Document of
The World Bank

Report No: ICR00003079

IMPLEMENTATION COMPLETION AND RESULTS REPORT
(TF-014915)

ON A

TRUST FUND GRANT

IN THE AMOUNT OF USD 40.0 MILLION

TO THE

PALESTINE LIBERATION ORGANIZATION

(FOR THE BENEFIT OF THE PALESTINIAN AUTHORITY)

FOR A

PALESTINIAN NATIONAL DEVELOPMENT PLAN

DEVELOPMENT POLICY GRANT V

March 30, 2014

MNSPR
West Bank and Gaza Country Unit
MENA

CURRENCY EQUIVALENTS

(Exchange Rate Effective March 19, 2014)

Currency Unit = New Israeli Shekel (NIS)
NIS 1.00 = US$ 0.288120
US$ 1.00 = NIS 3.470776

FISCAL YEAR: Calendar year

ABBREVIATIONS AND ACRONYMS

DPG	Development Policy Grant
GDP	Gross Domestic Product
GPC	General Personnel Council
MoF	Ministry of Finance
NEDCO	Northern Electricity Distribution Company
NDP	National Development Plan
NIS	New Israeli Shekel
OPCS	Operations Policy Country Services
PA	Palestinian Authority
PD	Project Document
PDO	Program Development Objective
PERC	Palestinian Energy and Natural Resources Authority
PNDP	Palestinian National Development Plan
PMT	Proxy Means Testing
PPL	Public Procurement Law
PRDP	Palestinian Reform and Development Plan
PRDP-MDTF	Palestinian Reform and Development Plan – Multi Donor Trust Fund
SAACB	State Audit and Administrative Control Bureau
SELCO	Southern Electric Company
WB	The World Bank
WB&G	West Bank and Gaza

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COUNTRY
West Bank and Gaza

Project Name
Palestinian National Development Plan DPG V

CONTENTS

A. Basic Information			
Country:	West Bank and Gaza	Program Name:	WBG - PRDP Support V
Program ID:	P129742	L/C/TF Number(s):	TF-14915
ICR Date:	03/30/2014	ICR Type:	Core ICR
Lending Instrument:	DPL	Borrower:	PALESTINE LIBERATION ORGANIZATION
Original Total Commitment:	USD 40.00M	Disbursed Amount:	USD 40.00M
Revised Amount:	USD 40.00M		
Implementing Agencies: PALESTINIAN AUTHORITY / MOF1			
Cofinanciers and Other External Partners:			

B. Key Dates				
Process	Date	Process	Original Date	Revised / Actual Date(s)
Concept Review:	01/04/2013	Effectiveness:		07/09/2013
Appraisal:	03/08/2013	Restructuring(s):		
Approval:	05/23/2013	Mid-term Review:		
		Closing:	09/30/2013	09/30/2013

C. Ratings Summary	
C.1 Performance Rating by ICR	
Outcomes:	Moderately Satisfactory
Risk to Development Outcome:	Substantial
Bank Performance:	Satisfactory
Borrower Performance:	Moderately Satisfactory

C.2 Detailed Ratings of Bank and Borrower Performance (by ICR)			
Bank	Ratings	Borrower	Ratings
Quality at Entry:	Satisfactory	Government:	Not Applicable
Quality of Supervision:	Satisfactory	Implementing Agency/Agencies:	Not Applicable
Overall Bank Performance:	Satisfactory	**Overall Borrower Performance:**	Moderately Satisfactory

C.3 Quality at Entry and Implementation Performance Indicators			
Implementation Performance	Indicators	QAG Assessments (if any)	Rating:
Potential Problem Program at any time (Yes/No):	No	Quality at Entry (QEA):	None
Problem Program at any time (Yes/No):	No	Quality of Supervision (QSA):	None
DO rating before Closing/Inactive status:			

D. Sector and Theme Codes		
	Original	Actual
Sector Code (as % of total Bank financing)		
Central government administration	72	72
Health	14	14
Other social services	14	14

Theme Code (as % of total Bank financing)		
Administrative and civil service reform	22	22
Health system performance	11	11
Public expenditure, financial management and procurement	22	22
Tax policy and administration	34	34
Vulnerability assessment and monitoring	11	11

E. Bank Staff		
Positions	At ICR	At Approval
Vice President:	Inger Andersen	Inger Andersen
Country Director:	Steen Lau Jorgensen	Mariam J. Sherman
Sector Manager:	Bernard G. Funck	Bernard G. Funck
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F. Results Framework Analysis

Program Development Objectives (from Project Appraisal Document)
"DPGV has been designed to support the achievement of the following development objectives in the context of the PA's National Development Plan (NDP): (a) strengthening the fiscal position by undertaking reforms to: (i) increase government revenues, (ii) improve the efficiency of public expenditures, and (b) laying the institutional foundations for improved governance and transparency in the public sector. The operation will directly contribute to Pillar 1 of the ISN aimed at strengthening the institutions of a future state to efficiently manage public finances and ensure services to citizens."

Revised Program Development Objectives (if any, as approved by original approving authority)

(a) PDO Indicator(s)

Indicator	Baseline Value	Original Target Values (from approval documents)	Formally Revised Target Values	Actual Value Achieved at Completion or Target Years
Indicator 1 :	Domestic tax revenues from VAT, customs and income taxes			
Value (quantitative or Qualitative)	US$480 million or 4.7 percent of GDP	Domestic revenues from VAT, Customs, and income tax combined in 2013 have increased by at least 10 percent in nominal terms and are higher as a share of GDP compared to 2012.		The indicator rose by 25 per cent in dollar terms in 2013 or by 0.5 percentage point of GDP.
Date achieved	12/31/2012	05/27/2013		12/31/2013
Comments (incl. % achievement)	100 percent achieved.			
Indicator 2 :	Public wage bill			
Value (quantitative or Qualitative)	The central government wage bill equaled US$1.767 billion in 2012 and amounted to 17.2 percent of GDP.	The 2013 central government nominal wage bill growth has not exceeded 4.25 percent (in Shekel terms) and is lower as a percent of GDP than the		The nominal wage bill in shekel terms has grown by 1.7 per cent or well below the result sought of a rise capped at 4.25 per cent. The wage bill in relation to

		2012 wage bill.		GDP fell from 17.3 per cent in 2012 to 17 per cent in 2013.
Date achieved	12/31/2012	05/27/2013		12/31/2013
Comments (incl. % achievement)	100 percent achieved despite a sharp reduction in growth.			
Indicator 3 :	Efficiency in public spending (social protection): Number of households in the "vulnerable group", not meeting proxy means test but still receiving cash benefits.			
Value (quantitative or Qualitative)	19,200+ and continues to grow.	Number of households in the "vulnerable category" not exceeding 19,200.		The number of households in the vulnerable category receiving cash benefits fell from 19,200 at end-2012 to 18,906 at end-2013
Date achieved	12/31/2012	05/27/2013		12/31/2013
Comments (incl. % achievement)	100 percent achieved.			
Indicator 4 :	Efficiency in public spending (health): Referral costs as a share of total public healthcare spending			
Value (quantitative or Qualitative)	31 percent	The share of outside referral costs to total public healthcare spending has decreased by at least two percentage points in 2013 compared to the 2012 figure of 31 percent.		6 percentage points higher than baseline
Date achieved	12/31/2012	05/27/2013		12/31/2013
Comments (incl. % achievement)	Not achieved. New estimate was subsequently obtained for baseline value (37 percent), but the actual value at completion amounted to 43 percent.			
Indicator 5 :	Transparency in public finances: Institutional arrangements to implement the new procurement law.			
Value (quantitative or Qualitative)	Implementing regulations for PPL are not in place, the Higher Council is not	(1) The conduct of public procurement is based on new		The conduct of public procurement is not yet based on

	operational, standard bidding documents in line with the new PPL have not been adopted.	implementing regulations to the PPL as well as on the (2) National Standard Bidding Documents for Goods, Works and Consultants Services, and Procurement Manual.		implementing regulations for the new PPL and the standard bidding documents are not yet in use.
Date achieved	03/27/2013	05/27/2013		12/31/2013
Comments (incl. % achievement)	Targets were not achieved, but improvement has been made compared to the baseline values as the Higher Council is fully operational and implementing regulations have been drafted. Procurement conduct under new regulations expected in 2014.			
Indicator 6 :	Transparency in public finances (access to information on municipal finances): Ability of municipal authorities, general			
Value (quantitative or Qualitative)	Municipal authorities, citizens, and other non-government stakeholders have no easy access to information on the amount of property tax collected, deductions from property tax collected by the central government, or the breakdown of transfer expenditures	Municipal authorities, other stakeholders, and general public can easily access information that indicates the amount of property tax collected, deductions from property tax collected by the central government and the breakdown of transfer expenditures in		The publications on property tax are published each quarter and the breakdown of transfer expenditures is published monthly on the Ministry of Finance's website.
Date achieved	12/31/2012	05/27/2013		12/31/2013
Comments (incl. % achievement)	Fully achieved.			

(b) Intermediate Outcome Indicator(s)

Indicator	Baseline Value	Original Target Values (from approval documents)	Formally Revised Target Values	Actual Value Achieved at Completion or Target Years

G. Ratings of Program Performance in ISRs

No.	Date ISR Archived	DO	IP	Actual Disbursements (USD millions)

H. Restructuring (if any)

Not Applicable

1. Program Context, Development Objectives and Design

1.1 Context at Appraisal

Background and macroeconomic environment

Following the Oslo Accords[1] and the establishment of the Palestinian Authority (PA) in 1994, the economy experienced rapid growth as a result of factor accumulation: labor from the return of refugees and capital from large private inflows and donor support for public investment. GDP growth between 1994 and 1999 averaged 8.4 percent and the rate of unemployment halved to 9 percent.

This trend was quickly reversed at the end of the 20th century following the stalled implementation of the Oslo Accords with a rise in violence and the outbreak of public uprising (the second intifada) as well as the imposition by Israel of a multi-layered system of physical, institutional, and administrative restrictions, including severely limited access to conduct economic activity in Area C of the West Bank .[2] This exacted a significant toll on the economy and constrained private investment and productivity. Growth fell sharply such that the economy contracted by 9 per cent and unemployment rose to 28[3] percent by the end of 2000.

The first half of the new decade was characterized by weak growth stemming from political disorder and high uncertainty. In mid-2007, after Hamas took control of government and security positions in Gaza, a new PA caretaker government, recognized by Israel and the world, took office, undertook fiscal stabilization and reforms, with the Palestinian Reform and Development Plan (PRDP) 2008-10 serving as a road map, to strengthen the institutions necessary for a future Palestinian state. A 2007 donor conference

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1 The Oslo Accords – the first face-to-face agreement between Israel and the Palestine Liberation Organization -- set up a framework for resolving the Israeli–Palestinian conflict. It provided for the creation of a Palestinian interim self-government, with the responsibility for the administration of the territory under its control. The Accords called for the withdrawal of Israel from parts of the Gaza Strip and West Bank.

2 Israeli government has placed barriers that restrict the flow of goods and services, including imports, and labor throughout the West Bank, citing overriding security concerns for it and for Israeli settlements located in the West Bank. The territory of the West Bank is subdivided into three areas: Area A consists of large towns under PA control, Area B of small towns under PA administration but Israeli security control and Area C, the only contiguous territory in the West Bank which makes up about 61 percent of the West Bank territory, and in which the PA exercises no administrative or security control. Under the Accords, a gradual transfer to PA jurisdiction of Area C was envisaged and was to have been completed by 1997, but this transfer has not taken place thus far.

3 The unemployment rate during the fourth quarter of 2000 and after the second intifada was 28 percent; however, the full year unemployment rate for 2000 was 14 percent.

endorsed the plan and pledged $1.8 billion[4] in funding. A further plan covering 2011-13 aimed to consolidate gains in institution building and to focus on reinforcing the role of the private sector, modernizing the education system and investing in infrastructure.

Donor aid, PA reform efforts and some easing of Israeli restrictions enabled the Palestinian economy to recover. During 2008-2011, GDP growth averaged 9 percent, or a rise of 5 percent in income per head, led by expansion of the public sector and non-tradables, largely donor-financed. Public services grew from less than 20 percent of GDP in 1994 to more than 27 percent in 2011, whilst tradables chiefly manufacturing and agriculture) declined from 13 per cent to 10 percent, and 9 per cent to 5 percent, respectively.

However, high growth was not sustained. From an annual average growth rate of nearly 10 per cent over 2009-11, output expansion fell to 6 per cent in 2012, largely reflecting a withdrawal to demand from a halving of aid support as compared to peak aid support in 2008. Moreover, no significant further easing of Israel-imposed restrictions on factor and goods movements took place and therefore supply continued to be constrained. In 2012, the lower than expected aid flows compounded with the lack of new easing of Israeli constraints had an immediate impact on the Palestinian economy. Unemployment rose to 25 per cent; and, notably, by end-2011 one quarter of the population was in poverty.

Table 1: Selected Macroeconomic Indicators for the Palestinian territories, 2009-2014

				Estimate	Projections				
	2010	2011	2012	2013	2014	2015	2016	2017	2018
Output and prices	(Annual percentage change)								
Real GDP (2004 market prices)	9.3	12.2	5.9	1.5	2.5	2.7	2.9	2.9	3.0
West Bank	8.4	10.4	5.6	0.4	2.3	2.2	2.5	2.6	2.6
Gaza	11.9	17.6	6.6	4.6	3.0	4.0	4.0	4.0	4.0
CPI inflation (period average)	3.7	2.9	2.8	2.7	2.3	2.5	2.6	2.6	2.5
CPI inflation (end of period)	2.8	2.7	1.7	1.7	2.2	2.7	2.7	2.8	2.7
Investment and saving	(In percent of GDP)								
Gross capital formation, of which:	18.5	17.3	13.7	12.6	11.6	11.6	11.1	10.7	10.5
Public	3.6	3.8	3.8	3.6	3.1	3.8	3.7	3.6	3.5
Private	14.9	13.5	9.9	8.9	8.5	7.9	7.4	7.1	7.0
Gross national savings, of which:	7.9	-6.4	-15.2	-5.8	-9.6	-10.2	-11.0	-11.9	-12.6
Public	-0.5	-4.7	-6.6	-1.1	-2.0	-1.9	-1.0	-0.3	0.4
Private	8.4	-1.6	-8.6	-4.6	-7.6	-8.3	-10.0	-11.6	-13.1
Saving-investment balance	-10.6	-23.7	-28.9	-18.4	-21.2	-21.8	-22.1	-22.6	-23.1
Public finances	(In percent of GDP)								
Total net revenues	22.6	20.9	20.2	20.5	21.2	22.0	22.3	22.5	22.7
Recurrent expenditures and net lending	36.9	34.0	34.4	32.7	32.5	31.7	30.6	29.6	28.7
Wage expenditure	19.3	18.2	17.3	17.0	16.8	16.4	15.9	15.4	14.9
Non-wage expenditure	14.7	14.3	14.5	13.9	14.0	13.8	13.5	13.3	13.0
Net lending	2.8	1.4	2.7	1.9	1.8	1.4	1.1	1	0.8
Recurrent balance (before external support)	-14.3	-13.1	-14.2	-12.2	-11.3	-9.7	-8.3	-7.1	-6.0
Overall balance (before external support)	-19.7	-16.9	-16.6	-13.9	-12.9	-12.1	-10.7	-9.5	-8.4
Monetary sector	(Annual percentage change)								
Credit to the private sector	31.1	23.8	14.2	9.8	10.9	11.1	11.3	11.3	11.4
Private sector deposits	9.9	4.1	6.9	9.4	8.0	7.5	7.0	6.5	6.0
External sector	(In percent of GDP)								
Exports of goods and nonfactor services	13.8	15.4	16.3	18.4	18.2	18.2	18.2	18.1	18.0
Imports of goods and nonfactor services	55.5	59.1	63.1	58.9	59.7	58.7	58.1	57.8	57.6
Net factor income	7.2	7.3	7.0	7.1	7.1	7.1	7.0	6.9	6.8
Net current transfers	23.9	12.7	10.9	15.1	13.2	11.6	10.9	10.2	9.6
Private transfers	10.2	4.4	3.3	3.9	4.0	3.8	3.5	3.3	3.1

[4] Throughout this document, reference is made to the US dollar.

Official transfers	13.7	8.3	7.6	11.1	9.2	7.8	7.3	6.9	6.5
Current account balance (excluding official transfers)	-24.3	-32.0	-36.4	-29.5	-30.4	-29.6	-29.4	-29.5	-29.6
Current account balance (including official transfers)	-10.6	-23.6	-28.9	-18.4	-21.2	-21.8	-22.1	-22.6	-23.1
Memorandum items:									
Nominal GDP (in millions of USD)	8344	9775	10255	11282	12022	12813	13654	14536	15451
Per Capita nominal GDP (USD)	2061	1345	2389	2552	2642	2736	2835	2935	3035
Unemployment rate (average in percent of labor force)	24	21	23	25	27	28	29	30	31

Sources: MoF, IMF and WB staff calculations.

The reduction in growth sharpened in 2013 when GDP is estimated to have expanded by only 1.5 per cent, equivalent to a fall in output per head. Economic activity weakened in both West Bank and Gaza as fiscal strains were translated into wage arrears in the early part of the year and political uncertainty affected private and foreign investor confidence. Externally-imposed restrictions in Area C had a strong impact on activity, wages and employment. Private investment has averaged around 15 percent of GDP over the past seven years, as compared with rates of over 25 percent in fast-growing middle income economies and has largely been directed towards non-tradables. A recent report by the Bank[5] suggests that a one-time expansion in GDP of 35 per cent would occur should restrictions be removed, with the dynamic effects being highly significant over the long run.

In the absence of autonomous monetary policy, inflation is largely determined by that in Israel, and remains contained at 2-3 per cent. Unemployment continues to be high mainly due to low private investment. Despite high public employment (23 percent of the workforce is employed by the PA), unemployment is 18 percent in the West Bank and a staggering 39 percent in Gaza. The external current account deficit at around 18 per cent of output (including large official transfers) is associated with large positive errors and omissions and financed by use of cash and foreign deposits.[6]

Table 2: Central Government Fiscal Operations, 2010-2018

				Estimate	Projections				
	2010	2011	2012	2013	2014	2015	2016	2017	2018
Public finances (commitment basis)	(In millions of USD)								
Total net revenues	1884	2045	2075	2312	2553	2819	3045	3271	3507
Recurrent expenditures and net lending	3076	3323	3531	3694	3910	4062	4178	4303	4434
Wage expenditure	1613	1782	1769	1919	2018	2101	2171	2239	2302
Non-wage expenditure	1227	1401	1483	1565	1681	1768	1843	1933	2009
Net lending	236	140	278	210	211	179	150	145	124
Recurrent balance	-1192	-1278	-1456	-1382	-1357	-1243	-1133	-1032	-927
Development expenditures	450	370	243	187	194	308	328	349	371
Overall balance (before external support)	-1643	-1648	-1699	-1568	-1551	-1550	-1461	-1381	-1298
Total Financing, of which:	1643	1648	1699	1568	1551	1550	1461	1381	1298
Identified external financing	1275	984	932	1351	1196	1206	1220	1234	1248
Other	368	664	767	217	355	344	241	147	50
Public finances	(In percent of GDP)								
Total net revenues	22.6	20.9	20.2	20.5	21.2	22.0	22.3	22.5	22.7
Recurrent expenditures and net lending	36.9	34.0	34.4	32.7	32.5	31.7	30.6	29.6	28.7
Wage expenditure	19.3	18.2	17.3	17.0	16.8	16.4	15.9	15.4	14.9
Non-wage expenditure	14.7	14.3	14.5	13.9	14.0	13.8	13.5	13.3	13.0
Net lending	2.8	1.4	2.7	1.9	1.8	1.4	1.1	1	0.8
Recurrent balance (before external support)	-14.3	-13.1	-14.2	-12.2	-11.3	-9.7	-8.3	-7.1	-6.0
Overall balance (before external support)	-19.7	-16.9	-16.6	-13.9	-12.9	-12.1	-10.7	-9.5	-8.4

Sources: MoF, IMF and WB staff calculations.

[5] Area C and the Future of the Palestinian Economy (World Bank, October 2013)

[6] Reliability of the balance of payments statistics is questionable. Large positive errors and omissions on the current account side are likely, due to informal trade, in particular purchases of goods and services by Israeli citizens in the West Bank and unrecorded private transfer inflows.

The macroeconomic framework in 2013 was adequate to secure the objectives of the DPG-V- supported reforms as strong fiscal action was taken. Domestic tax revenue grew by about 17 percent (in nominal NIS terms) when compared to 2012, reflecting both a rise of one percentage point to 16 percent in the VAT rate in June 2013 as well as greater attention to tax collection. Clearance revenues grew by 9 percent (in nominal NIS terms) in 2013 as a result of the VAT rate rise and also higher collections from petroleum excise as Gaza starting importing fuel from Israel. Following an agreement with Israel, PA is provided with daily customs data on imports from Israeli customs, which has resulted in higher tax collections.

The falling trend in recurrent spending (50 percent of GDP in 2006 to 33 percent in 2013) was achieved through fiscal consolidation efforts aided by strong economic growth. Restraint was exercised in 2013 on the wage bill, which is the largest spending item representing more than 50 percent of recurrent expenditure. Specifically, the PA implemented a zero net hiring policy and reduced the Cost of Living Allowance to 0.75 percent from 3.5 percent in previous years.[7] These measures limited the growth of the wage bill (in nominal NIS terms) to 1.7 percent in 2013 compared to around 7 percent in previous years. Nevertheless, the wage bill as a percentage of dollar GDP remained very close to its 2012 level at around 17 percent due to strong depreciation in the USD/NIS exchange rate in 2013.

Efforts to rationalize spending on goods and services and transfers led to a fall in the share of nonwage expenditures in the economy by 0.6 percentage points in 2013. Finally, net lending declined by 0.8 percentage points of GDP in 2013, but only because Israel tolerated a further debt accumulation to the Israeli Electricity Company from non-payment of bills in the West Bank and refrained from setting off these amounts from clearance revenues.

The strong adjustment in the recurrent deficit as a percentage of GDP – a decline from 26 per cent in 2007 to 14 per cent in 2012 – continued in 2013 with a further fall to 12 per cent, despite the GDP slowdown. This trend was driven by solid reform efforts supported by strong growth. Nevertheless, the fiscal outlook is highly fragile: first, donor aid for recurrent spending has declined from $1.76 billion in 2008 to $1.26 million in 2013—even if this represents a sharp rise from $775 million in 2012; secondly, revenue performance despite a notable improvement in 2013, remains fundamentally weak. Particularly problematic is the low revenue yield from Gaza, but the tax base in the West Bank also remains narrow as a result of inefficiencies in both enforcement and policy. The costly subsidies on electricity remain a major source of expenditure inefficiency.

Reliance on arrears is a fiscal weakness. Despite the rise in donor assistance in 2013, arrears accumulation continued to be source of financing in 2013 in the amount of $492 million, of which $155 million (32 percent) is owed to the private sector suppliers, while the rest is owed largely to the pension system. Arrears exceeded the financing requirement and

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7 Net zero applied to administrative decisions—within the power of the Palestinian Authority. However, in 2013 the government had to implement a Court Decision which forced it to reinstate to work 698 civil service personnel, which were severed in 2007 following the internal split between West Bank and Gaza.

hence net domestic bank financing was reduced by almost $248 million, yielding a stock of debt to local banks of $1.27 billion by the end of 2013. The PA obviously prioritized the reduction of domestic debt over the repayment of arrears. Such a policy is part of a broader effort to reduce the cost of interest, which also includes a plan to issue bonds, as well as to enable growth in borrowing capacity, in case of contingencies, but it withdraws private sector liquidity, potentially, to the detriment of investment and growth. Finally, while further improvements in fiscal sustainability have to be made to reduce inefficiencies and respond to declining donor aid, full fiscal sustainability can only be achieved once the restrictions that constrain private sector growth have been removed. Otherwise, the toll on growth and the associated socio-economic impact would be severe.

Rationale for Bank Assistance and Relevance of the Operation

The fifth development policy operation supported the reform efforts of the PA in strengthening its fiscal position through actions on both revenues and expenditures, and it furthered the goal of improved governance and transparency standards in the public sector. Thus, it was the key instrument to advance the central objectives of the Bank Interim Strategy for the West Bank and Gaza[8]: to strengthen public policies and institutions in the PA and to prepare the Palestinian territories for eventual statehood. This rationale remains even more relevant at project closure in view of the improved prospects for a peace settlement and the urgency of constituting a Palestine state.

This operation has provided technical and institution-building support to the ministry of finance and the tax and customs authorities in improving tax administration. It has also supported change leading to improvements in the efficiency and sustainability of expenditures in the areas of wage bill management, health, and social protection policies. Through the implementation of such expenditure policies, the PA has developed much improved coordination between these two high-spending line ministries and the ministry of finance – a model that can be emulated at other spending ministries. The governance reforms were achieved through modern standards being adopted in procurement practices and by greater information disclosure in spending decisions.

A further critical rationale of the operation was to leverage budget support funds, whilst efficiency in the use of budget funds was being raised. Given the still-narrow domestic fiscal base, which to a large degree is a reflection of externally imposed restrictions faced by the economy, the internal division between West Bank and Gaza, the lack of access to international capital markets, and domestic borrowing capacity constrained by the lack of a local currency, both growth and the budget remain greatly dependent on donor funds.[9] Volatility in donor aid is highly disruptive to the conduct of fiscal policy and to predictability

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[8] Interim Bank Strategy for the West Bank and Gaza,: 2012-2014 (World Bank, March 2012)

9 Due to internal division between the West Bank and Gaza, the PA still provides services in Gaza (e.g. health and education), but collects very little revenues in Gaza. In fact, about 43 percent of PA's expenditures are destined to Gaza, while only 3 percent of its tax revenues come from Gaza, which on top of everything else represents a major challenge for PA's finances.

in essential payments for wages and supplies. Thus, the DPG-V provided $40 million in grant resources but leveraged up a further $200 million in donor budget support from a multi-donor trust fund established in 2008 specifically for this purpose. Crucially, it bolstered the predictability of resources available to the budget for essential public spending. The five development policy grants have provided $200 million from the Bank and an additional $1.03 billion from the trust fund for a total of $1.23 billion over 2008-2013.

At project closure, the relevance of the specific policy actions of the operation and the critical budget financing leveraged by it has turned out to be even greater as the reform agenda becomes ambitious with a peace settlement.

1.2 Original Program Development Objectives (PDO) and Key Indicators (as approved)

The Program Document (PD) defined the PDOs as follows:

The proposed operation aims to support the PA in strengthening its fiscal position and laying the institutional foundations for improved governance and transparency in the public sector. The program supported under DPG V will be organized in two policy areas to support the following aspects of the PA's NDP: (Policy Area 1) Strengthening the fiscal position by undertaking reforms to (i) increase government revenues, (ii) improve the efficiency of public expenditures, and (Policy Area 2) laying the institutional foundations for improved governance and transparency in the public sector. Given a sharp and larger than expected reduction in donor budget support in recent years, the urgency of conducting these reforms has increased substantially. The operation will directly contribute to Pillar 1 of the ISN aimed at strengthening the institutions of a future state to efficiently manage public finances and ensure services to citizens.

Key indicators were developed in the framework of results expected. They relate to revenue targets, containment of the wage bill, improved efficiency in health and social protection spending, conduct of public procurement and disclosure of information on transfers by the PA.

1.3 Revised PDO (as approved by original approving authority) and Key Indicators, and Reasons/Justification

There have been no revisions.

1.4 Original Policy Areas Supported by the Program (as approved)

The DPG V operation was designed to support the PA selectively in its implementation of the National Development Plan (NDP) 2011-2013. It focused on two policy areas identified in the NDP as high priorities: (i) strengthening the fiscal position; and (ii) improving governance and transparency within the public sector.

A critical medium-term priority for the PA rightly continues to be bolstering public finances through reform measures on revenues and expenditures. A future Palestinian state can attain stability and advance development goals only on the basis of a strong budget. Thus, measures to widen the tax base, improve tax administration, and improve the

predictability of tax receipts, *inter alia,* by negotiating regular and full transfers of taxes collected by the Israel authorities on behalf of the PA (the "clearance revenues") are important. Equally so are improvements in the efficiency of spending such as the reduction in waste in health spending and the targeting of resources in social protection. These actions will also help to counter in part both aid volatility and declining aid inflows.

Responding to public demand, the Palestinian authorities have placed a priority on enhancing governance and transparency. This is a challenging area that required improved laws and regulations as well as strengthened implementation capacity within a context of governance and PFM reforms. The operation supported reforms in public procurement and the disclosure of information.

1.5 Revised Policy Areas (if applicable)

Not applicable.

1.6 Other significant changes

No other changes.

2. Key Factors Affecting Implementation and Outcomes

2.1 Program Performance

As noted, the authorities maintained macroeconomic stability under difficult conditions and a sharp slowdown in GDP growth. The revenue performance was impressive and expenditures were broadly contained, with the overall fiscal deficit falling in relation to GDP. A sharp rise in donor support in 2013 permitted repayment of loans to local banks; nevertheless, the accumulation of arrears as noted continued to be an issue. In 2014 and beyond, the macro-outlook will depend greatly on the outcome of the peace talks currently underway, but it is clear that renewed long-term efforts at fiscal reforms and at curtailing the fiscal deficit will be necessary.

In the policy areas supported by the operation, public finances have been strengthened through institutional reforms, notably in tax administration, and through improvements in expenditure efficiency in social protection. While formal action in health was met, it represented only an early step in addressing this challenging problem (as has been indicated in the DPG V PD) and due to delays in implementing follow up reforms (largely caused by the change in government in the summer of 2013) the expected efficiency gains have not yet been achieved. The budget commitment on introducing a net zero hiring, has been implemented, as the number of employed individuals exceeding those who left the public sector only by 168 staff who had already been in the pipeline to be hired before the measure came into force. This is in stark contract with previous years when the number of public service employees grew by about 3,000 per year. Furthermore, gains in governance and transparency sought by the operation have been achieved in the area of public disclosure of information. Following the implementation of the procurement prior action supported by DPG V, the reform process has been slower

than anticipated, largely due to a change in government during the summer of 2013, but reform efforts have accelerated again recently.[10]

A detailed account of program performance in terms of prior actions is given in the table below. The agreed program was implemented, but one of the nine prior actions, the action on restraining a category of health expenditures – medical referrals – was formally taken but proved to be ineffective in reaching its objectives. The performance is discussed in detail below as well as in sections on the assessment of outcomes and lessons learned.

Table 3 : Program Implementation

Policy Area I : Strengthen PA Fiscal Position	
List conditions from Legal Agreement/ Program Document	**Status**
Prior Action 1: The VAT Administration and the Customs Administration have been successfully merged in accordance with a decision of the Ministry of Finance and a new single administration has a new organizational chart and is fully staffed and operational.	**Met** The merged service will implement a unified revenue management system and is developing a plan to improve tax collections, with a focus on large tax-payers, on improved data sharing with Israel on clearance revenues and full use of the data from a recently introduced new Revenue Information Management System to check customs valuations and collections. This action was supplemented by a strengthened revenue strategy and further revenue reforms approved by the Cabinet in February 2014. The highly commendable developments in revenue performance in 2013 cannot be attributed to one particular action, but the set of institutional changes taken by the government.
Prior Action 2: A new Tax Identification Unit has been established within the Revenue Administration of the Ministry of Finance and is adequately staffed	**Met** This unit will cover all taxes and customs duties and provides critical support to the Revenue Council responsible for overall policy and implementation chaired by the minister of finance. Its first task in the coming weeks is to complete a tax payer register, deal with delinquents and those not registered.
Prior Action 3: All new hiring and promotions of the employees of the	**Met** Employment was frozen between August 25

10 Implementing arrangements have been agreed, which required some amendments to the Law on Procurement and these amendments were approved by the Cabinet on March 24, 2014. The implementing regulations have also been submitted to the Cabinet and their approval is expected on April 2, 2014. Their approval will put in place the legal and institutional framework for a modern procurement system to start operating.

Palestinian Authority have been effectively frozen during the period of August 25 – December 31, 2012 in accordance with a decree of the President of the Palestinian Authority	and December 31, 2012.
Prior Action 4: The Cabinet of Ministers has adopted a decision mandating zero net hiring of civil and security personnel in the 2013 Budget of the Palestinian Authority	**Met** The action was taken. In 2013, net increase in staff (excluding the Court Decision referred to earlier) amounted to 168 persons. The excess of 168 employees are those who had been in the pipeline when the net zero policy became effective. This number amounts to less than 0.1 per cent of the total civil service and security force, with increasing number of teachers and health personnel slightly exceeding the reductions that took place elsewhere. It may be noteworthy, that the Palestinian population is increasing at 3 percent on year on average and therefore no increase in the number of staff leads to reducing the size of the public sector relative to population.
Prior Action 5: The Ministry of Social Affairs of the Recipient has adopted a decision mandating the application of a proxy means test (PMT) formula set forth in the Cash Transfer Program's Operational Manual to determine the eligibility of households categorized as the "vulnerable group" to receive cash benefits under the Cash Transfer Program.	**Met** The PMT is now applied mandatorily. The PMT is used to determine the eligibility of those vulnerable (elderly, disabled, female-headed household, chronically ill) but otherwise not severely poor to receive cash transfer benefits.
Prior Action 6: The medical referral process has been strengthened through formal decisions and instructions taken by the Minister of Health to expand and refresh the membership of medical referral committees, to centralize the process by bringing the referral audit function under the direct authority of the General Directorate for Health Insurance, and instructions to medical referral committees to make referrals to medical institutions in Israel only when absolutely necessary and with the Minister's prior approval.	**Met** The referral committees cover geographical areas; three in the West Bank and one in Gaza. They have been refreshed with non-government members and improved criteria for decision-making. The administration and accounting is centralized.

Policy Area II: Increase Government Transparency and Accountability Through Improved Public Procurement and Disclosure of Information.	
List conditions from Legal Agreement/ Program Document	**Status**
Prior Action 7: The Higher Council for Public Procurement Policy has been established by a decision of the Cabinet of Ministers, its members have been appointed and it has prepared a set of draft regulations on public procurement.	**Met** The Higher Council for Public Procurement Policy has been established and its membership appointed. The draft set of regulations that it has prepared have been submitted to the government and is expected to be approved by the Cabinet during its April 1, 2014 session.
Prior Action 8: As of January 2013 the Ministry of Finance has started the practice of publishing quarterly reports on the allocation of property tax to municipalities that specifically indicate each deduction from the amount collected and the amounts paid to local government units.	**Met** Ministry of Finance quarterly reports reflect property tax allocations to municipalities and deductions made for unpaid municipal obligations relating to municipal purchases of goods and services.
Prior Action 9: Starting with January 2013 monthly fiscal reports published by the Ministry of Finance on its website are revised to include a breakdown of transfer expenditures into main subcategories (e.g. pensions, social benefits).	**Met** Ministry of Finance monthly reports provide the required breakdown of transfer spending.

2.2 Major Factors Affecting Implementation:

Improving prospects for a peace settlement and the government's commitment to fiscal consolidation contributed to operation's success. The reform program was implemented against the backdrop of a resumption of serious peace negotiations between Israel and Palestinian territories with unprecedentedly strong external pressures promoting a settlement. This reinforced incentives on the PA to implement its NDP commitments so as to be well prepared for eventual statehood. The likelihood of greater external funding, especially for investment, in the event of a peace settlement added to the viability of reforms. Finally, but perhaps more importantly, the government's commitment to fiscal consolidation in response to a trend of declining donor aid in recent years was the key factor in the operation's success.

A sharp drop in growth added to the burden of macroeconomic adjustment. Reforms took place against a sharp slowdown in growth which affected the tax base. The government's measures aimed at reining in the oversized wage bill encountered resistance and led to public strikes. The net freeze on public employment closed off a traditional valve to deal with high unemployment, especially youth unemployment. These factors led to popular discontent and protests and increased the prospect of serious unrest. However, without the measures the government took to control the wage bill, its arrears to the private

sector would have most likely been even larger than they were with a more severe social impact.

The change in government that took place during the summer of 2014 and a temporary resignation of the new Prime Minister affected the pace of reforms. It took several months of government consolidation before it became clear that the new government is, indeed, committed and continuing the reform efforts started by its predecessor in policy areas such as tax revenues, public procurement, and the health sector.

More ambitious reforms, although needed in the future, were not feasible for several reasons and therefore the design of the operation was appropriate. Thus, revenues will be sustainably bolstered only through continued and systematic efforts to widen the tax base, particularly on personal incomes and profits taxes, reductions in exemptions, particularly on highly expensive, wasteful and ineffective tax holidays, and improvements in tax administration practices. The recently-adopted revenue strategy and action plan marks an important step in the right direction. Ambitious civil service reforms will be needed to ensure long-term sustainability of the wage bill, but given capacity constraints and the current political economy of high unemployment, such reforms are not feasible at the moment. Furthermore, the failure of the reformed administrative structures and new rules in the health ministry to make any significant dent in the expenditures on medical referrals, largely because of weaknesses in systems and the political pressures for quality (but unaffordable) health care, indicates that more ambitious reforms are, indeed, needed, but were not feasible at the time. The new government has also reinvigorated efforts to reduce the cost of health referrals and several donors are providing technical assistance to the process, including the Bank, but the results of these efforts are yet to be seen. Furthermore, the measures supported in the area of procurement needed follow up actions in order for the intended results to be achieved. Finally, the setting up of new structures in public procurement has been time-consuming and faced some delays partly as a result of the change in government, but the whole effort has been recently reinvigorated and the legal and institutional framework for a modern procurement system is now in place.[11]

Under these conditions, the progress made by the PA in advancing the reforms during 2013 – the period covered by this operation – is certainly commendable. Restrictions on access and flows of labor, capital stifle economic development as does the internal political strife. Reforms would have led to greatly enhanced results over the long term had the restrictions imposed by the Israeli authorities on grounds of security been eased. These restrictions prevent free movements of goods and services, and labor and investment throughout the West Bank and Gaza and prohibit a range of essential imports necessary for investment and growth. They cause the tax base to shrink by hampering private sector activity, and lead to a rise in social tensions from the missed opportunities in employment. Internally, the political division between the West Bank and Gaza and attenuated political cooperation between Fatah, which governs the PA, and Hamas, the *de*

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11 At this stage capacity building efforts and internalization of new regulations and guidelines and the independent operation of the new structures free of political interference will be critical in ensuring sustainability of the reform progress achieved so far.

facto authority in Gaza, hamper reform gains. The closure of informal (but important) trade routes between Egypt and Gaza has imposed significant economic costs as well.

In the fragile context that Palestinian is, the sustainability of any reform efforts could be undermined should the political and security situation deteriorate. The political *stasis* (both vis-à-vis Israel and the Fatah-Hamas divide) constrain the sustainability of all reform efforts to the detriment of growth and raise risks. This key risk was recognized and taken into account in the preparation of the operation. However, the operation also acknowledged that this risk cannot be mitigated.

The factors affecting implementation were taken into account at preparation of the operation. The authorities were adjusting fiscal policies as well as building institutions for effective macro-fiscal and public finance management. The external and political constraints -- largely beyond the control of the PA – merited enhanced donor budget support to enable the provision of essential public services, promote stability and development. Both the IMF and the Bank have formally encouraged donors to provide more aid and ensure its predictability.

The operation was firmly embedded in the Bank's Interim Strategy and its design was underpinned by recent and relevant analytical work. The operation was frank in recognizing risks, including fiduciary risks. While certain identified risks were beyond the control of the Bank or the authorities, the operation supported policy actions within the official reform program that were largely immune to exogenous risks.

A more detailed discussion of the impact of the reforms, causal relationships, sustainability and lessons to be drawn follow in later sections of this report.

2.3 Monitoring and Evaluation (M&E) Design, Implementation and Utilization:

The design of the M&E arrangements built upon those developed under the earlier four development policy grants. The results framework of the DPG was agreed with the authorities and developed in consultation with other development partners. As has been the practice, the results framework was developed not only to monitor progress under the DPG, but also to monitor the implementation of the Multi-Donor Trust Fund (the source for donor funding to the budget) aligned to the NDP. Since both the DPG and the PRDP TF support the implementation of selected key objectives of the PA's strategy and aim to provide stable and predictable financial support to the PA budget, a shared results framework for the two operations has provided additional leverage to reform implementation. The indicators used were direct measures of project objectives, the data was collected by the statistics agency and finance and line ministries, and enjoyed full ownership across the government.

The monitoring arrangements have been institutionalized in the ministry of finance. Based on the inputs from line ministries and other government agencies, the PA prepares quarterly reports on a regular basis to monitor the performance under both the DPG and the PRDP/NDP MDTF. The same arrangement is utilized to monitor progress against the PA's medium term program. These reports are placed on the website of the ministry.

A stronger strategic dialogue within the government is a signal achievement. It is clear that the operation has strengthened the strategic dialogue between the ministry of finance, on the one hand, and the ministries of health and social protection, on the other, as well as led to a focus on implementation of agreed measures. Thus, the ministry of finance monitors the developments in medical referrals, particularly expenditures, and has been a partner in discussing future reform steps. The imminent development of a website that will be used as a MIS as well as a tool for managing referrals from later this year will involve the ministry of finance as a participant. The ministry of finance has also been following social protection expenditures and measures to limit spending on vulnerable groups and will play a part in the design of social assistance reforms. The reporting requirements on these line ministries have improved implementation discipline. The ministry of finance itself was responsible for fulfilling the revenue and hiring actions as well as information disclosure. These developments can clearly be attributed to the design and the use of the M&E arrangements.

These practices are indicative of good use of M&E data. In practice, the validity of the choice of M&E indicators as reflective of the causality linking policy measures to outcomes and final development goals was validated, particularly as the indicators were entirely outcome-based. Moreover, developments in the indicators are being used to redesign subsequent interventions, such as in medical referrals, to obtain satisfactory results; this is indicative of the use of the M&E systems to guide future policies.

The result indicators used in the operation were aligned with the objectives of the Bank's Interim Strategy Note, specifically with those of enhancing fiscal sustainability and strengthening public sector governance.

The specific objectives laid out in the results framework are closely related to PDOs. The actions supported by the operation were chosen to lead to the outcomes that would advance the PDOs. In the area of revenues (prior actions 1 and 2), institutional changes were expected to lead to a rise in taxes collected directly by the PA in nominal terms and in relation to GDP. The tax yield rose above the target and although this achievement cannot be exclusively attributed to the institutional changes specifically embodied in the operation (as the new structures, whilst constituted, are still to begin to function adequately), those changes provided an impetus for stronger enforcement efforts. Other improvements in tax administration practices that have taken place were in train prior to the operation within a medium-term reform plan and these also led to improved tax collections.

In the areas of expenditure efficiency (prior actions 3 to 6), the strong restraint on net hiring has helped to control the wage bill, the largest expenditure item in the budget. This attribution is clear: had past hiring practices been followed the wage bill would have risen in relation to GDP, in particular given the slump in growth. The actions on the cash transfer program has limited categorical spending and improved social protection spending efficiency; without this step, more of the severely poor would have been squeezed out of the social protection system to the detriment of poverty – again the attribution is persuasive. Actions in health, whilst necessary, were not sufficient to attain the outcome of reduced reliance on referrals as the implementation of other measures that were expected to follow has not taken place.

In the area of governance and transparency (prior actions 7 to 9), institutional changes have taken place and promise a much improved procurement, but there have been delays in implementation (as explained earlier) and the target values were not reached within the given timeframe. The disclosure of fiscal information will assist municipalities as well as budget formulation, with the outcome being clearly a consequence of actions taken, and fully supportive of the PDOs.

2.4 Expected Next Phase/Follow-up Operation (if any):

At the request of the PA, the Bank is presenting a follow up DPG operation to the Board in May 2014 intended to support a further phase of forms under the NDP and serve as a platform for donor support to the budget in 2014. DPG-VI will support three development objectives of the NDP: (i) reducing the PA's recurrent fiscal deficit, (ii) strengthening public finance management and (iii) improving the business climate. The operation is following up with new measures to enhance revenue performance, contain the wage bill reforms and finalize the institutional framework for the new public procurement system to start operating.

The operation will directly contribute to Pillar 1 of the ISN aimed at strengthening the institutions of a future state to efficiently manage public finances and ensure services to citizens, as well as Pillar 2, aimed at supporting the creation of an enabling environment for private sector-led growth. The inclusion of the private sector development is justified by the role the private sector has to play in sustained growth and job creation, particularly given brighter prospects for a peace settlement in which case regulatory inefficiencies would become the new binding constraint to private sector growth (replacing political uncertainty and restrictions).

Four important reform areas in the public sector will not be addressed by the proposed new operation: (i) pension system, where the government continues to accumulate arrears, de facto borrowing from the pension fund while current pensions payments are made regularly; but the system is not sustainable in the long term without reforms; (ii) health, where the medical referrals system is inefficient and costly; (iii) civil service reform to ensure a right-sized and adequately paid civil and security services; and (iv) measures to ensure financial viability in the electricity sector. The Palestinian Authority still does not see pension reforms as a top priority, which is not surprising given the unfavorable political economy for such reforms. Although the PA has launched reform initiatives under the last three reform areas and the Bank is continuing policy dialogue with the authorities around them, their absence in the follow up operation is appropriate for varied reasons: systematic reform efforts that were announced by the previous government have not taken place and although a reform taskforce has recently been put in place, no specific actions that promise tangible results have yet taken place; substantial amount of work is taking place that would facilitate civil service reforms in the future (such as the creation of job classifications and descriptions, the introduction of a new information management system), systematic reforms require further technical work and most probably enhanced job opportunities in the private sector; in the electricity sector, analytical work that is necessary to thoroughly understand the problem and prioritize reforms is just being finalized and institutional arrangements to support reform efforts have recently been put in place and the first significant action that promises results in this area has been taken only very recently.

3. Assessment of Outcomes

3.1 Relevance of Objectives, Design and Implementation

The objectives of the DPG remain highly relevant; even more so at grant closure than at the design stage of the operation in view of the improved prospects for a peace settlement that have raised the urgency of constituting a Palestinian state, but also in view of a heightened urgency in ensuring sustainable budgets. As noted, the operation supported strengthening a critical element of statehood: a viable budget with a firm base for domestic taxation and greater efficiency in public expenditures. Improvements in governance and transparency respond to public demand. Thus, the operation supported selected key elements of the NDP and was fully aligned with the Bank's ISN. Moreover, it served as the vehicle for donor financing of the PA budget in the aggregate amount of $240 million.

The design of the operation had to find the balance between critical reform elements and the art of the possible. The policy areas chosen and the actions were high priority in focusing on revenues, reducing inefficiency in wage, health, and social protection spending, and in promoting governance through procurement reforms and public disclosure of budget information. As observed, the PA has struggled to deliver meaningfully on some of these reforms – health expenditures most notably.

Implementation constraints were the decisive factor in the decision to exclude three areas where early action is warranted in the interests of fiscal stability – civil and security service reforms, pension reforms, and health. The operation was also bereft of actions or indicators on electricity payments which continue to bedevil net payments: arrears in payments to the Israel generating company on the part of municipalities and other consumers are deducted by Israel from taxes collected by it on behalf of the PA. Greater volumes of clearance revenues and much higher predictability in flows will arise if current efforts to negotiate arrangements between Israel and the PA on both electricity supply and billing reforms and medical referral reforms succeed.

Finally, despite substantial improvements in the PFM systems in recent years that took place amid a large degree of political uncertainty, the still PA suffers from deficiencies in public finance management and strengthening these systems remains highly relevant. The accumulation of arrears is but one piece of evidence of PFM weaknesses. The budget preparation process is basic, budget execution, commitment control, and cash forecasting and management are weak spots, accounting, auditing, management and reporting also require strengthening. The PA is receiving technical assistance notably from the Bank and DfID in some of these areas. Improvements in procurement have to be matched by PFM strengthening if governance standards are to be truly elevated; this task is all the more urgent as a peace settlement is likely to lead to stepped-up investment spending through the budget. On the basis of a recent PEFA report, the authorities are planning a set of reforms. Encouragingly, the proposed DPG-VI operation follows up with PFM reforms aimed at strengthening budget execution and arrears management.

3.2 Achievement of Program Development Objectives

Specific evidence on the achievement of the PDOs and the related outcome indicators are provided in the ICR data sheet. The data sheet also assesses the causal linkages between the individual policy actions and the outcome indicators against plausible counterfactuals.

In summary, the PDO achievement success can be rated as moderately satisfactory. On the first policy area, strengthening the fiscal position, revenue results were commendable, and on expenditures the wage bill was contained, but the sought-for result in medical referral expenditures in health was not achieved. Overall, the fiscal adjustment measures led to a commendable fall in the deficit equivalent to two percentage points of GDP. Questions, however, arise as to the sustainability of these results. In the second policy area, governance and transparency, although progress has been achieved over the baseline, target values on procurement have not been achieved within the envisioned timeframe, with some delays taking place, but these are well on the way due to a recent reinvigoration of the reform effort. The transparency indicators were met.

RESULTS FRAMEWORK ASSESSMENT

Strengthen the PA Fiscal Position

1.1 Enhance public sector revenues

Achievement.

Prior Actions 1 and 2. **Achieved**. The indicator relates to the taxes directly raised by the PA; therefore it excludes those collected on its behalf by Israel, and appears to be a measure in dollars (in view of the baseline value in dollars), though this should have been explicitly stated. The indicator rose by 25 per cent in dollar terms in 2013 or by 0.5 percentage point of GDP.

Comment. Although this commendable result cannot be exclusively attributed to the institutional changes specifically embodied in the operation (as the new structures, whilst constituted, are still to begin to function adequately), those changes provided an impetus for stronger enforcement efforts

1.2 Enhance efficiency of public expenditures

Achievement.

Prior Actions 3 and 4. **Achieved**. The nominal wage bill in shekel terms has grown by 1.7 per cent or well below the result sought of a rise capped at 4.25 per cent. The wage bill in relation to GDP fell from 17.3 per cent in 2012 to 17 per cent in 2013 despite a sharp slump in GDP growth. DPG-VI continues to support wage bill restraint.

Comment. Action 3 was implemented in 2012 and started the effort to reduce the wage bill to GDP ratio by keeping a lid on new hiring. The process continued with Action 4 that was implemented in 2013, which proved appropriate and effective in obtaining the result sought. The ideal way to rationalize the wage bill would be through the pursuit of civil service reforms, including functional reviews and a pay grading exercise, which is not a priority in the PA currently.

Prior Action 5. **Achieved**. The number of households in the vulnerable category receiving cash benefits fell from 19,200 at end-2012 to 18,906 at end-2013 as a result of the effective implementation of the decision to mandate the application of the proxy means test.

Prior Action 6. **Not Achieved**. The actions outlined were taken but were inadequate to address the problem of unjustifiably high and unaffordable spending on medical referrals to private providers within the West Bank, Israel and other foreign countries. The total referral costs rose by 8.5 per cent. The share of total referral costs in health spending rose from 37 per cent in 2012 to 43 per cent in 2013.

Comment. As noted earlier, the operation supported what was envisioned to be the start of a more systematic reform effort. However, following the change in government, several months passed without the implementation of any meaningful follow up measures to curtail the referral costs. The new government has as of recently reinvigorated reform efforts in this area with the assistance of several donors, but their recent attempt to take strong action to improve governance in the sector by prohibiting doctors from working simultaneously in the public health sector and providing health services privately has encountered strong resistance. Furthermore, political pressures to provide referrals and the nascent medical councils that provide technical judgments on referrals are also factors subverting expenditure control. According to the PA, another factor that affects the costs of referral services in Israel are the incentives in Israel to maximize the supply of such services, without attention to efficiency and economy, as they sometimes take patients in without prior approval by the PA and deduct the costs of such services directly from clearance revenues without any prior authorization by the PA. The current efforts by the PA to establish service agreements with Israel would limit referral services to only those with prior PA approval with pre-agreed unit costs and full data and management information sharing that also involves the ministry of finance would be a significant step towards referral control.

II.1 Strength transparency of public finances

Action 7. **Not Achieved**. The institutional reforms were implemented but with delays in the functioning of the procurement structures. Specifically, the implementing regulations to the public procurement law were prepared, but their approval was delayed and has recently been scheduled for April 2, 2014; thus, they are not as yet used in public procurement. Consequently, the national standard bidding documents and the procurement manual are being completed, but are not as yet in use. However, improvement has been made from the baseline as the Public Procurement Council is now functional and the implementing regulations were both drafted and submitted to the Cabinet for adoption.

Comment: Importantly, these deficiencies are now being addressed. DPG-VI rightly provides support for the continuation of reforms.

Actions 8 and 9. **Achieved**. The publications can be found every quarter on the website of the ministry of finance. As a result, municipal authorities and the public have easy access to information on transfers of property taxes to local authorities and deductions made with respect to outstanding expenditures by municipalities on electricity and other items. Similarly monthly fiscal reports from the ministry of finance contain details of transfer expenditures.

3.4 Justification of Overall Outcome Rating

Rating: **Moderately Satisfactory**

As noted in earlier sections, the operation is judged to be highly relevant in targeting the key objectives of the PA reform priorities as expressed in the NDP, and in particular fiscal reforms the importance of which has recently increased, and it is well aligned with the central goals of the Bank ISN. Relevance in design was also strong; the policy areas critical and the reform actions selective in their efficacy towards reaching the PDOs as well as being in the realm of implementability. Relevance is judged to be satisfactory.

The operation achieved most of its objectives but with moderate shortcomings in certain areas. Impressive were the revenue performance, the containment of the wage bill, efforts to further enhance the efficiency in social protection spending, and the advances on transparency in budgetary transfers. In contrast, shortcomings can be seen in containing health costs and in the delays with the implementation of public procurement. Thus, efficacy can be judged to be moderately satisfactory.

The implementation environment was challenging and volatile. A difficult and complicated change in government took place that was marked by the resignation of its newly appointed Prime Minister and his subsequent reappointment. Growth was sharply reduced, unemployment increased and no significant relaxations of the constraints posed by Israel on economic activity were experienced.

3.5 Overarching Themes, Other Outcomes and Impacts

DPGs are being structured as standalone operations in view of the political uncertainties and unpredictability of the external environment. Aid volatility is an additional factor. Nevertheless, looking at the six DPGs thus far, a clear programmatic character to these operations emerges. The underlying thread has been the aims of (i) strengthening the PA fiscal position and (ii) increasing government transparency and accountability.

Though this ICR evaluates DPG-V only, it is worth noting the impressive progress made against both of these broad development objectives as a result of a *de facto* programmatic, yet flexible form of engagement through DPGs I-V. A clear indicator of fiscal strengthening is the fact that recurrent expenditures were reduced from nearly half of GDP in 2009 to one-third in 2012, without jeopardizing the quality of social and other services; indeed, with some

improvements.[12] While the PA continues to substantially rely on external financing for recurrent expenditures, predominantly because of the unresolved political status, which stifles economic activity in the private sector, it has made some improvements in the efficiency of public spending.

The fiscal consolidation and efficiency improvements have benefited from efforts aimed at improving government transparency and accountability, with recent gains in disclosure of information. The foundations for improved procurement practices have been laid. Despite some gains in public finance management reforms, supported by the first four DPGs, there is a long way to go as a recent PEFA exercise illustrates.

Questions arise as to the sustainability of not only DPG-supported, but any reforms notwithstanding client ownership and determination to succeed, and the recognition of the centrality of such reforms to eventual statehood. Sustainability could be seriously undermined with a deterioration of political and security situation, which would also have a negative impact on the Palestinian economy. Furthermore, long term sustainability of reforms in some areas, such as the containment of the wage bill, also require more systematic reform efforts, which in turn call for an improvement in the political and security situation and the lifting of restrictions to support growth of the private sector.

(a) Poverty Impacts, Gender Aspects, and Social Development

The operation has significant implications for poverty and social development. Fiscal stability will lead to improved quality of public services with improved predictability and greater assurance of social spending. It provides vital resources and leverages additional support to the budget, which enables the provision of essential public services, such as education, health, and the provision of social assistance through one of the most advanced Proxy Means Targeting (PMT) systems in the region. The development objectives of the operation, through specific policy actions, also indirectly address both poverty and welfare through the strengthening of public revenues, improving the quality of governance and of public expenditures. These reforms are important prerequisites for sustainable economic growth, the most important tool for poverty alleviation and broader social development.

(b) Institutional Change/Strengthening

Institutional strengthening has been at the core of this operation, given its clear importance for a successful state. Specifically, the strengthening of the fiscal institutions was achieved through the merger of the customs and tax revenue-raising authorities thereby reaping efficiency gains and by the formation of the dedicated tax identification unit. The establishment of the High Council on Public Procurement is also notable.

Apart from such structural changes, modernization in ways of government functioning, such as improved coordination between the finance and the spending ministries, the greater role

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[12] For instance, the PA operates one of the best targeted cash transfer programs globally, with rising coverage of the poor.

for the specialized agency for personnel management, and improvements being negotiated in cooperative arrangements with Israel as well as improved inner-PA workings on the important issues of electricity payments and medical referrals offer examples of institutional change with potentially far-reaching consequences.

3.6 Summary of Findings of Beneficiary Survey and/or Stakeholder Workshops

Not applicable.

4. Assessment of Risk to Development Outcome

Rating: Substantial

The operation was implemented in an environment of high overall risk – political, social, institutional, and economic. The ISN encapsulates the overall operating environment for all Bank activities, "In West Bank and Gaza, the Bank operates in an environment of high political and security ambiguity. The uncertainty of the peace process and the isolation of Gaza in particular have a direct negative impact on the Bank Group's agenda and program implementation."

The overall political risk is largely exogenous and beyond the control of the authorities: relating to the tight externally-imposed restrictions on economic activity throughout the Palestinian territories. In addition, the amount and volatility in donor aid flows in a highly aid-dependent economy constitutes a major risk to the sustainability of the development achievements of DPG-V. Internal risks – within the control of the authorities – relate to the reconciliation process between the political authorities in West Bank and Gaza.

Thus, fiscal sustainability – a key achievement of reforms -- depends acutely on the peace process. The objective of strengthening governance and transparency in the public sector is arguably less exposed to the above risks, as the outcomes do not directly depend on the level of economic activity and foreign financial assistance, but if the political situation were to deteriorate, the achievements on that front would also be jeopardized.

Internal social risks stem from the political fracture within the Palestinian political establishment as noted and hence less than adequate cooperation between West Bank and Gaza. High unemployment, especially among the youth, and the frustrations of living in a restricted environment carry the potential of severe civil disorder.

The major economic risks arise from the need to reinforce reform measures taken under DPG-V with deep-seated and sustained policy change so that the gains can become permanent. This point has been elaborated in earlier sections of this document.

The key risks have been taken into account in the operation's design and mitigation mechanisms to the extent possible were put in place. Simplicity in reform design and alignment with the PA's own strategy to strengthen ownership mitigate risks. The operation itself addresses one of the main risks to fiscal stability at the moment—that of predictability of indispensible donor financial assistance. The operation also supports the reduction of dependence on donor financing of the PA budget through measures to boost domestic revenues and increase efficiency of public expenditures. In addition, the measures supported by the operation to strengthen governance are also intended to increase the efficiency of

public expenditures, and could also contribute to internal stability by enhancing governance and transparency in the public sector.

Finally, PA ownership for the reforms supported by the operation is a strengthening factor. Despite the constraints, the PA has managed to develop economic management practices on par with those of some middle income countries that do not face even the fraction of its risks and challenges.

5. Assessment of Bank and Borrower Performance

5.1 Bank Performance

(a) Bank Performance in Ensuring Quality at Entry

Rating: Satisfactory

DPG-V was designed to address some of the key reform priorities of NDP. Thus, the strategic relevance of the operation was high, it was also strategically aligned with the ISN and the approach of tackling fiscal stability and governance challenges was fully appropriate and timely. The design rested upon solid analytical work in all areas covered by the operation, in particular regular fiscal reporting (*inter alia* for donors), a PEFA, a CPPR, and health and social protection analyses. The macroeconomic framework was the fruit of close dialogue with the PA and well coordinated with the IMF, and rested on shared Bank-Fund judgments. Particular care was taken to develop a quality M&E set of arrangements in close work with the authorities.

Much attention was paid by the Bank to the fiduciary arrangements given well known weaknesses. The implementation arrangements included improvements in inner-government coordination, which will be further extended both within the government and also to Israel as durable solutions to electricity and medical referral payments are sought. The team was conscious of risks and the need to mitigate them to the extent feasible.

(b) Quality of Supervision

Rating: Satisfactory

Supervision was facilitated by strong M&E and regular reporting arrangements that the borrower had put in place. The alignment of the results framework of the DPG with the multi-donor trust fund (PRDP) was particularly beneficial. The authorities prepared regular quarterly reports on implementation progress which formed the basis for Bank supervision for both the DPG and the PRDP trust fund. The Bank supervision team also prepared detailed quarterly supervision reports that analyzed developments and provided guidance as to future actions. These reports drill down into developments and pro-actively identify possible risks.

The operation was supervised by the Task Team Leader (TTL), resident in the West Bank and Gaza Office in Jerusalem, as well as the team of sector and thematic specialists resident

in Jerusalem in close dialogue with the authorities. Pro-activity was facilitated by the highly frequent nature of the dialogue on all aspects of the operation. The long-term reform lens was preserved by the fact that the future DPG was being prepared at the same time and lessons were being incorporated into its design. This permitted a sharp focus on development impact and how best to maximize it. The candor of the dialogue and of the written reporting also assisted in improving implementation. .

(c) Justification of Rating for Overall Bank Performance

Rating: Satisfactory

Quality at entry and quality of supervision are both rated satisfactory, resulting in the overall rating of Bank performance of satisfactory.

5.2 Borrower Performance

(a) Government Performance

Rating: Moderately Satisfactory

The ownership and commitment to achieving the development objectives on the part of the PA has been commendable in both policy areas of the operation. This results in part from grounding the operation squarely in the NDP and in the selection of certain critical high priority areas for support The leverage created by the operation in donor funding strengthened the enabling environment for reforms. The authorities held commendably to a stabilizing macroeconomic course with timely adjustments in fiscal policy.

Performance fell short of expectations in two areas: (i) raising the quality of health spending where formal institutional changes proved to be insufficient to rein in referral spending and follow up reforms that the previous government announced have not yet been put in place; and (ii) public procurement, where delays in implementation progress prevented the achievement of intended results within the envisioned timeframe. Despite some recent ad hoc measures and the creation of the health referral reform taskforce, specific reform action plan that would put health referral costs on a sustainable footing has not yet been put in place by the new government. In procurement, implementation delays can only partly be justified by the transition to a new government.

The authorities maintained a close and cooperative dialogue with the Bank and other development partners, and with other stakeholders such as users of health and social protection services. They operated the M&E system effectively, in particular with the use of data gathered to ensure effective implementation and to influence design of future policies. They were ready to absorb the lessons from the current operation for the design of DPG-VI.

Taking the factors discussed above into account, a rating of Moderately Satisfactory for the Borrower is justified.

(b) Implementing Agency or Agencies Performance
Rating: Not Applicable

(c) Justification of Rating for Overall Borrower Performance
Rating: Moderately Satisfactory

6. Lessons Learned

The reform momentum can be safeguarded only through a combination of strong client commitment and assured donor financing for the budget. This operation was nestled within the NDP, was selective in its approach, and leveraged a five-fold additionality in donor financing. These factors created powerful incentives for success, even in a highly difficult political environment – both external and internal.

Firm attention to macroeconomic fundamentals is a necessary condition for success. Two implications follow: first, fiscal adjustments have to be adequate; second, the budget has to be adequately financed and this means full and predictable donor financing. Were the fiscal accounts to come under strain, the vital reforms in expenditures would unravel.

Single tranche operations should continue to be designed with a medium-term agenda in mind as was the case with DPG-V. This approach preserves flexibility in a highly uncertain environment, it is useful as a platform for the reform dialogue and as a stepping stone to future DPGs and eventually to a programmatic medium term series of grants or credits.

Over the medium term – and particularly against the context of a permanent peace settlement – sustainability of reforms is critical. This implies reinforcing short term measures, such as those to control the wage bill, reforms in spending with durable, systemic measures rooted in efficiency considerations. Examples have been provided in this document.

It is necessary to begin to prepare well ahead for reforms to be supported by future DPGs with respect to both institutions and policies; and to ensure that they are included in DPG programs when the client is fully ready. This is particularly true in the critical areas of civil service reforms, pensions, and health. The PA should re-energize its efforts in these areas such that they can form the subject of reforms in the medium term.

An effective, relevant and timely data-based M&E system can be utilized to assist implementation, take corrective actions, and to provide feedback to future reform design.

7. Comments on Issues Raised by Borrower/Implementing Agencies/Partners

(a) Borrower/Implementing agencies

(b) Cofinanciers

Not applicable

(c) Other partners and stakeholders

Not applicable

Annex 1 Bank Lending and Implementation Support/Supervision Processes

(a) Task Team members

Names	Title	Unit	Responsibility/ Specialty
Lending			
Orhan Niksic	Senior Economist	MNSED	Task Team Leader
Nour Nasser Eddin	Economist	MNSED	Team Member
Nadi Mashni	Financial Management Specialist	MNAFM	Team Member
Nikolai Soubbotin	Lead Counsel	LEGAM	Team Member
Samira Hillis	Senior Operations Officer	MNSSP	Team Member
	Senior Energy Specialist	MNSEG	Team Member
Lina Tutunji	Procurement Specialist	MNAPC	Team Member
Basheer Jabr	Procurement Consultant	MNAPC	Team Member
		MNSSP	Team Member
Tetyana Komashko	Program Assistant	MNSED	Team Member
Maha Bali	Program Assistant	MNCGZ	Team Member
Supervision			
Team composition did not change from the lending phase.			

(b) Staff Time and Cost

Stage	Staff Time and Cost (Bank Budget Only)	
	No. of staff weeks	USD Thousands (including travel and consultant costs)
Lending		
Total:	27.32	141,819.52
Supervision/ICR		
Total:	0.14	10,755.58

Annex 2. Beneficiary Survey Results

Not applicable

Annex 3. Stakeholder Workshop Report and Results

Not applicable

Annex 4. Summary of Borrower's ICR and/or Comments on Draft ICR

The borrower has expressed its satisfaction with the Draft ICR and provided only very minor editorial comments.

Annex 5. Comments of Cofinanciers and Other Partners/Stakeholders

Not applicable

Annex 6. List of Supporting Documents

Program Document for the Palestinian National Development Plan Development Policy Grant V (Report Number 74836-GZ).

Fiscal Challenges and Long Term Costs, Economic Monitoring Report to the Ad Hoc Liaison Committee, March 19, 2013 (http://siteresources.worldbank.org/INTWESTBANKGAZA/Resources/AHLCMarchfinal.pdf)