



1. Project Data

Operation ID P161252	Operation Name WB&Gaza: Fiscal Stability & Business Env
Country West Bank and Gaza	Practice Area(Lead) Macroeconomics, Trade and Investment

L/C/TF Number(s) TF-A5996,TF-A6118	Closing Date (Original) 30-Apr-2019	Total Financing (USD) 100,470,413.00
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Bank Approval Date 05-Dec-2017	Closing Date (Actual) 30-Apr-2019
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	IBRD/IDA (USD)	Co-financing (USD)
Original Commitment	100,470,413.00	100,470,413.00
Revised Commitment	100,470,413.00	100,470,413.00
Actual	100,470,413.00	100,470,413.00

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2. Project Objectives and Policy Areas

a. Objectives

According to the Program Document (PD, pages v, and 12), the project development objective (PDO) of the West Bank and Gaza Fiscal Stability and Business Environment Development Policy Grant was "to improve transparency of fiscal transfers to local service providers, and to improve the business environment" in West Bank and Gaza.

This was parsed into two objectives:

1. To improve transparency of fiscal transfers to local service providers;



2. To improve the business environment in West Bank and Gaza.

The grant agreement did not contain a PDO.

b. Pillars/Policy Areas

The program had two pillars/policy areas:

Improving the Transparency of Fiscal Transfers to Local Service Providers supported policy and institutional reforms to: (a) improve the availability of data on transfers to local government units, improving the predictability of resource flows and thereby enabling better planning and delivery of public services by local governments; (b) raise the quality of public services by local governments; (c) strengthen the incentives for the prompt and full payment to providers of utility services; and (d) increase efficiency and reduce waste in health services referrals.

Improving the Business Environment supported institutional reforms to: (a) improve the conditions for the issuance of business licenses to increase the number of business registrations; and (b) improve the functioning of the movable collateral system to increase the number of notices in the collateral registry.

c. Comments on Program Cost, Financing, and Dates

Program Cost: The cost of the program was estimated at US\$30 million at appraisal. According to the Program Document (pages 6 and 38), the operation was expected to "leverage other donor financing" in the amount of US\$45 million through the Palestinian Recovery and Development Plan Trust Fund, administered by the Bank.

Project Financing: The program was financed with a development policy grant of US\$30 million from the International Development Association, as administrator of the Palestinian Recovery and Development Plan Multi-Donor Trust Fund, to the Palestine Liberation Organization, for the benefit of the Palestinian Authority. According to the ICR (page 6), this operation actually "leveraged up a further" US\$70.5 million from the Palestinian Recovery and Development Plan Trust Fund (US\$30.5 million more than expected at appraisal). The additional funding was drawn by the Palestinian Authority on a quarterly schedule, following its submission to the Bank of reports on fiscal developments and progress with policy reforms.

Dates: The program was approved on December 5, 2017, became effective on December 12, 2017, and closed as scheduled on April 30, 2019.

3. Relevance of Objectives & Design

a. Relevance of Objectives



Relevance to Problems in Public Finance and the Business Environment

The program objectives were directed at pressing issues in public finance and in the business environment.

- **Public Finance.** Palestinian Authority and local government finances had been under pressure from two decades of poor macroeconomic performance amid episodes of violence, security threats, and political instability. In particular, collections by local government units from residents for electricity and water services had not been paid, or only partially paid, to utility suppliers in Israel but were used instead to fund local government operating and development budgets. To protect its utility suppliers, the Government of Israel had been deducting the overdue payments from the "clearance revenues" of the Palestinian Authority --- the value-added tax, excise taxes, and customs revenues collected by Israel for the Palestinian Authority under the terms of the 1994 Oslo Accords and the Protocol of Economic Relations --- and had begun to impose penalties on late utility payments. The Government of Israel had also resorted to revenue deductions to settle unpaid bills owed by West Bank and Gaza residents to healthcare providers in Israel. In turn, to recover revenue losses resulting from these deductions, the Ministry of Finance at the Palestinian Authority had been intercepting revenues bound for the local government units from the municipal revenue tax, the professional permit fee, and the transportation tax, creating a vicious cycle of revenue intercepts at the central and local levels and arrears on debt to service providers. This operation aimed to improve the governance and transparency standards related to these payments to service providers in the expectation that greater transparency would enable local governments to better manage local finances and hence offer better public services to their residents.
- **Business Environment.** A weak business climate had been a major obstacle to private sector activity. The *West Bank and Gaza Investment Climate Assessment - Fragmentation and Uncertainty* prepared by the Bank in 2014 following the *Enterprise Survey* and the *Informal Sector Survey*, both completed in 2013, identified "political instability, the result of the unresolved conflict and the restrictions on movement and access" as "the binding constraint in the Palestinian investment climate, resulting in uncertainty, risk, increased costs for businesses and investors, and the fragmentation of Palestinian economic space and markets." The assessment detailed six related constraints: (a) Gaza firms were hampered by a lack of a reliable electricity supply; (b) restrictions on the movement of people and goods impeded trade and investment in the Palestinian territories; (c) restrictions on the economic use of land in the West Bank limited the availability of infrastructure and serviced land and impeded new opportunities for growth; (d) legal and regulatory environments in the West Bank and Gaza had become disconnected due to the political and administrative separation since 2007; (e) informality was a significant issue --- formal small enterprises, and even formal medium and large firms, cited competition from the informal sector as a severe obstacle to business; and (f) engagement in innovative and business-upgrading activities had dropped among Palestinian firms in recent years. The *Investment Climate Assessment* proposed a comprehensive set of medium- and short-term priorities to address these constraints. The assessment clarified that policy directions in the medium- to long-term could only be formulated assuming the conclusion of a final peace agreement, but given that the final form of such an agreement was unknown, policy recommendations could only be made in the broadest terms. In the short-run, the document advocated for measures to mitigate the effects of political instability or to improve aspects of the



investment and business climate that could be improved, even if marginally, under the current constraints. The *Investment Climate Assessment* advanced 18 key recommendations organized around five areas: improving access to resources and markets; reversing the trends of fragmentation and isolation; mitigating political risk; improving business regulation and enhancing the role of the private sector; and investing in skills, technology, entrepreneurship, and innovation. This operation focused on three of the 18 recommendations in two of the five recommendation areas in the *Investment Climate Assessment* (page xvii): (a) "provide incentives for informal firms to formalize"; (b) "take on the secondary business regulation agenda, particularly in areas that simplify business regulation"; and (c) "support access to finance for micro and small enterprises."

Relevance to Government Priorities

The program objectives were aligned with the priorities of the *National Policy Agenda 2017-2022 - Putting Citizens First* (NPA). The NPA's second pillar on government reforms aimed to "expand LGU resource management mandates," "decentralize services to LGUs, while building their capability and fiscal capacity to carry out these services," and "strengthen transparency in government." The NPA's third pillar on sustainable development aimed to: "improve Palestine's business environment" by "cutting red tape for business through smart regulation" and "supporting business start-ups and MSMEs."

Relevance to the Bank Group Strategy

The program objectives were aligned with the Bank Group strategy in West Bank and Gaza. The *Assistance Strategy for FY18-21 for the West Bank and Gaza* commits Bank Group support for development priorities organized around three pillars. The Assistance Strategy's first pillar included "setting the conditions for increased private sector investment and job creation." It aimed to "improve the business environment," including by "reforming the business licensing system." It also aimed "to improve the confidence of the private sector to make investments in the West Bank and Gaza" by supporting public financial management reform, including for health expenditures "particularly medical referrals abroad." The Assistance Strategy's third pillar on "strengthening institutions for citizenry-centered service delivery" aimed to: "improve basic service delivery, including water and sanitation;" "strengthen [institutions] in the water sector to increase responsiveness in essential service delivery and improve financial sustainability in the sector;" and "support public institutions to be more financially disciplined, accountable, and transparent, while continuing to improve citizen engagement."

Rating

Substantial

b. Relevance of Design

Relevance of Prior Actions



The seven prior actions listed by the Grant Agreement (pages 7-8) were consistent with the program objectives. The prior actions for the objective to improve the transparency of fiscal transfers appeared to be of central relevance to the objective because their fulfillment would allow for a more transparent system of fiscal payments by local governments to electric utilities, bulk water suppliers, and medical service providers.

Prior Actions for the Objective to Improve the Transparency of Fiscal Transfers to Local Service Providers

- Prior Action 1: *At least 90 percent of all municipalities, village councils, and electricity distribution companies would, at the direction of the Palestinian Energy and Natural Resources Authority, open separate bank accounts to deposit funds collected from electricity bills to pay the Palestinian Electricity Transmission Company Ltd.* This prior action was consistent with the transparency objective. According to the Program Document (pages 14-16), despite recent improvements, collection rates by the distribution utilities lagged at a poor 64 percent. Even when revenues were collected, they were often diverted by municipal governments to cover sub-national expenditures rather than paid to the Palestinian Electricity Transmission Company Ltd., which purchased power from the Israel Electric Corporation. Accumulated debt to the Israel Electric Corporation was NIS 2 billion (US\$500 million) at end-September 2016. The Palestinian Authority was compelled to cover the payment shortfalls, including by allowing the Government of Israel to deduct payments from its "clearance revenues"; the subsidies were estimated to have reached about one percent of GDP. The separate banks accounts, created under this prior action, would collect payments from consumers and transfer the funds directly to the accounts of the Palestinian Electricity Transmission Company Ltd., effectively ring-fencing the revenues and identifying any fund diversions by the electricity distribution companies or by local governments.
- Prior Action 2: *At least five local government units would, at the direction of the Palestinian Water Authority, open separate bank accounts to deposit funds collected from household water bills to pay water purchases from the West Bank Water Department.* This prior action was similarly consistent with the transparency objective. According to the Program Document (pages 16-18), water service providers collected only part of the water service dues from customers and many municipalities diverted the water revenues to their municipal budgets rather than pay the West Bank Water Department, which purchased bulk water from Mekorot of Israel and managed wells owned by the Palestinian Water Authority. Accumulated debt to the West Bank Water Department was US\$275 million at end-June 2017. As with electricity services, the Palestinian Authority was compelled to cover the payment shortfalls, including by allowing the Government of Israel to deduct payments from its "clearance revenues"; the subsidies were estimated to have averaged NIS 130 million per year. The separate banks accounts, created under this prior action, would collect payments from consumers and transfer the funds directly to the accounts of the West Bank Water Department, effectively ring-fencing the revenues and identifying any fund diversions by the water service providers or by local governments.
- Prior Action 3: *The Ministry of Health would sign an agreement with at least six national hospitals to establish a framework for the purchase of medical referral services and would publish the harmonized standard procedures for medical referrals.* This prior action was consistent with the objective of improving



the transparency of transfers to services providers. The Ministry of Health purchased tertiary care services from around 79 healthcare providers, with most medical referrals made to private healthcare providers in the West Bank and Gaza, East Jerusalem, Israel, Jordan, and Egypt. Medical referrals grew from 8,123 in 2000 to 74,654 in 2016 and the corresponding healthcare costs from under US\$10 million in 2010 to around US\$210 million in 2014. Unpaid bills to healthcare providers had accumulated to US\$142 million by 2016. The publication of these harmonized procedures would help inform consumers, service providers, and local governments of the costs of medical referral services.

- *Prior Action 4: The Ministry of Finance and Planning would issue instructions mandating its Accounting Department and the Projects Department at the Ministry of Local Governments to produce annual reports on: (i) the amount of the Ministry of Local Government's capital budget allocated to each local government unit, (ii) the amount of revenue deductions or interceptions made by the Ministry of Finance and Planning from each local government unit; and (iii) the share of each local government unit (based on allocation criteria set by the Council of Ministers) of transportation fees collected by the Ministry of Finance and Planning.* These instructions would enable the Ministry of Finance and Planning and the Ministry of Local Government to produce these reports. This prior action was consistent with the transparency objective, as the publication of these reports would improve the transparency of inter-governmental fiscal relations between the central and local governments.

Prior Actions for the Objective to Improve the Business Environment

- *Prior Action 5: The Ministry of National Economy would submit to the Council of Ministers a new Companies Law that included simplified business registration procedures, new types of companies and shares, and good practices for protecting minority investors and for resolving insolvency.* With the inactivity of the Palestinian Legislative Council following the Fatah-Hamas conflict in 2006-07, laws in the West Bank and Gaza are approved by the Council of Ministers after three readings and forwarded to the President for signature and publication in the official gazette. This prior action was consistent with the business environment objective, addressing issues related to informality in the business sector in the West Bank and Gaza. According to the *Investment Climate Assessment* (page 20), two-thirds of informal entrepreneurs did not want their business or activity to be registered with the Ministry of National Economy, as they perceived "little benefit to registration." This prior action was aligned with the recommendation in the *Investment Climate Assessment* to promote formalization by informal firms --- "provide incentives for informal firms to formalize" (see Section 3.A).

- *Prior Action 6: The Ministry of National Economy would submit to the Council of Ministers amendments to the Law of Crafts and Industries of 1953, updating the three-tier system of approvals required for licensing businesses and the fee structure for licensing.* With the inactivity of the Palestinian Legislative Council following the Fatah-Hamas conflict in 2006-07, laws in the West Bank and Gaza are approved by the Council of Ministers after three readings and forwarded to the President for signature and publication in the official gazette. This prior action was consistent with the business environment objective, addressing constraints related to the legal and regulatory framework for business in the West Bank and Gaza. According to the *Investment Climate Assessment* (page 20), informal firms cited



"bureaucratic hurdles - such as time, fees, and paperwork" as disincentives to registration. This prior action was aligned with the recommendation in the *Investment Climate Assessment* to simplify business regulation --- "take on the secondary business regulation agenda, particularly in areas that simplify business regulation"(see Section 3.A).

- Prior Action 7: *The Ministry of National Economy would establish a movable assets registry, which would allow firms to secure loans and other financing by pledging movable assets as loan collateral.* Movable assets (equipment, inventory, and receivables) are typically used by business enterprises, especially small and medium-sized enterprises (SMEs) in developing countries, as the principal collateral for loans, rather than immovable assets (land, buildings) which many SMEs may not own. For the registry to become operational and effective, the Council of Ministers needed needed to pass the Law on Securing Rights to Movable Property and issue the Regulations on Securing Rights to Movable Property. This prior action was consistent with the business environment objective, addressing problems related to the drop-off in business activity in the West Bank and Gaza. According to the *Investment Climate Assessment* (page 23), access to finance was the highest constraint to business for informal entrepreneurs and the fifth-highest for formal firms. This prior action was aligned with the recommendation in the *Investment Climate Assessment* to support access to finance by small enterprises --- "support access to finance for micro and small enterprises" (see Section 3.A).
- In view of the determination by the *Investment Climate Assessment* that political instability was "the binding constraint in the Palestinian investment climate," it would appear that the three prior actions were not central to the principal problem in the investment climate. Rather, these prior actions were directed at secondary issues in the investment climate.

Relevance of Results Indicators

Results Indicators for the Objective to Improve the Transparency of Fiscal Transfers to Local Service Providers

- Three of four outcome indicators for the transparency objective went beyond measuring transparency to measuring bill payment, debt reduction, and cost reduction.
- Results Indicator 1: The "share of electricity purchased by local government units from the Israel Electricity Corporation to the electricity purchases paid by local government units to the Israel Electricity Corporation" would be a measure of the degree to which bill payments by local governments to the the transmission company and the power supplier had been increased.
- Results Indicator 2: The "accumulated debt of five local government units to the West Bank Water Department for bulk water purchases" would be a measure of the level in which debt owed to the bulk water supplier had been reduced.
- Results Indicator 3: The "average annual growth of total health referral cost" would be a measure of the extent to which the growth rate of medical referral costs had been cut.



- The fourth results indicator was a straight-forward measure of the degree transparency of public finances. Results Indicator 4: The "publication of three annual reports --- on the allocation of the Ministry of Local Government's capital budget to each local government unit, the revenue deduction by the Ministry of Finance and Planning from each local government unit; and the share of each local government unit in transportation fees collected by the Ministry of Finance and Planning" --- would provide evidence of efforts made by the government to increase the transparency of inter-governmental finances.

Results Indicators for the Objective to Improve the Business Environment

- Results Indicator 5: The "number of firms formally incorporated with the Companies Comptroller" would reflect the degree of achievement of the objective to improve one aspect of the business environment. Enterprise formalization refers to the process by which firms register and license their businesses and activities with the authorities, in compliance with business, tax, labor, social security, environmental and other laws. A friendly business environment would be conducive to enterprise formalization, with all of the latter's economic and commercial benefits (the ability of the formal firm to act as supplier to larger firms, eligibility to participate in public procurement, access to finance provided by formal institutions, better working conditions for workers, reduction in unfair competition posed to formal firms, and greater revenues for the government).
- Results Indicator 6: The "number of days, on average, to issue a business license and the fee to license an activity" would measure the reduction in time to obtain a business license and the reduction in licensing fees. These were effectively two indicators. A shorter time to obtain a license and lower cost to license an activity would help entrepreneurs to more readily start business ventures.
- Results Indicator 7: The "number of registration notices filed in the collateral registry" would signal the extent to which borrowers and lenders considered the registry useful to enhancing access to financing.

Adequacy of Macroeconomic Framework

The Program Document (page 11) determined that "with continued reform efforts by the Palestinian Authority and anticipated inflows of donor aid, the macroeconomic policy framework was adequate" for the program at appraisal in 2017. The economy rebounded from the 2014 war in Gaza with a real GDP growth rate of 3.5 percent in 2015, 4.1 percent in 2016, and an estimated 3.0 percent in 2017, driven by private consumption, financed by bank loans in the West Bank, and spurred by construction activity in Gaza. The fiscal position remained fragile, however, with constrained revenue collections (weak revenue administration in the West Bank and low tax effectiveness in Gaza) and poor expenditure composition (bloated wage bill and overly generous pensions) leading to a significant fiscal deficit, estimated at over 10 percent in 2017. With positive growth factors largely transitory (i.e., recovery from the war in Gaza) and a lack of private and public investment, the sustainability of the macroeconomic policy framework was at significant risk.

The West Bank and Gaza is not a member of the IMF.



Choice of Instrument

The development policy grant was an appropriate instrument for the provision of budget support. Constrained by a narrow domestic fiscal base, hampered by low domestic borrowing capacity, and lacking access to international capital markets, the West Bank and Gaza remained highly dependent on donors funds. The program provided US\$30 million at program effectiveness in 2017 and leveraged another US\$70.5 million from the Palestinian Recovery and Development Plan Multi-Donor Trust Fund for additional development assistance. To support the West Bank and Gaza, the Bank has historically tapped complementary financing from development partners through: (a) the Palestinian Recovery and Development Plan Multi-Donor Trust Fund, which provided budget support of US\$1.47 billion between 2008 and 2017; (b) the Partnership for Infrastructure Development Multi-Donor Trust Fund, which aims to improve the coverage, quality, and sustainability of infrastructure through financial and technical assistance in water, urban development, and energy; and (c) the Government of Norway's contributions, channeled through the Bank, which supports aid coordination and economic and sector work. The *ICR for the Series of Trust Fund Grants in the Amount of US\$1.47 Billion from the Palestinian Recovery and Development Plan Multi-Donor Trust Fund* (page 22), completed in July 2019, reported that operations under the trust fund, which aimed "to provide budget and development support for the Palestinian Authority's policy agenda as expressed in the PRDP," had also "achieved significant results" with the "strengthening of public institutions." The Ministry of Finance, the Higher Council for Public Procurement Policy, the Commission on Land and Water, and the Land Authority are cited as having made gains in institutional capacity building in areas including public financial management.

Rating

Substantial

4. Achievement of Objectives (Efficacy)

Objective 1

Objective

To improve the transparency of fiscal transfers to local service providers in West Bank and Gaza.

Rationale

Outcomes:

Three of four results indicator targets were achieved. Some of the indicators were outside the scope of the operation's stated objective of improving the transparency of fiscal transfers. The outcome was higher rates of payment for electricity purchases, reduced debt to the bulk water services provider, and a slower pace in the growth rate of medical referral costs. The fourth outcome target, which was more closely aligned to the transparency objective, was partially achieved.



- The share of electricity purchased by local government units from the Israel Electricity Corporation to the electricity purchases paid to the Israel Electricity Corporation rose from 86 percent in 2016 (baseline) to 95 percent in 2018, just short of the target of 100 percent. It could also be argued that the 100 percent target was "unrealistic", according to the ICR (page 20). The Palestinian Energy and Natural Resources Authority and the Palestinian Electricity Transmission Company Ltd., the transmission company which purchases electricity from the Israel Electricity Corporation, had made steady progress over the past years to raise the payment rate on electricity purchases by local government units, according to the ICR (page 21). The target is therefore considered to be achieved.
- The accumulated debt of five local government units to the West Bank Water Department for bulk water purchases was reduced from NIS 275 million at end-July 2017 to NIS 228 million at end-2019, meeting the target that the accumulated debt be reduced to under NIS 275 million. According to the ICR (page 21), there were early problems with some accounts. Some were not operational, others were dormant, and still, others were not segregated, permitting some local governments to draw from the accounts for purposes other than paying the water supplier. The Palestinian Authority intervened, conditioning the approval of local government budgets on their rescheduling water debts and committing to make full payments as bills became due.
- The average annual growth rate of total health referral costs was reduced from 14.5 percent over 2014-16 to 4.5 percent over 2017-19, meeting the target that average annual growth rate be reduced to under 14.5 percent. In addition to signing agreements with seven hospitals and two laboratories to contain costs (more than the six agreements required as a prior action) and publishing guidelines for referrals and protocols online, the Ministry of Health also piloted the use of a National Price Reference List to strengthen its purchasing capacity relative to at least five hospitals, according to the ICR (page 21). There was no target set for addressing the problem of unpaid bills to foreign health service providers.
- Two of three reports, that would have increased transparency with inter-governmental fiscal accounts, were published online: (a) the capital budget allocated by the Ministry of Local Government to each local government unit; and (b) the revenue deductions or "interceptions" by the Ministry of Finance from each local government unit. The third report was not yet publicly available at closing: an annex to the transportation fees report, showing the share of each local government unit. The target that all three reports be published is deemed partially achieved.

Rating
Substantial

Objective 2

Objective

To improve the business environment in West Bank and Gaza.

Rationale

Outcomes:



The first outcome target was not met the remaining two were met.

- The number of firms formally incorporated with the Companies Comptroller declined 0.2 percent by end-2019 from 1,783 firms in end-2016, failing to meet the target that the number increase by 15 percent from the baseline. The Companies Law was submitted to the Cabinet but had not been approved by program closing. Hence, any increase in the number of firms formally incorporated with the Companies Comptroller, even if it had been achieved, could not be attributed to the program activities. At the same time, the ICR (page 22) argues that there are many factors other than the mere existence of the Companies Law that could lead to more business registrations, including better economic conditions and prospects, a conducive business environment, incentives supporting formality over informality, the ease of licensing and inspection procedures, and a sound business tax regime, among others. Meanwhile, the Companies Law has been submitted to a public consultation process, and the expectation at project closing was that the law would be adopted by end-2020. The proposed law remained with the Council of Ministers at the time of this ICR Review.
- The number of days, on average, to issue a business license was reduced from 36 days in 2016 to 7 days in 2019, *de facto*, meeting the target to reduce the time to 15 days. The fee to license an activity was changed from Jordanian dinar (JD) 24-144 to JD 25, *de jure and de facto*, meeting the target that the fee be fixed at JD 25. Following the submission to the Cabinet of amendments to the Law of Crafts and Industries of 1953, the ICR (page 23) reports that the amendments had been subsequently adopted by the Cabinet and regulations to implement them have been issued. However, the number of business registrations at closing in 2019 declined from the baseline in 2016.
- The number of registration notices filed in the collateral registry rose from zero (the collateral registry did not exist in the baseline) to 397 by end-2019, higher than the target of 300 registration notices. Additional information supplied by the project team indicate that other critical elements of the movable collateral framework were activated with the passage of the Law on Securing Rights to Movable Property and the issuance of the Regulations on Securing Rights to Movable Property in 2016: (a) the conditions for the validity of a security interest were set in Articles 2 and 4 of the law; (b) the principle of priority over a security interest was established in Article 15; (c) the conditions for priority of security interest in different types of movable property were listed in Articles 16-23; (d) the process for publicizing interest in the movable asset of a borrower was described in Articles 24-27 and was to be determined through the registration of a notice in the collateral registry at the Ministry of National Economy; (e) direct or indirect possession of a movable property as a means of enforcing a lender's right was permitted under Article 9; and (f) the conditions for achieving possession of a movable property in the event of default were defined in Articles 15-19 of the regulations. The ICR (page 22) reports that the registry is being used by micro, small and medium enterprises (MSMEs), banks, leasing companies, and micro-finance institutions, but that an information campaign would raise greater awareness among borrowers of the availability of the facility.

Rating
Substantial



5. Outcome

The objectives of the operation were relevant to the priorities of the Palestinian Authority expressed in the *National Policy Agenda 2017-2022* and to the strategy of the Bank Group set in the *Assistance Strategy for FY18-21 for the West Bank and Gaza*. The relevance of design is assessed as substantial. The prior actions were consistent with the program objectives although, three of the four were outside the scope of the transparency objective as stated. The degree of achievement of the first objective to improve the transparency of fiscal transfers to local service providers in West Bank and Gaza is assessed as substantial. The degree of achievement of the second objective to improve the business environment in West Bank and Gaza is assessed as substantial. The outcome of the operation is rated as moderately satisfactory.

a. Outcome Rating

Moderately Satisfactory

6. Rationale for Risk to Development Outcome Rating

The risk to the sustainability of the development outcome is high, both with the goal of improving fiscal transparency and improving the business environment. Security, political, economic, institutional and social risks to private economic activity are high, requiring high rates of return on investment and, hence, rendering private investment scarce and economic and business activity difficult.

Security Risk. The West Bank and Gaza have continued to experience episodes of violence that, according to the ICR (page 7), "severely affect the prospects of economic growth and sustained poverty reduction." The ICR (page 7) lists these episodes in recent years as including: the the first intifada in 1987-93; the second intifada in 2000-05; the Fatah-Hamas conflict in 2007-08; the wars in Gaza in 2008-09, 2012, and 2014; and sporadic episodes of violence in Gaza since then.

Political Risk. The overall political risk is high, in both its external and internal dimensions. The high external political risk owes largely to the relations between the Palestinian Authority and Israel, which the ICR (page 7) notes as having "suffered from a lack of political dialogue and continuing tight restrictions on the Palestinian economy." The high internal political risk is due to the political fracture within the Palestinian political establishment between Fatah in the West Bank and Hamas in Gaza. According to the ICR (page 7), the poor relations between West Bank and Gaza is reflected in: a lack of firm vision on priority reforms, an uncertain stance on implementing reforms, and a lack of ownership of reforms.

Economic Risk: The West Bank and Gaza is highly dependent on external aid, but donor aid flows have been volatile, especially for budget support, and there is donor fatigue. Budgetary support from external donors fell from 27 percent of GDP in 2008 to under 4 percent of GDP in 2019, leaving the Palestinian Authority with large



financing gaps that have been filled with borrowing from banks and debt to the private sector. The accumulation of debt and arrears leads to fiscal instability and the recourse to domestic borrowing is detrimental to private sector activity, as government borrowing from banks crowds out private credit. The intractable external conflict and the internal fracture are the principal drivers of donor fatigue, with violence and instability testing the generosity of the international development community.

Institutional Risk: Fiduciary risk is an ongoing concern, and requires reforms with public financial management. A Bank operation, the Public Financial Management Improvement Project, aims to: improve budget expenditures management and control, improve financial accountability, and modernize public procurement.

Social Risk: Social risk is high and prevalent. According to the ICR (page 7), social risk arises from: the humanitarian catastrophe in Gaza, a sense of frustration among the population over external and internal political conflict, and the failure to hold elections in over a decade.

a. Risk to Development Outcome Rating
High

7. Assessment of Bank Performance

a. Quality-at-Entry

Policy reforms were informed by Bank analytic work found in: (a) the *Assessment and Action Plan to Improve Payment of Electricity Services in the Palestinian Territories: Study on Electricity Sector Contribution to Net Lending* (2014), which recommended improvements to cost recovery; (b) the *Securing Water for Development in West Bank and Gaza* (2018), which recommended critical infrastructure investments, efficiency improvements, and institutional reform to achieve water security; (c) the *West Bank and Gaza Health System Resiliency Strengthening Project* (2015), which recommended improvements in the management of medical referrals; (d) the *Public Expenditure Review of the Palestinian Authority: Towards Enhanced Public Finance Management and Improved Fiscal Sustainability* (2016), which advocated raising the quality and efficiency of public spending; and (e) the *Investment Climate Assessment of West Bank and Gaza - Fragmentation and Uncertainty* (2014), which recommended the harmonization, modernization, and improvement of the legal and regulatory framework for business activity in the West Bank and Gaza.

There were minor shortcomings with the quality an entry.

- Several outcome indicators were outside the scope of the transparency objective (see Sections 3.B and 7.A). . In effect, the *de facto* goals of this operation appeared to be bill payment, debt reduction, and cost reduction, implying that the objective "to improve the transparency of fiscal transfers to local service providers" was set too narrowly.



- The constraints and challenges to business activity and private enterprise development were clearly identified and extensively discussed in the *Investment Climate Assessment*, which the Program Document indicated provided the analytic underpinning for reforms supported by this operation. The *Investment Climate Assessment* also recommended sets of medium- and short-term actions to address these constraints. The Program Document (page 25) briefly referenced some of these recommendations. This ICR Review traces the origins of the prior actions in this operation to the recommendations in the *Investment Climate Assessment* (see Sections 3.A and 3.B).

Quality-at-Entry Rating Moderately Satisfactory

b. Quality of supervision

According to the ICR (page 25), supervision was performed by Bank economic and sector staff at the resident mission. The Bank supervision team prepared supervision reports that identified emerging problems and recommended courses of action. The Bank conducted continuous dialogue with development partners. The Bank prepared reports for the Ad-hoc Liaison Committee (AHLC), the body formed in 1993 to coordinate the delivery of international aid to Palestinians and the Palestinian Authority. Co-sponsored by the United States and the European Union, and chaired by Norway, the AHLC promotes policy dialogue among the Palestinian Authority, the Government of Israel, the United Nations, the World Bank, and the International Monetary Fund. Reports prepared by the Bank, together with the IMF, tracked progress with the reforms supported by this project and covered economic developments in the West Bank and Gaza.

Quality of Supervision Rating Satisfactory

Overall Bank Performance Rating Moderately Satisfactory

8. Assessment of Borrower Performance

a. Government Performance

The government was committed to the project objectives despite the difficult political and economic context.

- The Bank's *Doing Business 2019* publication (pages 28-29) cited the West Bank and Gaza for having "made the most noteworthy improvement in 2016/17" with strengthening access to credit "by adopting a secured transactions law in 2016 that establishes a modern collateral registry and allows a general description of present and future assets used as security interests. The new rules also establish priority for secured creditors outside insolvency and permit out-of-court



enforcement." According to the report (page 141), the "West Bank and Gaza strengthened access to credit by introducing a new secured transactions law and by setting up a new collateral registry. The new law implemented a functional secured transactions system. It allowed general description of single categories of assets and allowed a general description of debts and obligations. The collateral registry is operational, unified geographically, searchable by a debtor's unique identifier, modern and notice-based. The new law gave priority to secured creditors outside insolvency procedures and allowed out-of-court enforcement."

- The government maintained an ongoing dialogue with the Bank and other development partners.
- After submitting the draft Companies Law to the Cabinet in 2017, a prior action for this program, the government applied for and obtained technical assistance from the Bank to refine the draft law. In 2019, the government submitted to the Cabinet a stronger legislative proposal that: (a) provides legal certainty to the establishment and operation of companies; (b) enables online business registration; (c) facilitates the incorporation and operation of companies; (d) encourages the establishment of local SMEs and startups; (e) addresses the lack of clarity between the various company types; (f) regulates companies only to the extent necessary for the protection of stakeholders; (g) encourages investment by local and international investors; (h) and provides for transparency and accessibility of information on registered companies. This Companies Law is expected to be adopted by end 2020, according to the ICR (page 22).

There were moderate shortcomings with the government's performance.

- Structural reforms in the water sector lagged. Accumulated local government debt to the West Bank Water Department was reduced by the government imposing conditions on local government budgets (i.e. approving local government budgets only after the local governments rescheduled water debts and committed to make full payments on due amounts) rather than through systemic reforms.
- The third of three reports on inter-governmental finances was yet to be made public at the program closing date.

Government Performance Rating

Satisfactory

b. Implementing Agency Performance

The Ministry of Finance was the implementing agency of this operation. It oversaw the implementation of reforms supported by this operation. The Ministry was also responsible for several reform measures related to financial management, including the publication of financial reports.

The Ministry of National Economy, tasked with submission of the new Companies Law, establishment of the movable collateral registry, and amendments to the Law of Crafts and Industries, delivered on these actions. The Ministry of Health, responsible for developing the framework for health referral services, also delivered on this action.



Implementing Agency Performance Rating

Satisfactory

Overall Borrower Performance Rating

Satisfactory

9. M&E Design, Implementation, & Utilization

a. M&E Design

There were problems with the choice of indicators for the objective to improve the transparency of fiscal transfers to local service providers. They were broader than needed for the transparency objective (see Sections 3.B and 7.A).

According to the ICR, the indicators were to be also used to determine disbursements of additional financing from the Palestinian Recovery and Development Plan Trust Fund. This arrangement had the effect of extracting additional leverage on the government to implement the reform program supported by this operation.

b. M&E Implementation

According to the ICR (page 18), the government prepared quarterly reports to monitor progress of the operation.

The government transferred the responsibility for policy reform and aid coordination from the Ministry of Finance and Planning to the Office of the Prime Minister. According to the project team, this was a positive development. The Office of the Prime Minister exercises strategic oversight over all line ministries. The Office of the Prime Minister facilitated dialogue on reforms that were multi-sector by nature and involved multiple agencies.

c. M&E Utilization

According to the ICR (page 18), the M&E data were useful to design the next set of policy reforms in the West Bank and Gaza. The Strengthening Fiscal Resilience and Business Environment Development Policy Grant, approved in February 2019, targeted additional reforms in inter-governmental fiscal relations, electricity and water payments, and the business environment.

M&E Quality Rating



Substantial

10. Other Issues

a. Environmental and Social Effects

Environmental Effects: The PD (pages 28-29) determined that the actions which aimed to improve transparency of fiscal transfers to local service providers were not likely to have any direct or indirect environmental impacts. The actions which aimed to improve the business environment, however, might have environmental effects. To mitigate these effects, the business licensing procedures would have to follow existing regulations in the West Bank and Gaza related to health, safety and the environment. The PD noted that the government had an environmental regulatory framework that would govern the assessment and mitigation of environmental risks associated with the issuance of business licenses and activity permits. The PD also noted that the "formalization" of businesses would have a positive environmental effect as it would bring previously-informal businesses within the ambit of formal health, safety, and environmental regulation. The ICR did not discuss the environmental impacts of the operation during or after implementation or whether or not the *ex ante* risks were realized.

Social Effects: The PD (page 28) noted that actions to improve the business environment would have positive social effects. The expected outcomes of the prior actions --- more formal business formation and greater use by MSMEs of the collateral registry --- could potentially generate more economic activity, more employment, especially by previously-informal firms and by MSMEs, and hence foster more inclusive economic growth. Moreover, the actions aimed at improving the transparency of fiscal transfers to local service providers, including by reforming the medical services referral system, would not have negative but potentially positive social effects. The ICR did not discuss the social impacts of the operation during or after implementation.

b. Fiduciary Compliance

Procurement: There was no discussion of procurement activities related to the program in the PD or the ICR.

Financial Management: There was no discussion of financial management activities related to the program in the PD or the ICR, although the ICR (page 24) mentions that fiduciary risks are high in the West Bank and Gaza.

c. Unintended impacts (Positive or Negative)



d. Other

11. Ratings

Ratings	ICR	IEG	Reason for Disagreements/Comment
Outcome	Moderately Satisfactory	Moderately Satisfactory	The ICR treated the PDO as a single objective and rated its efficacy as Substantial, with four of seven outcome targets met. This ICR Review parsed the PDO into two objectives, rated the efficacy of both as Substantial.
Risk to Development Outcome	High	High	---
Bank Performance	Moderately Satisfactory	Moderately Satisfactory	---
Borrower Performance	Moderately Satisfactory	Satisfactory	---
Quality of ICR		Substantial	---

Note

When insufficient information is provided by the Bank for IEG to arrive at a clear rating, IEG will downgrade the relevant ratings as warranted beginning July 1, 2006.

The "Reason for Disagreement/Comments" column could cross-reference other sections of the ICR Review, as appropriate.

12. Lessons

Three lessons are drawn from the ICR (pages 27-28), with some adaptation. The first two lessons are highly specific to future institutional and policy reforms programs in the West Bank and Gaza. The third is applicable to other countries in fragility, violence, and conflict (FCV) settings.

Development policy operations in the West Bank and Gaza should continue to focus on critical reform areas but keep prior actions parsimonious. This operation supported the promotion of fiscal transparency and the improvement of the business climate. The prior actions were simple --- the opening of separate banks accounts to collect and transmit payments of electricity and water bills to the utility companies, the agreement with hospitals to rationalize medical referrals and healthcare services, the submission of draft laws on companies and business registrations, and the creation of a movable assets registry. Enactment of the draft laws was not required as a prior action for the effectiveness of operation, but the causal chain implied that the draft laws would have to be subsequently passed to achieve the target outcomes for business formation and registration. While the parsimony of prior actions is justified in the light of the high-risk environment in the West



Bank and Gaza, the prior actions must focus on addressing clearly identified and significant binding constraints and reflect a realistic timetable for the adoption of any proposed legislation, taking into consideration the need for public consultations.

The World Bank should support more ambitious reform objectives in the West Bank and Gaza. Keeping prior actions in reform programs in the West Bank and Gaza simple and parsimonious does not mean that reform objectives should be less ambitious than needful. In this operation, the first objective was framed in terms of improving the transparency of fiscal transfers. The outcomes, however, were defined in terms of updating payments to the Israel Electric Corporation, reducing arrears to the West Bank Water Department, and cutting the costs of medical referral services to external healthcare providers. These outcomes, the targets of which were achieved by this operation, could have been associated with more ambitious fiscal objectives including rationalizing fiscal expenditures and reducing arrears and debt. Such objectives are critical to fiscal consolidation --- revenue mobilization, expenditure control, and debt reduction --- in view of declining donor budgetary support in the West Bank and Gaza.

As in other FCV areas, reforms in the West Bank and Gaza should continue to emphasize institutional capacity building. In this operation, the Ministry of Finance and Planning and the Ministry of Local Government were supported to produce and publish reports on inter-governmental fiscal transfers. The Ministry was supported in negotiating medical referral services with the costliest hospitals. In FCV settings, where institutions are not well developed, these interventions are crucial to advancing development objectives and are generally complementary to budget support operations.

13. Assessment Recommended?

No

14. Comments on Quality of ICR

The ICR offers a candid assessment of the degree of achievement of each of the outcome targets.

The ICR (pages 20-21) argues that the creation of bank accounts for electricity payments to the Israel Electricity Corporation and water payments to the West Bank Water Department, while providing the mechanism by which payments would be made by local governments to the utilities, would not necessarily ensure payments by electricity consumers. Similarly, the ICR (pages 22-23) argues, submitting to the Cabinet a draft Companies Law and draft amendments to the Law of Crafts and Industries, while providing the necessary legal and regulatory framework for business formation and formal registration when the laws were enacted, but would not, by itself, constitute a sufficient condition for more business formation and registration.

The ICR (pages 24-25) provides a substantive assessment of the risks to the sustainability of the development outcomes of this operation. The risk assessment --- covering external and internal political risks,



macroeconomic risk, social risk, and institutional risk --- offers a credible justification for the Bank and the Palestinian Authority having kept the program design simple and the prior actions parsimonious.

a. Quality of ICR Rating
Substantial