



WEST BANK AND GAZA UPDATE

The World Bank Group

A Quarterly Publication of the
West Bank and Gaza Office
August 2002

The Palestinian Authority's (PA) Reform Agenda

Donors Mobilize To Support, Advance PA Initiative

The Palestinian Authority issued its "100 Days Plan of the Palestinian Government" on June 23, 2002. The Plan describes how the Government intends to make the Palestinian Authority "more efficient and effective in the service of the national good". (For a summary of the Plan, see Box.)

A local task force was established in order to support and advance this initiative, as well as to monitor its implementation - including the identification of obstacles that stand in the way of its successful achievement. On behalf of the International Task Force on Palestinian Reform (the so-called "Quartet plus Four" consisting of the European Union, Russia, the United States, and the United Nations, plus Japan, Norway, the International Monetary Fund, and the World Bank) and working closely with the members of the PA Ministerial Reform Committee, benchmarks were identified by which progress will be measured on each Reform Agenda item. To this end, "Reform Support Groups" have been established in seven areas: (i) financial accountability; (ii) ministerial and civil service reform; (iii) market economics; (iv) judiciary/rule of law; (v) local government; (vi) civil society; and (vii) elections.

One of the primary functions of these Reform Support Groups is the identification of appropriate Donor instruments for providing the necessary technical assistance and financial resources, which would be required both immediately and in the medium-term. Recognizing that greater accountability and transparency in expenditure management is due the Palestinian people (and would go far to reassure

Donor capitals that their financial support is indeed being used in the most effective and efficient manner), the Reform Agenda includes a number of specific measures in the area of fiscal management to be implemented within the first 100 days - many of which have been accomplished ahead of schedule.

Domestic Consensus In Support Of Reform

With the current emphasis being placed on a need for Palestinian reform, it is easy to overlook the notable achievements in developing Palestinian administrative and institutional capacity that occurred in the period since Oslo. Institutions were created, ministries and agencies staffed, and essential Government services provided.

Understandably, in such a setting, a number of inefficiencies and redundancies in administrative structure resulted. Nevertheless, prior to the Intifada and the subsequent institution of internal closures and curfews, as well as external closures, progress was real, if undoubtedly incomplete.

More importantly, at the same time there also existed a general consensus among Palestinian civil society, the PA, and the Palestinian Legislative Council (PLC),

CONTENTS	PAGE
"100 Days Plan of the Palestinian Government	6
Recent Economic Developments	7
Bank Group Operations	14
Bank Group News	23
New Bank Publications	25





West Bank and Gaza Update

and the international Donor community on the need for further institutional development. This included reforms in the areas of: governance, accountability, transparency, responsiveness, and efficiency of public services. While there was some divergence of opinion regarding the pace or sequencing of particular steps, there was general agreement on the path a reform program would take. This consensus is even stronger today.

Genuine administrative and financial reform cannot be imposed from the outside; it must be domestically driven, deriving from the wishes of the Palestinian people and their leadership. Palestinian civil society and public opinion has strongly supported such endeavors. Public opinion polls have shown near unanimity on the need to uproot corruption, base public sector employment on qualification and merit, achieve a more efficient justice system, and improve the performance of ministries. There was similar support for a stronger role for local Government, a more democratic decision-making process, and wider participation in Government policy.

PA And PLC Commitments

In recent months the Palestinian Authority and the Palestinian Legislative Council have explicitly committed themselves to a number of important reform measures. In the March 2002 World Bank publication, "*Fifteen Months - Intifada, Closures and Palestinian Economic Crisis - An Assessment*," the PA pledged itself to measures in expenditure management, planning, and aid coordination designed to cope with the current emergency, as well as a number of structural measures that advance the medium-term policy and institutional agenda.

On March 16, 2002, the PLC affirmed its commitment for a number of PA institutional reform measures designed to improve transparency of Government operations, greater accountability, and constitutional and judicial reform.

Thus, the appointment by President Arafat of the Ministerial Reform Committee to produce an agenda of reform measures is but the most recent in a series of domestic reform initiatives.

Donor Support

Discussions among the Donor community quickly showed that there was considerable willingness to collectively advance a number of agenda items in

the areas of institutional reform and good governance, particularly in the areas of fiscal management, economic policymaking, civil service and administrative capacity building (at both the national and municipal levels), and development of a legal environment conducive to private sector activity. Other areas, such as support for presidential, legislative, and municipal elections and reform of the security apparatus, are largely being pursued on a bilateral basis.

The World Bank Program

World Bank technical assistance and operational support is being focused around four areas: (i) financial management and economic policy-making; (ii) public administration and civil service reform; (iii) strengthening local government; and (iv) private sector development. Over the coming six months, considerable analytical and diagnostic work will need to be undertaken in these areas to ensure that critical work is adequately funded and that PA decisions are undertaken with the benefit of rigorous supporting analysis. Actual implementation of reform initiatives in these areas can reasonably be expected to take two- to three-years.

Financial Management And Economic Policy-Making

Broad-based public sector rationalization is a key element in fiscal reform. Improved management of the civil service is critical to achieving fiscal discipline, budget controls, accountability, and effectiveness and efficiency in the operation of Government programs.

Nevertheless, public financial management may be significantly improved in a number of key areas independently of civil service reform. This applies in particular to such weaknesses as repeated spending in excess of budgetary allocations, failure to issue payments to line ministries or settle debts in a timely manner, thus constraining operating budgets and building up arrears, severe delays in issuing VAT refunds, thus discouraging private sector investment, and delays in finalizing and reporting the public accounts.

Sound budgetary and financial management practices require that the budget be comprehensive and include all revenues and expenditures; otherwise there can be no assurance that scarce resources are assigned to priority programs. The creation of the single treasury





West Bank and Gaza Update

account, the inclusion in this account of revenues formerly outside the budget, and the cancellation of ministries ability to finance operations through independent revenue sources will go far towards meeting this objective.

Public enterprises, as well as other PA equity investments are being transferred to the newly established Palestinian Investment Fund (PIF). The release of audited details of the PA's private sector equity holdings in 2000 was an important step towards greater accountability. Going forward, the regular publication of PIF revenues and expenditures as part of the public accounts will further signal the PA's commitment to transparency in financial operations and thereby help boost public and international confidence in PA financial management.

Expenditure management capacity at the Ministry of Finance is being strengthened through the adoption of several other measures and procedures. Moving to the medium-term, the adoption of a modern, automated financial management system, Government Financial Management Information System (GFMIS), would provide rapid, comprehensive data for regular review of revenues, expenditures financing, transactions, cash balances, and spending versus budget allocations.

Such a system would not only help in gaining better control of expenditures, but also in increasing efficiencies and effectiveness in policy and program implementation that could be expected from adopting a medium-term framework for planning.

Adopting as a goal the linkage of spending priorities and investment plans over a specific timeframe with realistic financing projections means developing or increasing capacity in such functions as economic forecasting, debt management, and integration of capital and recurrent budgets for this goal to be actualized. The World Bank is ready to provide such support.

Over the next few months the World Bank will be jointly conducting with the PA a Country Financial Accountability Assessment (CFAA) - a diagnostic tool for enhancing financial accountability arrangements in both the public and private sectors. Typically, a CFAA's public sector component focuses on budgeting, accounting and financial reporting, internal control systems and records management, public sector auditing, legislative scrutiny of public sector financial management, and public access to information, with the idea of pinpointing specific areas

in need of strengthening. On the basis of such a review, a package of technical assistance to build capacity in the identified areas of weakness might be sought.

Particularly in the current situation during which economic activity is declining and economic units are shrinking rather than expanding, strengthening the capacity of core institutions to monitor events, evaluate data, and develop appropriate macroeconomic policies - be they fiscal, monetary, trade and competitiveness, labor, or public investment - is critical.

Improving the performance of core economic functions will involve considerable upgrading of ministry systems and staff skills that can only take place over time and should only be done within the context of a rationalization of the functions and responsibilities of the three core economic ministries: the Ministry of Finance (MOF), the Ministry of Planning and International Cooperation (MOPIC), and the Ministry of Economy, Trade, and Industry (MOETI).

Public Administration And Civil Service Reform

In February 1999 the World Bank produced a comprehensive report, *Strengthening Public Sector Management*, which called for improvements in a number of areas, particularly in the civil service incentive and personnel management structure.

In the words of the study, excessive and unplanned hiring "may be ascribed it the first instance to a lack of ministerial organization charts and job descriptions and overlapping responsibilities among ministries... Similarly, the failure to clarify ministerial mandates may mean that the authorities prefer to leave ministerial responsibilities deliberately vague in order not to hinder job creation."¹

Furthermore, the lack of clarity in the roles and the overlap in responsibilities between the various PA ministries and agencies has, in a few instances, resulted in a delay or even the cancellation of Donor-funded projects.

The recent reduction by one-third in the number of ministers presents a unique opportunity for further

¹ *West Bank & Gaza: Strengthening Public Sector Management, Social and Economic Development Group, Middle East and North Africa Region, The World Bank, 1999, page 26.*





West Bank and Gaza Update

rationalization. Ministerial mandates need to be clarified with overlapping authorities and redundancies removed, as recommended by the PLC Budget Committee and the Tripartite Action Plan of October 1999, and numerous subsequent studies. Enabling legislation needs to be passed to clarify ministerial responsibilities, convey the authority to establish operational policies, and to develop sectoral regulations.

Flowing naturally from the identification of ministerial functions and required organizational structure, such "strategic reviews" would then be extended to determine the real personnel needs and budgetary requirements, allowing for improved service delivery and eventual "right-sizing".

At the same time, as work on the administrative elements of the civil service (e.g., establishing unified, merit-based, open, and transparent recruitment, compensation, benefits, and promotion procedures) moves forward, development of a unified pension system that is financially sustainable and covers all public employees needs to progress. Such a system is a prerequisite for implementing a successful program of civil service restructuring that is commensurate with ministerial and agency requirements, and protective of the PA's fiscal position.

Improvements in public service delivery are another core objective of public administrative reform. This involves increasing the management roles of government in determining policy, setting service standards for government and non-government providers, and planning and regulating service provision - all of which require strengthening the capacity of ministries and agencies to effectively supervise, monitor and evaluate, and to conduct policy assessment.

Strengthening Local Government

The inability of the Palestinian Authority to invest in capital development since 1994 only reinforces the argument for increasing the fiscal base, institutional capacity, and political autonomy of municipalities at all levels and in all regions. The balance of the relationship between central and local government has yet to be settled comfortably; in a highly unstable political situation, the tendency of the PA to centralize government - reflected in central control over revenue collection, financial management and controls, and reliance on appointments by the Ministry of Local Government, especially at the village council level -

is understandable. Yet the deeper the centralization, even if entered into with the intention of later reversal, the more difficult will be any subsequent decentralization.

Notwithstanding the legitimacy that would accrue through periodic municipal elections, strengthening local government is also about finding means to hold municipal authorities accountable. The multiplicity of governance structures has not helped (many new municipalities and village councils appear to have been established for political reasons, without regard for financial or institutional capabilities). So long as the municipal authorities receive fees mainly by transfer from the central authority rather than taxes from local constituencies, accountability will be further impeded.

At the same time, local governments can and should increase their revenues by improved management of user fees. When and where such direct fees are inappropriate, local governments need to have access to a suitable tax base. Property taxes are appropriate for such purposes, and should be reserved exclusively for local governments' use. The Palestinian Authority has agreed to hand over the administration of property taxes to local governments; such transfer should be accelerated. Similarly, recognizing the existence of regional disparities in local tax bases, the PA should devise an appropriate financing system, possibly through "equalization" transfers, in order to ensure equity and efficiency in providing essential services.

The Ministry of Local Government (MOLG) will need to play a lead role, along with other relevant authorities, in assuring proper financial management and accountability. Looking forward, MOLG should also prepare to expand municipal boundaries once this is possible politically in order to alleviate overcrowding and congestion, and to plan appropriately for the delivery of new infrastructure and services. Urban planning, including master plans, commercial and residential districting, traffic management, and the like, will all be urgently needed, following upon years of piecemeal and limited efforts - the consequence of key physical and economic resources being outside the control of either the municipality or the PA.

Private Sector Development

The fundamental prerequisite for improving the environment for private sector investment and economic activity in the West Bank and Gaza is the





West Bank and Gaza Update

reduction of political instability and the return to unfettered movement of goods, services, and individuals. Only in such a context will the private sector be able to achieve its potential for job creation and dynamic, sustainable economic growth. Until then, recovery of the private sector will be halting at best; Donor-supported interventions such as the proposed *Private Sector Crisis and Recovery Fund*, while helpful in assisting in the process of private sector revival, will be limited in their effectiveness.

There remain a number of steps that need to be taken in order to improve the institutional framework and the current and future environment for productive private investment in Palestine. Arguably the most important of these are measures designed to create an appropriate legal framework for commercial activities and an effective, independent judicial system to implement and uphold laws and regulations, contracts, and property rights.

Such measures can significantly reduce the uncertainty and related costs of doing business. Studies show that differences in the quality of the institutional framework explain a large part of the differences in economic development among countries. Indeed, the importance of a sound institutional framework well exceeds the attraction of specific incentives for investment. Experience in other developing countries suggests that an emphasis on tax and other incentives to encourage investment in export-oriented manufacturing industries, in the absence of sound macroeconomic and framework policies, has had disappointing results in promoting growth.

From a governance perspective, creating a firm foundation of "economic legality" - laws, rules, and regulations that are consistent, widely disseminated and accessible to the public, broadly consistent with global norms, and applied and enforced uniformly by institutions of integrity - remains the over-arching task.

While much has been done to fill the gaps in needed commercial legislation in recent years - *the Agency Law, Investment Encouragement Law, Industrial Zones Law, Domestic Arbitration Law, Condominium Law, and Labor Law* - gaps in implementing regulations remain, and additional legislation still

needs to be drafted. Major strides could be rapidly achieved simply by completing the substantial backlog of draft laws awaiting parliamentary consideration and presidential endorsement. These include the: *Income Tax Law, Competition Law, Company Law, Intellectual Property Law, Securities Law (Capital Markets Authority Law), Insurance Law, Secured Lending and Leasing Law, International Commercial Arbitration Law, Rental Law, Pensions Law, Banking Law, Provident Funds Law, Mutual Funds Law, and Accounting and Auditing Law.*

The need to strengthen the regulatory environment is pressing, and particularly necessary for the deeper development of financial intermediation in the West Bank and Gaza.

The Country Financial Accountability Assessment, mentioned above in the context of public sector finance, also has a private sector component, one aspect being a review of private sector financial accounting and auditing practices. Other areas that would be reviewed involve corporate governance and disclosure rules and other aspects of financial accountability for publicly traded companies.

In addition to the salutary effect increased accounting and auditing standards would have on financial intermediation, business lending could also be increased by increasing the categories of assets that are eligible for use as collateral for loans. Similarly, removing obstacles preventing clear titling and registration of land would increase liquidity in the real estate sector, as well as support further business-related finance.

Completing the preparation of the framework for private sector development in advance of Palestinian statehood is imperative, given the challenges and opportunities that statehood will present. With independence will come a heightened need to generate jobs and investments associated with start-up and refugee absorption costs. While statehood is likely to be associated with a significant influx of assistance and compensation funds, without an appropriate framework, the return on such flows will be diminished and a one-time opportunity squandered.





"100 Days Plan of the Palestinian Government"

Released on June 23, 2002, the Palestinian Authority's (PA) Reform Agenda expressed the commitment of the Palestinian Government to a broad program of reforms. Because a number of specific measures were identified to be implemented within 100 days (while implementation of all other measures would be initiated so as to have a "tangible and visible" effect within three months of the Plan's adoption), the entire Reform Agenda has come to be known as the "100 Days Plan of the Palestinian Government." The Reform Agenda items are summarized here:

In The General Domain:

- Reinforce separation of powers of the legislative, executive, and judiciary branches of government;
- Restructure and modernize ministries and government institutions;
- Prepare for municipal, legislative, and presidential elections;
- Put into force all laws that have been passed;
- Improve the standard of living, particularly of the unemployed, and other segments of society that live in dire conditions;
- Rebuild the infrastructure that has been destroyed by the occupation;
- Tend to the needs of the wounded, families of those killed during the occupation, prisoners, and detainees.

In The Domain Of Public Security:

- Restructure and modernize the Ministry of Interior;
- The Ministry of Interior is to be in charge of all matters relating to internal security;
- Activate the role of the Ministry of Interior in the enforcement of court rulings;
- Respond to the expectations of the people for safety, order, and respect of the law;
- Improve discipline in the security services and strengthen social control;
- Reinforce the loyalty of the security services to the job, the PA, and the country;
- Raise awareness of the population to the measures above and secure their understanding, cooperation, and support.

In The Financial Domain:

- Reform operations in the Ministry of Finance;
- Deposit all incomes of the PA into a single account of the Treasury;
- Manage all commercial and investment operations through a Palestinian Investment Fund, which is subject to stringent standards of disclosure and audit;
- Limit expansion of employment in the public sector and unify payroll administration under the Ministry of Finance;
- Modernize the pension scheme;
- Strengthen internal and external auditing;

- Develop the process of preparing the general budget to include recurrent and developmental expenditure;
- Develop a monthly expenditure plan for the remainder of 2002;
- Begin preparation of the 2003 Budget;
- Reorganize the financial relations between MOF and the municipalities/local authorities.

In The Judicial Domain:

- Strengthen the judiciary, through appointment of judges and development of infrastructure;
- Implement measures required by the Judiciary Law;
- Prepare draft laws, decrees and decisions to accompany the Basic Law;
- Establish the Government Legal Cases Administration to handle cases to which the Government is party.

In Other Domains:

- Reinforce Palestinian values, including the spirit of democracy, enlightenment, and openness;
- Activate the role of the Ministry of Awqaf to serve national and religious objectives;
- Resolve the financial crisis of the universities, schools, and hospitals;
- Review Government institutions that operate outside the jurisdiction of the ministries with a view to attach or incorporate them within the ministries;
- End the role of the security services in civilian affairs;
- Improve employment policy, to prevent an inflated civil service;
- Unify and develop institutions - and promulgate laws - that encourage investment;
- Improve the training and conditions of employment of human resources;
- Increase the effectiveness of the Palestinian diplomatic corps;
- Rebuild the management boards of Government institutions according to the law;
- Pay special attention to the pollution of the environment

