

**PROGRAM INFORMATION DOCUMENT (PID)
CONCEPT STAGE**

Report No.: 44032

Operation Name	WBG-Palestinian Reform and Development Plan Development Policy Grant (PRDP DPG)
Region	MIDDLE EAST AND NORTH AFRICA
Sector	(100%)
Project ID	P111078
Borrower(s)	Palestine Liberations Organization
Implementing Agency	Palestinian Authority/MINISTRY OF FINANCE
Date PID Prepared	March 10, 2008
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1. Key development issues and rationale for Bank involvement

Key Development Issues

Efforts to build an independent Palestinian State have been stymied by enormous political complications and continued violence. Despite these challenges, the Palestinian National Authority, supported by the international community has continued to struggle towards this goal. In late 2000, a second *intifada* erupted throughout the West Bank and Gaza. The level of violence was much higher than in the previous *intifada* of the early '90's and it culminated in large Israeli military incursions into Palestinian controlled areas in 2002 and 2003. The incursions were accompanied by extensive closures and restrictions on movement imposed on the Palestinian population. These closures and restrictions on movement on people and goods in the Palestinian areas had a crippling effect on the economic situation, particularly on the private sector, and on the health and welfare of the Palestinian people.

In 2004, the level of violence ebbed and the economy began to recover slowly. However, in early 2006 a Hamas led government was elected. In response, most donors withdrew direct support to the Palestinian Authority (PA) and Israel cutoff the transfer of tax clearance revenues that Israel collects on behalf of the Palestinian Authority. This led the PA to reduce payments of public salaries and build up substantial arrears to the private sector. It also led to the deterioration of many of the government institutions that had been laboriously built over the last decade. At the same time Israel intensified the application of its policy of road closures and restrictions of movement of people and goods. During this period Israeli settlement activity and the construction of the separation barrier continued unabated, which resulted in ever greater restrictions on movement and access and further blows to the Palestinian economy.

In June 2007, Hamas took control of Gaza by force and on June 17th, President Abbas dissolved the Hamas led government and swore in an emergency government of technocrats, which has since become a caretaker government until new presidential and parliamentary elections can be held. The international community has rallied around the new government. Most donors have restarted their programs of financial and technical support to the Caretaker Government, and the Government of Israel (GOI) has released tax clearance revenues. However, the Palestinian territories remain

effectively split. Gaza, under the control of a Hamas administration, has been completely isolated by a strict trade closure applied by Israel resulting in a serious decline in social indicators in the Gaza population. The PA continues to pay most workers in Gaza but there is little government service delivery. Israel has sealed the border and there is continuing violence. Private sector activity has collapsed and the population subsists on emergency donor aid. On the other hand, the West Bank has seen a decline in violence and an increase in economic growth, albeit from a low base. However because of continued Israeli settlement expansion and closures, investment remains depressed.

By early 2008 the new government was moving rapidly to re-establish institutions and rebuild confidence in the West Bank and demonstrate its ability to govern effectively. In December 2007, the PA presented its Palestinian Reconstruction and Development Plan (PRDP) to donors at the Paris Donor conference. This comprehensive plan lays out reforms that the government hopes will help re-start economic growth and regain the trust of the population and international donors. Currently, the plan is only being implemented in the West Bank, where the new government is in control. However, it is designed to be expanded to Gaza as soon as the situation permits. The PRDP details steps towards establishing fiscal sustainability and increasing government transparency and accountability, particularly in matters of public financial management, and sets out the priority public sector investment program in the various economic sectors that will be a counterpart to the private sector investment that is expected to power the economy. The success of the PRDP depends upon parallel actions by the PA, the donor community and the Government of Israel (GOI). If GOI does not relax its movement and access restrictions then the private sector will not be able to grow and the PA will not be able to break its dependence on large amounts of donor aid. Likewise, if the donors do not initially fund the PA's budgetary requirements then the government will not have time to implement the reforms.

The international donor community embraced the PRDP at the Paris Donor Conference when the PA received around \$7.7b in pledges to fund the PRDP over the 2008-10 period. The PA requested much of the support in unrestricted budget support in order to allocate funds in an optimal way, but many donors are hesitant to provide funds directly to the PA budget. Some have pledged funds for projects and others have pledged to pay recurrent costs (mainly salaries) directly. Only a few donors, including the World Bank, have pledged untied budget support.

Untied budget support is essential for the PA to function. Its biggest expenses are salaries and "net lending", the majority of which are payments by the central government to the Israel Electricity Company for power supplied to Palestinian municipalities. Domestic revenues are not adequate to cover these costs, so without external budget support the PA will continue to accumulate large arrears. It is also important that external support be provided through the PA's Single Treasury Account (STA). Using the STA help the PA develop its public financial management systems, which were severely damaged during the aid cut in 2006.

To encourage donors to use the STA, the World Bank and IMF have jointly agreed to monitor and report to donors on a quarterly basis the PA's allocation and use of funds and to assess progress in meeting the goals outlined in the PRDP. The monitoring will focus on progress in improving the fiscal position and improving public financial management. In addition, the World Bank has been asked to establish a Multi-Donor Trust Fund called the PRDP-TF, to support the PRDP by providing untied budget support through the STA. For its contribution to budget support, the Bank has been asked by the PA for this proposed Development Policy Grant (DPG). The PA believes that such deep Bank involvement will help mobilize otherwise reluctant donors to provide budget support, which is critical for the successful implementation of the PRDP.

2. Proposed objective(s)

The proposed operation is designed to support the PA as it implements the reform program detailed in the PRDP. It takes advantage of the good will and high level of donor support pledged at the Paris donor conference in December 2007. To have the largest impact, the project is focused on two specific areas and will support the PA to quickly enact reforms that strengthen its fiscal position, and improve its public financial management. These are critical building blocks for the government of an independent Palestinian state and are also crucial for attracting continued international donor support, which the PA depends on. The World Bank's involvement in supporting and monitoring the reform effort will strengthen the PA's capacity to achieve the desired reforms and also help build the required support among donors.

3. Preliminary description

The World Bank will support the PRDP process by providing untied budget support through the Single Treasury account. This will be done in two complementary ways. First, the Bank will establish the multi-donor trust fund called the PRDP-TF, as requested by the PA. Second, it will provide the proposed DPG. The DPG is a single operation and should be released based upon a set of prior actions developed in areas discussed below. The first tranche of the PRDP-TF will be released under the same conditions as DPG. Future releases from the PRDP-TF will be made based upon the IMF and World Bank reviews of the progress towards the PRDP's reform goals.

The proposed DPG supports actions in the two policy areas highlighted in the LDP: (i) **strengthening the PA's fiscal position** and (ii) **improving public financial management**.

4. Safeguards

The project is expected to have minimal environmental effects. It is a budget support operation and is not subject to any safeguard issue. The project supports efforts by the PA to increase collection of utility fees and reduce the level of public employment. Both actions could negatively affect the most vulnerable groups. Consequently, the PA is making the development of the social safety net targeting data base and improvements in the social safety net implementation a high priority.

5. Tentative financing

Source:	(\$m.)
Recipient	0
WBG Trust Fund	40
Total	40

6. Contact point

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