



# Program Information Document (PID)

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Appraisal Stage | Date Prepared/Updated: 19-Feb-2020 | Report No: PIDA28291



**BASIC INFORMATION**

**A. Basic Project Data**

Country	Project ID	Project Name	Parent Project ID (if any)
West Bank and Gaza	P171819	Strengthening Fiscal Stability and Financial Integrity (P171819)	
Region	Estimated Board Date	Practice Area (Lead)	Financing Instrument
MIDDLE EAST AND NORTH AFRICA	06-Apr-2020	Macroeconomics, Trade and Investment	Development Policy Financing
Borrower(s)	Implementing Agency		
Palestine Liberation Organization (for benefit of the Palestinian Authority)	Ministry of Finance and Planning		

**Proposed Development Objective(s)**

The Development Objectives of the proposed operation are: (i) strengthen commitment control in line ministries and improve overall public procurement practice, (ii) improve sector governance in water and health service provision, and (iii) strengthen the stability and integrity of the financial sector.

**Financing (in US\$, Millions)**

**SUMMARY**

<b>Total Financing</b>	30.00
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**DETAILS**

<b>Total Non-World Bank Group Financing</b>	30.00
Trust Funds	30.00

Decision

Other

Explanation

the review authorized the team to appraise.



## **B. Introduction and Context**

### Country Context

As envisaged in the Assistance Strategy for the West Bank and Gaza, DPGs remain a key instrument aimed at supporting the Palestinian Authority's (PA) budget and strategic reform priorities as well as advancing policy dialogue. This proposed DPG, in the amount of US\$30 million, provides a lifeline to the budget amid difficult times. The PA continues to face a difficult fiscal situation mainly emanating from the dire situation in Gaza where the PA spends 33 percent of its expenditure when receiving minimal revenue -- while fiscal operations in the West Bank actually break even. The tight fiscal position has been further exacerbated by a prolonged dispute with the Government of Israel (GoI) over the transfer of revenues collected on behalf of the PA. Even though the dispute was resolved in September 2019, it had lasted over a period of 6 months causing a severe liquidity shortage that has forced the PA to exhaust all sources of financing to "muddle through" without 60 percent of its revenue. In addition, budget support in 2019 reached US\$600 million – a drop compared to 2018 (US\$670 million) and the lowest in decades. As a result, the PA's financing gap for 2019 is expected to be significantly higher than in previous years. The financing significance of this operation is not only in the funds it provides, but also in the positive signaling effect to other donors that provide assistance to the PA at a time when such assistance is of utmost importance for the Palestinian economy and public finances.

The West Bank and Gaza (the Palestinian territories) have faced long lasting political instability and periodic episodes of violence over the last two decades, exacerbating macroeconomic volatility. The economy has been driven by large inflows of transfers as other sources of growth have been long-hindered by the ongoing restrictions on movement and access. Inflows of transfers have significantly dropped in recent years, making it more pressing to unlock growth constrained by a difficult business environment. Also, restrictions on trade and movement have created a high risk of disruptions which has affected investment levels, pushing them towards non-traded services that have low productivity growth.

Poverty rates in the Palestinian territories have increased during 2011-17, with nearly one in three persons living in poverty, and with growing divergence between the West Bank and Gaza. According to the Palestinian Central Bureau of Statistics (PCBS), the overall share of population below the poverty line has increased from 26 percent in 2011 to 29 percent in 2017. This increase emanated from an increase in poverty rate in Gaza from 39 to 53 percent, leaving every second Gazan below the national poverty line.

### Relationship to CPF

The proposed operation is aligned with the World Bank's regional strategy, primarily on the pillars of "renewing the social contract", "resilience", and Maximizing Finance for Development (MFD) enabled recovery in the context of the West Bank and Gaza. In addition, it contributes to the implementation of the World Bank Group's Assistance Strategy for the West Bank and Gaza (FY18-21), especially the first pillar, which is increased private sector investments and job creation. The operation's actions aim to promote sustainability and transparency of public finance and service delivery. For example, the prior action supporting procurement reforms by establishing a single procurement portal and requiring all government agencies to publish their procurement opportunities and contract award notices will contribute to citizen trust and public-private collaboration. The prior actions supporting improved governance within the health sector, and improved performance controls in the water sector, further contribute to the regional strategic pillar of renewing the social contract by facilitating inclusive and accountable service delivery. Prior actions supporting financial sector stability and integrity reforms support both the private sector's resilience in the face of external shocks, as well as contribute to building an MFD-enabled environment to leverage long-term and alternative financing.

## **C. Proposed Development Objective(s)**



The Development Objectives of the proposed operation are to: (i) strengthen commitment control in line ministries and improve overall public procurement practice, (ii) improve sector governance in water and health service provision, and (iii) strengthen the stability and integrity of the financial sector.

#### Key Results

The actions under pillar I will strengthen commitment controls in line ministries and improve overall public procurement practice. They are also expected to contribute to addressing gender gaps in public procurement. Under pillar II, actions are expected to support evidence-based policy making in the health sector bridging human resource gaps and providing more comprehensive health services. Actions focused on the water sector under pillar II will improve overall transparency in the sector through the publication of performance reports for water service providers and will also improve the collection rate amongst consumers within Local Government Units (LGU) that have signed Memoranda of Understanding with the Palestine Water Authority to install prepaid meters. Under pillar III, actions are focused on improving AML/CFT internal controls in the banking sector, raising the minimum regulatory capital requirements for all banks and also standardizing the application of Islamic financial instruments amongst banks and non-bank Islamic financial institutions.

#### **D. Project Description**

This operation has been designed as a standalone, rather than a programmatic budget support operation, as it allows adequate flexibility in the choice of prior actions, which has proved advantageous within a highly volatile security and political context that often leads to reprioritization of reforms. That said, the programmatic nature of certain reforms has not been neglected as several prior actions in this operation build on important reforms supported by previous DPGs.

The first pillar of the operation focusing on introducing commitment controls in line ministries and improving procurement practices through launching a single procurement portal and mandating the use of SBDs for all public procurement, will help improve governance and fiscal integrity of the PA's operations. The objective of the second pillar is to improve governance in health service provision by allowing evidence-based policy making. The second pillar also focuses on installing water prepaid meters which will reduce non-payment by consumers and will improve the financial viability of the sector making it more attractive for private investment and will also reduce net lending (deductions made by the GoI from import taxes collected on behalf of the PA to offset utility bills owed by Palestinian LGUs to Israeli suppliers). Finally, under the third pillar, strengthening AML/CFT practices and mandating banks to follow Basel 3 requirements when it comes to their capital adequacy, would significantly improve the stability of the financial sector, which is key for a well-functioning private sector and a sound business environment.

#### **E. Implementation**

##### Institutional and Implementation Arrangements

The design of the M&E approach adopted under this DPG builds upon those developed under the earlier operations. The proposed results framework was discussed and agreed to with the PA and developed in consultation with other development partners. In line with previous operations, the results framework was designed to account for progress achieved under both the DPG and the implementation of the PRDP Trust Fund, which is a major source for donor funding to the budget, aligned to the NPA. Since both the DPG and the PRDP Trust Fund 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 both has provided additional leverage to reform implementation. The indicators used are direct measures of development objectives, the data is collected by the statistics agency, finance and line ministries, and the monetary authority, and enjoys full ownership of the PA.

The monitoring arrangements have been institutionalized in the Palestinian Ministry of Finance (MoF). Based on the inputs



from line ministries and other agencies, the PA prepares quarterly reports on a regular basis to monitor the performance under both the DPG and the PRDP Trust Fund. The same arrangement is utilized to monitor progress against the PA's medium-term program. These reports are placed on the website of the MoF. The monitoring arrangements developed in the context of DPGs and PRDP Trust Fund have not only been used for the purposes of those operations, but there is evidence that these arrangements have contributed to building stronger institutional arrangements for monitoring PA's broader reform efforts.

## **F. Poverty and Social Impacts, and Environmental, Forests, and Other Natural Resource Aspects**

### Poverty and Social Impacts

The overall poverty and social impact of the prior actions supported by this operation is expected to be largely positive or neutral. Efforts under pillar 1 to strengthen commitment controls in line ministries and improve overall public procurement practices are administrative measures that aim to improve Public Financial Management (PFM) in the PA and thereby increase transparency and reliability of public accounts. The poverty and social impact of these measures is expected to be neutral. Under pillar 2, efforts to improve governance in the health sector are expected to have a positive poverty and social impact as they will eventually lead to the availability of cheaper medical services in local facilities reducing the reliance on expensive outside medical referrals. Measures in the water sector enhance the transparency and sustainability of service providers with the aim of improving their overall performance, hence their poverty and social impact is expected to be neutral. Even though the introduction of pre-paid water meters will result in higher bill collections, analysis by the team has shown that in terms of its impact on poverty, no statistically significant changes are expected and hence, no tangible social impact. This is because, according to the Palestine Expenditure and Consumption Survey (PECS), spending on water is extremely low as a share of overall household spending. In fact, it is around 2.5 percent in the poorest quintile in the West Bank where the reform will be implemented. Measures under pillar 3 to improve anti-money laundering and combating of financing of terrorism (AML/CFT) and raise the capital adequacy of the banking sector should raise its resilience and in turn improve its ability to support private sector activity and job creation. These measures are expected to have positive poverty and social impacts.

### Environmental, Forests, and Other Natural Resource Aspects

Reforms supported by this operation are unlikely to have a significant negative environmental impact. The prior actions supported under pillars 1 and 2 aim to improve procurement practices and enhance governance in the water and health sectors and are likely to have positive environmental impacts. Prior actions covered by pillar 3 support reforms in the financial sector through improving the resilience, stability and integrity of the sector and those are also not expected to have any negative environmental impact.

## **G. Risks and Mitigation**

The overall risk of this operation is high. The political and security risks are heightened as Israel has had two inconclusive parliamentary elections in 2019 with an unprecedented third election coming up in March 2020, creating high political uncertainty. If the security situation relapses, the economic decline may have a negative impact on the PA's reform appetite. The international donor community is closely monitoring the economic activity in the West Bank and Gaza and is supporting the PA with grants and Technical Assistance. The PA's strong commitment to the continued implementation of structural reforms despite the highly difficult economic environment and fiscal pressures will provide a basis for boosting private sector confidence and support of development partners. The macroeconomic risk to the operation rating is high. The liquidity crunch that resulted from the clearance revenues standoff has had an impact on consumption and investment patterns and negatively impacted economic activity. Also, even though the fiscal stress has gradually started to ease given that clearance revenue transfers have resumed, fiscal demands remain very high. The recent escalation in trade disputes between the PA and Israel also poses a risk. The proposed DPG sends a strong signal to donors that the



World Bank places great importance on progress in implementing the PA's development plan. Moreover, the operation will leverage around US\$25 million in additional resources through the PRDP Trust Fund. This will mitigate the risk of reduced donor assistance on the PA's finances. The fiduciary risk is considered high. The Public Financial Management system is strained by the continued accumulation of arrears as a result of a large financing gap and limited ability to raise financing in an optimal manner. There has been a delay in the issuance of financial statements, but the backlog is being slowly cleared. The 2014 and 2015 audited reports were issued in November 2019. The 2016 and 2017 financial statements were finalized by the Ministry of Finance and submitted to the State Audit and Administrative Control Bureau (SAACB) for audit in November 2019. There is an expectation that the audited financial statements will be up to date in 2020. Implementation of some provisions of the Public Procurement Law has been delayed. However, momentum has strengthened in 2019 as key aspects of the law including mandating the use of a single procurement portal and standard bidding documents have been operationalized, and these efforts are supported by the DPG. A number of issues remain outstanding including: the mechanism for administrative review of bidder complaints is not yet operational, and the capacity of the procurement workforce requires strengthening. These weaknesses may stand in the way of the PA's ability to achieve results supported by the operation and the overall PDO. In mitigation, in recent years, the Bank and other donors have been supporting the PA through various Technical Assistance to the MoF aiming at strengthening the accountability of the PFM system and public procurement.

## CONTACT POINT

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**APPROVAL**

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**Approved By**

Country Director:	Kanthan Shankar	27-Dec-2019
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