OFFICIAL USE ONLY
IDA/R2019-0008/1

January 16, 2019

Closing Date: Thursday, February 7, 2019 at 6:00 p.m.

FROM: Vice President and Corporate Secretary

West Bank and Gaza - Strengthening Fiscal Resilience and Business Environment Development Policy Grant

Program Document

Attached is the Program Document regarding a proposed grant to West Bank and Gaza for the Strengthening Fiscal Resilience and Business Environment Development Policy Grant (IDA/R2019-0008), which is being processed on an absence-of-objection basis.

Distribution:
Executive Directors and Alternates
President
Bank Group Senior Management
Vice Presidents, Bank, IFC and MIGA
Directors and Department Heads, Bank, IFC, and MIGA

Document of
The World Bank

FOR OFFICIAL USE ONLY

Report No: 130555-GZ

INTERNATIONAL DEVELOPMENT ASSOCIATION

PROGRAM DOCUMENT FOR A

PROPOSED GRANT

IN THE AMOUNT OF US$30 MILLION TO THE

PALESTINE LIBERATION ORGANIZATION
(FOR THE BENEFIT OF THE PALESTINIAN AUTHORITY)

FOR THE

WEST BANK AND GAZA STRENGTHENING FISCAL RESILIENCE AND BUSINESS ENVIRONMENT DEVELOPMENT POLICY GRANT

January 11, 2019

Macroeconomics, Trade and Investment Global Practice
Middle East And North Africa Region

West Bank and Gaza

FISCAL YEAR

January 1 – December 31

CURRENCY EQUIVALENTS

(Exchange Rate Effective as of November 1, 2018)

Currency Unit: New Israeli Shekel (NIS)

US$1.00: NIS 3.68

ABBREVIATIONS AND ACRONYMS

AHLC	Ad-hoc Liaison Committee
AML/CFT	Anti-Money Laundering and Combating Financing of Terrorism
ASYCUDA	Automated System for Customs Data
BoP	Bank of Palestine
CBR	Correspondent Bank Relationships
CHU	Central Harmonization Unit
DISCO	Distribution Company
EA	Environmental Assessment
EIA	Environmental Impact Assessment
ESPIP	Electricity Sector Performance Improvement Project
GDP	Gross Domestic Product
GoI	Government of Israel
GRS	Grievance Redress Service
GSD	General Supplies Department
HCPPP	High Council for Public Procurement Policies
IAD	Internal Audit Department
ICR	Implementation Completion and Results Report
IEE	Initial Environmental Evaluation
IEC	Israel Electric Corporation
IFMIS	Integrated Financial Management Information System
IMF	International Monetary Fund
INTOSAI	International Organization of Supreme Audit Institutions
IPSAS	International Public Sector Accounting Standards
LGU	Local Government Unit
MCM	Million Cubic Meters
MoFP	Ministry of Finance and Planning
MoH	Ministry of Health
MoNE	Ministry of National Economy
MoI	Ministry of Interior
MSME	Micro, Small, and Medium Enterprises
NPA	National Policy Agenda
NIS	New Israeli Shekel
O&M	Operation and Maintenance
PA	Palestinian Authority
PCBS	Palestinian Central Bureau of Statistics
PEAP	Palestinian Environmental Assessment Policy
PEFA	Public Expenditure Financial Accountability Assessment
PEL	Palestinian Environment Law
PENRA	Palestinian Energy and Natural Resources Authority
PERC	Palestinian Electricity Regulatory Council
PETL	Palestinian Electricity Transmission Company Limited
PFM	Public Financial Management
PPP	Public-Private Partnership
PRDP	Palestinian Reform and Development Plan
PSEF	Private Sector Enhancement Facility
PWA	Palestinian Water Authority
RMIS	Revenue Management Information System
SAACB	State Audit and Administrative Control Bureau
TFGWB	Trust Fund for Gaza and West Bank
TA	Technical Assistance
UNRWA	United Nations Relief and Works Agency
VAT	Value-added Tax
WBWD	West Bank Water Department

Regional Vice President:	Ferid Belhaj
Acting Country Director:	Anna Bjerde
Practice Director:	Paloma Anos Casero
Practice Manager:	Kevin Carey
Task Team Leaders:	Damir Cosic, Nur Nasser Eddin

WEST BANK AND GAZA

STRENGTHENING FISCAL RESILIENCE AND BUSINESS ENVIRONMENT DEVELOPMENT POLICY GRANT

TABLE OF CONTENTS

This Development Policy Grant was prepared by a World Bank Group team co-led by Damir Cosic (Senior Economist) and Nur Nasser Eddin (Senior Economist), and consisting of Adnan Ghosheh (Senior Water and Sanitation Specialist); Dana Almubaied (Program Analyst); Rafeef Abdelrazek (Urban Development Specialist); Samira Ahmed Hillis (HD Program Leader); Fernando Xavier Montenegro Torres (Senior Health Specialist); Iulia Cojocaru (Senior Private Sector Specialist); Abed Khatib (Financial Sector Specialist); Maria Do Ceu Da Silva Pereira (Senior Financial Sector Specialist); Lina Tutunji (Senior Procurement Specialist); Riham Hussein (Financial Management Specialist); Maha Muhammad Bali (Operations Analyst); and Zein Azzam Ibrahim Daqqaq (Team Assistant). The team gratefully acknowledges the support and guidance provided by Marina Wes (former Country Director); Mark Ahern (EFI Program Leader); Bjorn Philipp (SD Program Leader); Kevin Carey (Practice Manager); Mariana Montiel (Senior Counsel), and Matthieu Bonvoisin (Counsel). The team would like to express its gratitude for the collaboration of the Palestinian Authority (PA), the Ministry of Finance and Planning, and other PA staff for the preparation of this Development Policy Grant.

SUMMARY OF PROPOSED FINANCING AND PROGRAM

BASIC INFORMATION

Project ID	Programmatic
P164427	No

Proposed Development Objective(s)

Development objectives of this operation are to support the efforts of Palestinian Authority to:
(i) Strengthen revenue and land administration and intergovernmental revenue framework;
(ii) Improve the business environment and foundations for a digital economy, and
(iii) Enhance sustainability and creditworthiness of local service providers for private investment

Organizations

Borrower:	PALESTINE LIBERATION ORGANIZATION (FOR BENEFIT OF THE PALESTINIAN AUTHORITY)
Implementing Agency:	MINISTRY OF FINANCE AND PLANNING

PROJECT FINANCING DATA (US$, Millions)

SUMMARY

Total Financing	**30.00**

DETAILS

Trust Funds	30.00
Special Financing	30.00

INSTITUTIONAL DATA

Climate Change and Disaster Screening

This operation has not been screened for short and long-term climate change and disaster risks

Overall Risk Rating

High

Results

Indicator Name	Baseline	Target
Gross domestic tax revenues.	NIS 2,750 million (2017)	NIS 2,982 million (2019)
Number of LGUs that have piloted collection of property taxes.	None (2017)	Three to Five (2019)
Number of days on average to issue a business license.	36 days (2017)	10 days (2019)
Number of days on average to obtain a land purchase permit.	30 days (2017)	15 days (2019)
Regulatory authorities have reviewed licensing applications for mobile payments providers under the new framework.	None (2017)	Five (2019)
Share of electricity that is purchased from wholesale suppliers is collected and paid by LGUs.	86 percent (2017)	95 percent (2019)
Percentage of unpaid debt for water owed by LGUs to the MoFP is rescheduled.	0 percent (2017)	15 percent (2019)
Service Purchasing Unit of the MoH has completed negotiations for contracting medical services using the NPR tool with domestic private healthcare providers.	No providers (2017)	Three providers (2019)

PROGRAM DOCUMENT
WEST BANK AND GAZA
STRENGTHENING FISCAL RESILIENCE AND BUSINESS ENVIRONMENT DEVELOPMENT POLICY GRANT

1. INTRODUCTION AND COUNTRY CONTEXT

1. **This program document presents the proposed West Bank and Gaza Strengthening Fiscal Resilience and Business Environment Development Policy Grant (DPG) in the amount of US$30 million.** The proposed DPG supports the strategic priorities of the Palestinian Authority (PA) envisaged in its development strategy—the National Policy Agenda (NPA) (2017-2022)—and provides essential financing for the PA's 2019 budget. The DPG supports the PA's reform efforts aimed to strengthen fiscal resilience and foundations for private sector investments and ultimately job creation. The US$30 million grant will directly leverage other donor financing in the amount of approximately US$45 million through the Palestinian Reform and Development Plan (PRDP) Trust Fund. The operation also sends a strong positive signal to other donors that directly provide bilateral budgetary support to the PA. While this operation is a standalone operation, it continues the practice started under the previous operation of presenting prior actions in a medium-term reform context.

2. **The proposed operation is aligned with the Maximizing Finance for Development (MFD) approach for mobilizing private finance, which is fully reflected in the World Bank Group's (WBG) Assistance Strategy for the West Bank and Gaza (FY18-21)**. The proposed DPG reflects the Bank's strategic shift to a stronger private sector focus. It supports improvements to the business environment while streamlining and modernizing the legal and regulatory framework for private firms, with the aim of promoting dynamic and inclusive private sector growth and formal private sector job creation. Reforms in the electronic payments systems aim to significantly reduce costs and deeper financial inclusion while providing a critical enabler for e-government services. In addition, the proposed prior actions on revenue and land administration not only contribute to larger tax collections, but they increase the availability of collateral for bank lending (only titled land can be used for collateral). Further, the prior actions on the utility sectors (such as electricity and water) continue to strengthen the progress achieved by the previous operation in improving creditworthiness and payment discipline of service providers, which is the single most critical challenge affecting the PA's ability to mobilize private and commercial finance to support investment in these sectors. These policy actions correspond to MFD interventions, namely, upstream reforms to unlock market and institutional failures, creating more space for private sector participation including investments.

3. **The proposed operation complements other grants presented in the indicative pipeline for the FY19 Replenishment Request**[1]. Given the difficult situation in Gaza, a sizable portion of the FY19 replenishment of the Bank-funded Trust Fund for Gaza and West Bank is allocated to investment projects at the humanitarian-development nexus in Gaza. The indicative pipeline included a DPG focused on upstream reforms that address market and institutional failures, creating more space for private sector investment. The recent DPGs have progressively incentivized continued progress within the PA to improve its creditworthiness and payment discipline in the utility sectors, enhance predictability in expenditures and the business environment, and strengthen fiscal institutions. The proposed operation continues support in all these areas, while building on new momentum on land administration and the digital economy.

4. **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

[1] Request for Replenishment of the Trust Fund for Gaza and the West Bank, July 24, 2018 (R2018-0173[IDA/R2018-0245])

Palestinian territories are a small open economy with a population of 4.8 million in 2016. The Palestinian territories have experienced political instability (both regional and domestic) and a series of violent conflicts over the years[2].

5. **The structure of the economy of Palestinian territories has transformed dramatically over the last two decades**. The manufacturing and agriculture sectors' share of Gross Domestic Product (GDP) contracted by around 40 percent and 75 percent, respectively, during 1994-2016. The share of public service sector (such as education, health, and security) in national income expanded by around 60 percent during the same period, largely financed by donors. This dramatic structural transformation in the economy has resulted in failure to generate sufficient private sector jobs to absorb the growing labor force (mainly youth and women) and revenues to provide services to a rapidly rising population. However, it is critical to highlight that intensified settlement activities, little progress in internal reconciliation, restrictions on movement, curtailed access to large areas of territory and restrictions on external trade continue to constitute the main impediments to private sector investment and job creation in West Bank and Gaza.

6. **Driven by episodes of conflict, 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.** Economic growth, social assistance and a well targeted cash transfer program run by the PA have helped reduce poverty in the Palestinian territories in the years following the second Intifada. However, political instability and multiple episodes of war in Gaza over the last ten years have significantly eroded these welfare gains. Following the 2007-08 and 2014 conflicts in Gaza, poverty increased significantly, pushing up the overall poverty rate in the Palestinian territories. Data from the Palestinian Central Bureau of Statistics (PCBS) shows that the overall share of population below the poverty line has increased from 26 percent in 2011 to 29 percent in 2017. This, however, masks a substantial divergence in trends between the West Bank and Gaza. Poverty rate in the West Bank declined from 18 to 14 percent, while poverty in Gaza increased dramatically from 39 to 53 percent leaving every second Gazan below the national poverty line.

7. **Similarly, shared prosperity outcomes are also dominated by the spatial divergence.** The performance on shared prosperity, as measured by the annualized growth of per capita consumption of the bottom 40 percent of the Palestinian population, has been improving at the same rate as the rest of the distribution. However, the overall growth of per capita consumption has slowed significantly: from average growth of 2 percent per year over the 2004-09 period to near zero average growth during 2009-11 period and, lastly, to negative average growth of 0.8 percent per year during 2011-17 period. The annualized rates of growth in per capita consumption expenditures also diverged sharply between the two regions with per capita consumption declines in Gaza and a slight increase in the West Bank.

[2] The series of conflicts include the first and second Intifada during 1987-93 and 2000-05, respectively, the Fatah-Hamas conflict in 2007-08, and wars in Gaza in 2008-09, 2012, and 2014.

2. MACROECONOMIC POLICY FRAMEWORK

2.1. RECENT ECONOMIC DEVELOPMENTS

8. **The economic conditions in the Palestinian territories have significantly weakened in 2018, due to a sharp decline in activity in Gaza.** According to preliminary data by the PCBS, real GDP growth contracted by 1.3 percent in the second quarter of 2018 —first negative rate of growth since the first quarter of 2015. For the first half of 2018, the economy grew just by 0.3 percent compared to the same period in the previous year. The economy has been hamstrung for more than two decades by restrictions on movement, access and trade that have kept investment levels extremely low and resulted in deindustrialization. Substantial transfers, mostly in the form of aid from the international community, have helped mitigate the impact of the restrictions by fueling consumption-driven growth. Nevertheless, transfers have been on a declining trend and have witnessed a very large drop in 2017-18, particularly in Gaza, resulting in a lower growth trajectory for the overall economy and revealing the fragility of the aid-driven growth model.

9. **Gaza's economy has seen a severe squeeze on movement of goods, people, and income support, pushing it towards a possible collapse.** Its economy has been under a blockade since 2007 and has been kept afloat by large transfers including donor aid and spending through the budget of the Palestinian Authority, which together amounted to 70-80 percent of Gaza's GDP. However, these transfers have significantly declined recently, negatively impacting growth. In 2017, the Gaza economy did not witness any real growth due to severe cuts in aid for reconstruction and transfers from the PA's budget in addition to its continued economic isolation. The situation has become more difficult in 2018 as transfers from the PA have continued to drop further increasing liquidity squeeze and placing severe pressure on the depleting buffers of the economy. As a result, Gaza's economy shrank by 6.1 percent in the first half of 2018 compared to the same period in 2017. Even though more recent growth data is not available yet, anecdotal evidence suggests that the ongoing liquidity squeeze in Gaza has further worsened and that the economic decline has also led to a rapid decline in humanitarian conditions. Unless the liquidity crisis is addressed through pumping additional liquidity into the economy and raising transfers to their pre-2017 level, the Gaza economy may be heading towards a possible collapse in the medium term.

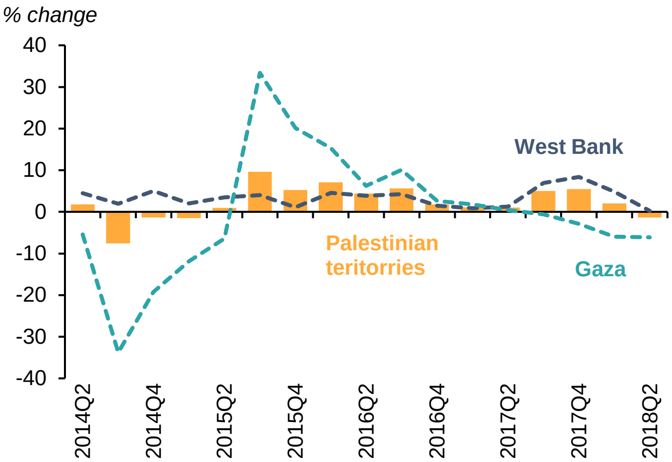
10. **Growth in the West Bank has started to slow down raising concerns over long-term sustainability.** According to the PCBS, real GDP growth in the West Bank was 2.5 percent in the first half of 2018, which is lower than its level in 2017. On a quarter-to-quarter basis, growth has slowed down sharply in the second quarter of 2018, registering a mere increase of 0.2 percent. Growth was concentrated in wholesale and retail trade and construction as these activities remain less affected by the restrictions. On the expenditure side, growth was mainly driven by public consumption while private consumption has slowed down. Financial sector data shows a substantial slowing in both credit and deposit growth and an increase in Non-Performing Loans (NPLs) in the West Bank, which raises concerns over the durability of the current growth model.

11. **The unemployment rate in the Palestinian territories has reached a new high.** It peaked at 32.4 percent in the second quarter of 2018, which is about 5 percentage points higher than its average in 2017 and the highest rate in two decades. The increase is due to a strong jump in Gaza, where 53.7 percent of those in the labor force were unemployed in the second quarter of 2018. Unemployment amongst Gaza's youth exceeded 70 percent while it was even higher for females amounting to 78 percent in the second quarter of 2018. The situation in the West Bank has been very different with the unemployment rate stagnating at around 18-19 percent over recent years.

12. **Investment rates have remained low, with the bulk channeled into non-traded activities and structures that generate low productivity employment.** Private investment levels, averaging about 15-16 percent of GDP

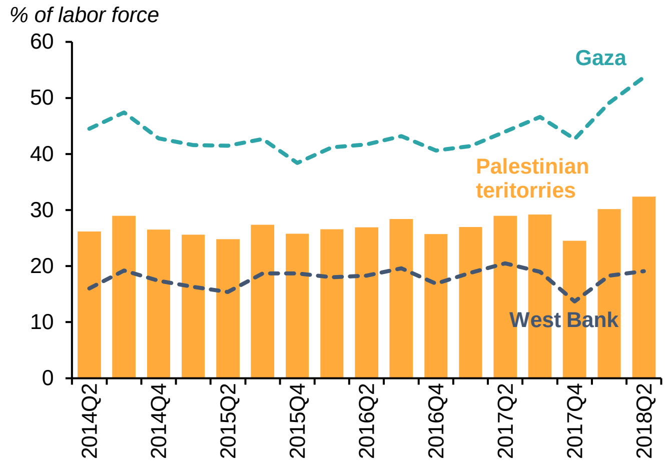
in recent years, have been low as compared with rates of over 25 percent in fast growing middle-income economies. Foreign Direct Investment (FDI), at a mere 2 percent of GDP, is also very low in comparison to most fast-growing economies. Low investment has not only been a result of a decline in foreign savings but also due to very low domestic private savings. Also, much of the investment has been concentrated in low productivity activities where returns are less affected by political risk, mainly internal trade and real estate development - neither of which generate significant employment.

Figure 1: Real GDP growth (y/y)



Source: PCBS, National Accounts.

Figure 2: Unemployment rate



Source: PCBS, Labor Force Survey.

Table 1: Palestinian territories: Key Macroeconomic Indicators, 2015-2020

			Prelim.	Projections		
	2015	2016	2017	2018	2019	2020
Output and prices			Annual percentage change			
Real GDP (2015 market prices)	3.4	4.7	3.1	1.7	1.9	1.9
West Bank	2.6	3.0	4.3	3.8	3.5	3.5
Gaza	6.1	7.7	-0.3	-5.0	-3.0	-3.0
Private Consumption	6.2	3.3	3.0	2.6	2.9	3.0
Government Consumption	5.8	1.8	0.9	1.8	2.5	2.6
Gross Fixed Capital Investment	9.0	-0.9	2.2	-0.8	-1.3	-2.2
Exports, Goods and Services	2.6	1.9	5.0	3.0	1.5	1.2
Imports, Goods and Services	9.5	0.2	4.7	2.6	2.4	2.2
Monetary sector			Annual percentage change			
Credit to the private sector	19.2	20.0	15.0	13.0	9.0	9.0
Private sector deposits	10.4	7.8	9.5	6.0	5.0	4.5
External sector			In percent of GDP			
Exports of goods and nonfactor services	18.4	18.1	18.2	18.6	18.6	18.1
Imports of goods and nonfactor services	59.5	56.6	55.1	55.0	55.3	54.6
Trade balance	-41.0	-38.5	-36.9	-36.4	-36.7	-36.4
Current account balance (incl. official transfers)	-16.3	-13.9	-10.6	-11.9	-12.4	-12.6
Memorandum items:						
Nominal GDP (in millions of USD)	12,673	13,425	14,498	15,081	15,554	16,297

Sources: MoFP, IMF and World Bank calculations.

13. **Inflation continues to be subdued.** Overall prices dropped by 0.8 percent between January and June 2018 (year-on-year). The Israeli Shekel, which is the main currency in circulation in the Palestinian territories, has continued its appreciation and this had a deflationary effect on the prices of imported goods. In addition, the prices of food products (most of which are produced domestically or in Israel) remained stable in 2018.

14. **Despite a decline in the trade deficit, the external current account deficit (including official transfers) is estimated to have widened in 2017 to about 11 percent of GDP mainly due to a reduction in transfers.** The trade deficit stood at 37 percent of GDP in 2017 – 1.5 percentage points lower than in 2016 following a drop in imports from Israel—the main trading partner. Exports continue to be constrained by the ongoing trade restrictions and have remained low and stagnant at around 18 percent of GDP. Current transfers as a share of GDP dropped from 16.7 percent in 2016 to 15.5 percent due to a decline in both private and official transfers.

15. **The medium-term fiscal stance is determined by three main drivers: wages and pensions, net lending (a form of municipal finance), and revenue mobilization.** Between 2006 and 2017, the relative size of the PA's total fiscal deficit fell from 30 percent of GDP to around 8 percent – an impressive achievement. The wage bill peaked at 23 percent of GDP in 2006 and has since been reduced to below 15 percent thanks to hiring control and wage growth restraints, coupled with solid GDP growth – especially in the early period. Net lending, discussed further below, has been a significant source of the fiscal burden and the PA has taken a number of actions that have reduced it from nearly 10 percent of GDP in 2006 to below 2 percent in 2017. Despite the internal divide between the West Bank and Gaza and the inability of the PA to collect taxes in Gaza over the last decade, the PA has managed to grow its revenues from 22 percent of GDP in 2006 to around 25 percent in recent years. This can mainly be attributed to the Ministry of Finance and Planning (MoFP) efforts in widening the tax base and rolling out reforms to address tax evasion. Cooperation by the Government of Israel (GoI) to offset some of the fiscal leakages under the current revenue sharing arrangements between the two parties has also contributed to revenue growth in recent years.

16. **The net lending phenomenon is a major distortion in service delivery arrangements which impedes the MFD approach through its impact on creditworthiness and predictability of financial flows in infrastructure sectors**. When local government units (LGUs) and distribution companies (DISCOs) fail to make payments for electricity and water to Israeli suppliers, the GoI deducts the corresponding amount from clearance revenues – tax revenues collected by GoI on behalf of the PA. In effect, the PA makes involuntary intergovernmental transfers to LGUs and DISCOs, undermining its own finances**.** In parallel, the municipalities are diverting bill collection from these services as a local revenue base, which deters private investors from seeing them as viable counterparts for infrastructure investment. The MFD approach applied to the net lending problem calls for twin tracks of better payment discipline for service provision and a strengthened revenue base for LGUs – both features of this operation.

17. **There is some scope for a continued expenditure-based adjustment without compromising the quality of public services or negatively impacting public welfare.** Doing so requires the PA to focus on a few key areas and emphasize the quality and value-for-money of expenditures. First, the size of the wage bill relative to GDP can be further reduced through wage restraint, grade restructuring and the gradual reduction of public sector staff in targeted categories, mainly security, health and education. Efforts are also needed to reform the highly generous public pension system which only covers a small share of the elderly population. Public health spending has been on the rise and the PA can substantially improve the value-for-money and quality of healthcare services through reform. Procurement reform, through ensuring effective implementation of the new public procurement law, would result in substantial savings and improved quality of public services. Reforming the distorted intergovernmental fiscal transfers system is also key to cut down on wasteful subsidies

to LGUs. These reforms are all part of the PA's reform agenda. It is important to note that some, including pension reform, may be more controversial given the political economy in the Palestinian territories.

18. **The PA's fiscal consolidation efforts continued in the first half of 2018.** Between January and June 2018, the PA's domestic taxes grew by 6 percent (year-on-year) mainly driven by a pickup in VAT receipts due to higher collections. Non-tax revenue also performed well, increasing by 16 percent (year-on-year) due to a large license payment by a telecom operator and a lump sum transfer by the GoI of fees collected from Palestinian workers in Israel during the period from July 2017 until May 2018. Clearance revenues[3] witnessed a sharp drop between January and June 2018 declining by about 10 percent due to lower petroleum purchases from Israel and lower transfers by Israel to offset fiscal leakages compared to the same period in 2017.

19. **On the expenditure side, public spending was reduced by about 7 percent in the first half of 2018 due to a drop in the PA's largest spending item – the wage bill.** In fact, the wage bill dropped by 17 percent (year-on-year) following recent measures to cut the salaries of PA employees in Gaza and a decline in the number of public servants due to early retirements executed by the PA. According to the MoFP data, the total number of PA employees dropped from 137,114 as of end-2017 to 129,845 as of June 2018. Net lending also declined by 12 percent in the first half of 2018 (year-on-year) due to the PA's reform efforts to control electricity related costs, while water related costs continue to rise and need to be addressed. The decline in the wage bill and net lending offset growth in transfers, which increased by 11 percent due to pension payments to early retire.

20. **The PA's overall deficit declined by about 20 percent in the first half of 2018, nonetheless, the fiscal situation remained tight.** The PA's total deficit amounted to US$400 million in the first half of 2018. Aid received was US$240 million, resulting in a financing gap of around US$160 million. Notably, aid received in the first half of 2018 was one-third lower than in the same period in 2017. To fill the gap, the PA resorted to domestic resources, namely arrears to the pension fund and the private sector. Despite repaying some dues from previous years, net accumulation of arrears in the first half of 2018 reached US$177 million.

21. **During the first half of 2018, the Palestinian financial sector, composed primarily of traditional banking, largely maintained stable growth against the backdrop of a declining macroeconomic performance.** The Palestine Monetary Authority's (PMA) reporting through June 2018 indicates that the banking system's assets reached US$15.4 billion. Loans maintained their growth in line with recent years, reaching US$8.3 billion by June 2018, a growth of 10 percent over the past 12-month period. The overall loan-to-deposit ratio, which had a historical range of 50-60 percent in recent years, further increased to 69 percent as of June 2018, due to faster growth rate of loans (10 percent) over deposits (5 percent). Despite the recent and modest uptick in loan-to-deposits, the banking system is still regarded as liquid – confirmed by the latest PMA stress tests. A review of credit exposure to the private sector indicates persistent sectoral concentration, with 43 percent of all private lending going to construction or consumer loans.

22. **Financial sector risks need to be very closely monitored in the context of potentially destabilizing risk factors.** In line with the sector's historical data, the banking sector maintained its overall risk averse lending position as reflected by a low, though increasing, non-performing loan (NPL) ratio 2.8 percent.[4] The impact of the deteriorating economic prospects in Gaza has resulted in an uptick in NPLs reaching US$234 million (equivalent to 2.8 percent of total loans compared to 2.3 percent at the end of 2017). Despite the deterioration of asset quality, provisioning for loan losses has improved in the first half of 2018, reaching 84 percent of NPLs. The volume and value of returned checks doubled over the past 4 years, from US$513.5 million in 2015 to over

[3] VAT and Import duties are collected by the GoI on behalf of the PA and should be transferred on a monthly basis based on an arrangement instituted by the Paris protocol.
[4] NPLs are slightly higher in Gaza at 2.9 percent compared to 2.2 in the West Bank.

US$1.1 billion in 2018 -- equivalent to 12 percent of total presented checks. Returned checks can carry particularly detrimental consequences on cash flow management of affected small and medium enterprises (SMEs), especially with the prevalence of retail financing. Another source of risk in the banking sector is the impact of United Nations Relief and Works Agency's (UNRWA) budget cuts. With approximately 18,000 UNRWA staff using their salaries as loan collateral, large scale disruption is likely to have an impact on some banks' balance sheets.

23. The banking system's credit exposure to the public sector moderated in the first half of 2018, but indirect exposure through households increased. Over recent years, the PA's reliance on financing from the banking sector has raised concerns over credit concentration risk. During 2016-17, exposure to the PA stabilized at a range of US$1.4-1.5 billion and it declined to US$1.3 billion by the first half of 2018. Total credit grew to US$8.2 billion resulting in a decline in the share of government loans from 18 percent in 2017 to 15.5 percent in the first half of 2018. The PMA sets an informal PA exposure limit equivalent to the banking sector's total owners' equity. In June 2018, PA debt was equivalent to 71 percent of the banking sector's total owners' equity. While direct exposure to the PA through direct lending has stabilized, indirect exposure is on the rise. Borrowing by PA employees (using future PA salary as collateral) continued to exceeded PA borrowing in recent years, reaching US$1.5 billion. When combined, PA and public employees account for US$2.8 billion, or 34 percent of total banking sector loans.

Table 2: Palestinian territories: Central PA Fiscal Operations, 2015-2020

				Budget	Projections		
	2015	**2016**	**2017**	**2018**	**2018**	**2019**	**2020**
(in US$ millions)							
Total net revenues	2756	3457	3567	3819	3492	3683	3872
Gross domestic revenues	855	1224	1154	1282	1254	1365	1478
Tax revenues	606	623	764	835	850	935	1028
Nontax revenues	249	601	390	447	404	430	450
Clearance revenues	2055	2325	2486	2590	2310	2379	2451
Less tax refunds	154	92	73	53	72	61	57
Recurrent expenditures and net lending	3976	4202	4370	4576	4367	4485	4607
Wage expenditure	1914	2041	2120	2228	1866	1922	1980
Non-wage expenditure	1761	1893	1983	2093	2241	2308	2377
Net lending	301	268	267	255	260	255	250
Recurrent balance	-1220	-745	-803	-757	-875	-802	-735
Development expenditures	230	335	367	540	367	380	390
Overall balance (before external support)	-1450	-1080	-1170	-1297	-1242	-1182	-1125
Financing	1450	1080	1170	1297	1242	1182	1125
External budgetary support	709	603	546	611	510	510	510
Development financing	89	157	175	178	174	183	199
Net domestic bank financing	174	-108	128	407	160	160	160
Domestic arrears	483	442	363	-407	443	373	301
External debt repayment	-11	-18	-43	0	-45	-44	-45
Residual/other financing	6	4	1	508	0	0	0
(in percent of GDP)							
Public finances (commitment basis)							
Total net revenues	21.7	25.7	24.6	25.3	23.2	23.7	23.8
Recurrent expenditures and net lending	31.4	31.3	30.1	30.3	29.0	28.8	28.3
Wage expenditure	15.1	15.2	14.6	14.8	12.4	12.4	12.1

Non-wage expenditure	13.9	14.1	13.7	13.9	14.9	14.8	14.6
Net lending	2.4	2.0	1.8	1.7	1.7	1.6	1.5
Recurrent balance (before external support)	-9.6	-5.5	-5.5	-5.0	-5.8	-5.2	-4.5
Overall balance (before external support)	-11.4	-8.0	-8.1	-8.6	-8.2	-7.6	-6.9
Budget support and development financing	6.3	5.7	5.0	5.2	4.5	4.5	4.4
Domestic arrears	4	3	3	-3	3	2	2
Memorandum Item							
Nominal GDP in US$ million	12673	13426	14498	15082	15082	15554	16297

Sources: MoFP, IMF and World Bank calculations.
Note: US$140 million of annual domestic arrears is to the pension fund.

24. **A structural concern for the banking system and the Palestinian economy is the potential negative impact of de-risking by Israeli banks.** Citing money laundering and financing of terrorism concerns, key Israeli banks signaled plans to limit or terminate correspondent banking services to Palestinian banks. Such termination of correspondent banking relationships (CBRs) by Israeli banks could have significant economic impact due to the highly interlinked structure of the two banking systems, and the use of Israeli Shekel as the primary currency in the Palestinian economy. In January 2017, the GoI assumed part of the risks by approving an indemnity and immunity package for Israeli banks working with Palestinian banks to alleviate the potential for disruptions to CBRs between the two banking systems. At present, a proposal is being discussed that aims to find a durable solution to this issue though significant risks remain. IMF assistance focuses on issues related to the legal and regulatory framework. With the World Bank support, the PMA is conducting its first self-assessment of money laundering and financing of terrorism risks. This technical assistance aims to enhance the ability of relevant anti-money laundering and combating financing of terrorism (AML/CFT) stakeholders in the Palestinian territories in identifying, assessing and understanding the money laundering and financing of terrorism risks.

2.2. MACROECONOMIC OUTLOOK AND DEBT SUSTAINABILITY

25. **Without a peace process breakthrough, economic conditions are expected to worsen, and jobs created will not be sufficient to reduce unemployment and improve living standards.** Under a baseline scenario that assumes a continuation of the Israeli restrictive regime and the persistence of the internal divide between the West Bank and Gaza, private sector activity is not expected to pick up and real GDP growth of the Palestinian economy is projected to drop to 1.7 percent in 2018 (-5 percent in Gaza and 3.8 in the West Bank) and to hover around 1.9 percent in the medium term. This growth level implies a decline in real per capita income and an increase in unemployment. Notably, downside risks to this projection remain significant. In the West Bank, growth has already started to slow down and if the Israeli legislation[5] to reduce clearance revenue transfers to the PA is implemented, this will result in larger than expected financing gaps and a major drop in public consumption - one of the major drivers of the economy. This is expected to drive down annual growth in the West Bank to 2.2 percent in the medium term. The PA may be able to offset part of this financing gap through revenue and expenditure measures. On the revenue side, widening the tax base to include high earning professionals such as doctors, engineers, pharmacists, etc., most of which are not covered by the system and updating public fees and charges that have not been revised since 1994 would be of great fiscal benefit. On the expenditure side, the wage bill continues to be an area where more work needs to be done mainly to reform the pay and grade scales that have resulted in overweighting of the higher grades. The PA can substantially improve the value-for-money and quality of healthcare services through reforming the insurance system while

[5] The “Palestinian Prisoners” Law promulgated by the GoI in July 2018 requires withholding an amount of clearance revenues equivalent to an estimate by Israel of payments made by the PA through its social spending on the families of “martyrs and prisoners”.

continuing the work it has started on reducing the cost of outside medical referrals. The very generous pension system that only serves a very small portion of the population, which raises equity concerns, also needs to be addressed. However, PA reforms alone will not be enough to close the gap. Also, since public spending multipliers are likely large, an aggressive fiscal consolidation approach at this point may be harmful for the economy and the welfare of Palestinians. Risks to financial stability are also mounting. In addition to longstanding issues related to credit concentration and exposure to the PA, provisioning has declined, some banks are facing liquidity pressures, and there are worrying signs about loan quality (despite a substantial slowing in both credit and deposit growth). Downside risks in Gaza are also considerable. If transfers through the PA's budget continue to decline, the UNRWA funding gap is not offset, and funds to continue the reconstruction efforts do not materialize, the current liquidity squeeze is expected to significantly worsen, which will have a severe impact on economic activity, service provision and social conditions in the Gaza Strip. This may, in turn, result in more violence and clashes. Consequently, the Gaza economy is expected to slip into deep recession, significantly raising the potential for unrest (see the risk section for more details).

26. **Inflation is expected to increase to around 1-2 percent in the medium term, in line with Israeli price trends**. The projected inflation figure takes into account the expectation of Israeli inflation increasing to around 2 percent in the medium term due to further rise in wage growth in Israel, together with higher foreign inflation and commodity prices.

27. **On the fiscal front, the PA's deficit as a share of GDP is expected to decline in the medium term, though significant downside risks exist.** In 2018, revenues are projected to drop relative to their 2017 level as payments by the GoI to offset fiscal leakages are expected to be lower. However, going forward, the PA's efforts in enhancing domestic revenues are expected to result in an increase in total revenues from 23.2 percent in 2018 to 23.8 percent in 2020. Public spending is expected to decline from 30.1 percent of GDP in 2017 to 29.0 percent in 2018 and continue this downward trend until it reaches 28.3 percent in 2020 due to a decline in the wage bill and net lending. Consequently, the PA's total deficit is expected to decline from 8.1 percent of GDP in 2017 to 6.9 percent in 2020. However, significant risks remain. Notably, above mentioned Israeli legislation on possible reductions of clearance revenues remains a key risk to this outlook.

28. **Even though the deficit is projected to decline, the financing needs would remain large.** The World Bank estimates indicate that the recurrent deficit (before grants) will amount to US$875 million in 2018. After accounting for development/capital spending, the overall deficit (before grants) will reach US$1.24 billion. Aid to the public sector for recurrent and capital spending in 2018 is expected to reach US$684 million. After accounting for external debt repayment, the PA will end up with a financing requirement after grants of around US$600 million. As in previous years, this is expected to be financed through domestic sources mainly, including arrears to the pension fund (de facto borrowing from the pension fund) of around US$140 million, in addition to arrears to the private sector and borrowing from commercial banks, especially since the PA had managed to maintain its debt to the local banking sector in 2017, creating room for additional borrowing.

29. **The PA will continue to rely on grant assistance funding for recurrent and capital budgets over the medium term.** The deficit in the medium term is expected to be financed mainly through aid and domestic sources. Given that the private sector remains severely constrained, aid has been the main driver of growth and the latter has facilitated fiscal consolidation efforts in recent years. Further reduction in the level of aid would weaken an already sluggish aggregate demand, further reduce growth, and increase unemployment, which will in turn make it extremely difficult for the PA to pursue structural reforms and fiscal consolidation efforts. Therefore, it would be critical for the PA's reform agenda to continue to benefit from sustained and substantial financial support from donors. As indicated by the IMF, the level of aid should increase, in particular that allocated to investment projects, until constraints on private sector investment have been substantially

relaxed. Predictability of donor aid is also important, as unpredictable aid flows introduce an additional layer of uncertainty to decision making, budget management, and prioritization of activities for the PA.

30. Due to the persistently high trade deficit, the 2018 current account deficit - including official transfers - is projected to stay high at 12 percent of GDP. Constrained by restrictions, Palestinian export growth is expected to remain sluggish and exports as a share of GDP will be around 17 percent in the medium term. The Palestinian territories will continue to heavily depend on imports to meet even some of the basic needs, and hence the share of imports in the economy will hover around 53-55 percent by 2020. Consequently, the current account deficit will remain high in the medium term at around 11-12 percent. In addition to official transfers, the current account deficit financing will continue to depend on informal private capital transfers and possibly further drawdowns of foreign exchange in cash and savings.

31. Risks to debt sustainability remain similar in direction to the assessment a year ago but accentuated by the possibility of new clearance revenue withholding.[6] The large projected financing requirement (after the inclusion of donor grants) in the PA's budget between 2018 and 2023 and weaker growth projections are the main drivers behind the risk to debt sustainability. The PA's public debt stood at 36.6 percent of GDP as of December 2017. It consists of external debt (7.9 percent of GDP), borrowing from the domestic banking sector (10.4 percent of GDP), and domestic arrears (18.4 percent of GDP). Under a baseline scenario (that assumes no large clearance revenue deductions by the GoI), public debt is expected to reach 53 percent of GDP in 2023 – higher than the 40 percent limit permitted by the law on public debt and only slightly higher than the assessment of 50 percent one year ago. A fiscal shock in the form of higher deductions of clearance revenues by GoI implementation of the "Palestinian prisoners law," estimated at NIS 1.2 billion per year, could push public debt to 63 percent of GDP by 2023.

32. With continued reform efforts by the PA and anticipated inflows of donor aid, the macroeconomic policy framework is adequate. The banking sector is healthy and has proven repeatedly resilient to shocks and exchange rate risks are minimized through the use of the NIS, which is appropriate, given that the vast majority of Palestinian trade is with Israel. The most relevant risks are related to the sustainability of the fiscal account, many of them beyond the PA's control. Nevertheless, as long as private sector growth remains constrained by factors outside the PA's control, there is no feasible alternative in the Palestinian territories to a macro-fiscal framework that relies on large amounts of donor aid to cover financing gaps, in addition to reform efforts to boost revenues and curb public expenditure growth, but without causing politically and socially unbearable impacts on citizen welfare and social stability. This grant will contribute to the reduction in the PA's fiscal deficit and is expected to leverage larger amounts of grant assistance that will altogether significantly help fill the PA's financing gap and improve debt sustainability prospects, along with ongoing and planned reform efforts by the PA.

2.3. IMF RELATIONS

33. The IMF supports the PA through macro-fiscal monitoring activities and technical assistance (TA) and publishes bi-annual reports prior to the Ad Hoc Liaison Committee (AHLC) meetings. While the West Bank and Gaza is not a member state of the IMF and thereby there is no IMF program, the IMF has a representative office for the West Bank and Gaza in Jerusalem and has been conducting macro-fiscal monitoring activities and providing TA to the PA in the area of public financial management (PFM), revenue administration, financial sector supervision, statistics, and macro-fiscal forecasting. The IMF publishes bi-annual reports in advance of the AHLC meetings, as well as other ad hoc reports.

[6] Based on debt sustainability analysis (DSA) conducted by the IMF.

34. The recent IMF assessment points to a shortage of productive capital and fiscal leakages as central to a difficult economic outlook, within a broader context of adverse political and socioeconomic trends. A statement at the end of the most recent staff visit to assess recent economic developments was issued on July 24, 2018.[7] The latest IMF AHLC report was released in September 2018 and the official summary is provided in Annex 2.[8] The report noted an increasingly difficult situation, with Gaza's economy in decline and facing humanitarian challenges, while the economy of the West Bank is stifled by external and internal constraints, and vulnerable to spillover risks from Gaza. The report assessed that a turnaround would depend on concerted action by the PA, Israel, and donors, and that increased donor financing of the budget could act to consolidate the institutions of the Palestinian administration, particularly if linked to progress on reforms and supplemented with technical expertise in specific areas.

3. THE PALESTINIAN AUTHORITY'S PROGRAM

35. The PA's development strategy, the National Policy Agenda: Putting Citizens First for 2017-2022, focuses on investing in human capital and on private sector development to achieve more sustainable growth and job creation. The NPA also focuses on institutionalizing gender mainstreaming and promoting gender equality and women empowerment. The NPA consists of three main pillars: 1) Path to Independence; 2) Government Reform; and 3) Sustainable Development. Under the first pillar, the PA aims to achieve national unity by upholding democratic principles and strengthening the Palestinian territories' international status by broadening its international participation and expanding bilateral relations. The second pillar focuses on establishing better public institutions to assure that the most vulnerable are targeted and protected, while providing better services to citizens and enhancing accountability and transparency of public institutions. In the third pillar, the emphasis is on building and enhancing an environment for dynamic and inclusive private sector growth for better job opportunities by improving the business environment and promoting the Palestinian industry. To promote the full participation and empowerment of women in society, the NPA focuses on creating an equitable society for all citizens, including women, to participate fully in the job market. The PA is committed to enforce laws that abolish discrimination based on gender and laws that punish violence against women. In drafting the NPA, the PA reached out to various stakeholders including the civil society, the private sector, academia and development partners for consultations and inputs.

4. PROPOSED OPERATION

4.1. LINK TO THE PA'S PROGRAM AND OPERATION DESCRIPTION

36. The proposed operation has been designed to support the implementation of key policy and institutional reforms defined in the second and third pillars of the PA's development strategy, NPA. The second pillar of the NPA - *Government Reform* - will be supported through the actions taken to improve transparency of fiscal transfers to local service providers in key sectors such as electricity, water and health, while reducing the fiscal drain on the PA budget. The third pillar - *Sustainable Development* - will be addressed through the actions aimed at strengthening the business environment, which promote private-sector-led growth and job creation.

37. The Program Development Objective (PDO) of this operation is aligned with the key PA priorities and broader private sector development goals. The objectives of the proposed operation are: (i) strengthen

[7] The mission findings are available at *http://www.imf.org/en/News/Articles/2018/07/24/pr18305-imf-staff-concludes-visit-to-west-bank-and-gaza*.
[8] The full report is available at *https://www.imf.org/en/Publications/CR/Issues/2018/09/17/west-bank-gaza-report-to-the-ad-hoc-liaison-committee*.

revenue and land administration and the intergovernmental revenue framework, (ii) improve the business environment and foundations for a digital economy, and (iii) enhance sustainability and creditworthiness of local service providers for private investment. Under the first objective, strengthening of the mechanisms for collection of domestic revenues will help strengthen PA's public finances at a time of continued decline in official transfers. Furthermore, improvements in land registration will not only contribute to larger tax collections, but also increase the availability of collateral for bank lending dramatically as only titled land can be used for collateral. Under the second objective, the enhanced legal and regulatory business environment will help private sector development and job creation. Finally, under the third objective, this DPG seeks further progress on increasing fiscal stability of the electricity, water, and health sectors. This is critical to lay the foundation for improved private sector activity, increased confidence of potential investors, and gaining greater citizens' trust.

38. The design of the operation has incorporated lessons learned from previous DPGs, including those related to the focus on longer-term perspectives of reforms and follow-up steps to secure the intended results, as well as the need for clear PA commitment. The last available Implementation Completion and Results report (ICR) of the Seventh Palestinian National Development Plan DPG (P156865), highlighted that future DPGs should cover long-term perspectives of reform and focus more strongly on criticality of prior actions. The ICR also found that the authorities' strong commitment to take the critical follow-up steps is key to secure the intended results. The previous DPG (P161252) adopted a medium-term framework by highlighting the future PA reforms beyond the immediate prior actions, while it was designed as a standalone operation. This proposed operation continues this practice, identifying the policy reform agenda with PA policy measures anticipated over the medium term. Further, follow-up reform steps for each prior action are described in the *Future Steps* section of the Section 4 of the Program Document.

4.2. PRIOR ACTIONS, RESULTS AND ANALYTICAL UNDERPINNINGS

39. The PA's strategy prioritizes more accountable and transparent public institutions (National Priorities 4 and 5) to provide essential services to citizens (National Priorities 8-10), especially the vulnerable, which will help lay the foundation for private-sector-led growth for better job opportunities (National Priority 6). Without a vibrant private sector mobilizing trade and investment prospects, fiscal measures alone would encounter rising socioeconomic strains, undercutting sustainable growth. Against the backdrop of the declining donor financing, the PA needs to focus on enhancing domestic revenue collection and curtailing fiscal leakages, while in parallel strengthening the prerequisites for greater private investment.

Pillar 1: Strengthen revenue and land administration and intergovernmental revenue framework

40. Intergovernmental fiscal relations between the PA and local governments suffer from misaligned revenue and expenditure assignments, lack of binding budget constraints, which is manifesting in proliferation of net lending. Palestinian municipalities and village councils (collectively referred to as LGUs) are responsible for providing critical public services but they have not been assigned sufficient revenue sources. No regular and predictable intergovernmental fiscal transfer exists to compensate for insufficient own source revenues. Fiscal transfers that do exist are subject to the MoFP's deductions to pay for the arrears accumulated for electricity and water by LGUs. As a result, and due to lack of binding budget constraints, LGUs accumulate electricity or water arrears to be able to use the collected user fees to cross-subsidize other services and operating expenses. Consequently, the insufficient revenue assignments, the lack of transparency and predictability of central fiscal transfers, and mechanisms that allow the accumulation of net lending, have caused the underfunding of basic capital investments by LGUs that could improve citizens' livelihood and unleash private-sector-led growth.

41. **Out of Palestinian LGUs' limited revenue endowments, immovable property in Areas A and B (i.e. subject to PA administration under the Oslo Accords) is the only economically viable tax revenue source, yet its potential remains untapped.** LGUs suffer from narrow and shallow revenue assignments that are insufficient to finance their legally mandated expenditure assignments. In general, they have sufficient levels of revenue to deliver 3-4 services out of 27 that are assigned to them. Property tax revenue that ultimately reaches the LGUs appears to be significantly below the tax revenue's true potential. For example, property tax rates are assessed at 17 percent of the property's annual rental value and as such are equivalent to the Organization for Economic Cooperation and Development (OECD) averages. However, the PA collects only 0.1 percent of GDP in property taxes, while developing countries collect, on average, about 0.5 percent of GDP in property taxes and developed countries collect, on average, 1 percent of GDP in property taxes.

42. **Incomplete land registration and weak land administration in Areas A and B specifically affect property tax collection.** Property tax is collected by the General Directorate of Property Tax (GDPT) of the MoFP, which collects the tax revenue on behalf of West Bank municipalities. In practice, out of the total 483 LGUs, property tax is collected only in 29 out of 146 municipalities and not in any of the village councils as they are exempt from property tax. Further, tax collection effectiveness appears to be significantly higher on registered land compared to unregistered land of equal value: effective tax rate on registered land is highest at 4.5 percent compared to 1.8 percent for unregistered land.

43. **Further, substantial revenues are lost due to a lack of collection of land transaction taxes when land is not registered, and property rights not formally transferred – which also disrupts the creation of collateral.** The exact losses are unknown since most transactions are not registered and there are no reliable estimates on the number of land transactions. Currently, the PA levies a tax of 3 percent on land transactions and no tax is levied on apartment sales. The transfer tax rate is half the regional average and lower than that in OECD and many other developing countries. Furthermore, in the future after land transactions become formalized there will also be the potential for the collection of taxes on capital gains made through real estate investments.

44. **This operation deepens the unification of revenue administration by extending it to domestic and border tax instruments (PA1).** Despite impressive fiscal consolidation efforts by the PA over the last decade, domestic revenue collection could be further enhanced as only 30 percent of the potential tax base is currently covered. To improve central revenue administration, the proposed DPG includes a prior action on merging the inland tax (RMIS) and customs[9] (ASYCUDA) revenue systems (PA1) as this would create a single tax payer base that would inhibit taxpayers from paying one type of tax while evading others. This prior action builds on the prior action supported under DPG7 that called for merging the inland Income Tax and VAT departments. Implementation of this prior action, building on DPG7, would see three separate revenue streams—income tax, VAT and customs—merged into a single taxpayer database.

45. **Further, in order to better align LGU revenue with expenditure assignments, this operation proposes prior actions that will transfer property tax collection to municipalities (PA2) and initiate the institutional improvements for effective administration of the instrument (PA3).** Implementation of both prior actions is necessary to create an effective property tax system at the LGU level as incomplete property registration significantly hinders property tax administration. Nearly 55 percent of the land in the West Bank is not formally registered because land administration faces both policy and institutional challenges. The PA has undertaken

[9] Given Israel's control of external borders, the GoI collects customs revenue on behalf of the PA for the foreign goods destined to Palestinian territories. Once the goods enter the Palestinian territories, they undergo customs clearance again to ensure compliance with PA's customs code and VAT provisions that may differ from those of the GoI and to obtain MoFP's customs forms from their ASYCUDA system in order to be eligible to claim credits under the PA's VAT system.

several positive steps demonstrating strong reform commitment. These include the approval by the Cabinet of the Roadmap for Reforming the Palestinian Land Sector that outlines a comprehensive, multiphase, multi-stakeholder approach addressing the specific policy, legal, and institutional reforms needed. Additionally, the Land and Water Settlement Commission (LWSC) was established to carry out land settlement activities, under which more land has been registered in the last two years than the past ten years combined.

46. In addition to completion of the systemic land registration, institutional reforms are key to sustained progress in the land sector in Areas A and B. The Palestinian Land Authority (PLA) is the central land administration organization established in 2002 and is governed by the PLA Law. Given that the governance structure of the PLA was never properly established, the institution languished. The LWSC was created in 2016 as a separate agency. While the LWSC is responsible for first-time registration activities, the PLA remains responsible for receiving and recording land titles issued by the settlement activities and ensuring that they meet the spatial and legal requirements of the PLA for registration. The PLA continues to be responsible for property transfers and mortgages. Management of state-owned property is also a mandate of the PLA. In April 2018, the Head of the LWSC was appointed to act jointly as the Chairman of the PLA in an effort by the PA to align the two land agencies more closely. With the appointment of the new Chairman of the PLA, the next steps are to modernize the functions of the land authority, and to establish a Board of Directors to serve both the PLA and the LWSC and provide strategic policy guidance and oversight of the two agencies.

DPG9 Prior Actions	DPG9 Results	Anticipated Actions for 2019	Anticipated Actions for 2020
Prior Action 1: The Ministry of Finance and Planning has taken the necessary actions to improve tax collection and operational efficiency, by connecting existing management information systems for domestic and border taxation (RMIS and ASYCUDA), as evidenced by the issuance of official letter No. 5426, from the General Directorate of Revenue to the General Manager of the Revenue IT Department, informing the completion of the merger of RMIS and ASYCUDA.	Increase in gross domestic tax revenues. Baseline (2017) = NIS 2,750 million; Target (2019) = NIS 2,982 million.	Complementary Step 1.1: MoFP prohibits suppliers of goods and services to the public sector from bidding on public tenders if they do not hold a no tax liability certificate.	Complementary Step 1.2: The Cabinet restructures the revenue function within the MoFP creating a single department for all revenue streams.
Prior Action 2: The President has taken the necessary actions to strengthen domestic revenue collection by LGUs by authorizing the Cabinet, in cooperation with the MoFP, to delegate the MoFP's responsibilities to collect property taxes and related penalties to LGUs, as evidenced by the enactment of Law No. 12, dated May 3, 2018, amending the 1954 property tax law.	Number of LGUs that have piloted collection of property taxes. Baseline (2017) = none; Target (2019) = three to five.	Complementary Step 2.1: MoFP transfers to these municipalities all related regulations, instructions, and tax files to enable them to carry out this new mandate.	Complementary Step 2.2: The Cabinet passes amendments to the property tax law revising the annual property tax rate and introducing: a) a transfer tax for land, b) a capital gains tax, and c) a tax on idle land.
Prior Action 3: The Cabinet has established strategic and policy oversight mechanisms for institutions in land administration, as evidenced by the adoption of Decision No. 17/229/18 signed by the Prime Minister on November 22, 2018,	Supporting the above result.	Complementary Step 3.1: To establish strategic and policy oversight of institutions in land administration, the President approves a	Complementary Step 3.2: PLA adopts a national policy on state-owned land and properties.

referring the draft amendments to the Palestine Land Authority Law for approval by the President.	draft Amendment to the PLA Law establishing a Board of Directors which would also supervise LWSC.

47. **Expected results.** These efforts are expected to lead to increased gross domestic tax revenues for the PA at the central level and to pilot collection of property taxes by the LGUs.

48. **Future steps.** Given the significant shift in the policy momentum on systematic land registration, implementation of legal and institutional reforms presents an opportunity to fundamentally reshape fiscal relationships between the central and local authorities in the future. This should result in more efficient tax collection as municipalities are closer to local tax units. In the process, LGUs would be able to plan and budget at the local level as information on tax revenues would be more predictable. The prior actions supported by the proposed DPG and potential future follow-up actions would lead to sounder fiscal footing for both central and local governments which should eliminate net lending, create fiscal space for funding of basic capital investments by LGUs that in turn could improve citizens' livelihood and unleash private-sector-led growth.

Pillar 2: Improve the business environment and foundations for a digital economy

Business environment reform measures

49. **A weak domestic business climate is a major internal constraint on private investment.** The Palestinian territories ranked 116 out of 190 countries in the 2019 Doing Business report. Cumbersome regulations and administrative procedures for businesses stifle enterprise and innovation and are found to be associated with a smaller number of legally registered firms, greater informality, a smaller tax base, and more opportunities for corruption. To formally register a business, comply with construction permitting formalities, or transfer property in Ramallah, separate interactions with several authorities are required. Each authority acts under its own specific mandate with little coordination among the authorities. Since information is not usually shared systematically among departments, each department has its own bilateral relationship with the business. From the business perspective, this increases compliance cost; from the authorities' perspective, it raises the complexity of administering regulations and makes enforcement and compliance more difficult. Where the rules are excessively burdensome, resource-constrained entrepreneurs, especially Palestinian women and young people more generally who are increasingly choosing the path of entrepreneurship, might not have the opportunity to turn their ideas into a business within a level-playing field[10]. As a result, making it difficult to start and operate a business, to access loans and financing, prevents the economy from reaping the benefits of a dynamic and inclusive private sector for job creation.

50. **A key reform of the municipal business licensing under the Law of Crafts and Industries of 1953 -- simplifying the approval process and reducing the cost of licensing – has been approved (supported by previous DPG) and its implementation is supported under the proposed operation.** This reform was proposed to address a main challenge that the businesses had identified, respectively the lengthy time it was taking to incorporate a company and begin operations. The process takes about 43 days on average for a limited liability company, of which 36 days are spent on obtaining a business license from the municipality. The Cabinet adopted amendments to a 65-year-old law to streamline the business licensing process by introducing a risk-based classification system of business activities, introduction of ISIC 4 coding of business activities and introducing a reduced flat fee per activity licensed.

[10] World Bank, 2018. Second Country Gender Action Plan (C-GAP II) for Palestinian Territories (FY2018-2021) (English)

51. **Following the amendment of the Law of Crafts and Industries of 1953, critical steps had to be taken for the implementation of the reform on the ground (PA4).** The Ministry of National Economy, as the champion of business environment reforms, has been working together with the Ministry of Health (the stakeholder mandated by the Act of 1953 to amend the Annex of the Law of 1953) to develop, issue and implement the business licensing reform. The Minister of Health approved the Instructions on July 27, 2018. Following the approval of the Instructions, 6 workshops/trainings for all the relevant employees of municipalities in West Bank were undertaken in September 2018, and around 250 people have been trained to apply the new licensing system.

52. **Furthermore, the Land Authority implemented a reform that reduced the time to register business property (PA5).** Reducing the time to register property was a key component of the Doing Business reform program. On February 7, 2017 the Chairman of the Land Authority issued Circular 6-15 canceling the internal procedure of a security check as part of a requirement to obtain a purchase permit from the Cabinet through the Land Authority for the following entities: Palestinian companies, Palestinian professional associations and Palestinian associations. During 2018, the Ministry of National Economy, as a champion of business environment reforms, followed up on this reform through the Business Environment Technical and Ministerial Committees to ensure its successful implementation. It succeeded in doing so in 2018, and the reform is captured as the only improvement for the economy in *Doing Business in 2019*. The overall time of the procedure to obtain a purchase permit has been reduced by nearly half.

DPG9 Prior Actions	DPG9 Results	Anticipated Actions for 2019	Anticipated Actions for 2020
Prior Action 4: The Ministry of Health has streamlined the procedures for issuance of business licensing, reflecting the amendments to the Law on Crafts and Industries of 1953, as evidenced by the issuance of: (a) Cabinet decision No. 1 for the year 2018, approving the amendments to the annexes of the Law on Crafts and Industries dated April 3, 2018; and (b) Guidelines and instructions for business licenses, issued by the MoH dated July 25, 2018.	Number of days on average to issue a business license. Baseline (2017) = 36 days; Target (2019) = 10 days.	Complementary Step 4.1: The President signs into law a new Companies Act that includes simplified business registration procedures.	Complementary Step 4.2: Cabinet approves necessary By-Laws for implementation of the new Companies Act.
Prior Action 5 The Cabinet has taken the necessary steps to reduce the land registration procedures for businesses, as evidenced by the issuance of Circular 6-15 dated February 2, 2017, describing the streamlined procedures necessary for obtaining a purchase permit.	Number of days on average to obtain a land purchase permit. Baseline (2017) = 30 days; Target (2019) = 15 days.	Complementary Step 5.1: Ministry of National Economy (MoNE) develops and implements simplified licensing procedures for home-based businesses.	Complementary Step 5.2: MoNE establishes an automated company registry.

53. **Expected results.** The implementation of the new licensing process and fee structure is expected to reduce the time for getting a business license from 36 days in 2017 to 10 days in 2019. The reform promoted by PLA is expected to significantly reduce the time to obtain a land purchase permit from 30 days in 2017 to 15 days in 2019.

54. Future steps. Over the medium term, the MoNE will proceed with reforms to further improve the business environment. In addition to the existing TA provided by the World Bank, the Private Sector Enhancement Facility (PSEF) will extend support aimed to create a more effective enabling environment for investors and entrepreneurs. First, the adoption of a new Companies law will provide a complementary impetus to MFD by strengthening the rights of minority shareholders, addressing corporate governance principles and issues related to start ups, allowing single person companies, different type of shares, simplified business registration requirements, etc**.** Second, implementing regulations and procedures related to the Companies Law will need to be prepared and submitted to the Cabinet for approval, and the institutional framework to support the new features of the Companies Law will need to be developed to ensure a successful implementation of the law. Third, MoNE will support the design and approval of a new framework for home-based businesses, many of which belong to women and youth. Moreover, the entire business licensing framework needs to be modernized, and streamlined and should provide the right incentives for businesses to become formal and grow.

Reform Measures for a Digital Economy

55. Digitalization through electronic provision of public services (e-government) holds great potential for the public sector to provide citizens with high quality services in a cost-effective manner. Since 2005, the Palestinian Authority has included e-government as a national priority in all its main policy documents and strategies. This was further affirmed in the 2010 Administrative Development Plan of the Ministry of Planning and in the establishment of the e-government ministerial committee in 2014. During this time, the PA had focused on the back-end infrastructure, that is government-to-government (G2G) services, which has laid the necessary foundation for the provision of government-to-citizen (G2C) and government-to-businesses (G2B) services. Consequently, the PA enjoys a commendable technological infrastructure: a government network through which all ministries are currently connected (so-called X-Road) to the government Computer Center. Common e-service enablers, such as e-signature, citizen e-authentication, and e-payments are necessary but have yet to be established.

56. In parallel, the Palestine Monetary Authority (PMA) has initiated and led the reform and modernization of the National Payment System (NPS) as a platform for the digital economy. Payment and clearing systems have been witnessing increasing and rapid changes worldwide. Mobile phone and internet penetration coupled with the rapid spread of e-commerce and enabled by the technological developments, have paved the way for novel and inclusion friendly e-payments. In 2005, the PMA adopted a strategy, coupled with an action plan, in cooperation with all relevant stakeholders with a goal of reforming the National Payment System in West Bank and Gaza.

DPG9 Prior Actions	DPG9 Results	Anticipated Actions for 2019	Anticipated Actions for 2020
Prior Action 6: The PMA Board of Directors has adopted regulations enabling the establishment of new electronic payments systems, fostering competition and reducing costs, as evidenced by the minutes of the PMA Board meeting signed by the Governor on July 17, 2018,	Regulatory authorities have reviewed licensing applications for mobile payments providers under the new framework. Baseline (2017) = none; Target (2019) = five.	Complementary Step 6.1: PMA establishes interoperability of: i) mobile payments; ii) point of sale (POS) card transactions. Automated Clearing House (ACH) payment system is in full use and function for domestic bank transfers.	Complementary Step 6.2: National Payments Company has been established to absorb the card and mobile payments switch and establish a modality to deal with Israeli counterpart on excess liquidity issues.

approving regulations for the licensing of payment service providers.	

57. **The World Bank has supported the PMA during its ongoing National Payment Systems reforms.** The PMA structured reforms in three phases. The first phase focused on legal and regulatory reform and implementation of Real Time Gross Settlement (RTGS) system for large transactions and Automated Clearing House (ACH) as an integrated platform called Automated Transfer System (ATS). The second phase of the reforms focused on elements such as securities settlement, payment systems oversight and co-operative arrangements. The third, and currently ongoing phase, is focusing on developing retail payments, including mobile payments, and further strengthening the legal, regulatory and oversight framework.

58. **In this context, opening of the market for new types of providers of payment services, including mobile payments, is key to reducing transaction costs and empowering women entrepreneurs.** New regulations that are needed for the introduction of mobile payments as well as removing restrictions for remittance services have been finalized, with support from the World Bank, and have been adopted by the PMA. These provide the necessary legal framework for licensing and establishment of mobile payments providers (PA6). Further, both the PMA and the PA have adopted a broader e-payments strategy that aims to enable various forms of electronic payments to provide cost and time effective alternatives to cash. This will be a foundation of a critical “digital utility.” In the framework of this strategy, several forms of electronic payments, such as card, bank transfer and mobile payments, will play a key role. Once the overall system is more developed, women, in particular, would benefit from digital payments. Social norms and family responsibilities, for example, often prevent women from traveling to distant suppliers or bank branches. Digital payments give women better access to the marketplace – with no need, for example, to travel far to deposit money – lowering these barriers to mobility[11]. Similarly, social norms also can limit a female entrepreneur’s control over her earnings. But electronic payments ensure a woman’s money is private and secure.

59. **Expected results.** The prior action identified above will support the objective to increase the use of e-payments by establishing an enabling regulatory framework, allowing for a variety of providers of transaction accounts and related e-payment instruments, such as mobile and other innovative and inclusion friendly payments systems.

60. **Future steps.** Clear and well-designed rules are needed for all participants in the electronic payments in all their forms (card, bank transfer, mobile). Regulations establishing these rules are needed and the PMA is to draft and implement these regulations. Plans for the establishment of a National Payments Company (NPC) that is expected to take over bank card switch, and mobile payments switch from the PMA will institutionalize interoperability of all electronic payment modalities. Further, the establishment of the NPC ensures private sector participation in retail payments systems as well and it reduces potential conflicts of interest for the PMA that is both a participant in and a regulator of the payments systems. Moreover, NPC is expected to establish modalities to liaise with Israeli counterpart on issues of excess liquidity. Finally, once regulations and infrastructure are in place, e-payments will be required for a number of governments services in order to jump start the demand for them. This will complete a key enabler for provision of e-government services.

Pillar 3: Enhance sustainability and creditworthiness of local service providers for private investment

61. **Establishing financially viable utility sectors such as electricity and water, as well as improving payment discipline are essential for MFD investments in these sectors.** Utility sectors are currently not financially viable

[11] World Bank studies have shown that Palestinian women face additional safety and security concerns during travel or commuting to work over and beyond what is imposed by traditional attitudes and cultural norms around women’s mobility.

due to the following reasons: (i) services are not priced at full cost recovery level; (ii) inefficient operational performance; and (iii) non-payment for utility services by LGUs (and distribution companies for electricity) due to the diversion of utility revenues into municipal expenditures. Non-payment for utility services by service providers/LGUs to suppliers has created a significant burden on the PA's finances, as hidden subsidies damage the creditworthiness of sectors and limit any prospects for capital investments. In the absence of financial viability, LGUs have little room for improving service delivery and no prospect of mobilizing public or private investment. Greater energy and water sector viability can be achieved through a more efficient and reliable provision of services (which are within the PA control) and increased supply which depends on Israeli and regional cooperation.

62. **The value chain of the utility sectors must be complete and sustainable for financial viability, and the proposed DPG is supporting the second (out of four) leg of the payment flow between the service providers and suppliers.** The value chain of the electricity and water sectors comprises the following four links: (i) suppliers provide electricity/water to service providers; (ii) service providers provide service to consumers; (iii) consumers pay service providers; and (iv) service providers pay suppliers. Currently, this chain is not complete because consumers do not pay fully to service providers and then service providers do not pay fully to suppliers. Whereas the previous DPG targeted ringfencing of utility revenues, this operation focuses on mechanisms to strengthen enforcement of bill collection from customers with significant past debts for electricity. Importantly, these procedures exempt households that are registered with the Ministry of Social Development as recipients of cash assistance.

63. **The proposed prior actions in this pillar are critical to unlock steps to financial viability but realizing the gains will require programmatic support through various instruments, including the PSEF.** The PA has initiated the process of implementing a broad set of reforms designed to establish financially viable utilities, which will be supported by various instruments, including ongoing projects and TA supported by the Bank, the recently launched PSEF, other donor support, and private and commercial investments. The PSEF would extend support in the area of long-term finance, payment risk associated with the utility sectors, capacity building activities, PPP advisory, and risk mitigation such as political risk insurance. The benefits from the reforms will be incrementally realized under the medium-term framework as the PA's reforms take hold and the sectors respond.

64. **At the local government level, the lack of a stable and predictable system of intergovernmental fiscal transfers has led to insufficient capital investment while increasing fiscal leakages through net lending.** Due to the lack of a sustainable subnational financing framework for ensuring that all LGUs have adequate financing, the underfunded LGUs have tended to dip into utility revenues to cover their operational expenditures as well as capital investment, leaving the PA to repay some or all of the costs (these are deducted by Israel from clearance revenues transferred to the PA). Thus, net lending resulting in unplanned subsidies paid through local governments' budget has become a drain for the PA's finances.

Power sector reform measures

65. **The Palestinian electricity sector has yet to establish its sectoral financial viability and creditworthiness, which is necessary to mobilize private investment in the sector.** There are three layers to this problem. First, despite efforts by the regulator, Palestinian Electricity Regulatory Council (PERC), electricity is not priced at cost recovery levels throughout the Palestinian territories[12]. Second, the sector is still only able to recover revenue for 64 percent of the electricity purchased in the West Bank. While the operational performance of the

[12] The program is not able to affect the energy situation in Gaza as PERC/PENRA have no ability to enforce laws there.

distributions utilities has been improving, the LGUs are lagging and some customer categories[13] continue to face challenges in terms of timely payments. Third, even when revenues are collected, they are often diverted by municipal governments to cover other subnational expenditures rather than being channeled to the purchase of power. As a result, implicit subsidies to the electricity sector have been estimated at close to one percent of GDP in the West Bank. While tariff reform is eventually needed, an immediate first step is to significantly improve the operational and commercial efficiency of the utilities. West Bank is witnessing growing demand and Gaza is facing extreme shortages. Utilities require additional, sustainable electricity supply. This supply can come from Israel, Egypt, Jordan or independent power producers (IPPs) in West Bank and Gaza. However, if non-payment remains an issue, increasing supply from any source would remain a significant challenge. The PA has identified a suite of measures that will have to be adopted to improve the financial viability of the sector.

66. The poor track record of paying Israeli power import bills continues to contribute to the so called 'net lending' fiscal distortion and accumulation of outstanding debt. As indicated, power purchased from Israeli Electric Corporation (IEC) is only partially paid for by some of the Distribution Companies (DISCOs) and LGUs that purchased and received power. Non-payment occurs due to the following reasons: i) consumers do not pay utilities; ii) utilities partially pay suppliers; and (iii) irregularities in billing and settlement systems. The shortfall is then partially covered by the PA through (involuntary) net lending and partially accumulated as outstanding debt. In 2015, the Israeli Minister of Finance deducted over NIS 1 billion (US$275 million) from the PA's clearance revenues. By September 2016, the accumulated debt owed to the IEC reached over NIS 2 billion (approximately US$500 million). In September 2016, an agreement between the Palestine Energy and Natural Resources Authority (PENRA) and the IEC was reached, which allowed for the settlement of past accumulated debt and laid out the vision for a new Palestinian power market with imports channeled through the new high voltage substations and tariff set according to a new long-term Power Purchase Agreement (PPA). A long-term PPA was initialed in May 2018, though crucial details remain to be finalized. Building on an interim PPA signed in June 2017, Palestinian Electricity Transmission Company Limited (PETL) is gradually taking on the role of the Palestinian 'single buyer' purchasing power from the IEC and selling it on to one DISCO that has achieved full repayment within the first year[14].

67. The creation of securitization mechanisms to ensure that electricity revenues of Palestinian electricity utilities (i.e. DISCOs, municipalities or village councils) are not diverted to other municipal expenditures is ongoing. The previous DPGs supported the interim mechanisms to ringfence the revenues needed for the service providers to meet the costs of wholesale power purchase by opening designated accounts that capture collection from consumer bills and transfer the funds to PETL's designated accounts or make direct payments to IEC. Following the Cabinet decision in September 2016 that required all electricity distributors open a separate bank account to deposit funds collected from electricity bills to pay the PETL in a timely manner, 125 out of 133 municipalities and local village councils as well as distribution companies have already opened the designated bank accounts and a few are still pending.[15] The ongoing Electricity Sector Performance

[13] Some DISCOs and VLCs have a higher share of low income and vulnerable populations (incl. refugee areas) and see very low collection rates.

[14] The debt agreement required the following conditions to be fulfilled: i) signing of a long-term PPA between the PENRA and the IEC with wholesale tariff lower than the existing bulk tariff charged by the IEC, ii) the transfer of more than 250 connection points from individual DISCOs and municipalities to the PETL, and iii) the energization of the newly built substations which would increase the amount of power supplied to the West Bank and reduce losses. Progress has been slower than expected.

[15] The Ministry of Local Government ordered, through the Cabinet decree, all electricity providers to establish a dedicated bank account for the electricity collection fees. Some municipalities and village councils are in Area C so outside of PA

Improvement Project (ESPIP)[16] focuses on enhancing the energy sector's institutional capacity and improving efficiency of the distribution system leading to improvements in bill collection. ESPIP targets the first leg of the payment flow between consumers and service providers to make more consumers pay their service providers, while DPG8 addressed the second leg between service providers and suppliers by helping prevent diversion of funds.

DPG9 Prior Actions	**DPG9 Results**	**Anticipated Actions for 2019**	**Anticipated Actions for 2020**
Prior Action 7: The Cabinet has set forth procedural steps to follow before service providers can cut off electricity following the accumulation of debt, including a grievance mechanism and protection of poor and vulnerable population, as evidenced by the issuance of official instructions dated April 17, 2018, published in the Official Gazette on April 22, 2018, that include the following provisions: (a) specification of exact periods of unpaid bills (30 days to households and 60 to non-households; (b) objections from the consumer to the distributor; (c) instructions on how to file a complaint; (d) instructions on how to reconnect power back to consumers; (e) guidelines on resolving disputes between the consumer and the distributor; and (f) exemptions.	Share of electricity that is purchased from wholesale suppliers is collected and paid by LGUs. Baseline (2017) = 86 percent. Target (2019) = 95 percent.	Complementary Step 7.1: PENRA and MoFP establish a settlement mechanism for timely payment of public-sector electricity bills.	Complementary Step 7.2: PENRA and PERC issue directives mandating LGUs that have not yet joined DISCOs to merge with existing or establish new DISCOs.

68. Expected results. The prior action (PA7) defines the legal steps that are necessary before a service provider can cut off electricity following an accumulation past debt. Importantly, these procedures exempt households that are registered with the Ministry of Social Development as poor households or refugees. This measure will result in the reduction of net lending by increasing payments of LGUs to PETL. This is expected to be achieved through improved bill collection and reduced diversion of electricity bills collected from being spent for other municipal expenses.

69. Future steps. Over the medium term, the PA aims to continue the reforms to increase financial viability of the sector to enable increased private sector participation and ensure more reliable and cheaper sources of supply, which would essentially require building investor confidence and mobilizing private and commercial finance into the sector. As future reform steps, the PENRA will continue the implementation of its Debt Agreement Action Plan. The subsequent actions will strengthen financial discipline by streamlining payments of public sector as well. Further, LGUs that are distributing electricity themselves will be required to merge with existing or create new DISCOs. As PETL takes charge as the single buyer and the off-taker of electricity from IEC, its operational efficiency and creditworthiness will increase. Signing of the long-term PPA with IEC will provide

access or control.

[16] For the first link, the ESPIP is implementing a 'Revenue Protection Program (RPP)' which aims to bill for every kilowatt-hour of energy the consumer consumes. The program will install smart meter infrastructure to ensure that the biggest consumers are paying their full electricity bill. That will increase the revenue for the utilities and improve their operational efficiency creating better cost recovery at the utility level.

for longer term contracts with more favorable rates, which will further improve the financial strength of PETL and the Utilities. The addition of Independent Power Producers (IPPs), including independent renewable energy providers (i.e., solar developers), who are required to provide electricity at a price lower than IEC, will further strengthen the financial viability of the sector while encouraging private sector participation.

Water Sector Reform Measures

70. Hidden subsidies have resulted in large deficits in the water sector that are financed largely by the practice of net lending. At the bulk level in the West Bank, water is being sold by the West Bank Water Department (WBWD) to service providers at prices that are 20 percent below the cost[17]. This serves as a direct transfer and results in a permanent structural deficit. There are also indirect transfers related to depreciation charges and water losses at the bulk level. Further, price of water charged by the service providers barely covers the operation and maintenance cost. Even so, service providers are not able to collect in full. Furthermore, many service providers are also diverting water revenues to their general municipal budgets. In 2014, the underpricing by the WBWD and nonpayment by municipalities provided an effective transfer of NIS 130 million (US$35 million) to service providers, mainly to the municipal water departments. Since service providers pay only a part of what they owe to the WBWD, large arrears have built up in the books of the MoFP. Taken together with charges from Israel for treating wastewater, the total net cost of the water and sanitation sector to the PA are high. Israel deduced US$101 million in 2016 and US$116 million in 2017 from clearance revenues due to the PA in respect of unpaid bills for water and charges for wastewater treatment.

71. The Palestinian Water Authority (PWA) has initiated steps toward the comprehensive reform of the water and sanitation sector with the aim of providing equitable access to safe and sustainable water services. The 2014 Water Law together with the water sector strategic development plan for 2017-2022 support medium-term reform plans, including four institutional changes: (i) sector policy, planning and investment, (ii) establishment of a national water company; (iii) a sector regulator, the Water Sector Regulatory Council (WSRC), which was established in 2014; and (iv) establishment of regional water utilities which operate on a commercial basis. In the current phase of the reform, improving the financial viability of the sector is an absolute priority to reduce hidden subsidies to service providers by the PA, improve services, and attract private finance. Without financial viability, there is no scope for private provision of services due to a low prospect of profitability and high risks. Like the energy sector's ESPIP, the current and planned interventions in the water sector focus on institutional capacity building, improved efficiency of the distribution system leading to improvements in bill collection. The proposed DPG complements the Bank's engagements in the water sector, with the aim of making the whole value chain sustainable.

72. Like the energy sector, restoring the financial viability of the water sector requires the establishment of mechanisms to prevent accumulation of new debts and settlement of old debts. Following a similar exercise for unpaid electricity bills, the proposed prior action (PA8) focuses on rescheduling debt owed by LGUs to the MoFP for the unpaid water bills. An intra-agency committee consisting of Ministries of Finance and Planning, and Local Government, along with the West Bank Water Department and the Palestinian Water Authority is gradually rescheduling these debts. Debt rescheduling includes an agreement to pay past accumulated debt of the LGU in monthly installments in addition to a commitment to pay current monthly invoices on time. This will enable service providers to pay down past debt in more manageable and predictable installments clearing a key obstacle for attaining future creditworthiness. Since the start of the work of the intra-agency committee to reschedule the debts, there has been a significant improvement in payment discipline by the LGUs. Payments

[17] The cost of water purchased from Mekerot is 3.25 ILS/m3 without depreciation while selling price is 2.68 ILS/m3.

for water and related debts to the MoFP have increased by 60 percent in the first half of 2018 when NIS 97.8 million were collected, compared to the same period of 2017 when NIS 60.4 million were collected.

DPG9 Prior Actions	DPG9 Results	Anticipated Actions for 2019	Anticipated Actions for 2020
Prior Action 8: The Intra-agency Committee has taken the necessary steps to strengthen payment discipline and improve financial viability of the water sector by rescheduling the debt for unpaid water bills owed by LGUs to the MoFP for at least 90 LGUs, as evidenced by: (a) the issuance of an Official Letter signed by the Head of the Intra-agency Committee and dated October 28, 2018 enclosing a report describing the balances of the municipalities after debt rescheduling; and (b) seven debt rescheduling agreements entered between the LGU and the Intra-agency Committee, selected on a sample basis.	Percentage of unpaid debt for water owed by LGUs to the MoFP is restructured. Baseline (2017) = 0 percent; Target (2019) = 15 percent.	Complementary Step 8.1: The Cabinet approves Unified Water Tariff by-law to the Water Law 2014 that would ensure that Water Service Providers cover operational costs.	Complementary Step 8.2: The Cabinet approves Regional Water Utilities (RWUs) by-law to the Water Law 2014 that would enhance the sector's efficiency through economies of scale.

73. Expected results. This prior action would help stabilize the rapidly accumulating debt of the LGUs to the WBWD in the short term and help lower it over the medium term. While improving the payment of LGUs to the WBWD will help with repayments of past debts, a significant decline requires the progress on other reform efforts to improve the financial viability of the water sector, including increased collection rates, reduced non-revenue water, and the tariffs set at the cost recovery level.

74. Future steps. The PWA's medium-term reform framework aims to increase the financial viability of the water sector, which would require establishing viable and sustainable water utilities. These utilities should be able to cover their O&M cost, recover costs on their capital, and provide more access, efficient and equitable water and wastewater service. The reform efforts will be supported by the Bank's continued engagement in the water sector and the PSEF, including capacity building activities and Public-private partnership advisory, as well as other donor-financed projects. PWA aims to put in place a national framework for regional utilities and submit to the Cabinet a regulation for the establishment of regional water utilities to allow the PWA in collaboration with the MoLG to create viable utilities separated from LGUs. The PWA is in the process of establishing sustainable municipal water utilities and anticipates having an additional four (to the existing three) by the end of 2022.

Health Sector Reform Measures

75. The Palestinian health system faces critical challenges to contain the rapid growth of health expenditures, specifically for medical referrals outside of the public health system, so called Outside Medical Referrals (OMRs)[18]. Due to various constraints, the Ministry of Health (MoH) relies on purchasing highly specialized and costly services from external providers. The relationships between the MoH and external providers (such as NGOs, private-for-profit providers and neighboring countries) lack a modern framework, tools and skills for conducting strategic purchasing to negotiate more predictable and better prices for health services. There is also a lack of tools to improve negotiation approaches with providers using modern tools based on

[18] Referrals are mostly made to Israeli hospitals and private healthcare facilities in the West Bank and Gaza, as well as East Jerusalem, and also to Jordan and Egypt to a lesser extent. Spending on health services that are provided in Israel to Palestinians is deducted monthly from clearance revenues by the GoI.

international good practices that can generate incentives for efficiency. For various reasons, OMRs to providers from the West Bank and Gaza use different ad hoc pricing arrangements, without using standard modern categorizations of conditions, or mechanisms to package services to incentivize efficiency such as International Classification of Diseases coding. This lack of standardized approach to negotiate prices leads to considerable inefficiencies in the referral application process and payment procedures by increasing the administrative burden on the Service Purchasing Unit (SPU). Over the last 15 years, the number of OMRs have grown rapidly from 8,123 in 2000 to 74,654 in 2016, while the corresponding cost has also increased significantly from less than US$10 million in 2000 to as much as US$210 million in 2014 (see 2016 World Bank Public Expenditure Review and MoH SPU 2016)[19]. Currently, unpaid bills to outside service providers amount to more than NIS 500 million (US$142 million)[20], which has been threatening the sustainability of the health system and the PA's finances.

76. **The proposed operation supports the critical next step in key PA's reform actions to further advance the policies to reduce the speed of growth in health spending envisaged in the Medical Referral Master Plan ("Master Plan"), which was approved by the Cabinet in September 2016.** The MoH has developed the Master Plan, which outlines a shared strategic vision and policy options to strengthen the referral system and is a key platform for organizing all tools such as procedures and protocols and tools for better negotiating prices with providers. By implementing the recommendations of the Master Plan, the MoH has negotiated preliminary arrangements on health referrals including lower rates and savings for higher volumes of services delivered. The MoUs, similar to those achieved with Israeli hospitals, were signed with the six largest private Palestinian hospitals (three in the West Bank and three in East Jerusalem)[21] in January 2017. These six hospitals are also the top recipients of the medical referrals volume. Negotiations with three additional national hospitals are underway. In addition, the MoH has developed harmonized standard procedures for medical referrals, which include the following manuals and protocols: (i) procedure manuals for local hospitals and Israeli hospitals; (ii) National Referral Protocols (Oncology, Ophthalmology, Cardiology, Neurology, Nephrology); (iii) Diagnostic Related Group (DRG) User Manual (for Israeli DRGs); and (iv) Financial Audit Manual. However, legally binding contracts are critical to ensure these gains are not reversed and to improve incentives for efficiency in the delivery of bundles of services contracted.

77. **The proposed DPG complement to the ongoing Health System Resiliency Strengthening Project (HSRSP P150481) by enabling transparent and predictable cost commitments, opening the way to achievement of the more complex objectives to be realized under the HSRSP.** With funds from the HSRSP a National Reference Price (NRP) tool was developed. However, to conduct cost-effective negotiations for the first formal contracts with non-MoH healthcare providers, it is important that the NRP tool is refined in a process that engages all stakeholders from physicians from the referring hospitals to the hospitals that provide the services to ensure relevance in price negotiations. To ensure an effective use of the NRP tool, it is important that the MoH refines the relative weights and categorization of diseases and therapies and other technical aspects of this tool. This process of implementation of the NRP tool will ensure that it will be relevant to the context of the specific diseases and available diagnostic and therapeutic interventions for which the MoH is sending patients to providers outside its network. Implementation of this tool is a critical step to enable the MoH to move to

[19] Notably, the highest unit cost for referral cases is charged by Israeli hospitals, so even though this category of referral cases represents only 11 percent of the total number of referred cases, the associated cost is about 47 percent of the total referral cost.

[20] The figure shows the accumulated arrears up to 2016.

[21] These six hospitals are: (i) Augusta Victoria Hospital, Jerusalem; (ii) St. John Hospital, Jerusalem; (iii) the Jerusalem Princess Basma Center, Jerusalem; (iv) Istishari Arab Hospital, Ramallah; (v) Al-Ahli Hospital - Hebron; and (vi) Caritas Baby Hospital, Bethlehem.

contract negotiations with local non-MoH providers that will make the cost of OMRs more predictable and better controlled.

78. The National Reference Price tool is a key step in a process of strengthening the strategic purchasing capacity of the country to rein in the growth of expenditures for OMRs. As in most OECD countries along with Diagnostic Related Groups, National Price list tools are part of the modern set of approaches to introduce standardized categories and packages of services so as to foster efficiency in allocation of resources. This tool seeks to strengthen the capacity of national health authorities to avoid ad hoc (individual definitions) as is happening today and replace them with international standard definitions of packages of services and estimation of their respective relative prices.

79. The MoUs with health providers supported under the previous operation were a necessary step but the process needs to continue further. The existing MoUs were a good step in the right direction and can continue but the next step is to avoid disparate individual approaches to categorizes services and prices delivered by providers which currently are based on an ad hoc approach basically using lists imposed by each provider. This fragmentation on categorization of services and relative prices does not foster efficiency and increases the administrative burden of processing bills. New NPR list would facilitate negotiations for MoUs and more importantly eventually for formal contracts which are more solid, legally binding tools to harness the growth of expenditures on OMRs. NPRs also help to standardize the framework for negotiations with providers introducing bundling of services which can foster efficiency on the providers' side and facilitate the use of modern tools for monitoring efficiency such as DRGs.

DPG9 Prior Actions	DPG9 Results	Anticipated Actions for 2019	Anticipated Actions for 2020
Prior Action 9: The Ministry of Health has directed its Service Purchasing Unit to plan and implement training and capacity building to make the National Price Reference List tool ready to be used for medical referrals with domestic non-MoH healthcare providers when negotiating with at least three hospitals, as evidenced by the issuance of Directive No. 32/110/1139/18, dated October 30, 2018.	Service Purchasing Unit of the MoH has completed negotiations for contracting medical services using the NPR tool with domestic private healthcare providers. Baseline (2017) = none; Target (2019) = three providers.	Complementary Step 9.1: Ministry of Health introduces standard international classifications for disease and medical procedures to improve the quality of medical referral information and price negotiation.	Complementary Step 9.2: Ministry of Health implements a single database that includes comprehensive information on the volume and cost of medical referrals.

80. Expected results. It is expected that the MoH will be ready to use the NPR for negotiating with at least local three providers in the Palestinian territories, adding a new mechanism to harness health expenditures. The growth rate of OMR expenditures has experienced an unexpected hike over the past three years, for example, due to the lack of harmonized standards, a repressed demand, and hikes in prices by providers. The prior action supported by the DPG will help stabilize the growth rate of referral costs to health service providers over time

81. Future steps. Over the medium term, the MoH aims to further advance the rationalization of the purchase of outside referral services by: (i) introducing standard international classifications for disease and medical procedures to improve the quality of medical referral information for better negotiations with providers and; (ii) implementing a single database that includes comprehensive information on the volume and cost of medical referrals. The MoH also plans to strengthen the regulatory framework for medical referral systems, build institutional capacity of the SPU on strategic purchasing[22] and improve human resource capacity.

Table 3: DPG Prior Actions and Analytical Underpinnings

Prior Actions	Analytical Underpinnings
Pillar 1: Strengthen revenue and land administration and intergovernmental revenue framework	
Prior Action 1	"The Public Expenditure Review 2013-2014", World Bank, 2016; and "The Performance of Palestinian Local Governments", World Bank, 2017. *Key findings:* The lack of transparency and absence of data in certain aspects of intergovernmental fiscal relations have resulted in net lending issues and also created a serious problem for local governments in fiscal planning, revenue resource mobilization, and better service delivery.
Prior Action 2 **Prior Action 3**	"The Socio-Economic Effects of Weak Land Registration and Administration System in the West Bank", World Bank, 2018. *Key findings:* Lack of systemic land registration in the West Bank incomplete and weak land administration capacity pose large social and economic costs. The fiscal impact related to the lack of formal registration for nearly half of the West Bank's land is not negligible. The tax base could be substantially expanded from growth in real estate development that land registration would facilitate. Furthermore, tax collection effectiveness appears to be significantly higher on registered land compared to unregistered land of equal value, with an effective tax rate of 4.5 percent for registered land and 1.8 percent for unregistered land. In addition to lost property tax revenues, substantial revenues are lost due the lack of tax collection from land transactions when land is not registered, and property rights are not formally transferred. Only with the completion of land registration through systematic efforts could property tax collection reach its full potential.
Pillar 2: Improve the business environment and foundations for a digital economy	
Prior Action 4 **Prior Action 5**	"Doing Business Report", World Bank, 2017; "Investment Climate Assessment in the West Bank and Gaza," World Bank, 2014. *Key findings:* It is critical to help harmonize, modernize and improve the legal and regulatory frameworks (incl. the Companies Law and the Secured Transactions Law) for doing business in the Palestinian territories. The gaps in access to finance among smaller firms could be mitigated by improving key aspects of the financial infrastructure, namely the limitations in the credit bureau and lack of a collateral registry. For existing firms, factors related to business regulation such as business licensing and permits are the identified top constraints to business. West Bank and Gaza ranks 140th out of 189 economies. Globally, West Bank and Gaza performs badly in the following areas: (i) the ease of starting a business; (ii) the ease of getting credit; (iii) the strength of minority investor protection index; (iv) the ease of resolving insolvency; and (v) the ease of dealing with construction permits.
Prior Action 6	"The Telecommunication Sector in the Palestinian Territories: A Missed Opportunity for Economic Development", World Bank, 2016. *Key findings:* Following the introduction of 3G, the Palestine Monetary Authority (PMA), supported by World Bank TA on Payment Systems, has taken steps to facilitate

[22] Strategic purchasing involves a continuous search for the best ways to maximize health system performance by deciding which interventions should be purchased, how, and from whom.

	mobile financial services and online payments—both critical features for any digital economy especially in MENA which continues to lag compared to other regions. Poaching of higher value customers by Israeli telecom operators through illegal distribution of SIM cards in the West Bank severely impedes the development of digital economy. A World Bank report from 2016 confirms this, but also finds a range of issues under PA control (e.g. competition, regulation) that would have considerable positive impact.
Pillar 3: Enhance sustainability and creditworthiness of local service providers for private investment	
Prior Action 7	"Securing Energy for Development in the West Bank and Gaza", World Bank, 2017; and "Assessment and Action Plan to Improve Payment for Electricity Services in the Palestinian territories," World Bank, 2014. *Key findings:* Both studies underpin the importance of enhancing the energy sector's financial value chain through improved efficiencies and reduced leakages in order to minimize debt which will in turn allow expansion and diversification of power supply in the West Bank and Gaza.
Prior Action 8	"Toward Water Security for Palestinians: West Bank and Gaza WASH Poverty Diagnostic," World Bank, May 2017. *Key findings:* Increasing the viability and sustainability of the water sector requires the establishment and corporation of water utilities with an ability to operate on a full cost recovery basis, make a timely payment to the bulk water supplier, and provide efficient and equitable water and wastewater services.
Prior Action 9	"Report on Policy Directions for Outside Referrals – Technical Assistance on Health Financing." World Bank, 2013; and "The Master Plan for Organizing Medical Referrals to Service Providers Outside the Public Sector," Palestinian territories, August 2016. *Key findings:* To improve efficiency and equity of the health referral design, organization and process of referrals needs to be improved using modern tools such as a National Reference Price tool. Clinical and administrative tools such as manuals/guidelines for managing referrals are needed given the lack of clear and written guidelines. Most services contracts are outdated with no quality indicators against which the performance of providers can be evaluated.

4.3. LINK TO CPF, OTHER BANK OPERATIONS AND THE WBG STRATEGY

82. The proposed operation is aligned with the World Bank Group's strategic goals of eradicating extreme poverty and boosting shared prosperity in a sustainable manner. This operation will help improving financial viability of key sectors of the Palestinian economy, e.g. electricity, water and health, and increase the transparency of intergovernmental fiscal relations (putting LGUs at a sounder financial footing). More predictable, transparent and sustainable public finances will create the fiscal space for productive infrastructure and human capital investment, enabling the PA to provide better services to citizens and to promote private sector investment and growth. Business environment reforms supported by this operation will enable more equitable participation in the economy for all segments of the society.

83. The proposed operation contributes to the implementation of the World Bank Group's MENA regional strategy, especially for renewing the social contract. The prior actions supported by the operation will contribute to more financially viable electricity, water and health sectors by better aligning incentives of fiscal transfers among three different parties: the PA, the GoI, and LGUs. One of the prior actions also targets more transparent intergovernmental fiscal relations. These policy measures aim to support the PA achieve more predictable, transparent, sustainable public finances. This would in turn help improve the private sector activity by increasing confidence of private investors and gaining greater citizens' trust associated with improved public service delivery. Prior actions 4, 5, and 6 aimed to modernize legal and regulatory business environment will encourage technology innovations and provide opportunities for youth. All these measures would help renew the social contract by supporting an enabling environment for formal private sector jobs and sustainable growth, while providing better public service delivery to citizens. Furthermore, energy and water sector reforms supported by the operation have potential to promote active regional cooperation because only stronger institutions in electricity and water supply would be able participate in cross-border solutions with neighboring countries.

84. **This operation supports the objectives of the WBG's Assistance Strategy for the West Bank and Gaza (FY18-21) and the FY19 Replenishment Request for Trust Fund for Gaza and West Bank.** The proposed DPG will directly support the first pillar of the Assistance Strategy (setting the conditions for increased private sector investments and job creation). Prior actions 4 and 5 will help improve the business environment. SMEs' access to finance will be increased through prior action 6. In addition, this DPG will help strengthen Palestinian institutions to deliver citizen-centered service delivery (prior actions 7, 8, 9), as well as increase transparency of intergovernmental fiscal relations (prior actions 1 and 2). World Bank grants funded from the FY19 replenishment, including this DPG, will support sectoral reforms and institutional strengthening, mitigate the residual risks faced by investors in an uncertain and fragile environment, and help create jobs.

85. **Reforms supported by this operation will further advance the agenda of the World Bank-funded projects under implementation and several of those under preparation.** For instance, the Health System Resiliency Strengthening Project aims to secure continuity in healthcare service delivery and building its resilience to withstand future surge in demand for effective healthcare coverage. This DPG supports this goal by focusing on adoption of National Price Reference List tool in negotiations with non-MoH hospitals for the costs of Outside Medical Referrals with the aim to slow the growth of these health expenditures (PA9). The Electricity Sector and Performance Improvement Project aims to enhance institutional capacity of the energy sector and improve efficiency of the distribution system. This DPG supports this objective by strengthening payment discipline to local service providers (PA7). The Local Government and Services Improvement Program-for-Results aims to strengthen the local government financing system and improve local service delivery. This DPG supports the changes in the legal assignment of tax revenue for LGUs (PA2). In addition, prior actions 4, 5 and 6 complement the ongoing TA activities in improving business environment and reform of the electronic payments systems. Further, prior actions 3 and 7 help planned engagements in the land and water sectors. This approach would allow the policy reforms supported by this DPG to be supported by multi-year ongoing and planned programs of TA and investments. Stable support (both financial and technical) is essential to build the PA's institutional capacity over the medium term.

86. **The proposed DPG will support the development partners' collective reform priorities because of synergy with the Bank-administered PRDP Trust Fund.** Donors have channeled their budget support through the Bank-administered Palestinian Reform and Development Plan Trust Fund (PRDP-TF). Disbursements from the PRDP-TF support implementation of the PA's national policy agenda. Progress of the PA's reform agenda is monitored against priority policy and institutional actions jointly identified by the PA and the Bank for support through development policy grants. Upon assurance of satisfactory progress, the PRDP-TF disburses every quarter, and its overall disbursement to date has reached over US$1.5 billion (US$51 million in 2017). Australia, France, Japan, Norway, and Kuwait have committed to continue channeling their budget support through the PRDP-TF.

4.4. CONSULTATIONS AND COLLABORATION WITH DEVELOPMENT PARTNERS

87. The proposed DPG supports the PA's reform agenda, the NPA, which was developed by the PA in consultation with various stakeholders. Formal consultations were an integral part of the NPA drafting process. Broad-based consultations were held with representatives of the private sector, civil society, and donors and their feedback had been reflected in the NPA. Taking into account inputs received during the consultations, sector and cross-sector strategies were reviewed and updated by the Sector Strategy Teams, which included representatives of the private sector and civil society. Furthermore, all major donors to the PA were consulted during the strategy preparation process and were given an opportunity to comment on the draft NPA. The NPA also states that the extensive consultations that informed the preparation of this agenda alongside the sector and crosscutting strategies will be extended to the implementation phase to ensure that the decisions taken to achieve the NPA goals consider all perspectives and tap into all areas of expertise.

88. The PA and the Bank have consulted a wide range of stakeholders on measures supported by this DPG. As they have done with previous DPGs, the PRDP Trust Fund donors are expected to continue to rely on the DPG policy and results matrix as the criteria to evaluate the PA's performance in implementing the NPA for the purpose of quarterly disbursements under the PRDP Trust Fund. The Bank has therefore held consultations with the PRDP Trust Fund donors on reforms supported by this DPG and incorporated their feedback prior to finalizing the matrix. The PA from its side has consulted with donors on measures supported by this operation. This has proven to be an efficient and effective way to leverage donor budget support on key structural reform agenda, which proves that the importance of the DPG-supported program goes significantly above and beyond the operation itself. Furthermore, the Bank has held close consultation with the European Union, which provides the largest single contribution to the Palestinian budget through its direct financial support mechanism – PEGASE, to make sure that the DPG-supported reforms are aligned with the EU's Results Oriented Framework (ROF). The Bank has also consulted with DFID counterparts to align areas covered by the DPG, as much as possible, with those covered by DFID's conditional support.

89. A more formal aid coordination mechanism in the Palestinian territories was set up following the decision made at the December 14, 2005 meeting in London of the AHLC. The objective behind this mechanism was to improve the effectiveness of aid coordination structures in providing coherent TA and financial support based on the national priorities to the Palestinian people in line with the OECD-DAC Paris Declaration on Aid Effectiveness. This mechanism was reviewed and updated in 2018 by removing some ineffective coordination committees, and streamlining the sector working group structures to enhance engagement between the PA, development partners and civil society.

5. OTHER DESIGN AND APPRAISAL ISSUES

5.1. POVERTY AND SOCIAL IMPACT

90. The overall poverty and social impact of the prior actions supported by this operation is expected to be largely positive or neutral.

91. Reforms under pillar 1, and on the health referral system (pillar 3) are unlikely to have negative poverty and social impact. The efforts under pillar 1 to support better tax collection and improve the land registration of property, coupled with improved intergovernmental fiscal arrangements are expected to contribute to increased fiscal space for capital investment and allow LGUs to deliver services to citizens in an accountable manner. None are expected to have negative poverty or social impacts. The reforms that seek to improve fiscal stability of the health sector by reforming the referral system are not expected to have a negative social and poverty impact, as they seek to lower the cost of certain health services through more efficient contracting with external healthcare providers. Measures that support harmonizing standard referral procedures also improve the equity of access to health referral services for all segments of the Palestinian population.

92. **The poverty and social impact of the reforms supported under pillar 2 is expected to be positive or neutral.** The regulatory and business climate reforms supported under pillar 2 are critical to achieve the goal of enabling private sector growth, improving employment outcomes, and increasing public revenue. Streamlining business registration and licensing processes will contribute to the incorporation of small businesses, their growth and thereby formal sector job creation. At the same time, these businesses will be granted better access to finance and markets, and legal protection. Since unemployment is a key correlate of poverty, creating more formal private sector jobs due to the enhanced business climate will have a positive impact on the economic welfare of the poor and vulnerable. In the context of a sheer lack of employment opportunities, the potential of these reforms to support inclusive growth will, however, depend on the scale of employment opportunities and on the access to these jobs of women and youth who are increasingly excluded from the labor market. Further, actions relating to regulatory and business climate are not waiving any worker protections currently in force.

93. **The prior actions supported under pillar 3 related to utility sectors are expected to have a largely positive or neutral poverty and social impact[23]**. The proposed fiscal reform focuses on improving fiscal viability of utility sectors (such as electricity and water) with the aim to increase investments in those sectors over the medium and long term. In the electricity sector, the goal of the reforms is to ultimately increase power supply in the West Bank. This will help address critical firm-level constraints[24] to growth which would, in turn, have a positive impact on poverty through increased employment opportunities, in addition to better meeting the demand of households for better service provision. Importantly, poor households in receipt of cash transfers are exempt from potential loss of electricity due to a better enforcement of bill collection. Similarly, the Bank's engagement in the water sector will concentrate on improving the water supply and reducing dependence on illegal water trucks which provide unregulated poor-quality water at higher costs. At the same time, the fiscal reforms related to bill collection efforts will focus on restructuring of past debts between LGUs and bulk service suppliers (WBWD for water) rather than on increasing payments from the end-consumers, and therefore, this prior action is not expected to have an adverse impact on poverty.

5.2. ENVIRONMENTAL ASPECTS

94. **The Palestinian Environmental regulatory framework is modern and comprehensive, covering environmental protection, conservation of natural resources, and preservation of biodiversity.** The Palestinian Environmental Law addresses various environmental issues, including Environmental Impact Assessment (EIA) and auditing, permitting of development projects, monitoring of environmental compliance, and enforcement. The Palestinian Environmental Assessment Policy represents three sequential stages in project life-cycle. The environment review process and approval include application for Environmental Assessment (EA); Initial Environmental Evaluation (IEE); and Environmental Impact Assessment. The Environmental Quality Authority (EQA) established by a President's decree in 2002 provides guidance on the preparation of the EA reports and determines whether an IEE or an EIA is required. An EIA is required for projects that are likely to have significant environmental impacts, and it specifies measures for mitigation and monitoring. EQA is responsible for ensuring that development processes are undertaken in an orderly manner, projects' developers have capacity to implement the environmental management plans, and monitor compliance.

[23] The World Bank conducted an analysis looking at the non-payment patterns for water (part of WASH Poverty Diagnostic 2016/2017) and electricity services using most recent LGPA data representative at the LGU level.

[24] World Enterprise Survey (2013), where close to 13 percent of firms in the Palestinian territories report electricity as their biggest obstacle. In four out of five comparator countries, this figure is 5 percent or lower.

95. Furthermore, the NPA 2017-2022 policy interventions are aimed at environmental sustainability and adaptation to climate change, via: (i) reducing pollution and greenhouse emissions, (ii) expanding wastewater management, treatment, and reuse, (iii) increasing energy efficiency and expanding renewable energy resources, and (iv) conserving biodiversity and expanding green spaces. In the past few years, the PA has taken major steps for the construction and operation of modern wastewater treatment plants in Gaza and the West Bank, expanding power supply including renewables, mainly PV solar energy, as well as modern solid waste management systems and landfills. The PA has also taken major steps to address the increased demand on water resources and supply, including new agreements on water supply from Israel, digging new water wells (those must get approvals by the Israeli-Palestinian Joint Water Committee), wastewater reuse, and sea water desalination. Yet, the PA will continue to face a challenge on the front of scarce resources.

96. Reforms supported by this operation are unlikely to have a significant negative environmental impact. The prior actions supported under pillars 1 and 3 aim to improve the fiscal sustainability of the PA's finances and enhance sustainability of service providers in the electricity, water and health sectors and are likely to have positive environmental impacts. However, prior actions supported under pillar 2 could entail environmental risks. While the promotion of MSMEs is critical for economic growth and job creation, they are typically a major source of nonpoint source pollution with potentially significant cumulative impacts. It is important to mention that the business licensing reform, specifically amending the Law on Crafts and Industries of 1953, focuses on streamlining the issuance of the municipal license by ensuring that security clearance is required only for specific activities that might pose a security risk. The rest of the procedures required for the issuance of business license, including environmental licensing follow the Palestinian regulatory framework, and are not subject to the proposed reform. Furthermore, these reforms will not only promote the growth in MSMEs but also encourage them to officially register rather than operate in the informal sector. Given the significant share of the informal sector in the Palestinian economy[25], reducing the size of the informal sector and increasing the number of formal firms will result in reducing environmental risks.

97. Climate Change and Disaster Screening. This operation has not been screened for short and long-term climate change and disaster risks, as this is not mandatory for special financing operations.

5.3. PFM, DISBURSEMENT AND AUDITING ASPECTS

Fiduciary

98. The fiduciary risk related to the proposed DPG is considered high. The PFM 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, which manifests itself, among other ways, in weak budget execution. While the MoFP can produce regular financial monitoring reports there were issues in the production of audited accounts in earlier years which have recently being addressed.[26] Furthermore, PFM deficiencies in some sectors (e.g., education, health, local governments) keep impacting budget implementation and the associated service delivery (see Annex 5 for more details). Procurement reform is also delayed. While a new Public Procurement Law and its implementing regulation were enacted in 2014 to regulate procurement at all levels of government, and a procurement policy and oversight body was established, several provisions of the law remain unimplemented.

[25] In the Palestinian territories, close to 60 percent of total non-agricultural employment engaging in the informal sector.
[26] The audit of 2013 financial statements has been completed and is awaiting endorsement of the President. The audit of 2014 is underway and the financial statements of 2015 have been submitted to the SAACB. It is expected that the MoFP will resolve the backlog during calendar year 2019.

99. **Substantial TA in PFM has been provided by partners**. During 2014-2017, the Bank conducted several TA missions to the MoFP (General Accounting Department) aimed at strengthening accountability of the PFM system in relation with continued budget support. Those missions focused on: (i) developing a framework for commitment recording and control procedures, (ii) establishing an annual cash plan, (iii) monitoring the generation of arrears in order to serve as a guide for budget execution affordability, and (iv) review of the bank reconciliation process between the accounting data in the IFMIS and the cash in the bank accounts of the PA and recommendations for improvement. Other donors have engaged in a series of activities to streamline the MoFP upstream budget cycle in relation with a multi-year budgeting approach and top-down budget preparation process, as well as to strengthen the financial audit capacity of the State Audit and Administrative Control Bureau (SAACB) in order to get the financial statements of the PA audited in line with international standards. The Bank has been the main provider of TA on procurement reform.

100. **The PA has issued a PFM strategy covering 2017-22 to underpin the alignment of further TA with its own objectives**. The PFM strategy emphasizes expenditure management and control, accounting reporting and procurement. These areas meet the scope of the PFM Improvement Project which became effective in July 2018. The project aims at strengthening the *downstream* cycle of the PFM system with emphasis on effective implementation, building on the previous TA activities while broadening their implementation to other line ministries (education, health and local governments). It will also support implementation of the main recommendations related to the lack of accuracy and timeliness in the final account preparation process which is crucial for the accountability of the PFM system, as well as procurement modernization.

101. **The PFM Improvement Project, effective since July 2018, is addressing some of the risks in the PFM system** through the following components: (i) improving budget expenditure management and control, (ii) improving financial accountability of the PFM system, and (iii) modernizing public procurement. Specific activities are detailed in Annex 5.

Flow of Funds and Auditing Requirements

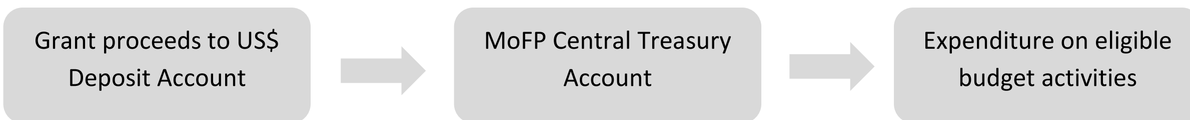
102. **No IMF Safeguard Assessment is available for the West Bank and Gaza since there is no full-fledged Central Bank**. The PMA is an independent public institution responsible for formulating and implementing the monetary and banking policies, safeguarding the banking sector, and ensuring the growth of the national economy in a balanced manner. The PMA performs several central banking duties such as supervision over banks, money changers, and microfinance institutions, organizing the payment services, and spreading financial awareness. The PMA has adopted a Corporate Governance Code for banks to ensure that banks adopt and implement sound corporate governance practices and therefore maintain public trust and confidence in the Palestinian banking sector. The code has been set at a high standard, consistent with the international best practices. The code is based on the principles of Basel Committee on Banking Supervision's paper on enhancing corporate governance for banking organizations that introduced principles for sound corporate governance practices for banks.

103. **As with previous DPGs, the DPG proceeds will be deposited in a single tranche to a US dollar deposit account that forms part of the PA's official foreign exchange reserves.** The deposit account will be held at the Bank of Palestine (Ramallah), which is part of the MoFP single treasury account and where previous DPG proceeds had been deposited. Then, an equivalent amount in local currency will be credited to the single treasury account of the PA to finance budgeted expenditures. The conversion will be based on the prevailing exchange rate on the date that the funds are credited to the Treasury Account.

104. The BoP financial statements for the year ended December 31, 2017 were audited by Ernst and Young. No key issues were identified in the management letter. The financial statements for the year ended December 31, 2017 are published on the BoP's website[27].

105. The MoFP will confirm to the World Bank, within 15 days of disbursement, the receipt of the grant funds and that the grant proceeds have been credited to the Central Treasury Account at the BoP to finance national budget expenditures, including the date and number of the Treasury Account in which the funds have been deposited as well as the exchange rate applied. If any portion of the grant is used to finance ineligible expenditures as defined in the Financing Agreement, the Bank shall require the PA to refund the ineligible amount and the amount will be canceled from the grant.

Figure 3: Flow of funds diagram



External Auditing of the Grant Deposit Account

106. The PA will hire an independent external auditor acceptable to the Bank to perform an audit of the deposit account. The audit will be conducted in accordance with International Standards on Auditing and with the terms of reference acceptable to the Bank. The audit report will be approved by the MoFP before it is submitted to the Bank. The audit report will be submitted to the Bank within six months of the release of the single tranche payment. For the previous DPG financing releases to the designated account, the MoFP submitted acceptable audited financial statements in a timely manner. The auditor's opinion was unmodified "clean" confirming the acceptable presentation of the DPG financial statements, compliance with the legal agreement, the proper use of the deposit account, and the use of the MoFP accounting system to record the financial transactions. The auditor will be required to:

(i) Validate the transfer and deposit transactions into the deposit account relating to the DPG funds;

(ii) Verify that no funds are kept in or paid into the deposit account other than those disbursed by the Bank for this particular operation;

(iii) Confirm that all payments out of the deposit account were not made for any excluded expenditures as defined in the Financing Agreement;

(iv) Ensure that the MoFP follows adequate disbursement procedures as per PA standards, including accuracy of the exchange rate prevailing at the date of conversion from the US dollar to the NIS, and deposit to the Central Treasury Account used to finance budget expenditures within one week of the receipt of funds in the deposit account.

5.4. MONITORING, EVALUATION AND ACCOUNTABILITY

107. The design of the monitoring and evaluation arrangements builds upon those developed under the earlier 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

[27] https://bop.ps/files/ir/annual_report_17_EN.pdf

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 and finance and line ministries and enjoys full ownership of the authorities.

108. The monitoring arrangements have been institutionalized in the Palestinian MoFP. 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 MoFP. 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.

109. Grievance Redress. Communities and individuals who believe that they are adversely affected by specific country policies supported as prior actions or tranche release conditions under a World Bank Development Policy Operation may submit complaints to the responsible country authorities, appropriate local/national grievance redress mechanisms, or the WB's Grievance Redress Service (GRS). The GRS ensures that complaints received are promptly reviewed in order to address pertinent concerns. Affected communities and individuals may submit their complaint to the WB's independent Inspection Panel which determines whether harm occurred, or could occur, as a result of WB non-compliance with its policies and procedures. Complaints may be submitted at any time after concerns have been brought directly to the World Bank's attention, and Bank Management has been given an opportunity to respond. For information on how to submit complaints to the World Bank's corporate Grievance Redress Service (GRS), please visit http://www.worldbank.org/GRS. For information on how to submit complaints to the World Bank Inspection Panel, please visit www.inspectionpanel.org

6. SUMMARY OF RISKS AND MITIGATION

110. The overall risk of this operation is high. Areas of concern include risks related to political and governance, macroeconomic, institutional capacity and fiduciary.

111. The political and security risks are high, as the situation in the Palestinian territories remains fragile. If the security situation relapses, the economic decline may have a negative impact on the PA's reform appetite and may create an environment that is not conducive for reforms which may hamper the achievement of the PDO. However, there currently are renewed efforts to achieve reconciliation between the West Bank and Gaza. The international donor community is also closely monitoring the economic activity in the West Bank and Gaza and is supporting the PA with grants and TA. The authorities' 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. All of these measures mitigate the negative impact on achievement of the PDO.

112. The macroeconomic risk to the operation rating is high. If donor financing further declines, and the Israeli legislation to cut clearance revenue transfers (by around 2.2 percent of GDP starting 2019 onwards) is implemented, this will result in larger than expected financing gaps and a large drop in public consumption. In this scenario, the financing need after grants is expected to increase from US$600 million under a baseline scenario to around US$1.0 billion, seriously undermining adequacy of the macroeconomic framework. These impacts could lead the PA to emphasize crisis response over program implementation. 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$45 million in additional resources through the PRDP Trust Fund, which the Bank administers. This will mitigate the risk of reduced donor assistance on the PA's finances. Business environment reforms supported by the operation would encourage additional private investment and eventually lead to better economic outcomes. A simple design of this operation and strong PA ownership of the reform program supported by this operation, which contributes to fiscal consolidation and reduced reliance on donor assistance over the medium term, are also mitigating factors for the risks to achievement of the PDO.

113. The institutional capacity risk is rated as substantial due to two factors: capacity in local government and land administration to take on enhanced functions foreseen in the reforms, and the multi-agency nature of reforms within the PA. Mitigation of the first risk (which mainly applies to pillar 1) is provided by strong Bank engagement with the key entities through two ongoing activities in the area of local government sector reform and land sector reform. More generally, consistent with the approach of recent DPGs, the prior actions focus first on enabling decisions rather than implementation, and the decisions will trigger a process of assessing the capacity needs to follow through on the reform; this is the same process exhibited for business licensing and health referrals cost control across DPG8 and the proposed operation. Regarding the second risk, the multi-agency nature of reforms stretches the coordination capacity of the PA. However, the budget process serves as a coordinating mechanism for actions with fiscal implications. Furthermore, the operation benefits from strong continuity and experience of core staff in key counterpart entities including the Ministry of Finance and Planning. Nonetheless, turnover of these staff would be a risk to sustainability.

114. The fiduciary risks are also high, as discussed in Section 5.3. The PFM system suffers from significant weaknesses which materialized in weak budget execution and the continued accumulation of arrears, delays in the production of the audited annual accounts mainly due to the lack of timely preparation of the financial statements by the MoFP and delayed implementation of the procurement law. These weaknesses may all 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 TA to the MoFP aiming at strengthening the accountability of the PFM system. The Bank has been providing capacity building and training to help the PA meet international accounting standards (IPSAS) and to accelerate the preparation of financial statements. The PA recently issued a new PFM strategy (2017-2022) with the emphasis on expenditure management and control, accounting reporting and procurement. The Bank is supporting the implementation of the strategy through the new PFM Improvement Project, which builds on the previous TA activities. The project will particularly assist the PA to improve the accuracy and timeliness in the final account preparation process, which is crucial for the accountability of the PFM system, and to accelerate the implementation of the procurement law. Furthermore, the flow of funds and audit requirements for this operation (outlined in Section 5.3) serve as an additional mitigating measure.

Table 4: Summary Risk Ratings

Risk Categories	Rating
1. Political and Governance	High
2. Macroeconomic	High
3. Sector Strategies and Policies	Moderate
4. Technical Design of Project or Program	Moderate
5. Institutional Capacity for Implementation and Sustainability	Substantial
6. Fiduciary	High
7. Environment and Social	Low
8. Stakeholders	Moderate
9. Other	
Overall	High

.

ANNEX 1: POLICY AND RESULTS MATRIX

Pillar 1: Strengthen revenue and land administration and intergovernmental revenue framework			
DPG9 Prior Actions	***DPG9 Results***	***Anticipated Actions for 2019***	***Anticipated Actions for 2020***
Prior Action 1: The Ministry of Finance and Planning has taken the necessary actions to improve tax collection and operational efficiency, by connecting existing management information systems for domestic and border taxation (RMIS and ASYCUDA), as evidenced by the issuance of official letter No. 5426, from the General Directorate of Revenue to the General Manager of the Revenue IT Department, informing the completion of the merger of RMIS and ASYCUDA.	Increase in gross domestic tax revenues. Baseline (2017) = NIS 2,750 million; Target (2019) = NIS 2,982 million.	Complementary Step 1.1: MoFP prohibits suppliers of goods and services to the public sector from bidding on public tenders if they do not hold a no tax liability certificate.	Complementary Step 1.2: The cabinet restructures the revenue function within MoFP creating a single department for all revenue streams.
Prior Action 2: The President has taken the necessary actions to strengthen domestic revenue collection by LGUs by authorizing the Cabinet, in cooperation with the MoFP, to delegate the MoFP's responsibilities to collect property taxes and related penalties to LGUs, as evidenced by the enactment of Law No. 12, dated May 3, 2018, amending the 1954 property tax law.	Number of LGUs that have piloted collection of property taxes. Baseline (2017) = none; Target (2019) = three to five.	Complementary Step 2.1: MoFP transfers to these municipalities all related regulations, instructions, and tax files to enable them to carry out this new mandate.	Complementary Step 2.2: The Cabinet passes amendments to the property tax law revising the annual property tax rate and introducing: a) a transfer tax for land, b) a capital gains tax, c) and a tax on idle land.
Prior Action 3: The Cabinet has established strategic and policy oversight mechanisms for institutions in land administration, as evidenced by the adoption of Decision No. 17/229/18 signed by the Prime Minister on November 22, 2018, referring the draft amendments to the Palestine Land Authority Law for approval by the President.	Supporting the above result.	Complementary Step 3.1: To establish strategic and policy oversight of institutions in land administration, the President approves a draft Amendment to the PLA Law establishing a Board of Directors which would also supervise LWSC.	Complementary Step 3.2: PLA adopts a national policy on state-owned land and properties.
Pillar 2: Improve business environment and foundations for a digital economy			
DPG9 Prior Actions	***DPG9 Results***	***Anticipated Actions for 2019***	***Anticipated Actions for 2020***
Prior Action 4: The Ministry of Health has streamlined the	Number of days on average to issue a business license.	Complementary Step 4.1: The President signs into law a new	Complementary Step 4.2: Cabinet approves necessary By-Laws

procedures for issuance of business licensing, reflecting the amendments to the Law on Crafts and Industries of 1953, as evidenced by the issuance of: (a) Cabinet decision No. 1 for the year 2018, approving the amendments to the annexes of the Law on Crafts and Industries dated April 3, 2018; and (b) Guidelines and instructions for business licenses, issued by the MoH dated July 25, 2018.	Baseline (2017) = 36 days; Target (2019) = 10 days.	Companies Act that includes simplified business registration procedures.	for implementation of the new Companies Act.
Prior Action 5 The Cabinet has taken the necessary steps to reduce the land registration procedures for businesses, as evidenced by the issuance of Circular 6-15 dated February 2, 2017, describing the streamlined procedures necessary for obtaining a purchase permit.	Number of days on average to obtain a land purchase permit. Baseline (2017) = 30 days; Target (2019) = 15 days.	Complementary Step 5.1: Ministry of National Economy (MoNE) develops and implements simplified licensing procedures for home-based businesses.	Complementary Step 5.2: MoNE establishes an automated company registry.
Prior Action 6: The PMA Board of Directors has adopted regulations enabling the establishment of new electronic payments systems, fostering competition and reducing costs, as evidenced by the minutes of the PMA Board meeting signed by the Governor on July 17, 2018, approving regulations for the licensing of payment service providers.	Regulatory authorities have reviewed licensing applications for mobile payments providers under the new framework. Baseline (2017) = none; Target (2019) = five.	Complementary Step 6.1: PMA establishes interoperability of: i) mobile payments; ii) point of sale (POS) card transactions. Automated Clearing House (ACH) payment system is in full use and function for domestic bank transfers.	Complementary Step 6.2: National Payments Company has been established to absorb the card and mobile payments switch and establish a modality to deal with Israeli counterpart on excess liquidity issues.
Pillar 3: Enhance sustainability and creditworthiness of local service providers for private investment			
DPG9 Prior Actions	***DPG9 Results***	***Anticipated Actions for 2019***	***Anticipated Actions for 2020***
Prior Action 7: The Cabinet has set forth procedural steps to follow before service providers can cut off electricity following the accumulation of debt, including a grievance mechanism and protection of poor and vulnerable population, as evidenced by the issuance of official instructions dated April 17, 2018, published in the Official Gazette on April 22, 2018, that include the following provisions: (a) specification of exact periods of unpaid bills (30 days	Share of electricity that is purchased from wholesale suppliers is collected and paid by LGUs. Baseline (2017) = 86 percent. Target (2019) = 95 percent.	Complementary Step 7.1: PENRA and MoFP establish a settlement mechanism for timely payment of public-sector electricity bills.	Complementary Step 7.2: PENRA and PERC issue directives mandating LGUs that have not yet joined DISCOs to merge with existing or establish new DISCOs.

to households and 60 to non-households; (b) objections from the consumer to the distributor; (c) instructions on how to file a complaint; (d) instructions on how to reconnect power back to consumers; (e) guidelines on resolving disputes between the consumer and the distributor; and (f) exemptions.			
Prior Action 8: The Intra-agency Committee has taken the necessary steps to strengthen payment discipline and improve financial viability of the water sector by rescheduling the debt for unpaid water bills owed by LGUs to the MoFP for at least 90 LGUs, as evidenced by: (a) the issuance of an Official Letter signed by the Head of the Intra-agency Committee and dated October 28, 2018 enclosing a report describing the balances of the municipalities after debt rescheduling; and (b) seven debt rescheduling agreements entered between the LGU and the Intra-agency Committee, selected on a sample basis.	Percentage of unpaid debt for water owed by LGUs to the MoFP is restructured. Baseline (2017) = 0 percent; Target (2019) = 15 percent.	Complementary Step 8.1: The Cabinet approves Unified Water Tariff by-law to the Water Law 2014 that would ensure that Water Service Providers cover operational costs.	Complementary Step 8.2: The Cabinet approves Regional Water Utilities (RWUs) by-law to the Water Law 2014 that would enhance the sector's efficiency through economies of scale.
Prior Action 9: The Ministry of Health has directed its Service Purchasing Unit to plan and implement training and capacity building to make the National Price Reference List tool ready to be used for medical referrals with domestic non-MoH healthcare providers when negotiating with at least three hospitals, as evidenced by the issuance of Directive No. 32/110/1139/18, dated October 30, 2018.	Service Purchasing Unit of the MoH has completed negotiations for contracting medical services using the NPR tool with domestic private healthcare providers. Baseline (2017) = none; Target (2019) = three providers.	Complementary Step 9.1: Ministry of Health introduces standard international classifications for disease and medical procedures to improve the quality of medical referral information and price negotiation.	Complementary Step 9.2: Ministry of Health implements a single database that includes comprehensive information on the volume and cost of medical referrals.

ANNEX 2: FUND RELATIONS ANNEX[28]

INTERNATIONAL MONETARY FUND

WEST BANK AND GAZA

REPORT TO THE AD HOC LIAISON COMMITTEE[1]

September 6, 2018

KEY ISSUES

Deepening rifts between key stakeholders and surging violence in Gaza further imperil prospects for peace. Protests in Gaza ahead of, and turbulence since, the Nakba day and relocation of the United States' embassy to Jerusalem in mid-May, mark the most serious escalation since the 2014 war. Relations between the parties have hardened, amid a spate of new laws in Israel. The Palestinian Authority has expressed skepticism about the U.S. role as a neutral arbiter in the peace process. The domestic political situation remains tense and reunification plans have stalled.

The outlook is increasingly untenable. Longstanding constraints continue to act as a brake on growth, aggravated by large aid cuts and revenue losses. Gaza is suffering disproportionately, with its economy shrinking and unfolding humanitarian catastrophe. Overall GDP growth is projected to languish below 2 percent per year. The intended withholding of clearance revenues under new Israeli legislation will seriously undermine the already fragile fiscal situation. Large external imbalances will persist as restrictions impede development and add to vulnerabilities. Weaker growth and demographic pressures will substantially worsen unemployment, poverty, and per capita incomes.

The overriding challenge is to revive growth and alleviate poverty in the face of shrinking resources. More than ever this will depend on the Palestinian authorities, Israel, and donors coming together to ensure a comprehensive approach to reforms. The priority is to implement adjustment measures that help protect critical public service delivery, social spending and investment, and avoid a disorderly expenditure rollback disruptive to growth. Reforms to strengthen the fiscal framework and public institutions will help achieve this objective, promote public accountability, and reassure donors that resources will be well spent. Faster progress to systematically reduce "fiscal leakages"—based on fair and transparent discussions between the Israeli and Palestinian authorities—will be imperative. Stronger action to avert a build-up of financial sector risks and maintain correspondent banking relations will be essential to preserve financial stability and ensure banks can support economic activity. Finally, steps to shore up economic institutions, together with actions to ease restrictions on movement and access, will be crucial to stabilize Gaza and revitalize the overall economy's capacity to grow.

[1] The IMF provides technical services to the West Bank and Gaza, including policy advice in the macroeconomic, fiscal, and financial areas, as well as technical assistance, with a focus on tax administration, public expenditure management, banking supervision and regulation, and statistics. See www.imf.org/wbg for recent reports.

[28] The full report is available at *https://www.imf.org/en/Publications/CR/Issues/2018/09/17/west-bank-gaza-report-to-the-ad-hoc-liaison-committee*.

ANNEX 3: LETTER OF DEVELOPMENT POLICY

State of Palestine
Prime Minister

دولـــة فلســـطين
رئيس الوزراء

Ramallah, 29 October 2018

Dr. Jim Yong Kim
President
The World Bank Group
1818 H Street, NW
Washington, DC 20433
United States of America

Subject: Letter of Development Policy

Dear President Kim,

I am writing this letter of Development Policy which lays out the key elements of Palestinian National Authority's (PNA) National Policy Agenda for 2012-2017, and the proposed policy and institutional reform program for this year. The PNA requests the assistance of the World Bank Group in the form of the Development Policy Grant (DPG) instrument for US$30 million. This assistance is needed to support the PNA's efforts in strengthening fiscal resilience and improving private-sector investments. This assistance is also essential for job creation.

The PNA would like to thank the International Bank for Reconstruction and Development for providing extensive support through the DPG instrument. Previously, the PNA has benefited from the use of the DPG instrument on eight occasions as most recent operation is being approved by the Board of Directors of World Bank in December 2017. All these operations helped to deepen policy and institutional reforms in our country, and have been crucial in mobilizing additional donor support. Furthermore, a successful implementation of the proposed DPG sends an important signal to the international community at the time the donors' funding continues to decline.

Building on the momentum and the lessons learned from the past DPG operations, the PNA believes that the instrument is highly useful in facilitating reforms in Palestine. In particular, we have the presentation of reforms in a medium-term context as this helps us keep the momentum between different operations. The PNA requests selective support of the National Policy Agenda, and is committed to implementing the institutional and policy reforms as described in the policy and results matrix.

State of Palestine

Prime Minister

دولــــة فلســــطين

رئيس الوزراء

The following three broad areas are being addressed in this DPG: A) Strengthening revenue and land administration and the improvement of intergovernmental revenue framework; B) improvement of business environment and foundations for a digital economy; C) enhancing sustainability and creditworthiness of local service providers.

A) Strengthening revenue and land administration and the improvement of intergovernmental revenue framework

Strengthening fiscal resilience is a paramount objective of PNA's policy. Over the past ten years, we have managed to reduce our deficit from 30 percent of GDP in 2006 to 5.2% percent in 2017. However, our fiscal position remains difficult as donor funding continues to decline: it dropped from 11% of the GDP in 2013 to 4.9% of GDP by end 2017, considering the PNA does not possess ability to finance its deficits in an optimal manner. Consequently, we will continue with implementation of our Revenue Action Plan, which aims to improve collection of domestic revenues through expansion of tax base and the improvement of compliance through establishment of a fully integrated tax administration.

Furthermore, we have taken measures that will enable transfer of collection of property tax to selected municipalities, thereby putting their financing on a sounder footing. The selection of these LGUs will be based on predefined criteria, and the PNA will provide the necessary technical support in order to improve these LGU's capacities, thus hoping to reach full property tax collection decentralization in the coming few years.

Additionally, land registration is another critical reform priority of this administration. Economic benefits of land registration are numerous. It is not only going to help with collection of property taxes, but it will also help the PNA with broader private sector development and investment. Only titled land can be used as loan collateral. At present, estimates show that the value of unregistered land is on par with the current outstanding loan portfolio of the banking sector. Implications for SMEs or unregistered businesses are huge.

Consequently, we have undertaken serious reform efforts to expedite this process. Since 2016, the PNA has established the Land and Water Settlement Commission (LWSC) which is tasked with the first-time registration of land. In the past two years, it has managed to register more land that in the previous decade. Furthermore, we are reforming the Palestinian Land Authority (PLA) whose task is to record land transfers and mortgages. Leadership is an important aspect in the reform process, thus a decision was made by which the two institutions would be leaded by professional chairperson, and will soon be governed by a Board of Directors in order to provide critical oversight of these institutions while providing strategic guidance for further development.

State of Palestine

Prime Minister

دولـــة فلســـطين

رئيس الوزراء

In this context, the LWSC has achieved the following:

- A road map for the reform of the land sector is being implemented in cooperation with the World Bank Group. It includes the reforms mentioned earlier in the legal and structural frameworks of the sector.
- The LWSC introduced a new approach by involving Local Government Units (Municipalities and Local Councils) in land settlement activities, where contracts are signed with private sector surveying companies to survey lands, under the supervision of the LWSC's technical and legal teams. This helps in reducing the time and cost of the entire settlement process.
- The LWSC managed to survey more than half a million dunums in the past 18 months. Ready titles for more than 150 thousand dunums were transferred to the PLA, and the rest is pending at various stages of completion.

It is worth highlighting here that the Prime Minister's office is overseeing the whole process, as requested by the World Bank Group. In addition, the World Bank Group is helping the LWSC in setting up plans, and time schedules for the commission's activities to reach its goals, as rapidly and efficiently as possible.

B) Improvement of business environment and foundations for a digital economy

Job creation is critical for our population and in particular for our youth. To that end, we are aiming to improve our business environment rapidly. Previously, we have implemented reforms on registry of movable assets resulting in US$300 million of additional financing to businesses. For this operation we have implemented streamlined and updated business licensing procedures and streamlined procedures further for obtaining permits for land registry of businesses.

Our main efforts have focused on drafting of a modern Companies' Act. The World Bank Group has provided technical assistance to improve the draft law which was initially submitted to the Cabined at the end of 2017. The revised draft will be re-submitted to the Cabinet by mid of October 2018, and it represents a major revision to the 2017's version. Our goal is to adopt the act by the end of 2018. Once adopted, it will be a modern law, thus replacing the 1958's version of the Jordanian law currently in force, and perhaps becoming one of the finest of its kind in the MENA's region.

Moreover, the government has supported the foundation of national competitive industries by endorsing legal and regulatory infrastructure that would enhance the production growth, and is considered a catalyst for capital injection. Among these instruments, we have the revision of national products protection, and drafting the competition law. In this regard, the government launched incentives package for the private investors, and supported the establishment of an additional Indusial Park in Hebron. Our strategic direction is to improve the business environment by enabling a comfortable investment climate, and thus reaching our full economic independence. This path is vital for making the two-state solution a reality.

State of Palestine
Prime Minister

دولـــة فلســـطين
رئيس الوزراء

Furthermore, the PNA has prioritized the development of e-government services. We have received assistance to develop common infrastructure such as government network and computing center. One of the critical enablers of e-government services are e-payments. In this DPG we have undertaken to set up regulations for several new e-payments service providers. Beyond enabling e-government services, these reforms will have significant economic benefits as transactions cost will be reduced and financial inclusion will be expanded.

The core objective of these major reforms is job creation among Palestinian youth. Recent official statistics shows that unemployment rates steadily increased to reach 32.4% in the 2nd quarter of 2018, 19.1% in the West Bank and 53.7% in Gaza Strip; 65% among the youth. Therefore, the PNA is determined to implement a comprehensive, responsive and resilient polices that would tackle the high unemployment rates and improve Palestinians livelihoods. Thus, we encouraged and supported the design of programs targeting entrepreneurships and startups, SMEs, and home-based businesses while taking into consideration the quality of products and services in order to increase the accessibility for regional and international markets.

C) Enhancing sustainability and creditworthiness of local service providers.

Following up on the actions taken under the previous DPG, the PNA has undertaken further actions to eliminate the practice of net lending, a form of involuntary subsidies to local service providers. When local government units (LGUs) and distribution companies (DISCOs) fail to make payments for electricity and water to Israeli suppliers, the Government of Israel (GoI) deducts the corresponding amount from clearance revenues – tax revenues collected by the GoI on behalf of the PNA in Israel. In effect, the PNA makes involuntary intergovernmental transfers to the LGUs and the DISCOs, thus undermining its own finances. In parallel, the municipalities are diverting bill collection from these services as a local revenue base mostly transferred into administrative expense, and the LGUs accumulated debt deters private investors seeing them as viable counterparts for infrastructure investment.

Eliminating non-payment of electricity and water utility charges by distribution companies (DISCOs) and Local Government Units (LGUs) is a critical bottleneck to increase the financial sustainability of utility sectors as well as to enhance PNA's fiscal stability. The PNA has initiated comprehensive reforms on utility sectors to enhance their sectoral viabilities with the aim of increasing private sector participation and providing affordable and reliable services to citizens. As a key priority step, we are supporting a measure to enhance payment discipline in these sectors by establishing mechanisms to ring-fence utility revenues to avoid deviation into municipal budgets.

State of Palestine
Prime Minister

دولــــة فلســـــطين
رئيس الوزراء

The PNA is highly committed to the reform progress supported by the proposed DPG's operation, and determined to move forward with the institutional reforms mentioned above. We wish to express here our sincerest appreciation for the generous support and assistance extended by the World Bank Group to Palestine's socio-economic development. Similarly, we are fully committed to maintaining our cooperation, thus seeking to achieve the objectives prescribed in our reform plans. We look forward to the continued support and the fruitful collaboration in the years to come.

Please accept, your Excellency, the renewed assurances of my highest consideration and cordial greetings.

Sincerely,
R. Hamdallah

Rami Hamdallah
Prime Minister

ANNEX 4: ENVIRONMENT AND POVERTY/SOCIAL ANALYSIS TABLE

Prior Actions	Significant positive or negative environment effects	Significant poverty, social or distributional effects positive or negative
Pillar 1: Strengthen revenue and land administration and intergovernmental revenue framework		
Prior action 1	Adverse environmental effects are not expected.	Adverse poverty and social impacts are not expected.
Prior action 2	Adverse environmental effects are not expected.	Adverse poverty and social impacts are not expected.
Prior action 3	Adverse environmental effects are not expected.	Adverse poverty and social impacts are not expected.
Pillar 2: Improving business environment and foundations for a digital economy		
Prior action 4	Adverse environmental effects are not expected.	Adverse poverty and social impacts are not expected.
Prior action 5	Adverse environmental effects are not expected.	Adverse poverty and social impacts are not expected.
Prior action 6	Adverse environmental effects are not expected.	Adverse poverty and social impacts are not expected.
Pillar 3: Enhancing sustainability and creditworthiness of local service providers for private investment		
Prior action 7	Adverse environmental effects are not expected.	Adverse poverty and social impacts are not expected.
Prior action 8	Adverse environmental effects are not expected.	Adverse poverty and social impacts are not expected.
Prior action 9	Adverse environmental effects are not expected.	Adverse poverty and social impacts are not expected.

ANNEX 5: PUBLIC FINANCIAL MANAGEMENT AND FIDUCIARY ASPECTS

This annex summarizes the current state of certain aspects of the PA's PFM system and ongoing reform efforts. The PA PFM system is functional for the purposes of general budget support operations but is afflicted by high fiduciary risks.

Integrated Financial Management System (IFMIS)
The PA budget preparation and execution process has been supported by IFMIS since 2009. The IFMIS has been rolled out to all line ministries and is considered the official country system to account for public financial resources. Transactions are entered by line ministries with approval for the transaction by MoFP Financial Controllers who are located in all line ministries. IFMIS modalities have been updated which has led to improvements in terms of consolidation of the financial statements, production of financial reports and the orderly exchanges between line ministries and the MoFP. The IFMIS has controls for payments against cash ceilings; however, the insufficiency of commitment controls can lead to generation of arrears.

Treasury Single Account
All tax revenue is paid directly into the treasury account, and most operational payments and transfer expenditures are executed by line ministries in a devolved Treasury model, using IFMIS. Reconciliation between the Treasury subaccount and payment is made on a regular basis. There are three main Treasury Accounts: (i) Clearance Revenue Account; (ii) a Donor Fund Account used to deposit budget support financing (e.g. DPG, Program for Results); and (iii) an account catering to domestic revenues and expenditures. Each Treasury Account has subaccounts with virtual ceilings which are consolidated each day to ensure zero balances in the subaccounts. However, a Bank TA mission to review the MoFP bank reconciliation process identified certain weaknesses and delays in preparing monthly bank reconciliations for the zero balance accounts by government entities. These weaknesses were addressed by the Accountant General's department and this will be verified by another TA mission part of the PFM Improvement Project.

Financial and Commitment Control
A key component in the MoFP internal control framework is the function of the financial controller. This is the traditional ex-ante model ("pre-audit") used by many ministries of finance. Each financial controller posted at the respective line ministry is required to review and clear all transactions, including those relating to TFGWB-financed projects, before they are processed for payment. Financial controllers are appointed by the MoFP Accountant General. The financial control function is not driven by risk-based guidelines and procedures. Currently, there is a functionality in IFMIS to enter and record budget commitments, but it is not mandatory and is not controlled by the financial controller. With the support of an earlier DPG this functionality has been utilized on a pilot basis at the Ministries of Education, Interior, Public Works and Housing, and Transportation. This will be expanded into all ministries with the support of the abovementioned PFM Improvement Project by designing, developing and implementing a proper Commitment Control System to upgrade the existing pilot-based commitment recording system.

Internal Audit
The Internal Audit Department (IAD) was created in 2004 within the MoFP with the dual mandate of performing the MoFP internal audit, and decentralizing the internal audit function from the MoFP to line ministries. The scope of the Internal Audit Function across the Palestinian National Authority is governed by regulation No. 11/2011 (the Charter) issued in August 2011, which clarifies roles and responsibilities of the IAD as well as reporting requirements. A Central Harmonization Unit (CHU) was established within the

MoFP pursuant to article No. 5 of Regulation 11/2011 issued by the Minister of Finance. However, these internal audit arrangements are not currently implemented.

Accounting and Reporting

The fiscal year of the PA is January 1 to December 31. The financial statements of the PA are prepared in accordance with cash basis IPSAS standards. Monthly bank reconciliations are performed at the level of line ministries through the IFMIS and are submitted to the MoFP. The identified deficiencies in the bank reconciliation process have been addressed, as stated above, and there will be further verification through the ongoing PFM Improvement Project.

The PFM Improvement Project will also help the MoFP complete the alignment of the accounting and reporting on international Government Finance Statistics (GFS) and International Public-Sector Accounting (IPSAS) standards. This will include issuing and implementing Accountant General's instructions in several areas including, among others: (i) mandatory cash basis IPSAS policies; (ii) preparation of financial statements (including at line ministries); and (iii) financial reporting in GFS-format. Trainings will be provided to staff involved with IFMIS-based transactions on the Accounting Handbook.

State Audit and Administrative Control Bureau (SAACB)

The SAACB is the supreme audit institution responsible for independent oversight and external audit over public sector bodies in accordance with provisions of PA law. The organization in its current form was established in 2004. The SAACB has issued its opinion on the financial statements of the PA since 2008, the latest covering the year ended December 31, 2012. The Governing Board of INTOSAI approved in 2016 SAACB's application for membership.

Despite some institutional and financial limitations of independence, the SAACB is a well-managed organization with a high degree of openness to its stakeholders, including the public and civil society. The SAACB has made important improvements in its audit performance over the last few years, and the newly adopted audit methodology is largely compliant with international standards. Its audit of the financial statements of the PA is highly valued by the various stakeholders, in particular the Bank in conducting its TA activities on financial accountability. External partners have provided support in areas of significance to the SAACB and are likely to continue to assist SAACB in its efforts, including an upcoming twinning arrangement supported by the EU. The PFM Improvement Project will also provide TA to the institution in order to initiate a plan for SAACB's work as auditor of Bank-supported operations and will engage with the SAACB in a capacity building and training program to select at least one new World Bank-funded project to be audited by the institution. The PFM Improvement Project will also help the SAACB expedite the backlog of unissued financial statements.

Procurement

The enactment of the new public procurement law (PPL) - Law No. 8 of 2014 - supported by an earlier DPG, has brought substantial improvement to the legal framework for public procurement on aspects of efficiency, transparency, accountability and integrity. The law entered into effect on July 1, 2016. It is consistent with international best practice and aims to regulate procurement activity at both the central and municipal levels of government. However, several aspects of the law remain unimplemented. The High Council for Public Procurement Policies (HCPPP), which is responsible for the development of the procurement system[29], was established in September 2012. Despite prolonged delays in getting the

[29] HCPPP functions outlined in the law include: policy setting, institution building, development of standard

financial and human resources necessary for its operation, HCPPP, with the Bank's support, has been involved in following up on the implementation of the new PPL, developing National Standard Bidding Documents (SBDs) for use by all procuring entities, and establishing the Single Procurement Portal to serve as a gateway to all information about the procurement system and proceedings (procurement plans, notices and award decisions and other bidding procurement documentation). Recently, HCPPP hired key staff.

The Bank-financed PFM Improvement Project and the associated TA aim at improving procurement management through accelerating the implementation of the law. In particular, support will be provided for: institutional strengthening and operationalization of HCPPP to assume its policy setting and oversight role, setting up a Dispute Review Unit to handle complaints from aggrieved bidders concerning alleged non-compliance by procuring entities in conducting procurement proceedings, rolling out the single procurement portal to procuring entities at the central and municipal levels of government and capacity building of the procurement workforce at both levels. Procurement arrangements under the law are a combination of centralized and decentralized procurement.[30] The thresholds for centralized procurement, in particular for goods, non-consulting services and non-engineering consulting services were set at relatively low levels. This risks over-centralization and resultant bottlenecks and inefficiencies that would undermine the performance of the procurement system. To address this risk, functional reviews of the two central procurement entities (CTD and GSD) will be carried out and mitigation measures will be identified.

Anti-Corruption Overview

Due to political reasons, the legislative council is not convening, the legislative branch therefore is having difficulty fulfilling its role as a monitoring institution over the government. This diminishes government accountability and increases the risk of unregulated corrupt practices.[31] In addition, the lack of access to information legislation negatively affects transparency and citizen engagements. A 2011 World Bank study summarizes the progress made and challenges ahead in this area as follows. First, the PA made significant strides to improve economic governance since 2000. Second, reform efforts achieved varying degrees of success and the PA needs to prioritize and address the ongoing challenges. Finally, the PA needs to take a more proactive approach to investigating and prosecuting corruption, as well as communicating its anti-corruption activities to build public confidence in PA accountability.[32] An Anti-corruption law and an Anti-Corruption agency have been in place since 2010.

In conclusion, over the past decade, the PA has made progress in reforming PFM, and there is broad agreement between the PA and the international partners to continue to pursue these efforts. However, weaknesses remain, especially related to the delayed preparation, audit and oversight of the financial statements, that need continuous commitment from the PA to be addressed. This is the reason why the fiduciary risk is high. The ongoing PFM Improvement Project is expected to address this fiduciary risk.

---

procurement documentation and tools, establishing a single procurement portal, training and public awareness campaigns, as well as performance monitoring and oversight of all public procurement activity.

[30] Procurement packages with estimated costs higher than the threshold set in the implementing regulation to the law are to be handled by the Central Tenders Department (CTD) of Ministry of Public Works and Housing (MOPWH), in the case of works and engineering consultants' services; or by the General Supplies Department (GSD) of MOFP, in the case of goods, non-consulting services and non-engineering consultants' services.

[31] http://www.transparency.org/country/#PSE

[32] The World Bank. Improving Governance and Reducing Corruption in West Bank and Gaza. May 2011.