problems of accountability and transparency, and obstacles to social capital formation highlighted in Sections 2 and 3 represent worrisome developments. Addressing these issues is vital to maintaining public confidence in PA institutions, maximizing the ability of donor investments to improve the everyday lives of Palestinians, enhancing the capacity of Palestinians to determine their own future, and laying solid foundations for future social and economic development.

### The Context and Impetus for Reform

5.5. Given the importance of institutions and policy to sustainable development in the WBG, it is useful to ask what sorts of conditions are likely to hasten—or slow—the pace of reform efforts. Recent comparative research by the World Bank (1999a) underscores the following points.

- The primary impetus behind institutional and policy reform is rooted in *the domestic political economy*. Although economic crisis does not necessarily result in reform, economic need is a major contributor to reform efforts.
- *Ideology* may be a source of resistance to reform, or may condition the types of reforms that governments are willing to undertake.
- Of greater importance, however, is the role played by various *stakeholders*: that is, the institutions, vested interests, and various political/economic constituencies who comprise the “winners” and “losers” in the reform process. The existence of a cadre of *pro-reform technocrats* can be an important part of the picture.
- Perhaps most important of all is the role of *political leadership*. In the absence of this, there is little prospect of meaningful change.

In light of these determinant factors, what can be said about the context and impetus for reform in the WBG? The picture that emerges is mixed, but the underlying potential for reform is substantial.

### *The Domestic Political Economy*

5.6. The need and prospects for reform in the WBG have been conditioned, in the first instance, by the inherited legacies of occupation. The existing legal environment within which any reform must take place is extremely complex, comprising an awkward mix of Israeli military regulations, Jordanian and Egyptian law (in the West Bank and Gaza respectively), British Mandatory regulations, and even former Ottoman legal provisions, together with new legislation and regulations introduced by the PA, and the general framework for Palestinian self-government set by the various interim agreements. At the

time the PA was first established, the only relatively well-developed administrative institutions within the former Israeli Civil Administration were those involved in the delivery of health and especially education services. Various Palestinian NGOs also played key roles in service delivery, and since 1994 have had to adapt their operations to the newly-established responsibilities of the Palestinian Authority. Prior to 1994, there was little economic development policy *per se*; public investment budgets were low, and there was no systematic effort or strategy to promote the productive sectors of the economy. While the Palestinian economy experienced substantial growth in the 1970s, much of this was fuelled by the inflow of exogenous resources, namely the earnings of Palestinian laborers in Israel or remittances from Palestinian migrant labor in the oil-producing countries of the region. The task of designing, from scratch, the policies and institutions necessary to promote economic growth has been daunting, even more so given the dynamic political and economic environment in which Palestinian decision-makers necessarily operate.

- 5.7. On the other hand, the absence of any preexisting policy environment can also be seen as an advantage. The West Bank and Gaza—unlike most other developing economies—occupy an unusual position to start fresh, avoiding the policy errors that others have made. The absence of a prior policy framework means that there are fewer vested interests embedded in the status quo. The PA has a valuable opportunity to learn from the experiences of others, utilize the policy advice and other support offered by the international community, and design the “right” policies and institutions from the outset.
- 5.8. In the Palestinian case, a variety of economic challenges collectively provide a strong motivation for reform. Economic stagnation in the first years of the peace process, coupled with demographic growth and the consequent expansion of the labor force, has made it imperative to stimulate private sector growth. Failure to do so will risk deterioration in existing unemployment rates. The sharp decline in donor support for the PA’s recurrent expenditures, and the resulting need to balance the recurrent budget, provide good reason for strengthening fiscal management. Indeed, it is no accident that some of the most impressive institutional development within the PA has occurred in the area of resource mobilization. The imposing challenges of future permanent status arrangements provide even greater urgency for continued reform. So, too, should concerns of eroding confidence in public institutions.
- 5.9. In some cases, however, the PA’s short-term response to these same economic challenges may generate other problems. In particular, the rapid growth of public sector employment—spurred at least in part by the need to absorb large numbers of unemployed workers in 1995-97—creates a risk of structural imbalances in both the pattern of institutional development and in the recurrent budget.

### *Ideology*

- 5.10. Ideological factors, which might constrain reform in other cases, do not present a substantial obstacle in the Palestinian case. Most political groups, and the PA in particular, have expressed the importance of private sector development and the need to establish a supportive regulatory and institutional environment, a position that enjoys broad support. According to the data on Palestinian public opinion presented in Section 3, the general public is increasingly critical of institutional weaknesses, and supports reform efforts. Similarly, Palestinian elites also express concern over evidence of institutional weaknesses, and favor initiatives to address them, such as legal reform.

### *Stakeholders*

- 5.11. As with all governments, the Palestinian Authority must be mindful of the response by political constituencies to any reform efforts. Again, the PA starts with some significant advantages in this regard. In many countries, a variety of prior economic policies—consumer subsidies, social service entitlements, extensive agricultural regulation, guaranteed state employment, or highly protectionist tariff structures—have generated groups of entrenched beneficiaries or have sustained various types of rent-seeking activity. As a result, efforts to change these policies bring an immediate counter-reaction from the groups that have profited from them. In the WBG, however, there is little legacy of past economic regulation, and hence greater societal openness to reform. This is not to

#### **BOX 5.11: The Challenge of Civil Service Reform**

In May 1998, the PA adopted a new *Civil Service Law* intended to create a unified civil service, clarify the role of the General Personnel Council, define and increase the role of line ministries in managing their staff, standardize hiring and remuneration practices, and introduce more transparent and merit-based systems of staff evaluation. A number of donors and international agencies provided technical advice during the process of drafting the new civil service code. The legislation was widely seen as a major accomplishment of the Palestinian Legislative Council. The PLC—reflecting the concerns of its many constituents who were employed in the public sector—tended to favor early and significant pay increases for the public sector. PA ministries tended to champion the position of “their” employees, while the Ministry of Finance expressed concern over the PA’s ability to finance sudden, widespread pay increases.

The implementation of the Civil Service Law in late 1998 soon encountered serious obstacles. In particular, the PA—lacking the financial capacity to adopt simultaneously all of the law’s provisions regarding public sector pay scales—decided to phase in these provisions selectively. In November 1998, pay increases were given to teachers and civil servants in the lowest pay grades. But because some aspects of pay guidelines remained unclear and the cost to the wage bill was substantial, these increases were subsequently reduced—generating dissatisfaction among recipients. In January, doctors launched strike action to protest their exclusion from the initial round of increases, as well as other technical aspects of the Civil Service Law. Some public sector engineers expressed similar concerns. Faced with limited resources and mounting claims, the PA announced in January 1999 that it would suspend the law. This in turn provoked labor unrest in the education sector, where most workers had already received the initial round of raises.

At present, the issue of civil service pay and incentives remains unresolved. Given the weaknesses in the current system, these need to be addressed. Equally importantly, by suspending implementation of the Civil Service Law, the PA also delayed the introduction of much-needed administrative and other reforms essential to promote a productive and cost-effective public sector.

- say, of course, that there are not winners and losers in the Palestinian reform process as well, and that these groups will not mobilize to pursue their collective interests. As in any pluralist society, there are many interests at stake, demonstrated by the fate of the 1998 Civil Service Law (Box 5.11). In general, however, societal constraints on PA policy reform are less intense than in many other regions.
- 5.12. Institutional factors present a more difficult challenge to institutional and policy reform in the WBG. Both within and across ministries, overlapping or confused mandates are a significant source of delay, either by slowing decision-making, impeding critical information flows, or creating opportunities for individuals and groups to resist or slow change. The physical separation of PA ministries in the West Bank and Gaza has compounded this problem. The use of political criteria in hiring creates coalitions and dependencies that crosscut the formal organizational hierarchy of ministries, further obfuscating the locus of policy responsibility. Much the same is true of other more apolitical patronage connections (*wasta*) and the informal horizontal and vertical networks they sustain. In general, patronage-based systems of bureaucratic and political management, whatever their short-term contribution to political consolidation or their utility in rewarding past years of service to the Palestinian nationalist movement, have a profoundly corrosive effect on institution-building. By signaling the primacy of political allegiance or personal connections, they make it difficult to establish the credibility of a rule-based system, thus increasing the uncertainty of transactions with the government and hence raising the effective cost of doing business. Finally, patronage systems generate economic incentives (for some parties at least) to maintain the status quo—hence creating additional challenges to reform.
- 5.13. In the West Bank and Gaza the operation of semi-public, semi-private systems of supply management for fuel, concrete, and some foodstuffs presents a particular problem. Popularly known as the “monopolies,” many of these mixed enterprises generate unknown revenues by controlling imports or setting the prices of key goods, distorting local markets through higher prices and a lack of competition. Moreover, the volume of revenues from these enterprises is unknown, as are the ways in which these revenues are spent. To the extent that some of these “public” revenues may be diverted into private hands, they represent a significant source of financial leakage. To the extent that these revenues finance undeclared public sector activity, they undercut the effectiveness of fiscal and development planning, and compound the problems of patronage discussed above. In all cases, the likely large magnitude of these flows creates significant resistance to change on the part of those benefiting from the status quo.
- 5.14. This resistance is evidenced by the extended delays in addressing the monopolies problem despite periodic pledges to do so. In the Tripartite Action Plan first signed by donors in April 1995, the Palestinian Authority pledged to centralize all fiscal revenues, expenditures, and external receipts into a central account under the control of the Ministry of Finance by January 31, 1996. Although there has been partial consolidation, full consolidation had not yet occurred by the end of 1999. In particular, petroleum excise

taxes continued to be paid into an account of uncertain status outside the Ministry of Finance. The announcement in January 2000 of a new General Revenue Administration promises to resolve some of these problems by establishing a single treasury account for fiscal revenues. However, the decree does not address the problem of mixed enterprises, other than promising future movement towards privatization.

- 5.15. Continued operation of these monopolies, failure to regularize fiscal accounts, and other institutional and policy weaknesses give rise to a number of negative political externalities. Supply controls have increased the blame directed towards the PA when commodities are in short supply or of low quality, or when prices rise. The failure to centralize revenues has created periodic government liquidity crises that have adversely affected the delivery of health, education, and other social services (World Bank 1999a). The corrosive effects are evident from the public opinion data presented in Section 3.
- 5.16. As noted above, the existence of a cadre of technocratic personnel can provide an important resource (and constituency) for reform efforts. In the WBG, the potential role of technocrats is significant, but constrained. On the one hand, Palestinian society has traditionally placed a high premium on education, and in both the WBG and the diaspora significant numbers of Palestinians have received higher education in fields relevant to economic and social policy making. There are several obstacles to using these potential human and analytical resources effectively, however. First, not all advanced university education adequately prepares graduates for policy-making roles, and Palestinian universities in particular do not have a well-established tradition of advanced training in policy analysis, strategic planning, and other related fields. Second, the lure of well-paying jobs in the private sector or outside Palestine, compared to relatively low rates of remuneration within the PA, can make it difficult to attract the best local or diaspora analysts into public service for sustained periods of time. Finally, the mere presence of a technocratic cadre within policy-making institutions does not guarantee them an effective role in policy analysis or advice. In an environment where political loyalties or personal connections are particularly important, policy input may be more a function of who—rather than what—one knows. These problems are not unique to the WBG, of course. Rather, they are characteristic of many developing countries (and, it might be admitted, informal policy networks are a phenomenon embedded in many donor agencies too). However, in assessing the prospects for policy reform, it is important to be forthright about their potential effects.

### *Political Leadership*

- 5.17. Finally, there is one critical dimension to any reform process: political leadership. The PA has, at the highest levels, formally committed itself to the principles of accountability, transparency, a supportive environment for private sector development, and policy reform. It also established in August 1999 a high-level ministerial committee on reform, the Higher National Committee for Institutional Development, with a mandate to evaluate current performance, identify areas of weakness, and make recommendations for change.

Six sectoral committees (political and strategic; fiscal reform; administrative reform; judicial sector; health sector; retirements and pensions) were created (HNCID 1999). It is essential that these declarations are followed up with practical dedication by implementing specific and substantial reform in a timely fashion.

- 5.18. All of this should be viewed in context of significant progress already achieved to date. It must also be set against the primacy, in the eyes of Palestinian decision-makers, of continued progress and successful conclusion of Middle East peace talks. These twin demands—consolidating the domestic position of the PA, and buttressing the PA’s negotiating position—have consumed much of the political attention of the Palestinian leadership. One consequence may be less attention from senior decision-makers to important issues of economic policy and institutional reform. There may also be reluctance to take on sensitive or time-consuming tasks of internal change when collective energies must be harnessed in support of negotiating peace. For donors as well as reformers within the PA, one key challenge is to communicate clearly the urgency and value of institutional and economic policy reform at a time when political and diplomatic imperatives naturally tend to supersede other considerations in Palestinian decision-making. And it is incumbent upon donors to recognize the complexity and magnitude of the challenges facing the Palestinian leadership as they attempt to fulfill their people’s aspirations for self-determination.

### **The Role of Donors in Supporting Good Policies and Strong Institutions**

- 5.19. Change requires political will, and designing and implementing strategies for institutional development and policy reform is a task in which Palestinian leadership is essential, as is Palestinian “ownership” of the reform process. However, the international community can be important in this process too; with the appropriate mix of assistance at timely junctures, donors can support, facilitate and encourage the process. Comparative examination of donor assistance to other developing countries suggests that donors generally do a poor job of discriminating between different phases of the reform process and adapting packages of assistance to support policy reform (World Bank 1999a).
- 5.20. Broadly speaking, donors have three sets of policy instruments available to promote reform: *money*, *conditionality*, and *technical assistance/policy dialogue*. How effectively have these instruments been used to encourage reform in the WBG?

#### *Money*

- 5.21. The simple provision of assistance—*money*—can have both positive and negative effects on policies and institutions. On the one hand it can directly or indirectly support inefficient policies and prop up weak institutions by freeing up other resources. Indeed, this appears to be the case in many developing countries. On the other hand, as the quality of institutions and policies improves, it can help to sustain the reform process. In an improved policy and institutional environment, moreover, donor assistance has much

more positive effects (World Bank 1999a). In the WBG—where a great deal of donor money has been spent—both effects are observed. Donor assistance helped to support unproductive (although perhaps politically unavoidable) expansion in the public sector, for example, and delayed the introduction of necessary financing reforms in post-secondary education. At the same time, significant institution-building and sectoral achievements in other areas have only been possible because of the availability of donor funds.

- 5.22. Donor resources can have other implications for the path of institutional development. In the past, many donors implicitly steered away from sectors where institutional capacity is judged to be weak (agriculture, smaller local government units), and towards those areas where Palestinian counterpart institutions are stronger (education, health, or major municipalities such as Gaza, Ramallah, or Nablus). This pattern of allocation may optimize the practical effect of donor resources by spending them in areas where—in synergy with effective institutional or policy environments—they are likely to have the most immediate beneficial effects. The negative side, however, is that this pattern of donor assistance reinforces existing administrative lopsidedness in the PA. This can only be offset if the PA adopts a clear strategic plan for institutional development both within and across sectors, supported by willing donors. At present, however, issues of institutional development tend to be addressed within, rather than across, PA ministries, and too many donors pay relatively little attention to PA priorities in deciding where to allocate support for capacity-building.
- 5.23. Donor resources may also serve to aggravate, rather than reduce, administrative fragmentation. This can occur when poor donor coordination results in different donors supporting rival bureaucracies or competing programs. For example, in the environmental sector during 1996-98, three different PA agencies (the Environmental Planning Directorate of MOPIC, the Palestinian Environmental Authority, and the Ministry of the Environment) received support from at least seven different donors.
- 5.24. Another risk associated with donor programs is the incentive for administrative rent-seeking behavior, in which Palestinian agencies pursue project initiatives because they seem likely to attract external support, rather than because they are most needed from a development perspective. This is particularly problematic when the provision of donor technical assistance—especially technical assistance from donor nationals—is linked to project funding, or when projects involve donor support for staff salaries within the Palestinian agency concerned. In the former case, some PA officials are frank that the lure of broader project funding may lead them to accept otherwise unwanted or marginally-relevant technical assistance. In the latter case, the lure of staff or salary support may result in the acceptance of otherwise low-priority projects. This is, of course, a universal problem in development assistance around the world, and far from unique to the Palestinian case. It is also impossible to avoid entirely. However, a clear and robust strategic vision on the part of the PA reduces the risk that donor resources will fuel administrative distortions rather than fund administrative development.

### *Conditionality*

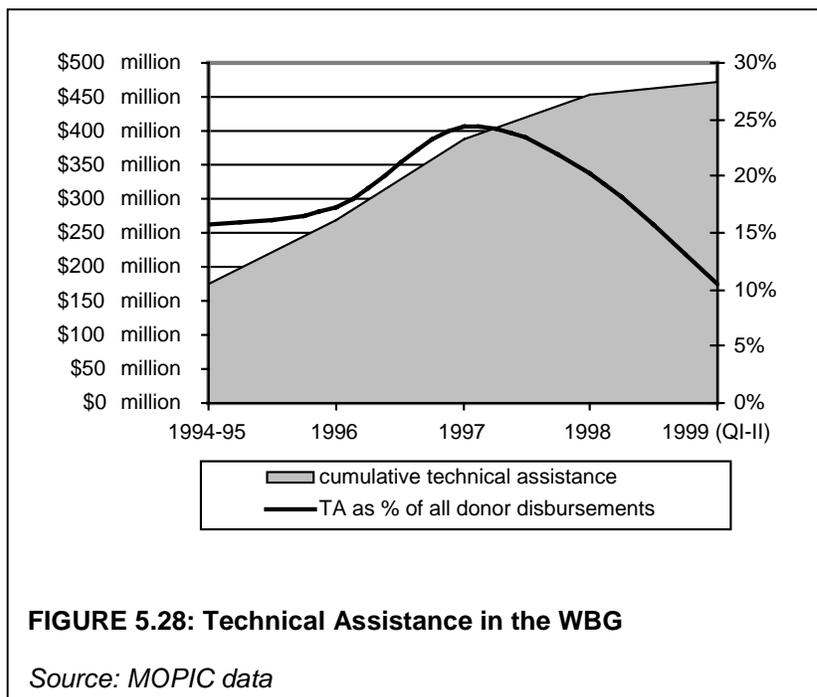
- 5.25. In order to increase the positive effects of money on reform, donors can impose greater *conditionality* in the provision of assistance by explicitly tying disbursements to the achievement of particular policy objectives. Comparative evidence from other countries suggests that this mechanism has a mixed record at best. Efforts to use conditionality to press reluctant governments into reforms that they do not truly support is rarely effective, and may undermine the credibility of the reform process altogether. It is also ineffective when governments have already undertaken substantial reform, because it tends to disguise policy responsibility and complicate decision-making. Only in the early phases of reform, where it may serve as a signal that serious reform is underway, has conditionality proven effective (World Bank 1999a).
- 5.26. In the WBG, there has been little explicit economic conditionality attached to donor assistance. Given the political urgency of peacebuilding, it seems unlikely that conditionality could be effectively implemented in the present Palestinian context, since the international community's desire to reinforce the momentum of the peace process clearly outweighs any immediate objectives of economic policy reform.
- 5.27. Donors, the PA and Israel have publicly committed themselves to a series of measures in the various Tripartite Action Plans. The TAPs have a mixed record of implementation, as is evident from the periodic status reports presented to the AHLC and donor community. They have nevertheless provided a useful standard against which to measure progress on a variety of policy- and institution-building issues, and the regular reporting mechanism associated with them provides added incentive for the parties to fulfill their commitments. These incentives could be strengthened by releasing the periodic TAP status reports to the public. On the other hand, this might excessively politicize the reporting process, creating pressures on the AHLC Secretariat to dilute its assessments.

### *Technical Assistance*

- 5.28. In the WBG, as elsewhere, technical assistance has been a primary instrument of donor efforts to support institutional development and policy reform. Between 1993 and mid-1999, disbursements in this area totaled over US\$450 million, accounting for almost one-fifth of all donor aid (Figure 5.28).<sup>1</sup> A cursory examination of MOPIC project data reveals that the overwhelming majority of this assistance appears to have been spent by donors within their own countries, on their own NGOs or technical experts. Although no detailed assessment has been made, some PA officials claim that 70 percent of all donor funding of this sort is spent on the salaries of external experts and other forms of external procurement.<sup>2</sup> Palestinian researchers claim that an even higher 90 percent of technical assistance funds are spent on donor personnel or in donor countries (JMCC 1997, 46).
- 5.29. Many donors argue that there is a substantial need for technical assistance to address institutional bottlenecks in the aid effort. Conversely, many PA officials complain about the high cost and limited utility of much past technical assistance. The 1999-2003

Palestinian Development Plan states that “the level of disbursement in [institution building] has been too high, relative to the desired level, at a time when this kind of investment should now actually be decreasing considerably.”

- 5.30. Several problems can be identified in the provision of technical assistance. Many TA assignments are of short duration, leaving little time for orientation and productive impact, and sometimes leading local



staff to resent external experts for their perceived lack of commitment. In many cases, the external experts cannot speak Arabic (an often unavoidable shortcoming), and have a poor understanding of local conditions and politics (an entirely avoidable circumstance). This can result in reports that are divorced from local realities and ultimately languish on bookshelves. Foreign experts are paid at rates several times greater than their local counterparts, creating additional tensions. Initiatives such as the UNDP’s TOKTEN program and the World Bank’s Palestinian Expatriate Professional Fund have attempted to alleviate some of these weaknesses by making greater use of expatriate Palestinian expertise financed through a centralized mechanism. However, these programs continue to face the dilemma of having to offer higher financial incentives to attract expertise while ensuring their smooth integration into local institutions where salaries are substantially lower.

- 5.31. Training programs can also be problematic. In several cases, donors preferred to train Palestinians within donor countries at great expense when more cost-effective training programs could be designed within the WBG or elsewhere in the Middle East. Because of the prestige associated with external travel and training, these programs attract upper level Palestinian staff who are unlikely to use the technical skills, rather than mid-level staff who would benefit most from the training. The provision of scholarships to study in donor universities is a particularly costly and ineffective mechanism for capacity-building; the standard curricula in donor countries do not facilitate that transfer of appropriate skills, and studying abroad removes productive Palestinians from the WBG at a critical time and increases the possibility of their future permanent emigration.

- 5.32. More broadly, the institutional weaknesses of the PA have meant that the provision of technical assistance was often supply- and donor-driven, rather than arising from clearly identified, prioritized, and expressed Palestinian needs. The availability of technical assistance in some sectors and not in others acted to distort strategic institution-building, and poor internal tracking of externally-funded staff positions disguised the long-term recurrent costs of certain PA activities and projects.
- 5.33. Inadequate donor coordination (or donor competition) can be particularly problematic. Not infrequently, Palestinian agencies have been offered multiple technical experts from alternative sources, each offering differing advice or training. Wide variation among donors vis-à-vis consultant and contracted staff salaries also creates difficulties.
- 5.34. Finally, Palestinian officials report considerable frustration at being offered external technical assistance instead of the required equipment or financial resources—especially when local expertise is available but other resources are not. According to senior MOPIC officials, technical assistance and ancillary activities can comprise up to half of donor support for any given (capital) project. Indeed, there is widespread perception among Palestinian aid officials that the potential ability of donors to insert their own national technical experts into a project plays a major role in shaping donor priority-setting (Brynen 2000). As one external assessment notes, “Both the PA and MOPIC itself are displaying all the unsettling attributes of [technical assistance],” including support for “activities which are unlikely to be sustainable, either because of the PA’s overall inability to afford them without donor support, or because skill transfer is not taking place, or, even if it is, because the PA is unlikely to retain the services of those trained” (Bird and Lister 1997).
- 5.35. This is not to say, however, that all technical assistance has been of limited utility—many PA officials report very positive experiences with technical assistance provided by multilateral agencies or by bilateral donors. There is, however, a need to focus on *quality*, rather than *quantity*. Previous studies have emphasized that technical assistance is generally *least* effective when it is donor-driven, finances unsustainable activities, distorts civil service development, and relies too heavily on external consultants and (offshore) training when local resources are available. Linking technical assistance more closely to Palestinian needs as defined by the PA itself, and paying more attention to the absorption and sustainability of technical advice, would represent steps in the right direction.

### **Conclusion: Putting It All Together**

- 5.36. In the early phases of the WBG aid program, both donors and the PA concentrated on establishing structures, without adequate attention to the ways in which the institutional and political setting affected policy processes. Establishing the right “rules of the game”—that is, focusing on processes and underlying dynamics rather than structures—is essential.

- 5.37. Some external assessments of the aid program suggest that many past donor efforts in this area have been “naïve”:

On one level, the mere establishment of offices—through the provision of office equipment, expertise, and project funding—had often been seen as sufficient to develop Palestinian capacities in needed areas. Administrative shortcomings and the need for civil service reform, on the other hand, had tended to be seen as a technical issue: if the PA could just be shown how to operate a rational-bureaucratic public sector, the necessary adjustments would then follow. Similarly, legal reform was seen as requiring the right laws, with little attention to what their actual (rather than theoretical) impact might be. Reflecting their technocratic expertise, the reports of external consultant thus tended to be a catalog of inefficiencies and weaknesses, current and possible organizational schema, and accepted international “best practices” in the sector concerned. Rarely were underlying, often informal, dynamics taken into account. Yet, as has been seen—in the difficulties of the environmental and agricultural sectors, the growth of public sector employment, the development of commercial monopolies, or the subordination of economic planning to the imperatives of the peace process—many outcomes were inexplicable *without* reference to the context within which Palestinian development has occurred. In short, in a situation where administrative inefficiencies often served real political purposes, they could hardly be addressed from a narrowly technical point-of-view (Brynen 2000).

- 5.38. Moreover, donor policies have sometimes aggravated the very problems that donor programs sought to address. As seen in the environmental sector, for example, donor support could reinforce the fragmentation of the PA, with different donor agencies supporting competing institutions. And the agricultural sector illustrates the risk of a vicious circle whereby donors avoid problematic areas, thus compounding sectoral weaknesses by targeting resources elsewhere. These weaknesses, in turn, further deter donor support. Conversely, other sectors might receive support precisely because they were already strong. Much the same effect can be found within ministries as well, where bureaucratic development occurred in those areas where donor resources were forthcoming, but not in others. Collectively, there is little explicit recognition that donor appeals to the PA to put its administrative house in order ought to be combined with greater awareness of what donors can do to help rather than hinder this process.
- 5.39. In order for donors to promote more effective institutional and policy reform, emphasis should be placed on broad policy dialogue rather than narrow and disconnected donor initiatives. International experience suggests that policy dialogue is most effective when linked to positive incentives rather than conditionality, when innovation and long-term thinking is encouraged, and when there exists strong donor coordination and partnership with host countries (World Bank 1998a, 100-105). Dialogue needs to be underpinned by a clear donor understanding of the various political and other dynamics at work, and by an equally clear Palestinian commitment to progress in these areas.

**BOX 5.39: Aid and Reform in the WBG**

In the WBG, two donor initiatives, the Gaza Industrial Estate and projects in the water sector, are examples of effective infrastructure investments that required the establishment of an appropriate regulatory and institutional environment.

In the case of the Gaza Industrial Estate (GIE), establishing a physical site was only part of the task to be undertaken. It was also necessary to secure passage of an Industrial Zones Law, establish the legal basis and institutional structure for the Palestinian Industrial and Free Zones Authority (PIFZA), and revise the Encouragement of Investment Law to enhance the protection accorded to investors and improve investment incentives. While other aspects of the GIE were slowed by the need to secure Israeli-Palestinian agreement on access and other issues, the reform aspects proceeded in a relatively timely fashion. A close working relationship emerged among the World Bank, other donors, the Ministries of Economy, Industry, and Justice, PIFZA, and the private sector through the Palestinian Industrial Estate Development and Management Company. Reform was facilitated by providing effective Palestinian and external legal assistance, by establishing a clear locus of authority (PIFZA) on the Palestinian side, and by strong political support for the initiative at the highest levels of the PA and donor community. More than US\$60 million in donor aid for off-site infrastructure, technical assistance, and site development provided a further incentive for progress.

In the water sector, reforming the current system of tariffs and utilities is essential to establishing the basis for sustained development. The Gaza Water and Sanitation Services Project (Box 2.64) was a pioneer in this regard, and is now being followed by the Southern Area Water and Sanitation Improvement Project. The obstacles to change are significant: many municipalities derive important revenues from the existing fragmented system of local water utilities, and any change affects broader issues of local government reform. Building a constituency for reform, therefore, has involved working closely with the Palestinian Water Authority, convincing local government units of the value of new arrangements for supply and distribution, and obtaining the support of the Ministry of Local Government. A good working relationship between the World Bank and other major donors (notably the US and Germany) has been essential, given the large number of donors active in this area. Technical assistance supplied through the World Bank, USAID, BMZ (Germany's Federal Ministry of Economic Cooperation and Development), and UNDP, has also played an important role. Once again, the financial incentive for reform was of key importance, with the two projects totaling more than \$125 million in present or anticipated donor support. Smaller and more fragmented packages, or a lack of coordination among the largest donors, would likely have rendered the reform process far less effective.

- 5.40. Institutional and policy reform in the WBG could be advanced using a multisectoral approach in which regulatory reform, bureaucratic reorganization, and incoming project support are all linked to clear and coordinated institution-building objectives. A successful approach would harmonize or at least reconcile administrative function and political imperatives, and overcome inertia or entrenched resistance by constructing coalitions for reform. It must also anticipate probable obstacles to implementation, including difficulties in mobilizing adequate donor resources for the multiple components of a program, the inherent complexity of multisectoral initiatives, and the resulting risk that problems with one element will have an undesirable ripple effect on other components. On the donor side, policy reform efforts could be spearheaded by coalitions of like-minded donors or by multilateral organizations (such as the World Bank, IMF, UNDP or other specialized UN agencies), or some combination of the two. Donor coalitions have the obvious advantage of immediate and secure access to potential funding, and may be able to combine both economic/technical assistance and political

engagement. However, the inherent problems of coordination across multiple leading donors may be substantial. Multilateral agencies can usually draw on extensive in-house technical expertise as well as valuable international experience. And to the extent that their involvement is less tied to diplomatic interests or export-promotion, they may be seen as more impartial interlocutors. On the other hand, multilateral agencies may have a technocratic focus that inhibits their ability to undertake the necessary political analysis if reform is to move forward. In the WBG, there is scope for the Sectoral Working Groups to provide the focal point for joint cooperative efforts to promote reform (although their performance to date has been uneven in this regard). The SWGs are well-placed to provide a venue for the PA to present systematic assessments of institution-building needs at the sectoral level. They should also be the forum in which donors coordinate their response, in order to avoid gaps or overlapping in donor support.

## **SECTION 5: NOTES**

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<sup>1</sup> Although MOPIC's regular donor matrices track the amount of donor assistance allocated to technical assistance, examination of MOPIC project-level data suggests that some non-TA projects may be miscoded as TA, while some other investment programs may contain a significant TA component that is not recorded. On balance, it appears that MOPIC data may underestimate the total volume of technical assistance provided to the WBG.

<sup>2</sup> Al-Sharq al-Awsat (London), January 28, 2000, p. 16.