

- 6.1. The overall impression that emerges from the aid effectiveness study is a positive one. Donor assistance slowed the rate of economic deterioration in the West Bank and Gaza in 1994-97, and contributed to the modest growth experienced by the Palestinian economy since then. It has built local capacities and strengthened critical infrastructure. Despite past economic decline, public opinion data shows a general perception that conditions have improved in many key sectors, and indicates a growing public optimism about the economic future. In political terms, donor aid helped to consolidate the Palestinian Authority and supported continued negotiation in periods of political uncertainty. Indeed, without such assistance it is difficult to see how a functioning Palestinian administration could have been established, or whether there would have been any peace process to negotiate.
- 6.2. Learning from the strengths and weaknesses of past assistance efforts in the WBG is an important step toward improving the partnership between donors and the Palestinian Authority. Above and beyond this, however, both donors and the PA must look to the future, where several looming issues confront them. The development effort stands at an important turning point.

Palestinian Development at a Crossroads

- 6.3. The first crossroads concerns *a necessary shift in the orientation of donor activity*. With the establishment of the PA, the resumption of local economic growth, and the reinvigoration of the peace process, the donor effort must move beyond its initial emergency stage to one of building longer-term development. And the criteria for assessing donor assistance must shift in conjunction. The imperatives of immediate social and political impact are diminishing in importance, while the need to lay the foundations for sustainable development has grown in importance. In many ways this involves new challenges: it requires increasingly sophisticated Palestinian planning and administrative capacity, clear Palestinian leadership, and effective donor coordination.
- 6.4. The second juncture concerns *the future nature of the West Bank and Gaza*. In political and economic terms, the contours of this future will be determined by the outcome of permanent status negotiations between Israel and the Palestinians. However, this future will also be fundamentally shaped by the legacy of existing economic and political structures. Putting in place the appropriate institutions, rules, and relationships today will

contribute to a robust economy, social development, and a vibrant civil society in the future. But allowing weak institutions to endure, the wrong rules to become established, and inappropriate relationships to persist will bequeath a disappointing legacy to future generations of Palestinians. Put simply, it is easier to establish the right environment at the outset, rather than trying to correct it later when dysfunction has become firmly entrenched and donor support has diminished.

Key Trends

6.5. These considerations emerge in the context of the trends highlighted in the aid effectiveness study.

- Donor disbursements dropped substantially in 1998-99 from earlier levels. While these levels might rebound for a time following some permanent status agreement, recent trends highlight that fact *that external donor support for the WBG will inevitably diminish over the long-term*. Indefinite dependency is not an option; a strong productive base must be established in the WBG economy.
- *In sharply reducing the level of budgetary and transitional donor support to the PA, donors have not increased the absolute level of disbursements for infrastructure projects*. On the donor side there should be greater awareness of this trend. However, the current situation whereby donors finance almost all public investment is clearly unsustainable. As a matter of urgency, *the PA needs to budget fully for the cost of maintaining existing public assets, and steadily increase its share of public investment expenditures*.
- *The composition of donor assistance may also be shifting to a greater reliance on aid in the form of loans and credits rather than grants*. Concessional loans have a potentially important role to play in Palestinian development, especially in sectors with clear economic and social returns on investment. However, their use needs to be carefully planned, strategized, and monitored.
- *The PA's current fiscal balance is fragile*. It is also somewhat misleading, given that some recurrent costs are still covered by donor project support, and in view of the lack of support for maintenance and capital investment noted above. Perhaps the largest threat to fiscal stability, however, is posed by continuing expansion of the public sector payroll. Left uncurbed, this risks setting in place a structurally bloated public sector that can only be supported through increased domestic taxation (with negative effects on economic activity), downward pressure on public sector wages (with its attendant political and social costs), or borrowing against fiscal deficits (thereby embarking on a path to future fiscal insolvency or painful structural adjustment measures).

- Amid widespread reports of inefficiency, financial irregularity, and unwarranted restrictions on human rights, *public confidence in public institutions is eroding*. Similarly, there have been *multiple pressures on the NGO sector and civil society* which threaten to limit their potential contribution to political, social, and economic development.
- All development efforts in the WBG occur against a backdrop of *rapid population growth*. This creates rising demand on government services and increasing need for employment, which can only be offset by corresponding growth in economic activity and fiscal revenues, both of which require a supportive environment for private sector investment.

Invigorating the Palestinian Private Sector

- 6.6. The WBG thus stands at a developmental crossroads. The decisions taken today will have lasting consequences for generations of future Palestinians. They will also determine the viability of any future Palestinian entity. A number of critical trends, highlighted above, must be taken into consideration as the PA and donors select a future path. Equally important, the many positive features of the Palestinian economy must be developed further, namely strong support from the international community, a generally well-educated and entrepreneurial population both within the WBG and in the Palestinian diaspora, and the ability since 1994 to design a new regulatory and institutional setting.
- 6.7. These latter two factors assume particular importance, since future development hinges on the existence of a vibrant private sector in the WBG. A business-friendly environment would attract greater levels of private capital investment from Palestinian and other investors alike. Private sector growth will be the primary source of expanded employment and enhanced government revenues.
- 6.8. To date, many aspects of private sector activity have been disappointing, and remain disappointing despite a partial turn-around since 1997. As this and other reports have shown, the poor business environment in the WBG is the product of many factors, including:
- complex restrictions on the movement of goods and persons—whether arising from the current interim agreements, security procedures, or periodic use of closure—and the resulting uncertainty by firms in the ability to import and export goods;
 - political uncertainty, which in turn erodes investor confidence;
 - a complex legal and regulatory environment, characterized by laws of uneven quality and a substantial need for continued modernization and harmonization of commercial codes;

- a weak judicial system, and a consequent lack of confidence that commercial disputes will be settled fairly;
- increasing reports of public sector corruption, including economic coercion of firms through extortion and kick-backs;
- the operation of PA-linked monopolies, supply management systems, and quasi-public commercial enterprises.

All these factors heighten concerns about the PA's commitment to transparency and the rule of law, increase the costs (and unpredictability) of doing business, weaken the fairness and competitiveness of the marketplace, and deter both local and foreign investment.

- 6.9. Although the first two factors listed above are largely beyond the control of both donors and the Palestinian Authority, the other constraints on private sector investment can and must be addressed by the PA in partnership with the donor community. *In the absence of a clear, strong and unequivocal commitment to reform at the highest levels of the PA, there is little prospect for progress in these areas. Without reform, donor aid will be much less effective than it might be. Indeed, without such reform there is little likelihood of real, sustained economic growth.* This is the central finding of the aid effectiveness study, and its fundamental importance cannot be overemphasized.

Building a Partnership for Reform

- 6.10. A number of recent efforts to identify and redress areas of institutional weaknesses include the Tripartite Action Plan, UNSCO's *Rule of Law Development in the West Bank and Gaza*, the Council on Foreign Relations Task Force Report on *Strengthening Palestinian Public Institutions*, and work by the World Bank on *Strengthening Public Sector Management* as well as various sectoral analyses, all of which help to define a detailed agenda for reform. The PA itself established in August 1999 a Higher National Committee for Institutional Development to enhance the performance of public institutions. It also announced in January 2000 the formation of a Higher Council for Development to oversee revenue administration, investment funds, and borrowing. These are important steps in the right direction, and deserve donor encouragement and support.
- 6.11. The case for reform is a strong one. As emphasized above, there are convincing economic reasons to accelerate the pace of institutional and policy reform in the WBG. While a number of institutional constraints foster an increase and consolidation of constituencies that benefit from the status quo, other factors can facilitate reform. In particular, the public opinion survey data presented in this study highlights the imperative for change: declining Palestinian confidence in public institutions is strongly related to perceived weaknesses in institutional performance, concern at growing corruption, and fear of eroding civil liberties. Quite apart from its administrative contributions, therefore,

institutional reform is likely to consolidate—rather than weaken—the structures of Palestinian governance and political leadership.

- 6.12. Donors can play a key role in the reform process, but not all donor assistance necessarily has the desired effect: injecting financial support does not always promote reform (and can even make matters worse), and the provision of expertise can be ineffective and unwelcome. With regard to TA in particular, the findings of the aid effectiveness study point to the need for greater attention to the *quality* rather than *quantity* of assistance provided.
- *TA should be demand- rather than supply-driven.* This requires the PA to determine more effectively its TA requirements, and donors to refrain from using TA as an instrument of trade promotion. Local expertise should be used where possible. Efforts should be made to ensure that institutional development within PA ministries is not distorted by the availability of TA, and the level of externally-funded staff positions should be adequately monitored.
 - *The provision of TA should be based on donor cooperation, not competition.* Local aid coordination mechanisms (notably the various SWGs) could be used more effectively in this regard. A stronger prioritization of TA requirements within the PA would also help to alleviate some of these problems. Donor coalitions or multilateral agencies may be more likely to provide an appropriate range of technical support than the fragmented and episodic efforts of individual donors.
 - *Technical experts need to have both technical expertise and a basic prior understanding of the complex political and policy environment in the WBG.* Policy advice that ignores these underlying realities is unlikely to be effective.
- 6.13. Overall, donors seem best able to promote policy and institutional reform when they leverage the desired changes through the positive incentive of substantial project funding. Technical assistance plays a potentially important role in this regard. Integrating policy dialogue, aid incentives and technical assistance is most effective when underpinned by a clear agreed sectoral strategy. This approach should be accompanied by effective donor coordination mechanisms and rooted in the principles of Palestinian ownership of the development effort.
- 6.14. The downward trend in recent aid disbursements in the WBG has important implications for the ability of donors to leverage policy reform. On the one hand, any faltering in Palestinian reform efforts will most likely contribute to donor frustration and fatigue, further depressing the levels of assistance provided to the WBG. On the other hand, the credibility of donor support for reform is weakened by the perceived failure of some key donors to act on their pledges and commitments. If donors wish to promote reform, they must signal their commitment to the reform process by committing and disbursing aid on a timely basis, rewarding constructive innovation and reinforcing successful change.

What We Know: The Importance of Knowledge Management

- 6.15. Assessing progress in the development effort in the West Bank and Gaza—whether for the purposes of this project or for any other development planning initiative—requires a systematic base of data and analysis. While substantial progress has been made in this area, “knowledge management” could be enhanced in a variety of ways.
- *Establishing a “one stop” central collection of development information on the WBG.* Ideally this would be based at a public institution, and would utilize both traditional methods and new information technologies to facilitate free public access.
 - *Developing mechanisms, preferably within the framework of existing aid coordination structures, for donors to share project assessments.* Donors and the PA should make greater use of participatory program design and beneficiary impact assessment methodologies in designing and evaluating projects.
 - *Strengthening the PA’s ability to collect and analyze core social, environmental, economic and other data.* This is particularly important in areas (such as the water sector) where fragmented collection methods undermine the reliability of existing data and inhibit the analysis of trends over time.
 - *Continuing efforts to improve the quality of MOPIC donor matrices.* These should include investigating the lags between agency disbursement and expenditures “on the ground”, and more analysis of sectoral and aggregate trends in donor assistance. Particular effort should be devoted to maintaining the integrity of pledge and commitment data, in light of possible problems arising from recycled or inflated donor pledges. There is also a need to maintain much more detailed information on the terms of non-grant assistance.
- 6.16. One of the most useful and striking components of the aid effectiveness report has been the preliminary data collected on mass and elite attitudes. This is the first time such data has been collected on a national scale to inform peacebuilding efforts. The survey casts light on public perceptions of services and infrastructure, as well as on developmental priorities. It also allows some measure of the differential impact of the aid effort on the basis of income, region, gender, and other socio-demographic variables. Such data ought to be collected by the donor community on an ongoing and increasingly sophisticated basis, in order to facilitate more effective monitoring of the aid effort and better planning of future initiatives.
- 6.17. Knowledge management also requires harnessing existing information to illuminate eventual policy choices, and anticipating the analytical work necessary to support future decision-making. Policy planning is, of course, particularly difficult in the uncertain context of a transitional WBG. It is nevertheless necessary. As argued in the aid effectiveness report, both donors and the PA would benefit from data collection, analysis, and policy planning undertaken *now* in support of eventual permanent status

arrangements, so as to minimize the costs, uncertainties, and shocks of future transition, and enhance the effectiveness of donor aid.

Looking Ahead

- 6.18. Creating an appropriate environment for economic growth and social development is essential to the future of the WBG. Donors are an important component of this: donor assistance plays a key role in building Palestinian capacities, and the quality of local institutions and policies have a major impact on the effectiveness of donor assistance in all sectors.
- 6.19. Effective change, however, cannot and should not be imposed from outside. Rather, it is ultimately founded on partnership, dialogue, and—perhaps most importantly—Palestinian ownership and leadership of the reform process.

