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Economic Monitoring Report to the Ad Hoc Liaison Committee

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ACRONYMS

AHLC	Ad Hoc Liaison Committee
AML/CFT	Anti-Money Laundering and Combating Financing of Terrorism
BBB	Building Back Better
CBRs	Correspondent Banking Relationships
CCS	Commitment control system
DFID	Department for International Development
DSL	Digital Subscriber Line
FATF	Financial Action Task Force
FCV	Fragility, Conflict and Violence
GDP	Gross Domestic Product
GEDCO	Gaza Electricity Distribution Company
GoI	Government of Israel
GNI	Gross National Income
GPP	Gaza Power Plant
GRM	Gaza Reconstruction Mechanism
ICT	Information and Communication Technology
HCPPP	High Council for Public Procurement Policies
IEC	Israel Electricity Company
ITU	International Telecommunication Union
JDECO	Jerusalem District Electricity Company
LGUs	Local Government Units
LCOE	Levelized cost of energy
MENA	Middle East and North Africa
MENAFATF	Middle East and North Africa Financial Action Task Force
MoF	Ministry of Finance
MTIT	Ministry of Telecommunications and Information Technology
MHPSS	Mental Health and Psychosocial Support Services
MOE	Ministry of Education
MSME	Micro, small and medium size enterprises
MW	Megawatt
NEDCO	Northern Electricity Distribution Company
NPL	Non-Performing Loans
NWC	National Water Company
PA	Palestinian Authority
PalTel	Palestine Telecommunications Company
PETL	Palestinian Electricity Transmission Company
PCBS	Palestinian Central Bureau of Statistics
PENRA	Palestinian Energy and Natural Resources Authority
PFM	Public Financial Management
PMA	Palestine Monetary Authority
PPA	Power Purchase Agreement
PPP	Purchasing Power Parity
PWA	Palestinian Water Authority
RDNA	Rapid Damage and Needs Assessment
RWU	Regional Water Utilities
SBD	Standard Bidding Documents
SMEs	Small and Medium Enterprises
TFP	Total Factor Productivity
UNRWA	United Nations Relief and Works Agency for Palestine Refugees in the Near East
VAT	Value Added Tax
VLP	Virtual Landing Point
WHO	World Health Organization
WRC	World Radiocommunications Conference

Executive Summary

- 1. The Palestinian economy has started its recovery in 2021 as COVID-related measures have been eased, but sustainable sources of growth going forward remain limited.** Given the decline in the daily number of new COVID-19 cases, lockdowns have been significantly eased in 2021. This combined with the pickup of the vaccination campaign allowed consumer confidence to slowly pick up and business activity to gradually rebound. The economy is estimated to have grown by 5.4 percent, in real terms, in the first half (H1) of 2021, year-on-year. The improved economic performance was fully driven by the West Bank economy while Gaza's economy remained almost stagnant in H1 2021 due to the 11-day conflict in May. Growth is expected to further pick up throughout the remainder of the year and reach 6 percent in 2021 as the West Bank economy continues to regain more of what was lost during 2020 and with the implementation of some Israeli confidence building measures supporting economic activity and facilitating reconstruction in Gaza. In the following years, growth is expected to hover around 3 percent as the low base effect weakens and as sources of growth remain limited given the ongoing restrictions on movement, access and trade.
- 2. Unemployment remained stubbornly high in 2021, mainly driven by Gaza.** The unemployment rate in the Palestinian territories reached 26.4 percent in the second quarter of 2021: 16.9 percent in the West Bank and 44.7 percent in Gaza, reflecting the particularly difficult economic situation in the Strip due to the effect of the 11-day conflict and the ongoing restrictions. The extremely high unemployment rate in Gaza comes hand-in-hand with deteriorating social conditions in the Strip. Estimates by the World Bank indicate that the recent conflict has pushed poverty in Gaza to 59.3 percent in 2021 (using US\$5.50 a day (2011 PPP) international poverty line). This is 2.3 percentage points higher than the COVID-19 induced peak in 2020, and a 16.3 percentage point increase above the 2016-2017 values (latest available official data).
- 3. In spite of significant increases in fiscal revenues, the fiscal situation remains fragile due to high public spending and very low external financing.** The Palestinian Authority (PA)'s revenues grew by 18 percent in the first eight months of 2021, year-on-year, driven by an improvement in economic activity. Public spending also grew by 18 percent mainly due to an increase in the wage bill following the PA's decision to reinstate the wages of public employees in Gaza to 100 percent in March 2021, up from 70 percent in the past several years. Assuming those trends continue for the remainder of the year and accounting for the Government of Israel (GoI)'s decision to increase its monthly revenue deductions, the PA's deficit is expected to reach US\$1.69 billion in 2021. Donor financing is projected to amount to US\$184 million—38 percent of what was received in 2020. An advance payment on clearance revenues in the amount of US\$153 million (NIS500 million) provided by the GoI in September 2021 has provided some relief and combined with identified aid, it is expected to reduce the financing need to US\$1.36 billion. Efforts by all parties are critical to avoid a crisis as without additional financing, the PA may encounter difficulties in meeting its recurrent commitments towards the end of the year.
- 4. To address the challenging financial situation, PA efforts alone will not be enough.** Domestic bank borrowing already exceeds the limit set by the Palestine Monetary Authority (PMA), eliminating this financing option going forward. Hence, the PA may be forced to accumulate additional arrears to the private sector, pulling away more liquidity from the market. This will have a drastic impact on the economy and will eventually further reduce revenue generation. Development partners' support is required to secure additional funds and raise budget support which is already very low and would only make a partial contribution to the gap. Support from new partners, in addition to support from the traditional donor group, is critical for closing the financing gap. Beyond the immediate priorities, the PA needs to advance the structural reform agenda. Reforms should continue to focus on improving revenues, rationalizing spending and strengthening governance, including the PFM system. PA reforms should also focus on providing a more conducive environment for the development of the private sector. In this area, the recent signature

by the President of the new companies' law and the telecoms law are critical steps in the right direction.

5. **Also, the GoI can play an important role through addressing some of the fiscal leakages that remain outstanding.** Among other things, establishing a mechanism to electronically link the Israeli and Palestinian VAT systems and renegotiating the 3 percent handling fee charged by the GoI to handle Palestinian imports would be useful. Recent news about an understanding reached between the GoI and the PA to implement an E-VAT system in December 2021 is encouraging.
6. **Financial sector risks have increased due to the prolonged negative economic impact of the COVID-19 pandemic, the continued exposure to the PA's fragile fiscal situation, and limited portfolio diversification.** PA borrowing exceeded US\$2 billion during 2020, reaching US\$2.5 billion as of August 2021 (23 percent of total direct credit). Moreover, an indirect additional exposure to the PA are the public sector employees' accounts, which combined represent US\$4 billion, or 40 percent of total banking sector credits. The Non-Performing Loans (NPLs) ratio increased to 4.2 percent as of June 30, 2021. Overall, the NPLs concentration, and expected further deterioration in the quality of small and medium Enterprises (SME), consumer, and Gaza loan portfolios could translate into an additional increase in NPLs.
7. **Strong and sound prudential regulations and supervision framework is critical to ensure and safeguard the stability of the financial system.** Particular attention should be given to the mutual interdependence between the fiscal imbalances and the stability of the financial sector in a context of limited policy tools that are normally available to modern economies, but not for the PA. Respect for the independence of the PMA, as supervisor and prudential regulator of the banking system in the West Bank and Gaza, is a critical pillar of a stable financial framework. In addition, ensuring the stability of cross-border payments should remain a priority policy goal for both the PMA and the PA. Due to the highly interlinked banking systems, the Palestinian economy can potentially be severely impacted by the cessation of correspondent banking relationships (CBRs). In this regard, conducting an evaluation of the existing regulatory arrangements by the Middle East and North Africa Financial Action Task Force (MENAFATF), initially planned for 2020 and postponed to the second half of 2022, should remain a short-term priority.
8. **The report shows that the external restrictions on Gaza resulted in a closed economy.** The most recent available data shows that since 1994, Gaza's compounded annual growth rate was only 1 percent, resulting in a dramatic decline of the contribution of Gaza's economy to the Palestinian economy from 36 percent in 1994 to 18 percent currently. As a result, the Gaza GNI per capita is now less than a third of the West Bank's, whereas in 1994 it represented 87 percent. Moreover, unemployment and poverty indicators have deteriorated systematically. According to UNRWA, 80 percent of the population in Gaza is dependent on international assistance. Aid and remittances are almost the only source of foreign exchange inflows that drive consumption in Gaza. Restrictions on access and movement in and out of Gaza for people and goods explain the decline in tradable activities, one of the main sources of growth for a small economy. Therefore, the physical connectivity of the Gazan economy is limited, and transport logistics activities are costly and unreliable due to the numerous controls and the deteriorated transport infrastructure.
9. **The structure of Gaza's GDP has regressed toward low productivity activities and drivers of growth have all but disappeared.** Gaza's economy has undergone a deindustrialization and the economy has become highly dependent on transfers from outside, weakening its economic prospects. The productive base of the economy has been eroded with the combined size of the manufacturing and agriculture sectors falling from 27 percent of GDP in 1994 to 17 percent today. Even the services sector has reduced its share in the economy, and only the public administration has increased its share in GDP. Gaza's investment-to-GDP ratio has declined and real capital stock in Gaza declined by 20 percent from 1994-2020. Finally, while Total Factor Productivity (TFP) has contributed to growth in the West Bank, in Gaza the TFP contribution to growth has fallen by about 0.6 percent per annum from 1997-2020.

- 10. This AHLC report argues that the declining trajectory of the Gazan economy and the deterioration of the quality of life for the Gazan population can and should be reversed.** To achieve this goal, first, a constructive dialogue and cooperation between the Government of Israel and the Palestinian Authority is necessary. Second, coordination between the Palestinian Authority and the international community to support the implementation of the priorities and actions identified in this report, should be ensured. Third, a short-term priority is to address the needs that were identified in the recently concluded Rapid Damages and Needs Assessment report published jointly by the European Union, the United Nations, and the World Bank.¹
- 11. The report recommends focusing, on medium- and longer-term measures, to revert Gaza's declining development trajectory.** First, to restore the growth drivers, connectivity to the West Bank economy, the regional markets, and beyond, the current trade-related restrictions should be reviewed to facilitate trade, movement of people, and promote business sector. Second, basic infrastructure, in particular, continuous energy supply, high-quality water, and wastewater services, and in the modern world, a digital economy infrastructure, are needed to create an enabling environment for private sector-led growth. Third, to contribute to economic growth, and the development of the private sector and job creation, municipalities in Gaza need to be connected, offer reliable services and infrastructure, attract investment, and be responsive and resilient to shocks. Finally, ultimately, investment in human capital is critical. Today, three out of four Gazan graduates have no employment prospects. Employers, on the other hand, declare that workers lack relevant digital, language, and soft skills. As a result, in the next five years, both the skills conveyed through tertiary education and labor market opportunities for graduates need to be strengthened. While these recommendations do not tackle all the development pillars that need to be addressed to reverse the current declining development trajectory of Gaza, they are critical conditions to drive change.
- 12. The main body of the report is organized in two chapters and one supporting annex.** Chapter I focuses on recent economic developments in the real, fiscal, and banking sectors, while providing a near-term outlook that highlights critical challenges facing the Palestinian economy. Chapter II looks at Gaza's economic performance over the past two decades. It looks at the economic and social impact of the 11-day conflict. The chapter analyses key sectors in Gaza and presents recommendations on how to address infrastructure and development needs to reverse the declining development trajectory and on how to create conditions for a sustainable path to recovery and economic and social development.

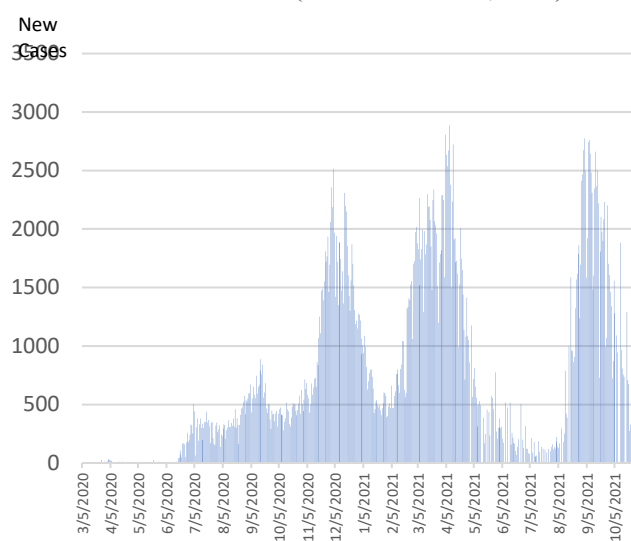
¹ See World Bank: The Gaza 2021 Rapid Damage and Needs Assessment- June 2021, <https://www.worldbank.org/en/country/westbankandgaza/publication/the-gaza-2021-rapid-damage-and-needs-assessment-june-2021>

CHAPTER I: RECENT ECONOMIC DEVELOPMENTS

1. Economic Activity

- 14. As COVID-19 related lockdowns were eased during the first half (H1) of 2021, economic activity in the Palestinian territories picked up during this period.** Given the decline in the daily number of new COVID-19 cases, especially in the second quarter (Q2) of 2021, lockdowns have been significantly eased. This combined with the pickup of the vaccination campaign allowed consumer confidence to slowly pick up and business activity to gradually rebound. According to data published by the Palestine Central Bureau of Statistics (PCBS), real Gross Domestic Product (GDP) of the Palestinian economy grew by 5.4 percent in H1 2021, year-on-year (y-o-y).

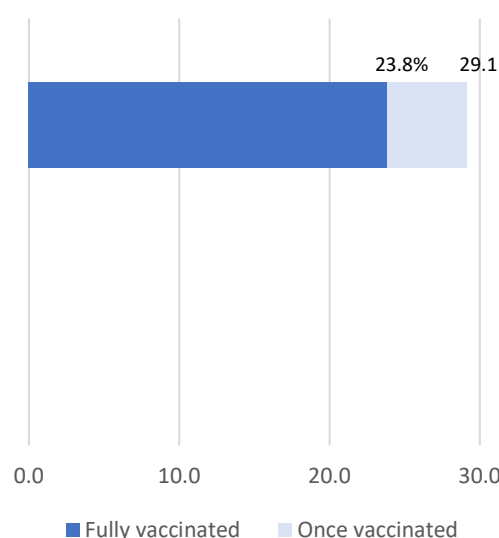
Figure 2: New daily number of COVID-19 cases, Palestinian territories (as of October 26, 2021)



Source :

<https://ourworldindata.org/coronavirus/country/palestine#confirmed-cases>

Figure 1: Percentage of vaccinated population, Palestinian territories (as of October 21, 2021)



Source:

<https://who18.createandsend.com/campaigns/reports/viewCampaign.aspx?d=j&c=99FA4938D049E3A8&ID=EC45861661DC52CD2540EF23F30FEDED&temp=False&tx=0&source=Report>

- 15. The improved economic performance in H1 2021 was fully driven by the West Bank economy while Gaza's economy remained almost stagnant.** The West Bank grew by 6.5 percent in H1 2021, y-o-y, mostly driven by consumption due to the ease of COVID-related measures, a significant increase in public spending, and an increase in the number of Palestinians working in Israel and the settlements from 125 thousand in 2020 to 146 thousand in Q2 2021.² The average daily wage of these workers is NIS265-- twice the average daily wage in the West Bank, implying a larger impact on demand. In Gaza, the conflict that took place in May 2021 negatively impacted economic activity and is estimated to have destroyed 2 percent of Gaza's capital stock. Despite an increase in public spending in Gaza and initial reconstructions efforts, Gaza's real GDP growth is estimated at a mere 0.3 percent in H1 2021, y-o-y.
- 16. Inflation in the Palestinian territories has turned positive in 2021, reflecting a gradual increase in demand.** Growth in consumer prices had been modest prior to the outbreak of COVID-19, where prices generally moved in the 1-2 percent range. However, in April 2020, growth in prices turned negative and continued this trend throughout the year. In total, prices in 2020 were 0.7 percent lower

² According the PCBS Q2 2021 LFS.

than in 2019, reflecting weak demand by consumers. In 2021, consumer prices have started to gradually increase and by September, they were 1.72 percent higher than in September 2020 - reflecting a pickup in demand.

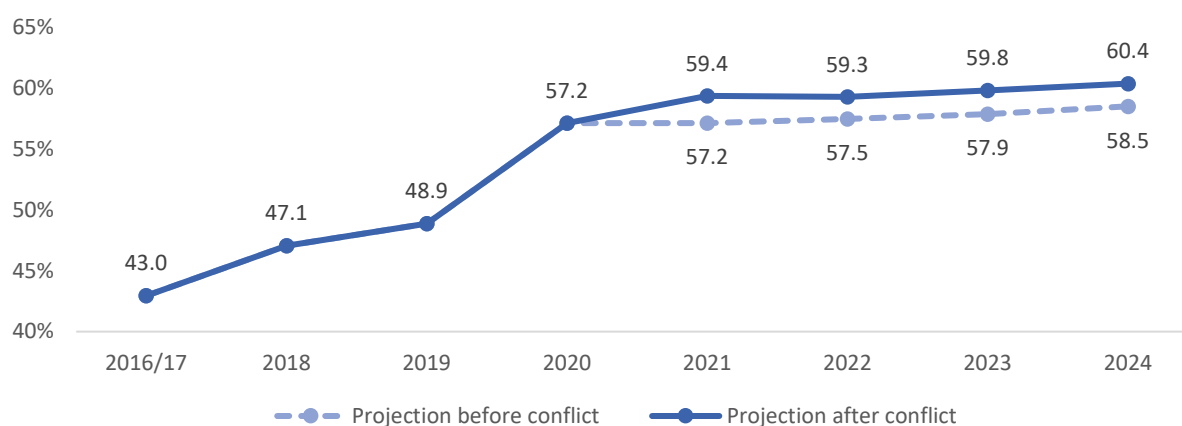
Table 1: Labor Market Statistics, Palestinian territories, Q2 2021

Indicator (%)	West Bank	Gaza	Palestinian territories
Unemployment rate	16.9	44.7	26.4
Labor force participation rate	45.5	38.3	42.7
Youth unemployment (15-29 yrs)	25.8	61.9	39.0
Male	21.2	56.3	33.3
Female	47.4	79.4	61.5

Source: Palestine Central Bureau of Statistics.

- 17. The unemployment rate has remained stubbornly high in 2021.** After the breakout of COVID-19 in the Palestinian territories in March 2020, the unemployment rate started to increase given the restrictions on economic activity and the loss of Palestinian jobs in the Israeli market. The unemployment rate peaked at 28.3 percent in Q3 2020 until it slightly eased toward the end of the year, reaching 23.4 percent in Q4 2020. Even though the lockdowns were eased in 2021, the unemployment rate increased and reached 26.4 percent in Q2 2021 in the Palestinian territories. The increase could be explained by a 1.9 percentage point rise in the participation rate as a higher number of men and women were encouraged to join the labor market with the improvement in economic conditions. The overall rate masks a wide regional divergence whereby unemployment in the West Bank reached 16.9 percent in Q2 2021 while in Gaza it was 44.7 percent, reflecting the effect of the 11-day conflict compounded with worsening COVID-19 conditions.
- 18. Poverty has been adversely affected by slow growth over the past few years and the pandemic during 2020.** Based on the latest available official data, 22 percent of Palestinians lived below the US\$5.5 2011 PPP a day poverty line in 2016/17. In the West Bank, poverty rates are lower but sensitive to shocks in household expenditures, while in Gaza any change in social assistance flows can significantly affect the population's wellbeing. Projections based on GDP per capita growth suggest that the poverty rate has been constantly increasing since 2016, reaching 28.9 percent in 2020, a significant increase of 7 percentage points in the past four years. This represents approximately 1.4 million people living in poverty in 2020. The recent conflict in Gaza has resulted in worse social conditions in the Strip. Bank estimates suggest that the conflict has pushed poverty in Gaza to 59.3 percent in 2021 (using US\$5.50 a day (2011 PPP) international poverty line). This is a 16.3 percentage point increase above the 2016-2017 values.

Figure 3: Gaza - Projected poverty rates 2016/17 - 2024



Source: MTI, GMD, and WB staff calculations.

- 19. The near-term economic outlook for the Palestinian territories shows signs of recovery but sustainable sources of growth remain limited going forward.** Following a strong performance in H1, the Palestinian economy is expected to continue to grow during the remainder of the year and regain more of what was lost during 2020 due to the pandemic. In the West Bank, growth is expected to reach 6.7 percent in 2021 driven by a continued easing of the lockdown measures and progress in the vaccination campaign. In Gaza, the implementation of some confidence building measures by the GoI including granting 10 thousand Gazans trade permits to Israel, widening the fishing zone, and easing some restrictions on exports while allowing some construction material to come in to enable reconstruction after the last conflict are all expected to push growth in Gaza to around 3 percent in 2021. In total, the Palestinian economy is projected to grow by 6 percent in 2021. In the following years, growth is expected to hover around 3 percent as the low base effect weakens and as sources of growth remain limited given the ongoing restrictions on movement, access and trade.

2. Public Finance

a) Fiscal Performance January-August 2021

- 20. The easing of COVID-19 related lockdowns in 2021 and the subsequent economic improvement have resulted in a significant boost to public revenues.** According to data published by the Ministry of Finance (MoF), domestic tax collections grew by 28 percent in the first eight months of 2021, year-on-year. The increase was driven by income tax and VAT which grew by 13 and 14 percent, respectively, following the increase in economic activity. Domestic customs collected on used cars also increased by 79 percent as consumers that had delayed such purchases in 2020, given the closures and the perceived uncertainty, proceeded in 2021. Also, excise on tobacco increased by 24 percent in the first eight months of 2021, year-on-year, as the closure of the border with Jordan eliminated tobacco smuggling, resulting in higher public revenues. Non-tax revenues also grew significantly due to a 46 percent increase in domestic fees and charges following the receipt of around NIS110 million in license payments from telecoms providers. On the other hand, investment profits declined by 96 percent as the PA barely received any investment profits

from the Palestine Investment Fund in the first half of 2021, compared to NIS42 million in the same period of 2020.

- 21. Clearance revenue transfers stabilized, and further increased in the first eight months of 2021 by 15 percent, year-on-year, despite higher deductions by the GoI.** The GoI increased monthly deductions from NIS42 million to NIS50 million, since April 2021, to account for some of the payments made by the PA to Palestinian prisoners in Israeli prisons, ex-prisoners, and families of those deceased as a result of violence. Deductions were further increased to NIS100 million in August 2021 to offset payments made by the PA in 2020 and not deducted by the GoI. Despite the additional unilateral deductions, clearance revenues' growth in the first eight months of 2021 remained strong. It was mainly attributed to a 24 percent growth in customs collections due to Palestinian importers purchasing three months' worth of stock of raw tobacco from third countries in May, to avoid any future import delays related to the GoI changing its tobacco packaging laws. Some of this increase, hence, is expected to be offset in future months. Petroleum excise also increased by 8 percent due to higher imported quantities compared to the same period in the previous year in line with the rebound in economic activity. Notably, income tax collected by the GoI from Palestinian workers in Israel and the settlements increased by 23 percent and amounted to NIS60 million in the first eight months of 2021, reflecting a decision by the GoI to increase the number of work permits granted to Palestinians.
- 22. Public spending increased by 18 percent in the first eight months of 2021, year-on-year.** The increase was mainly driven by a 16 percent increase in the wage bill due to the PA's decision to reinstate the wages of public employees in Gaza to 100 percent in March 2021, up from 70 percent in the past several years. Spending on goods and services also increased by 77 percent in the first eight months of 2021, reflecting additional expenses associated with the regular return of public employees to their duty stations and to normal working hours compared to the same period in 2020, in addition to higher spending on vaccines and medical supplies. Net lending also increased by 121 percent indicating the urgent need for significant reform in the intergovernmental fiscal transfer system. On the other hand, transfers declined by 11 percent as the PA only disbursed one payment through the National Cash Transfer system compared to three or four payments in previous years.
- 23. Despite the impressive revenue performance, financing was very tight in the first eight months of 2021 due to high public spending and very low external support.** The total deficit amounted to US\$803 million in the first eight months of 2021 – a 13 percent increase year-on-year.³ Donor financing was US\$99 million (US\$31 million in budget support and US\$68 million for investment projects). Budget support was only 10 percent of what was received during the same period last year. This drop is attributed to the absence of funding from GCC countries, lower contributions by donor countries to the World Bank's Multi Donor Trust Fund, and a delay in the European Union (EU)'s contribution, which is now expected to be fully disbursed in 2022. Given the decline in external financing, the PA faced a large financing gap of US\$704 million in the first eight months of 2021. To finance this, the PA relied on arrears to the private sector and the pension fund and on domestic borrowing. Even though comprehensive data on arrears is not available, estimates suggest that the stock of arrears to the private sector accumulated over the years now amounts to US\$923 million. The stock of domestic debt increased from US\$2.3 billion as of December 2020 to US\$2.5 billion as of August 2021.
- b) Fiscal Forecast*
- 24. The financing situation is expected to remain very tight, and higher deductions from clearance revenues will add further strain.** Assuming that the lockdown measures remain eased allowing

³ The increase is calculated in NIS terms to avoid the impact of the USD/NIS exchange rate.

further revenue generation, and the PA's spending is maintained at the same level it was in the first eight months of 2021, the PA's deficit is expected to be US\$1.69 billion. Donor financing is projected to amount to US\$184 million: US\$83 million in budget support and US\$101 million in investment project financing. This is only 38 percent of what was received in 2020. An advance payment on clearance revenues in the amount of US\$153 million (NIS500 million) provided by the GoI in September 2021 has provided some relief and combined with identified aid, it is expected to reduce the financing need to US\$1.36 billion. The projected gap remains very large and additional efforts by all the parties are key to avoid a crisis as without additional financing, the PA may encounter difficulties in meeting its recurrent commitments towards the end of the year.

Table 2: The PA's Finances, 2021 Projections

US\$ million	2021 proj.
Revenues	3,709
Tax revenues	975
Nontax revenues	365
Net clearance revenues	2,548
Gross clearance revenues	2,758
Deductions	210
Tax Refunds	179
Expenditure	5,141
Wage bill	2,376
Social contributions	224
Use of goods and services	896
Transfers	1,166
Minor capital	29
Interest	77
Net lending	375
Recurrent balance	-1,433
Development expenditure	260
Total balance	-1,693
Financing	1,693
Budget support	83
Development financing	101
Clearance revenue advance	153
Gap	1,355

Source: Palestinian Authority Ministry of Finance, and WB staff calculations.

- 25. Actions by the PA alone will not be enough to cover the fiscal needs, especially since domestic bank borrowing has already exceeded the permissible limit set by the PMA.** Hence, the PA may be forced to accumulate additional arrears to the private sector, pulling away more liquidity from the market. This will have a drastic impact on the economy and will eventually further reduce revenue generation.
- 26. Working diligently with development partners would help the PA secure additional funds and raise budget support.** Budget support already identified from traditional donors is very low and would only make a partial contribution to the gap. Substantial increases in support from outside this group will be important if the donor community is to make a significant contribution to closing the financing gap.
- 27. Cooperation by the GoI is key for bridging the financing gap.** The GoI can play an important role through providing financial support by addressing some of the fiscal leakages that remain outstanding. Under the 1995 interim agreement, the Israeli civil administration is expected to collect revenues from businesses operating in Area C and remit them to the PA.⁴ Even though the Israeli

⁴ See Annex III, Appendix I, Article 8, Paragraph 2 (a), 2(b) and Article 18, Paragraph (4) of the Interim Agreement on the West Bank and the Gaza Strip, Washington, D.C., September 28, 1995 (the Interim Agreement).

civil administration collects these funds, they have not been transferred to the PA. Further, the PA reports that the GoI currently retains Allenby Bridge⁵ exit fees that should be transferred to the PA according to the Paris Protocol.⁶ Releasing some of these funds would provide much needed quick financing in these difficult times.

- 28. In the medium term, cooperation by the GoI to implement institutional measures to reduce fiscal leakages would significantly help the PA's finances become more sustainable.** Required actions include putting in place a mechanism to electronically link the VAT systems of both authorities to exchange real-time information on all purchases being made. This will inform each tax authority about the actual amount of VAT paid by its registered businesses rather than what was reported to it, and hence reduce fiscal leakages. Recent news on the parties reaching an understanding to implement an E-VAT system in December 2021 is encouraging. Furthermore, renegotiating the 3 percent handling fee charged by the GoI to handle Palestinian imports could further mitigate the PA's trade-related fiscal losses as this fee is considered extremely high.⁷
- 29. If the external parties cannot collectively provide the necessary resources, the PA will be forced to severely cut spending, impacting basic service delivery and the performance of the economy.** Lack of additional financing would force the PA to scale back on some of its medical and social expenditures in response to the COVID-19 pandemic, exacerbating the health situation. It may also result in the PA reducing wage payments, as it has done in the past. Neither option is desirable and will have severe implications for both the livelihoods of vulnerable households, and the speed with which the economy will emerge from the pandemic. The extent of the economic malaise that results would increase the demands for future support but could also raise broader security and operational challenges.
- 30. Beyond the immediate priorities, it is important to note that efforts should be exerted by the PA to place the fiscal stance on a more sustainable path.** On the revenue side, reforms are needed to widen the tax base as only 30 percent of those that need to pay taxes do. Tax enforcement should be improved through capacity building of the Large Taxpayer Unit (LTU) in order to strengthen targeted audit activity and dispute management capacity. Furthermore, legislation ought to be strengthened to penalize non-payers. On the expenditure side, the fairness, effectiveness, and efficiency of public spending needs to be improved. The focus should be on reforming the generous public pension system, and untargeted transfers that result in significant support to some segments of society at the expense of other more needy groups. Better managing health referrals is a priority. There is also a case for reorganizing civil service arrangements to establish a more responsive and efficient public sector. Reforming the intergovernmental fiscal transfer system will also result in transparent transfers to LGUs and will eventually reduce net lending. Reforms should also continue to focus on strengthening governance, including the PFM system, enhancing accountability, and procurement practices, which would encourage donor involvement.
- 31. PA reforms should also focus on providing a more conducive environment for the development of the private sector.** The high level of payment arrears to private sector suppliers pulls away liquidity from the market and is inhibiting the development of the economy. Limited land registration and unclear property rights, even within Palestinian-controlled areas, are a major challenge for urban/housing and business development. Despite improvements, the regulatory framework governing private sector activity can be further enhanced. The recent signature by the President of the new companies' law and the telecoms law are critical steps in the right direction.

⁵ Allenby Bridge is a crossing that crosses the Jordan River near the city of Jericho and connects the West Bank with Jordan.

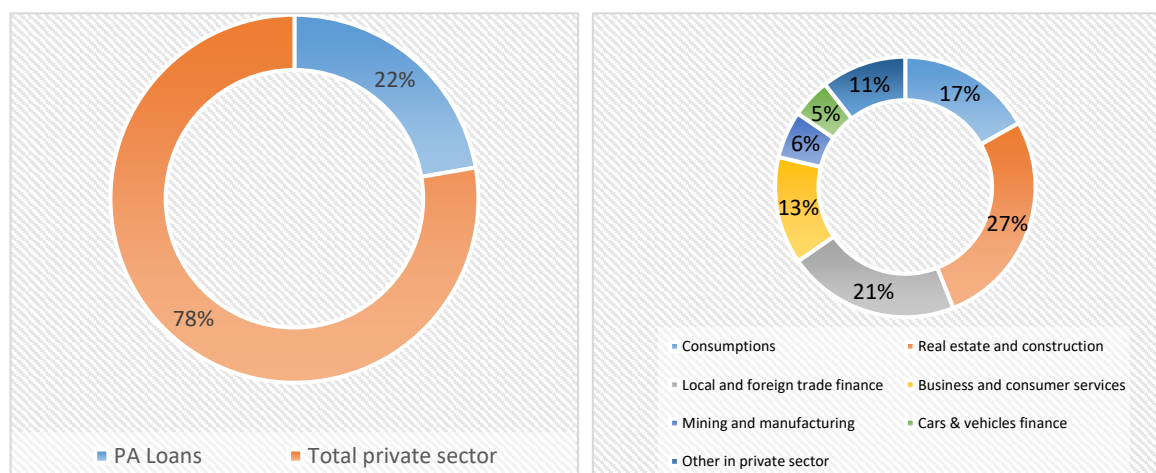
⁶ See Section G of Appendix 5 to Annex I of the Interim Agreement.

⁷ For more information, see: <http://documents.worldbank.org/curated/en/780371468179658043/main-report>

3. Money and Banking

- 32. To avoid further destabilization, financial sector regulators should emphasize the importance of safeguarding the banking system against emerging and protracted economic shocks.** According to preliminary reporting by the PMA through June 2021, total banking system assets reached approximately US\$20 billion. After a drop during 2020, the banking sector registered some recovery in profitability during the first half of 2021. Return on Equity signaled a modest recovery reaching 4.5 percent, an improvement compared to 2020 levels (2.4 percent) but still far below pre-COVID levels, 8.3 (2019) and 9.4 percent (2018). Return on Assets shows a similar trend, reaching 0.45 percent in 2021, compared to 0.27 percent (2020), but still far below pre-COVID levels, 0.95 (2019) and 1.15 percent (2018). The growth in deposits during 2021 exceeded growth in credit when compared to the same reporting period in 2020, resulting in a net decline in the overall credit-to-deposit ratio, down to 66 percent in Q2 2021, compared to 70 percent in Q2 2020. Growth in credit during the reporting period was mainly driven by the growth in domestic public debt – associated with the protracted fiscal imbalances. A review of credit exposure to the private sector indicates unchanged sectoral concentration, with two-thirds of all private lending going to construction, trade finance, or consumer loans.

Figure 4: Distribution of credit by sector (left) and by economic activity in the private sector (right)



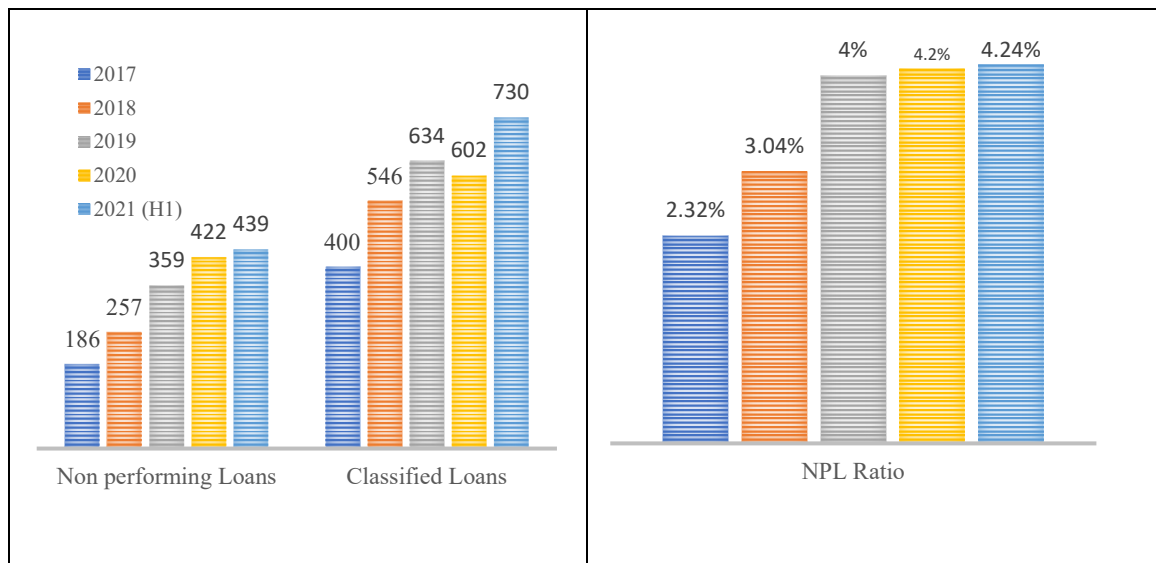
Source: Palestine Monetary Authority.⁸

- 33. Protracted crises have gradually deteriorated the quality of loan portfolios across the banking and microfinance sectors, and further deterioration is likely.** Both non-performing loans (NPLs) and classified loans have maintained an upward trajectory since 2018⁹. The NPL ratio (which represents the percentage of NPLs out of all direct loans, and is a lagging indicator) stands at approximately 4.2 percent as of June 30, 2021. While this appears manageable given the context, discussions with several local banks indicated that NPLs are concentrated in critical portfolios (e.g., SMEs), and that aggregate NPL indicators are likely underestimated as a result of regulatory forbearance measures. Recognizing that the implementation of regulatory forbearance (and temporary suspension of the classification of bad checks) had the advantage of providing fast relief, they are also extraordinary measures that do not discriminate between impacted and non-impacted borrowers. The downside risk of such measures is the potential unintended decline in new lending to truly distressed or recovering solvent enterprises. The expected further deterioration in the quality of SME, consumer, and Gaza loan portfolios could soon translate into higher NPLs, particularly in banks with substantial exposure to Gaza, SMEs, and PA employees.

⁸ According to June 2021 preliminary data.

⁹ It is worth noting that some of the banking sector indicators have been impacted by the adoption of IFRS9.

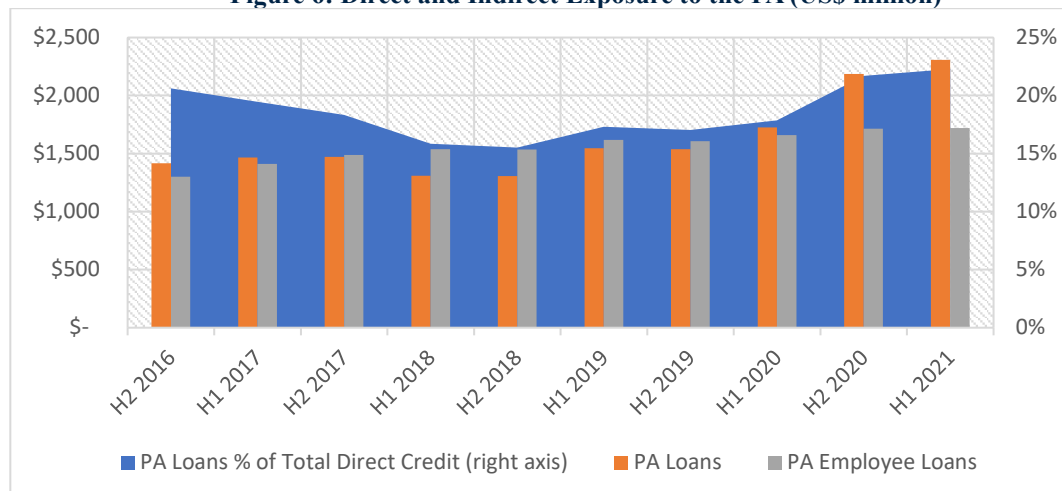
Figure 5: Growth in non-performing and classified loans (US\$ million and % of gross loans)



Source: Palestine Monetary Authority.

- 34. With declining financing, the PA has significantly increased borrowing from domestic banks, exceeding bank exposure limits set by the PMA, and potentially generating new stability risks for the banking system.** Following a few years of relative stability in PA borrowing (about US\$1.3-1.4 billion), the banking system's exposure to the public sector (through domestic public debt) registered an increase. PA borrowing exceeded US\$2 billion during 2020, reaching US\$2.5 billion as of August 2021 (23 percent of total direct credit). Borrowing by PA employees also represent an indirect channel of exposure to the public sector, along with the expanded usage of promissory notes. When combined, PA and public employees account for approximately US\$4 billion, or 40 percent of total banking sector credits.

Figure 6: Direct and Indirect Exposure to the PA (US\$ million)



Source: Palestine Monetary Authority.

- 35. Given the sustained fiscal imbalances and limited donor assistance, Palestinian policymakers should carefully balance fiscal, monetary, and financial considerations and interrelations.** The independence of the PMA, as supervisor and prudential regulator of the banking system, should be respected and upheld. This principle is especially critical during times of economic distress, where the financial system is critical in mitigating the impact of this shock, but if not managed effectively, could also create an additional source of instability - if the current accumulation of risks is not effectively managed. In light of the growing fiscal challenges faced by the PA over the past decade, the banking system's rising direct and indirect exposure to the public sector (exceeding PMA set

limits on multiple occasions) continues to be a cause of unease and needs to be actively managed to maintain depositor confidence.

36. The PMA has been taking steps toward advancing financial inclusion through digital payments and microfinance:

- Five recently established payment service providers are now offering payment services in Palestine, primarily through E-wallet based payment services. As of May 2021, a total of 113,000 E-wallets have been issued with a total stored value of US\$530,000. Approximately 20 percent of these E-wallets have been issued to women. More than 5,000 merchants are capable of accepting payments through E-wallets. Furthermore, the PMA is exploring possible options for upgrading the national payment system through the integration of new types of services and capabilities. In this regard, PMA is in the process of issuing a number of Requests for Proposals (RFPs) in relation to electronic bill presentment and instant payments.
- Eight microfinance institutions currently deliver microlending services to 65,000 clients, 35 percent of which are women. The size of the microfinance sector - both in terms of number of borrowers and outstanding portfolio - has been shrinking due to repeated economic shocks in recent years. The size of the sector is currently reported at US\$247 million (across 65,000 borrowers) compared to US\$270 million (across 90,000 borrowers) in 2018.

37. The stability of cross-border payments remains a major cause for concern due to the potential negative impact of de-risking by Israeli banks. Citing money-laundering and financing of terrorism concerns, key Israeli banks have repeatedly signaled plans to limit or terminate correspondent banking services to Palestinian banks in recent years. Such termination of correspondent banking relationships (CBRs) is likely to have significant economic impact due to the highly interlinked structure of the two banking systems, and the use of the Israeli Shekel as the primary currency in the Palestinian economy: payment activity between Israel and the West Bank and Gaza has an estimated yearly value of more than NIS44 billion. In 2017, the GoI approved a temporary indemnity and immunity package for Israeli banks working with Palestinian banks, thereby taking on part of the risks, to alleviate the potential for immediate disruptions to CBRs between the two banking systems. This temporary package has been repeatedly extended by the GoI, most recently until July 2022, while a more stable arrangement for cross-border payments is jointly developed by the PMA and the Bank of Israel (BoI). In a related development, the MENAFATF onsite visit to the West Bank and Gaza (a requirement for its Mutual Evaluation), initially planned for 2020 but postponed due to the pandemic, is now scheduled for the second half of 2022.

CHAPTER II: ZOOMING IN ON THE GAZA ECONOMY AND A VISION FOR SUSTAINABILITY

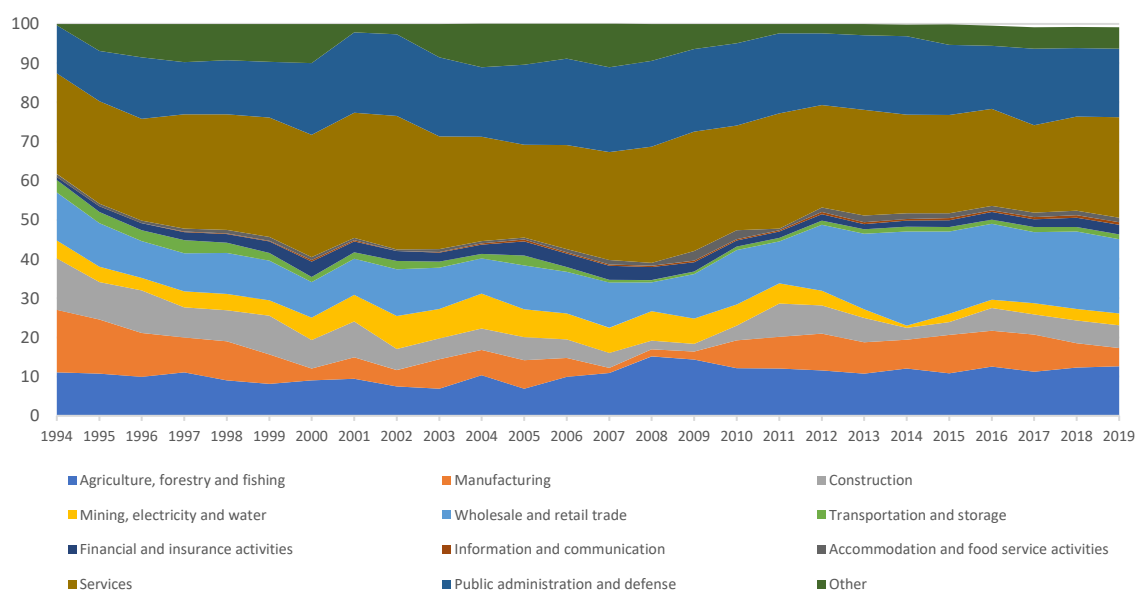
1. Introduction

38. This chapter looks at Gaza's economic performance over the past two decades, the human consequences of its evolution, and the path towards a sustainable recovery. It starts with an overview of the main economic indicators in Gaza to show that the structure of the economy has been significantly altered. The second section looks at the economic and social impact of the recent conflict. The chapter then presents recommendations on how to address infrastructure and development needs to reverse the Strip's deteriorating trajectory and place it on a sustainable path for recovery.

2. Gaza's Main Economic Indicators

39. Gaza's economy has been reduced to a fraction of its estimated potential. The Strip has been suffering for years under a blockade resulting in restrictions to movement of goods and people, leaving very limited linkages to the outside world. Data indicates that since 1994, Gaza's compounded annual growth rate was a mere 1 percent. Looking at the economic performance of all suitable comparators makes it clear that this growth level is very low. For example, average annual growth was 3.7 percent in the Arab world, 3.5 percent in low-income countries, 4.4 percent in lower middle-income countries, and 3.9 percent in MENA (excluding high-income countries).¹⁰ As a result, the contribution of Gaza's economy to the Palestinian economy was cut by half over the past three decades, from 36 percent in 1994 to 18 percent currently.

Figure 7: Sectoral contribution to Gaza's GDP, %

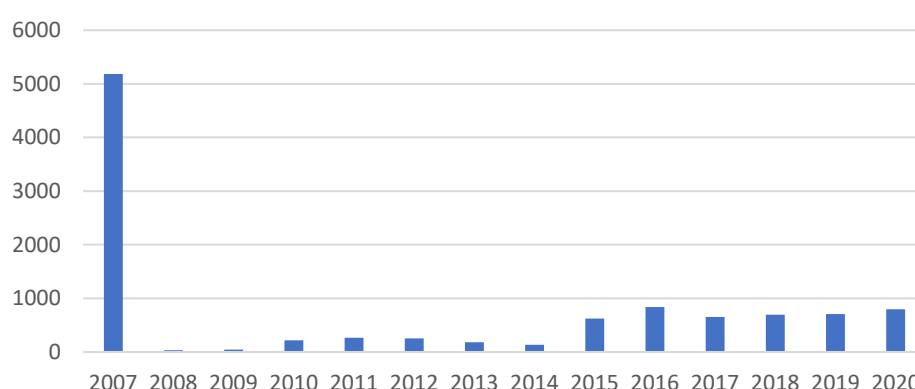


Source: Palestine Central Bureau of Statistics.

¹⁰ <https://data.worldbank.org/indicator/NY.GDP.MKTP.KD>

40. Gaza has also undergone deindustrialization and the economy has become highly dependent on external transfers, weakening its economic prospects. The productive base of the economy has been eroded by the combined size of the manufacturing and agriculture sectors falling from 27 percent of GDP in 1994 to 17 percent today (Figure 7). Gaza's exports virtually disappeared (Figure 8).¹¹ Aid and remittances are almost the only source of foreign exchange inflows that fuels consumption in Gaza, particularly since exports are extremely small and investment activity is weak. It can be safely assumed that the PA's and UNRWA's expenditures in Gaza, in addition to informal flows to the *de facto* authority, have in certain years amounted to almost 100 percent of Gaza's GDP, keeping its economy afloat despite the restrictions.¹² These transfers have dropped in recent years given the PA's decision to reduce salaries for Gaza employees and UNRWA's funding gaps. As a result, Gaza's economy has continued to shrink since 2017 and the COVID-19 shock exacerbated the situation, resulting in the economy contracting by 12 percent in 2020.

Figure 8: Gaza's Yearly Exports in Truckloads



Source: UNOCHA.

41. Examining the sources of growth in Gaza over the past two decades clearly illustrates the negative impact of the multiple challenges on its capital stock.¹³ Real capital stock in Gaza declined by 20 percent from 1994-2020. During this period, real capital stock in the West Bank grew by 3.9 times. Despite the marginal increase in recent years, the capital-to-labor ratio in Gaza in 2020 was still one-third of the 1994 level. The current capital-to-output ratio for Gaza is only half the level of the West Bank. The growth accounting exercise indicates a decline in labor productivity growth in Gaza and suggests that the decline was not only attributed to a decrease in the capital stock, but also to a decline in Total Factor Productivity. TFP has fallen by about 0.6 percent per annum from 1997-2020.¹⁴ In contrast, TFP contributed positively to growth in the West Bank during this period (Figure 9).

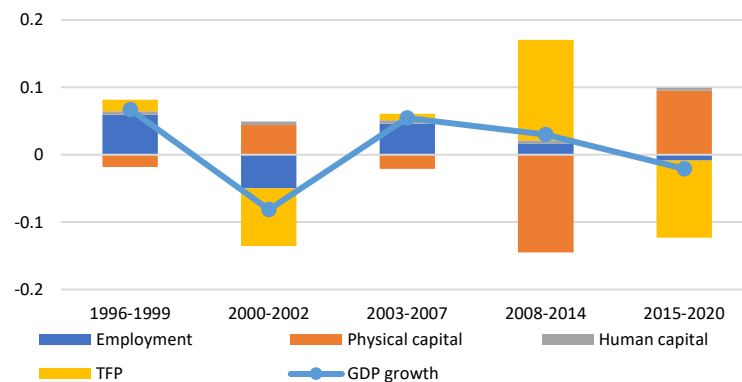
¹¹ <https://www.ochaopt.org/data/crossings>

¹² World Bank report to the AHLC, March 2018.

¹³ The growth accounting exercise decomposes output growth into contributions from changes in the factors of production (capital, labor, and human capital) and a residual component, known as TFP growth. The methodology consists of applying a neoclassical Cobb-Douglas production function, in which the estimate of the output with respect to labor is crucial. The West Bank and Gaza's share of labor income of 0.520 is proxied by the 2019 average value for relatively conflict-free middle-income MENA economies from PWT10.1. This value is close to the average for lower-middle-income countries (0.510).

¹⁴ The protracted decline in TFP is likely related to the "disorganization" effect of violent conflict. This concept and its quantification in conflict has been elaborated by a recent report on Syria. World Bank. 2017. The Toll of War: The Economic and Social Consequences of the Conflict in Syria. World Bank, Washington, D.C. © World Bank. <https://openknowledge.worldbank.org/handle/10986/27541> License: CC BY 3.0 IGO.

Figure 9: Contribution to GDP growth in Gaza, percentage points



Source: PCBS, PWT10.I, IMF (2017), UNOSAT (2014), World Bank estimates.

42. Gaza's economic decline has had a severe impact on living standards as real per capita incomes have significantly dropped over the past three decades. Real per capita income (GNI) in Gaza has fallen by almost a half since 1994, from US\$2,659 to US\$1,432 currently. Consequently, while GNI per capita in the West Bank was only 8 percent higher than in Gaza in 1994, the difference has increased to 303 percent (Figure 9). Unemployment in Gaza reached 48 percent in the first quarter of 2021, prior to the recent conflict. This is the highest unemployment rate in the World Bank database.¹⁵ The overall rate disguises a particularly high youth unemployment rate, which stood at 66 percent amongst those aged between 15-29 before the conflict. The latest actual poverty data for Gaza is for 2016/17 and it shows that 43 percent of the population was below the US\$5.5 a day poverty line, even though 80 percent of the population receive some sort of social assistance.¹⁶ Projections suggest that the poverty rate has been rising steadily since 2016/17, with an 8.3 percentage point increase between 2019 and 2020 due to the COVID-19 pandemic, when it reached 57 percent, in response to a real GDP per capita contraction of 15 percent in 2020.

43. Despite their severity, these numbers fail to fully portray the degree of suffering of Gaza's citizens due to poor electricity and water/sewerage availability, conflict-related psychological trauma, limited movement, and other adverse effects of the pandemic and protracted conflict. The deteriorating state of the health sector also has severe effects on the wellbeing of Gazans, especially given the stress it has undergone to deal with COVID-19. Poor housing conditions and internal displacement also negatively impact the quality of life. According to UNRWA, Gaza has 1.4 million refugees, out of its 2.1 million population.¹⁷ A large portion of the population, including the refugees, has been displaced more than once. To address demographic growth alone, there is a backlog of thousands of housing units in Gaza. The housing shortage significantly increased after the recent conflict, which resulted in the destruction of 4,100 housing units: around 1,600 units were totally destroyed and 2,500 partially damaged.¹⁸ This has exacerbated the housing needs that were yet to be addressed due to damages caused by the 2014 war, after which around 5,500 families were still displaced prior to the 2021 conflict.

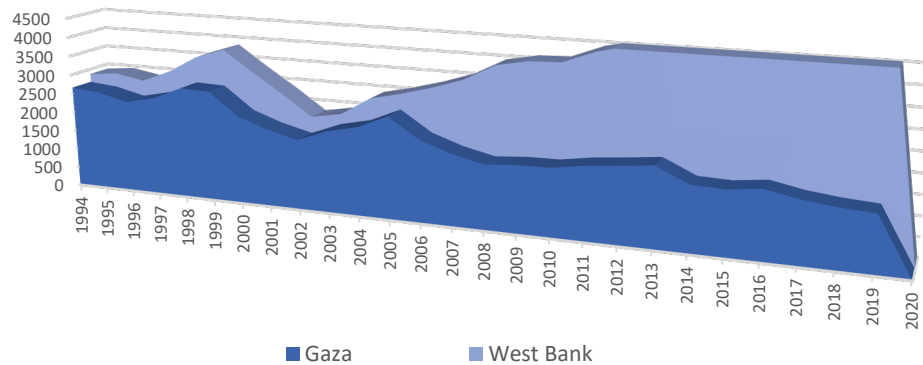
¹⁵ <https://data.worldbank.org/indicator/SL.UEM.TOTL.ZS>

¹⁶ <https://reliefweb.int/report/occupied-palestinian-territory/echo-factsheet-palestine-last-updated-25052021>

¹⁷ <https://www.unrwa.org/where-we-work/gaza-strip>

¹⁸ Gaza Rapid Damage and Needs Assessment. World Bank, EU and UN. June 2021.

Figure 10: Real GNI per capita, US\$



Source: Palestine Central Bureau of Statistics.

3. Towards a Sustainable Development Strategy

44. The declining trajectory of the Gazan economy and the deterioration of the quality of life can be reversed. To achieve this goal, four sets of priority actions should be pursued. First, on the policy front, to restore connectivity to the West Bank economy, the regional markets, and beyond, the current restrictions on access and movement of goods and people could be reviewed, while keeping due considerations to legitimate security concerns. Second, to lead growth, a private sector-driven economy requires continuous and reliable energy, high-quality water, and wastewater services, and in the modern world, a digital economy infrastructure. Third, cities and their local authorities play a critical role in creating a conducive environment for private sector investment and development. To contribute to economic growth, and the development of the private sector and job creation, municipalities in Gaza need to be connected, offer reliable services and infrastructure, attract investment, and be responsive and resilient to shocks. Finally, a sustainable growth strategy for Gaza requires creating good jobs and a well-educated workforce that is able to participate in a modern economy, innovate, and attract investment.

45. The critical policy areas to improve Gaza's growth and development trajectory include:

- ***Foster global trade relations, including Israel and the West Bank.*** Efforts should focus on easing constraints that currently limit private activity, including the granting of business permits to Gaza traders to facilitate trade and building relationships with external markets, and setting the enabling conditions for private investment. This should include efforts by the GoI to streamline trade procedures at Gaza's commercial crossing and expand its capacity by adopting modern technologies that can provide the same level of security with a much shorter processing time and significantly reduce trade costs.
- ***Relax the restrictions on dual-use inputs to production, as these have hindered the development and export capacity of almost all economic sectors in Gaza.*** Relaxing the system includes aligning Gaza's dual-use list more closely with the West Bank's; improving the application procedure for dual-use goods and the transparency of the approval processes; revising the dual-use restrictions applied by the GoI in the Palestinian territories and adopting international practices and recommendations; and implementing a risk-based approach to enable access to dual-use items for legitimate businesses and utility operators through greater monitoring and verification. This also requires that the PA builds its own capacity to meet international standards for controlling and regulating the use of dual-use goods. Finally, the GoI

and the PA should continue to review the Gaza Reconstruction Mechanism (GRM) with the objective of contributing to growth and development in Gaza.

- ***Gaza’s physical connectivity depends on road transportation.*** As a result of the recent conflict, the priorities in the transport sector include service delivery restoration, rehabilitation works to repair damages, strengthening institutional capacity building, improving regulations as well as creating safer roads. In the medium term, revitalizing the transportation network (including looking at the feasibility of building a commercial port in Gaza), provision of integrated trade-related logistics services, and product safety and quality infrastructure, among others, are critical for the development of tradable activities in Gaza.

a- Energy Sector: Continuous Energy Supply for Gaza

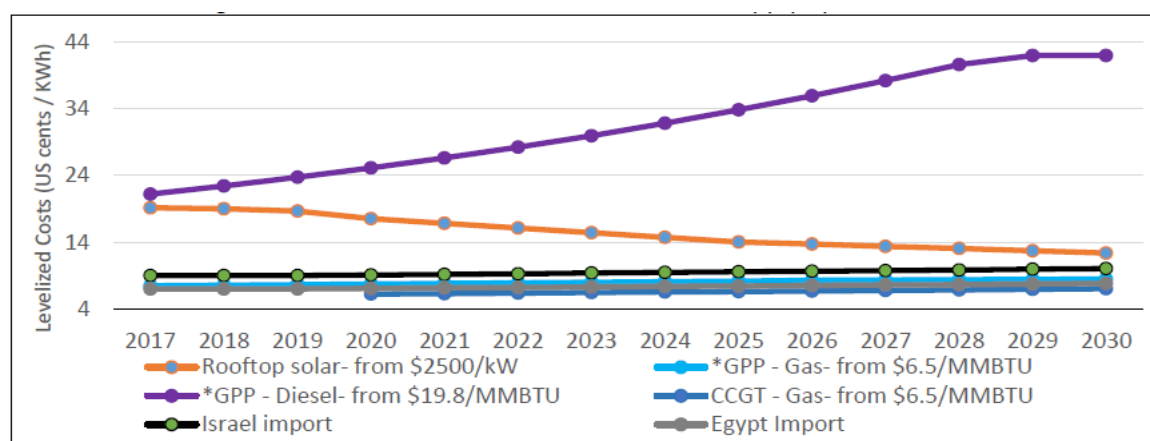
- 46. The energy crisis in the Gaza Strip has persisted for decades.** The source of the crisis is the lack of energy supply and severely limited options for power generation within Gaza. The transmission and distribution networks have continuously deteriorated due to long-term suboptimal operation caused primarily by the high levels of unmet demand, regular energy shortage, and funding limitations. Following the 2014 conflict, the electricity network was rehabilitated, but neither the Gaza Power Plant (GPP) nor the distribution systems were fully restored and there were no efforts to address the ever-growing demand. While the May 2021 conflict lasted for a shorter period, the dispersed nature of the attacks has exacerbated the fragility of the electricity sector’s distribution network. In fact, the physical damages were primarily in the distribution network, with extensive damage to power infrastructure around targeted roads, buildings, and neighborhoods. Rehabilitation needs are centered around replacement of damaged power equipment and repair of networks.
- 47. Increasing electricity supply is essential to enable economic growth, improve public services, and enhance quality of life in Gaza.** As of 2021, Gaza’s average demand for electricity is estimated at 550 – 600MW and the total electricity supply is 165-190MW. Actual supply from the GPP varies (45-70MW) depending on the diesel supply, and supply from Israel Electric Corporation (IEC) is around 120MW. The ongoing power supply shortage is 60 percent, which increases to 80 percent in case of non-availability of fuel for GPP. In an effort to ensure continuous power supply for critical public services, including health, water, and wastewater services, the electricity supply for private sector and residential customers is further reduced, which results in limited availability (8-16 hours/day).
- 48. Increasing supply, improving efficiency, and enhancing utility performance are key to achieving the vision of ‘24/7 power for Gaza’.** This vision is the foundation for building back better (BBB) from the damages incurred during the conflict of May 2021. The electricity sector master plan for the Gaza Strip (2018-35), developed by the Palestinian Electricity and Natural Resources Authority (PENRA) and the Gaza Electricity Distribution Company (GEDCO), recommends a comprehensive set of measures encompassing generation, transmission, and distribution of electricity. The current demand of around 600MW (available supplies are 190MW) is likely to rise by 2035 to around 900 – 1,400MW under different growth rates. This means there is need for an additional 700-1200MW of generation capacity or imports. This significant supply gap is unlikely to be filled by any single source. Increased local generation with higher imports from Egypt and Israel are likely solutions. Construction of a transmission network and expansion of the distribution network is essential. Working on various scenarios, the master plan laid down a phased schedule for expansion of generation, transmission, and distribution facilities over a 15-year period.
- 49. Financial support to implement recommendations of the Gaza electricity master plan will establish the foundation for dialogue on reform of the electricity sector in the Gaza Strip.** Without concrete efforts to increase electricity supply, discussions on financial and operational sustainability of GEDCO remain futile. Breaking out of the vicious circle of low supply, low revenues, and low efficiency, requires a substantial increase in electricity supply. The GPP was constructed in 2004, however, it has not fulfilled its potential due to lack of natural gas supply and

continued dependence on donor-funded diesel fuel. Natural gas-based GPP can scale up power supply to 200-300MW, filling the enormous gap while retaining cost-effectiveness and affordability (see Figure 14 below¹⁹). The expectation of increasing sales and revenues can provide the incentive for the electricity utility to implement the reform measures identified in a recently conducted institutional review.

Box 2: Energy Damages RDNA

The Rapid Damage and Needs Assessment (June 2021) identified damages of US\$10-15 million and losses of US\$5-10 million for the electricity sector. The total cost for recovery and reconstruction needs was assessed to be US\$20-30 million. The damaged plant and equipment included 37 substations (indoor and outdoor), 51km of medium voltage underground cables, 135km of medium voltage overhead lines, and 600km of low voltage overhead lines. Almost 1,000 consumers faced damage to their side of the low voltage network. While GEDCO has been able to restore power supply in most areas using temporary connections and other stopgap measures, these will have to be replaced with new equipment to ensure quality and sustainability. All planned recovery activities will be designed to strengthen resilience of the network and align with the vision of the master plan. During the short term, the focus of reconstruction needs will be to rehabilitate and stabilize damaged power lines and low-voltage distribution networks. This will include restoration of electricity service connections to reconstructed houses, businesses, and other dwellings.

Figure 11: Gaza – Time trends of LCOE for different supply options in Gaza (2017-30)



Source: World Bank. 2017. Securing Energy for Development in the West Bank and Gaza.

Note: LCOE, levelized cost of energy, is defined as total capital and operating costs across the lifetime of a power project averaged over the total electricity produced.

50. Increasing electricity supply to Gaza requires coordinated investment in infrastructure to boost generation, optimize imports, and enhance networks. The Gas for Gaza (G4G) initiative, led by Office of the Quartet (OQ) in cooperation with PENRA, is working on the technical, financial, legal, and operational modalities of the natural gas pipeline from Israel to Gaza. The GPP will need to be rehabilitated and upgraded to operate on natural gas and with increased capacity. In parallel, the associated transmission and distribution infrastructure will need to be upgraded for evacuation of the electricity to all parts of the Gaza Strip. Imports from IEC are expected to continue at current levels, with possibility of resumption of Egyptian supply. Gaza already has experience with some smart grid solutions, which would need to be expanded to enhance management, improve quality of supply, and reduce losses. Increased self-reliance could create the positive reinforcement toward longer-term financial and operational sustainability of the energy system.

¹⁹ World Bank (2017). Securing Energy for Development in the West Bank and Gaza (SED).

- 51. Bringing natural gas to Gaza will unlock the renewable energy and energy efficiency potential in the Gaza Strip and improve management of imports from Israel and Egypt.** The existing Solar PV capacity in Gaza is estimated at 25MW and increasing this capacity faces spatial limitations and system challenges. Harnessing solar energy and enhancing efficiency requires an optimal electricity network that can manage variability and provide stability. The chronic power shortage reduces not only the ability to use solar energy in the form of net-metering, it also reduces the lifetime of all electrical equipment. For example, the solar boom coupled with poor network is creating an environmental disaster in the form of battery waste in Gaza. The extreme gap between demand and supply leads to recurrent overloading of the supply lines from Israel, impacting an already limited supply.
- 52. The energy sector in Gaza needs to be placed on the path of long-term sustainability.** Operational and financial sustainability of the sector is linked to the chronic supply crisis. Inadequate or poor quality of electricity is considered as the top binding constraint by Palestinian firms in Gaza. GEDCO's unsustainability is rooted in operational, technical, and governance factors. Due to the intermittent supply, customers are forced to pay for expensive alternate energy sources, which erodes revenue bases and inhibits appropriate tariff-setting. It further promotes use of diesel-fired generators, which are inefficient and highly polluting. A line-of-sight to increasing supply at lower cost is essential to building customer confidence and re-setting the dialogue between the key stakeholders. This is also essential to reduce the energy sector's fiscal burden.

Table 3. Energy Sector: Priorities and Actions

Key priorities	Key actions by different stakeholders
Short-term	
Address immediate energy sector needs identified in the Gaza RDNA for rehabilitation and repair of damaged infrastructure (Box 1)	<ul style="list-style-type: none"> • GoI to facilitate import of necessary construction materials for rehabilitation and repair of damaged infrastructure. • PA to actively support PENRA's close coordination with GEDCO to expedite implementation • Donors to coordinate the various emergency support initiatives to avoid over-burdening the counterparts.
Strengthen electricity system operations and infrastructure in the West Bank and Gaza	<ul style="list-style-type: none"> • GoI to facilitate expedited approvals for construction of transmission infrastructure and imports of materials. • PA to actively support PENRA's close coordination with electricity sector institutions in implementing infrastructure and innovative financial solutions to facilitate greater private sector participation • Donors to scale up and prioritize support to financing infrastructure construction and upgrade to improve electricity services
Medium-term	
Establish a Platform for Building Power Infrastructure towards the vision of Gaza Electricity Sector Masterplan 2030 (including Gas for Gaza project)	<ul style="list-style-type: none"> • GoI to actively support and participate in the platform and support activities to increase electricity supply • PA to actively support and participate in the platform, facilitate coordination across institutions and support acceleration of analytical activities (incl. feasibility studies) towards a phased implementation • Donors to actively support and participate in the platform for provision of technical assistance (to support analytics and feasibility studies) and infrastructure investment

- 53. Addressing Gaza's economic and energy crisis requires a holistic approach and coordinated effort.** To facilitate this sustainable future, the vision of "24/7 power for Gaza" needs to be supported with a funding platform and reform program. The GoI can facilitate the construction of the natural gas pipeline and signal support for the commercial arrangements for natural gas supply. The GoI can also encourage IEC to work toward upgrade of the existing supply lines into Gaza. The PA should facilitate transparency in the commercial arrangements for natural gas supply, establish

direct support for reform-linked investments, and create incentives for implementation of the recommendations of the recent energy sector institutional review. The donor community could coordinate around the Gaza electricity sector master plan and create a cohesive funding plan for tripling the current energy supply. This is the only way to ensure adequate supply to the critical public services (water, wastewater, health), to unlock private sector-led economic growth, and to enable a resilient and inclusive quality of life. Table 4 provides a summary of key priorities and actions for the energy sector in Gaza.

b- The Water and Wastewater Sector

- 54. Gaza faces serious challenges in providing water and wastewater services due to problems in quantity and quality of bulk water.** Access to improved water has plummeted from near total coverage two decades ago to almost zero today. Although 95 percent of the population is connected to the piped network, only 1 percent of the population has access to improved drinking water that meets WHO standards. Over the past few decades, the Coastal Aquifer - the only source of water in Gaza - has been overexploited, as a result significant seawater intrusion has occurred, contaminating the aquifer with salts. Wastewater treatment has historically been limited, further contaminating the aquifer. Given limited bulk water availability, water service is intermittent and only one-third of Gaza households receive water daily. Climate change and population growth will further reduce per capita availability. Given these challenges, residents rely on expensive and unregulated small-scale private providers.²⁰ Access to improved sanitation is universal in Gaza, with 73 percent of the population connected to sewerage networks and treatment of 75 percent of the waste from those on-sewer households; 27 percent of people rely on on-site services. However, sewage overflows are commonplace and treatment for the remaining 45 percent of the population is much needed.
- 55. Institutional reform in line with the 2014 Water Law is needed to improve financial management and cost recovery to allow for proper operation and maintenance of current infrastructure, and future investment in the water sector in Gaza.** The Palestinian Water Authority (PWA) and the independent Water Sector Regulatory Council (WSRC) are established. The National Water Company (NWC), once established, will assume the role of bulk water provider to the service providers. The Law also envisages consolidating service providers into regional water utilities (RWUs), with one RWU envisioned for Gaza. Through this process, financial systems should be disentangled from municipal revenue streams and aligned with the new institutional structure. Cost-recovery mechanisms should be strengthened for improved operations (service providers cover 24 percent of costs).
- 56. Despite the centrality of water in lifting gender-based constraints and empowering women, their formal participation in the sector is limited.** Palestinian women play a vital role in water resource allocation and management at the household level. However, they are largely excluded from participation in institutions that establish policies, design programs, or deliver services targeting them and their families. In a survey conducted by the WSRC of women's formal participation in public entities that provide water and sanitation services across the Palestinian territories, women comprise only 6 percent of staff. When women are excluded from formal structures, they are prevented from having influence over decisions along the water supply and sanitation value chain, their status as key customers of the sector is overlooked, and their role in maintaining their family livelihoods is compromised. The ongoing Associated Works Project specifically promotes gender diversity by including specific measures to enhance recruitment, retention, and promotion of women in a new bulk water supply unit. By promoting gender diversity, the project leverages the untapped pool of highly skilled unemployed female graduates with relevant degrees. Additionally, risks of gender-based violence during civil works and construction will be mitigated by ensuring that prior to starting works the support of existing women's

²⁰ A PWA/WASH Partners/GIZ study found that only 59 percent of private desalination plants in Gaza are monitored and almost 20 percent of the plants produce water contaminated by coliforms, a proxy indicator of fecal pollution.

organizations in each municipality will be sought to take considerations of women into account in hiring and in terms of respectful workplace protocols.

- 57. A concentrated focus on transformation in the water sector is needed over the next decade to build human capital, improve productivity, and improve the chronic humanitarian situation in Gaza.** The transformational objectives for the sector over this timeframe are to restore universal access to improved water supply and to achieve treatment of 95 percent of wastewater produced in Gaza. These goals would be underpinned by institutional reform in the sector that enables financial and operational sustainability.
- 58. To achieve these objectives, the PWA is focusing on improving water quality, scaling up wastewater treatment, and implementing the Water Law.** The PWA is partnering with development partners²¹ on the Gaza Central Desalination and Associated Works Program (GCDP) as the cornerstone project to improve water provision. Once fully operational, the system will restore universal access to improved drinking water in Gaza. Efforts to scale up wastewater treatment are underway - three wastewater treatment plants have been constructed in Gaza over the past 15 years and several new facilities are under construction. New works include innovative approaches including reuse of treated wastewater for agriculture and incorporation of renewable energy to enhance resilience of the system. Given the overall low cost-recovery in the sector, covering operations and maintenance costs of these new facilities is a major challenge. Concurrent implementation of the 2014 Water Law by PWA is also needed to ensure the sustainability of the actions taken to achieve these transformational objectives. The objectives would be complemented by water loss reduction, improved tariff collection, and improved service delivery.
- 59. The recent conflict in Gaza has caused significant damage to most parts of the water and wastewater infrastructure, including damaged water pipelines across 135 locations and 1,500 domestic water connections, sewage pipelines across 101 locations, water and sewage pumping stations, water wells, and reservoirs.** These losses resulted in limited water, sewerage, and wastewater services (e.g., 40 percent of normal water supply) and some services are not yet fully restored. About 100,000 cubic meters per day of sewage leaked into the Mediterranean Sea, also impacting Israel's activities along the coastline. The total cost of the damage and losses were estimated to be US\$10-15 million and US\$3-5 million, respectively.²² Once indirect costs are accounted for, such as restoration of delivery services, provision of required maintenance materials, and re-stocking of emergency equipment, and other associated needs, the required financing envelope for reconstruction and recovery is estimated to be US\$15-25 million. Humanitarian agencies have allocated funds to address immediate needs and some restoration has already taken place, however, significant investment is still needed to fully restore the sector.
- 60. Repair and reconstruction of infrastructure and systems impacted by the crisis are immediately needed in Gaza.** These measures (see Table 5 below) include the reconstruction and rehabilitation of the following: (i) sewer lines (30 locations) and three sewage pumping stations; and (ii) repair priority water lines (21 locations), two key water reservoirs, and 14 damaged water wells. Retaining the principle of BBB, these efforts should be coupled with a focus on the key investment projects under way such as the GCDP, the new wastewater treatment plants. The PA should simultaneously focus on implementation of the Water Law, advancing establishment of the NWC and RWU in Gaza, as planned. Given the need for continuing private provision during the recovery phase, the PA should regulate these providers to ensure their water meets health and safety standards and to control pricing. Parallel to these measures, service providers should incrementally improve collection efficiency and the PWA should examine how a revision to water pricing can equitably improve cost-recovery.

²¹ The European Commission (EC), the European Investment Bank (EIB), the Union for the Mediterranean (UfM), the Islamic Development Bank (ISDB) and the World Bank.

²² Gaza Rapid Damage and Needs Assessment, June 2021

- 61. Gaza's freshwater resources are transboundary in nature and shared with Israel.** While there are some challenges that the PA can resolve independently, such as reduction of non-revenue water, the transboundary nature of the resource means that partnership and cooperation are essential for water security. Given the unique situation in Gaza, the PA's national actions on policy reform and investments should be complemented by regional cooperation and development partner support.
- 62. The PA reform and investments to improve sector performance are grouped in four action areas.** The first action area proposes to plan, manage, maintain, and develop investments for bulk water security at the appropriate levels. The water sector needs the capacity to maintain, protect, and expand its bulk water supply so that it can: (i) close the gap between supply and demand; and (ii) restore quality of its bulk water to meet international health standards. This includes investment, operation, and maintenance of multiple types of infrastructure, including desalination, water supply network, sewerage, wastewater treatment, drainage, and measures to recharge and restore the aquifers, in particular, the GCDP. Gaza will continue to rely on Israel for its bulk water, therefore national entities and donor partners need to work together around bulk water needs in Gaza. These reform measures should be complemented by establishment of the NWC.
- 63. The second action area is institutional structuring and strengthened performance for service provision.** To strive for efficiency and accountability in water and wastewater service provision, service providers and PWA in cooperation with the WSRC should have distinct roles and responsibilities. This includes a focus on operational performance measures and target setting for reducing non-revenue water. These reform measures should be taken in line with the 2014 Water Law and as detailed in the PWA roadmap to establish the RWUs.
- 64. The third area requires aligning revenue and expenditure systems with functioning accountability mechanisms.** The revenue and expenditure systems should be realigned to ensure that funds received for water services support sustainable water sector service delivery and related systems. Strengthening financial systems and aligning expenditure systems will reduce net-lending and allow the utilities to cover their operational costs as well as perform maintenance and approach new investment.
- 65. Finally, Gaza should also act in energy and agriculture to improve the functionality and sustainability of its water sector.** Expanded renewable energy and increased power production and/or purchase are needed to meet the sector's increasing energy needs and expanded reuse of treated wastewater will improve efficient use of existing resources.
- 66. Transboundary water management can serve as a connector between Gaza and its neighbors and is increasingly necessary as the region faces challenges such as increasing variability in water flow as a result of climate change, population growth, and development.** Deepening analytics and dialogue around transboundary wastewater are an opportunity to improve cooperation and coordination while identifying options for non-traditional water sources such as reuse of treated wastewater for productive purposes. Concrete, near-term opportunities where cooperation between the PA and the GoI can improve water sector performance in Gaza and benefit Israel include:
- Multisectoral cooperation to improve the limited entry of construction material and other supplies into Gaza which have hampered repairs to existing networks and treatment facilities;
 - Continued work through the special Task Force that coordinates the GCDP, where remaining challenges include entry of critical materials, the security of the investment, additional water supply, and satisfying energy requirements;
 - Assessing financial opportunities where treatment of transboundary wastewater may have beneficial outcomes for multiple parties;
 - Support identification and assessment of regional projects with shared benefit, including deepening the shared understanding of real costs of desalinated water production, natural

water production, and transport of blended water to provide a strengthened basis for bulk water supply negotiations and tariff setting;

- Improving the basis for transboundary cooperation and dialogue to support improved water resource availability and risk management in Gaza will improve outcomes for Israel.

Table 4 . Water and Wastewater Sector: Priorities and Actions

Key priorities	Key actions by different stakeholders
Short-term	
Repair and reconstruction of water infrastructure systems impacted by the conflict	<ul style="list-style-type: none"> • PWA to focus on the resilient reconstruction of the damaged infrastructure -as detailed in the Gaza Rapid Damage and Needs Assessment • Donors to support the reconstruction efforts with additional funds and ensure coordination of various efforts for efficient and quick implementation • GoI to facilitate import of necessary construction materials for damaged facilities.
Ensure increased water availability and quality	<ul style="list-style-type: none"> • GoI to supply additional 10 million m3 from MEKOROT • PWA to establish the Bulk Water Supply Unit (BWSU) in Gaza – as part of the National Water Company • PWA to accelerate the construction of the bulk water carrier, the blending reservoirs and the distribution networks in key areas -as per the ongoing Associated Works project. • PWA and donors to accelerate the preparatory works and mobilize financing for the Gaza Central Desalination Plant • PWA and GoI to ensure that the energy and operational needs of the Short-Term low volume desal plants are continuously met • PWA to closely monitor and regulate the private water vendors to ensure quality and fair pricing. • PWA to accelerate the gradual expansion of the Coastal Municipalities Water Utility (CMWU), towards a region-wide water utility per the 2014 water law – to cover water distribution and wastewater services across all the 25 local government units • PWA and donors to ensure the continued operation of the wastewater treatment plants through O&M support – with gradually increasing contributions from beneficiaries to cover these costs
Medium-term	
Improve the reliability of the bulk water availability	<ul style="list-style-type: none"> • PWA to ensure that all bulk water assets (wells and reservoirs) of the bulk water system have been transferred to the BWSU and the bulk water supply unit is fully operational and linked to the NWC • PWA to ensure that the construction of the Central Gaza Desal Plant is under construction
Achieve improved financial and operational sustainability of providers	<ul style="list-style-type: none"> • Donors to increase funding to the sector through a coordinated uniform platform to improve the operational (particular focus on non-revenue water) and financial performance of the CMWU and other (municipal) service providers. • PWA to ensure that cost recovery tariffs (water and wastewater) are applied by the CMWU (and other service providers) and follow the methodology approved by PWA and are enforced by the Water Sector Regulatory Council (WSRC) • Donors and PWA to increase support on investments on reuse of treated wastewater effluent and in solar/biomass generated power for wastewater treatment plants

67. Development partners provide four main types of support to the PA: project support, technical advice, policy dialogue, and donor coordination. Building on strengths of the current engagement and lessons from ongoing work and from FCV situations around the world, the development partners could strengthen the operational approach to support the water sector as follows:

- Anticipate provision of sustained support from the donor community, mobilizing a consolidated approach to project support for both institutional strengthening and infrastructure investment. This will help avoid fragmentation and streamline project coordination among the partners.
- Introduce performance-based tools and incentive mechanisms to focus on results and accountability.
- Mainstream citizen engagement to assist utilities and municipalities/local governments in including it in their strategic outlook and day-to-day operations.

68. In addition to these lines of support, if requested by all parties, the development partners could scale up support for a cooperative dialogue on issues of shared interest, such as transboundary wastewater, energy trade, and broader water-related capacity and technology transfer to strengthen the water sector in Gaza for the benefit of the whole region. Table 5 provides a summary of key priorities and actions for the water and wastewater sector.

c- Digital Infrastructure for a Prosperous and Connected Gaza

69. Digital infrastructure is significantly underdeveloped in the Palestinian territories, particularly in Gaza, due in large part to the political environment that resulted in the restrictions on the import of information and communication technology (ICT) equipment and the lack of radiofrequency spectrum required. In particular, Palestinians in Gaza are limited to the outdated 2G service. Mobile broadband internet (3G/4G/5G) is not available in Gaza as the frequency spectrum bands required for those services have not been released by the Israeli authority. In the World Radiocommunications Conference 2019 (WRC-19), *Resolution 12 (REV. WRC-19) Assistance and Support to Palestine*²³ was approved, which urged the establishment of a timeframe for allocating frequencies for 3G, 4G, and 5G to Palestinian operators. However, no progress has been made in implementing this resolution.

70. Against this backdrop, the underlying digital infrastructure for fixed-line broadband internet becomes crucial in the context of Gaza where mobile broadband internet is not readily available. As mentioned previously, 3G/4G internet is still not available in Gaza while the West Bank launched 3G only in 2018. Nevertheless, internet is available and accessible through Wi-Fi hotspots in Gaza, with about 73 percent of households having access to the internet in 2019. The recent conflict, however, destroyed fiber-optic infrastructure that used to be key to enabling Wi-Fi networks and fiber-to-the-premises (FTTP) services. Furthermore, Gaza is currently dependent on the West Bank for access to submarine cables, which is the first mile of the broadband value chain that enables internet connectivity.²⁴

71. The competitive market and the enabling policy and regulatory environment, which play a key role in advancing digital infrastructure deployment, is currently lacking in the Palestinian territories. PalTel is the monopoly operator in wholesale broadband services in the entire territories through its subsidiary Hadara, therefore the only backbone telecom infrastructure provider in Gaza. PalTel's mobile arm, Jawwal, and Ooredoo Palestine are the two mobile network operators that provide 2G cellular services in Gaza. However, as a result of spillover from sites in Israel and Area C, Israeli mobile network operators are unofficially providing services, which represent about 17 percent of market share (in the entire territories), creating a competitive disadvantage to the Palestinian providers in Gaza (PalTel and Ooredoo). According to Telegeography, it is estimated

²³ RESOLUTION 12 (REV.WRC-19): Assistance and support to Palestine. Available at: https://www.itu.int/dms_pub/itu-r/oth/oC/oA/RoCoAoooooFooo6PDFE.pdf

²⁴ Recently, the PA announced that an agreement was reached with the GOI to introduce 4G across the Palestinian territories, see Palestinian Economic Bulletin, September 2021, Bulletin # 180.

that there were 870,000 Palestinians signed up to a service offered by an Israeli provider in 2020.²⁵ Moreover, there is no sector regulator in the Palestinian territories. The new telecommunications law, which has the policy basis for establishing such a regulator, has been drafted but is pending adoption by the President's Office of the PA.

- 72. Development of digital infrastructure as the key foundation of the pillars underpinning the digital economy is of great importance for socio-economic development and human capital building in Gaza, connecting its people and economy to regional and global markets instantaneously.** As the first step, it is imperative to ensure universal access to high-speed, affordable broadband internet in Gaza in the next 5 to 10 years, which will be a key requirement to increase adoption of digital technologies and the delivery of digitally enabled services.
- 73. To achieve universal access to digital connectivity, it is critical to introduce at least 3G mobile broadband in Gaza given the high cellular phone penetration and scalability of mobile broadband services.** While 73 percent of households have access to internet, it is mostly through fixed-broadband services or Wi-Fi hotspots where internet connectivity is limited or “fixed” to certain physical boundaries, leaving Gaza out of the benefits of mobile broadband. Indeed, a recent study by UN International Telecommunication Union (ITU) found that mobile broadband adoption is associated with higher economic development impact compared to fixed broadband adoption. According to the study, a 10 percent increase in mobile broadband was associated with a 1.82 percent increase in GDP in the Arab States region, whereas the impact of the 10 percent increase in fixed broadband was associated with a 0.71 percent increase in GDP in the same region.²⁶
- 74. Taking into account the damage to key digital infrastructure in Gaza,²⁷ the reconstruction of fiber-optic network infrastructure, data centers, and cellular towers should be prioritized in the next two years.** Given the frequency spectrum resources required for mobile broadband are not available, it is particularly important to re-build and deploy future-proof fixed broadband infrastructure, such as fiber-optic networks. Fiber-optic networks are also among the most advanced technologies designed to deliver high-speed internet services and meet peak data demands, and thus would be a forward-looking technology to rebuild Gaza's digital infrastructure. It will be important to adhere to a “dig once” policy when laying fiber-optic cables underground, to avoid redundant infrastructure deployment. Infrastructure construction in public institutions, such as schools and hospitals, should be considered a priority, given the impact of the global pandemic and the essential need for a functioning healthcare and public education system.
- 75. In the meantime, to avoid prolonged internet service disruption,** it is also necessary to provide temporary measures to ensure connectivity where the reconstruction of digital infrastructure will take time, particularly in hospitals and schools. Innovative solutions like satellite connectivity, which can cover larger geographical areas, and microwave links could be considered as alternative transmission technology where the reconstruction of fiber-optic network infrastructure is not plausible.
- 76. Also, it is necessary to create an enabling policy and regulatory environment to ensure market-driven investment in the sector and competition to spur further innovation.** The new telecommunication law should be adopted as soon as possible so that the sector regulator can be established to devise necessary regulations and address market failures. In the meantime, the international community should continue to pressure for implementation of the WRC-19 Resolution 12, thereby ensuring that the frequency spectrum resources will be released by the Israeli authority for the deployment of mobile broadband services and the modernization of telecommunication networks in Gaza can begin in earnest.

²⁵ <https://www.telegeography.com/products/globalcomms/data/country-profiles/me/palestinian-territory/wireless.html>

²⁶ https://www.itu.int/dms_pub/itu-d/opb/pref/D-PREF-EF.BDR-2020-PDF-E.pdf

²⁷ *Telecommunications Backhaul Network Damages in Gaza*. May 2021. Office of Quartet

- 77. The GoI can significantly contribute to create a modern and reliable digital infrastructure.** The GoI can carry out bilateral discussions with the Palestinian authorities to set a clear timeframe for identifying, designating, and allocating spectrum frequencies required for at least 3G deployment in Gaza, according to Resolution 12 of WRC-19. Easing the restrictions on the movement and import of ICT equipment to facilitate reconstruction is also crucial.
- 78. The PA can further support the digital economy development in its early stages.** It should first develop a comprehensive strategy that outlines the high-level vision of leveraging the digital economy for its development and assesses resources that need to be mobilized to make the vision a reality. Furthermore, there needs to be a clear roadmap for rebuilding digital infrastructure in public institutions as part of the broader recovery plan from the recent conflict in May 2021, which should be complementary to the earlier mentioned strategy. The roadmap should identify areas of public support, such as subsidies or grants, that may be necessary to assist the private sector in reconstruction to ensure continuity of public services delivery and operation of public institutions.

Table 5 . Digital Infrastructure: Priorities and Actions

Key Priorities	Key actions by different stakeholders
Short-term	
Create an enabling policy and regulatory environment to ensure market-driven investment in the sector and competition to spur further innovation	<ul style="list-style-type: none"> • Adoption of the new telecommunication law (PA) • Establish the sector regulator to devise necessary regulations and address market failures (PA) • Ease the restrictions on the movement and import of ICT equipment to facilitate reconstruction (GoI)
Rebuild fiber-optic network infrastructure, data centers, and cellular towers destroyed during Gaza's conflict	<ul style="list-style-type: none"> • Deploy future-proof fixed broadband infrastructure (forward-looking technology), such as fiber-optic networks, to rebuild Gaza's digital infrastructure (PA) • Adhere to a "dig once" policy when laying fiber-optic cables underground, to avoid redundant infrastructure deployment (PA) • Prioritize infrastructure construction in public institutions, such as schools and hospitals, given the impact of the global pandemic and the essential need for a functioning healthcare and public education system (PA)
Avoid prolonged internet service disruption and provide temporary measures to ensure connectivity where the reconstruction of digital infrastructure will take time, particularly in hospitals and schools	<ul style="list-style-type: none"> • To consider innovative solutions like satellite connectivity, and microwave links as alternative transmission technology (PA)
Medium-term	
Achieve universal access to digital connectivity	<ul style="list-style-type: none"> • Request implementation of the WRC-19 Resolution 12, to ensure that the frequency spectrum resources will be released by the Israeli authority for the deployment of mobile broadband services and the modernization of telecommunication networks in Gaza can begin in earnest (International community) • Introduce at least 3G mobile broadband in Gaza (according to Resolution 12 of WRC-19) given the high cellular phone penetration and scalability of mobile broadband services (GoI, PA)

- 79. The PA should implement the recently approved telecommunications law** and strengthen its collaboration with the Gaza counterpart of the Ministry of Telecommunications and Information Technology (MTIT) to increase interoperability of digital systems underpinning citizen-facing e-

government services. Finally, donors and international partners should continue to urge the bilateral dialogue between the GoI and the PA to resolve the spectrum management issue and the existing restrictions on ICT equipment. Table 6 summarizes the main priorities to support the development of the digital infrastructure in Gaza, and the Palestinian territories.

d- Municipalities as Enablers of Sustained Growth and Economic Development

80. Municipalities play a crucial role in the economic growth and development of the Gaza Strip.

Entrepreneurship, innovation, and investment by the private sector are key ingredients to economic growth and job creation, however, cities and their local authorities²⁸ play an elemental role in creating a conducive environment for private sector investment and development. Investment decisions are heavily influenced by planning (land use, connectivity and mobility, sectoral priorities), regulations (zoning, business registration) and access to and quality of services (municipal infrastructure and utilities) provided by local governments. To enable economic growth, municipalities in Gaza need to be connected, offer reliable services and infrastructure, attract investment, and be responsive and resilient to shocks. Making the Gaza Strip inclusive, healthy, resilient, and sustainable requires a combination of policy and action levers.

81. Municipalities assume a unique governance role. The de-facto governing authority of Gaza is not widely recognized officially,²⁹ and the municipalities offer a more stable form of governance and reliable channels of support, especially for external aid which heavily contributes to keeping the Strip economically afloat.³⁰ This approach is particularly important during crises when immediate or post-conflict support needs to be delivered in a timely and efficient manner. The Gazan municipalities have so far been able to deliver, with strategic technical assistance from the Municipal Development and Lending Fund (MDLF), a quasi-government entity established by the PA to support municipalities.

82. The May 2021 conflict inflicted significant physical and economic losses and damages to municipal assets in Gaza. Estimated between US\$25-30 million, the damage to municipal infrastructure and services is concentrated in highly urbanized areas, rendering significant concentrations of people and businesses without basic services. Gaza City, the leading socio-economic commercial center, accounts for 47 percent of the total municipal damages. Around 15 percent of damages were to public facilities and spaces, already deficient in Gaza. The municipalities have experienced an increase in their operating expenditure coupled with a loss of revenue (between US\$2-5 million). The debris clean-up has also added to their expenditures and diverted funds from the repair of key municipal services. The widespread urban infrastructure damage is impacting living conditions and the operating environment, with constrained mobility, increased air pollution, and further degradation of the environment, causing risks to public health. Impaired public space is hampering economic activities and further reducing quality of life for the urban poor.

83. Gaza municipalities were already under heavy stress prior to the conflict. Municipal services have been deteriorating for years due to the severe economic situation, repeated shocks, and external restrictions. The external restrictions limit the import of materials, goods, and equipment necessary for operations, maintenance, and development of municipal infrastructure and services.³¹ Additionally, the persistent economic contraction in Gaza, resulting decrease in municipal revenues, lack of fiscal transfers, and declining aid have severely compromised the ability of municipalities to render local services. This has exposed the population to increased health and sanitation risks,

²⁸ The Gaza Strip comprises 25 municipalities with joint service councils to support service provision. There are no village councils in Gaza.

²⁹ Hamas is the de-facto ruling party in the Gaza Strip but is labelled a terrorist organization by a number of countries and therefore has no formal relationship with foreign governments and development organizations.

³⁰ PCBS data shows private and public consumption financed by aid flows were dominant contributors to Gaza's economy over the past two decades.

³¹ With support from development partners (DPs) for certain projects, coordination can be facilitated with the GoI, however the approval process is uncertain, lengthy, and can result in massive delays and significant extra costs.

safety risks, and increased environmental degradation.³² The pandemic has brought further strain to municipal capacity, as the municipalities lead the COVID-19 response under their emergency management responsibilities.³³ This has further increased expenditure and decreased revenues, due to weaker economic activity and intermittent lockdowns and restrictions. The overall fiscal constraints are also impacting municipal functionality, with all 25 local authorities paying partial salaries for several months now. As such, municipalities continue to urgently require sustained donor support to maintain critical local services and operations.

- 84. Restoration of critical municipal infrastructure is the immediate need for Gaza.** Total recovery needs for municipal services are estimated around US\$34 million. These include around US\$30 million for infrastructure rehabilitation and construction and US\$4 million for municipal service delivery restoration in the Strip. Immediate needs include destroyed and damaged streetlights, municipal service vehicles, solid waste containers, and partially damaged roads, aimed at ensuring safety and restoring lives of citizens. Short to medium-term (two to three years) recovery should focus on reconstruction of completely destroyed roads and infrastructure including public buildings and spaces (see Table 7 below). Recovery of basic services is necessary to enable the resumption of economic activities particularly in the productive, manufacturing and services, and transport sectors, as well as to support continuation of social services including healthcare and education.
- 85. Recovery should be led through integrated neighborhood upgrading approaches and capital investment programs (CIPs).** Integrated, inclusive, and resilient area-based urban transformation goes hand-in-hand with BBB and green recovery. Urban infrastructure investments need to be holistic, cross-sectoral, and scalable to enable neighborhood level and city-wide upgrading. In severely damaged and densely populated neighborhoods, single-sector localized reconstruction of damages misses the opportunity for wider, longer-term impact. Municipal infrastructure, such as roads, will need to be coordinated with other networks, including water, drainage, storm water, sewage, as well as with social infrastructure like community amenities and natural open spaces. Integrated approaches should aim to improve accessibility and circulation to and within neighborhoods, including refugee camps, and to the rest of the city for more inclusive recovery. Road rehabilitation should address safety through street lighting and improve mobility (i.e., traffic juncture improvements, bike lanes) to better connect people to jobs and opportunities. Lastly, all public works should include audits on women's safety to ensure that their design address the concerns for safety and needs of the female population.
- 86. Open space development on the coastline offers another investment opportunity.** Marine pollution control and nature-based solutions can be combined with public-private beachfront redevelopment that will offer recreational and business opportunities to the Gaza population mostly deprived of such amenities. These programs will need to be coordinated across multiple municipalities and could pave the way for cross-jurisdictional planning and metropolitan approaches. The cross-sectoral infrastructure development both at neighborhood scale and in the CIPs should be supported by municipal planning and policies for integration with residential and commercial reconstruction initiatives and social protection efforts. Plans should be developed through a consultative, community-based process that ensures inclusion of women, youth, and vulnerable groups. Infrastructure investments can be paired with jobs generation and skill training through interventions using labor-intensive public works for green infrastructure and rehabilitation. Lastly, municipalities should pursue zoning and other regulatory measures for land management to better manage the densification process and reserve available space for productive uses, e.g., private sector enterprise. Integrated recovery approaches will revitalize and reconnect the Strip improving livability, and in turn attract investment and stimulate growth.

³² Mounting and decomposing solid waste in urban areas, unlit and damaged streets, and sewage and water contamination.

³³ Municipalities must maintain local public services and facilities essential in the COVID-19 crisis, including sanitation and public health (hygiene); sanitization and cleaning of public roads and facilities; solid waste collection, transport, and disposal; and mandating social distancing.

Table 6 . Municipalities: Priorities and Actions

Key priorities	Key actions by different stakeholders
<i>Short-Medium term</i>	
1. Restoration and reconstruction of partially/completely destroyed roads and infrastructure including public buildings, streetlights, municipal service vehicles, solid waste containers, and public spaces, while promoting job creation.	<ul style="list-style-type: none"> • Municipalities: (i) prepare one year restoration/reconstruction program, prioritizing assets to be restored and providing cost estimates; (ii) adjust current budgets to accommodate financing urgent restoration/reconstruction costs; (iii) prioritize and divert what funding they do have to restoration of services; (iv) identify reconstruction activities that can be carried out through labor-intensive public works. • The associated public works will be designed to be labor intensive to help create temporary jobs. • The PA, MoLG, and municipalities: mobilize international support for the reconstruction efforts (referencing the RNDA). • Donors: (i) mobilize reconstruction funds to immediately support municipalities repair damages; (ii) prioritize funding support to labor-intensive infrastructure investments. • <u>GoI: ease restrictions on material and equipment entry to the Gaza Strip.</u>
2. Implement community-upgrading projects, piloting in areas worst-damaged by the May 2021 conflict. These area-based urban projects will showcase integrated, inclusive, and resilient transformation of select communities.	<ul style="list-style-type: none"> • Municipalities, service providers and local communities coordinate and jointly plan neighborhood upgrading plans. • Municipalities implement priority neighborhood upgrading projects. • Municipal infrastructure such as roads to be coordinated with other networks, including water, drainage, storm water, sewage, as well as with social infrastructure like community amenities and natural open spaces. • Donors provide technical assistance on Build Back Better techniques and green recovery.
<i>Medium-Long term</i>	
3. Improve urban resilience to shocks	<ul style="list-style-type: none"> • Municipalities, JSCs, and service providers develop medium to long-term resilience and disaster recovery plans in Gaza in alignment with an overall regional plan for the Strip. • Donors provide technical assistance (TA) to: (i) support the development of resilience plans; and (ii) advance technical capacity and skills to employ BBB, green approaches, and nature-based solutions for long-term development.
4. Intensify municipal technical capacity to plan, finance and sustain urban development programs.	<ul style="list-style-type: none"> • Municipalities strengthen fiscal capacity including policies that encourage cost recovery and O&M not only to maintain services but also to invest in resilient infrastructure. • PA pursue sectoral policy reforms focusing on generating additional revenues for municipalities while increasing efficiency and efficacy of spending for a more sustainable fiscal position.
5. Improve urban management and functionality	<ul style="list-style-type: none"> • Municipalities consider developing a metropolitan unit for areawide management for selective functions. • Donors provide TA to help municipalities develop tailored financing and institutional arrangements for metro area.
6. Develop and implement wider-scale, multi-year capital investment programming (CIP) for the Gaza Strip to support economic growth.	<ul style="list-style-type: none"> • Municipalities jointly prioritize and finance key investments to improve circulation and services in Gaza. • Donors pool financing to support investment in larger-scale cross-jurisdictional projects with greater impact. • GOI to ease dual use restrictions to allow for entry of material and equipment to enable sustainable longer-term development.

87. Forming an agglomerated metropolitan area in Gaza can offer a path to improved urban management and functionality and help address the needs emerging from rapid population growth, particularly the demand on services. The 25 municipalities in Gaza constitute a single economy and labor market serving a community with common interests. Unlike the West Bank they are also spatially contiguous with the same governance structure, and already form an agglomeration. Areawide management for selective functions would serve to address demands of a similar nature among local jurisdictions that are most effectively addressed jointly, such as mass

(public) transport, local road networks, solid waste disposal, road maintenance, and drainage. A metropolitan area approach can offer benefits from coordinating or integrating service provision, joint development, and cost sharing, in turn gaining efficiency and saving public resources. Tailored financing and institutional arrangements including support and commitment of all involved local governments are essential for the metropolitan government to fulfill its function sustainably. The existing joint service councils (JSCs) offer a replicable governance structure which could be built on to establish metro area planning units. The metro unit would then be best placed to implement the recommended, wider-scale capital investment plans. International experience has shown that in successful metro areas, significant economies of scale have been achieved in service functions. Moreover, the improved services and functionality of these areas attract new investment for job creation and economic development.

88. Intensify municipal technical capacity to plan, finance, and sustain urban development programs. BBB and green investments must be accompanied by responsive action levers. Developing resilience and disaster recovery plans (including post-pandemic) should be a priority for all municipalities in Gaza in alignment with an overall regional plan for the Strip. These should have well-defined integrated sectoral plans with scenarios and options for sustaining services during crises. Advancing technical capacity and skills is needed to employ BBB and green approaches long-term for future development. Additionally, strengthening fiscal capacity should remain a priority including policies that encourage cost recovery, not only to maintain services but also to invest in resilient infrastructure. Sectoral policy reforms should focus on generating additional revenues for municipalities while increasing the efficiency and efficacy of spending. Lastly, municipalities should explore engaging the private sector in services provision, such as outsourced operation and management of municipal facilities and services.

89. For short to medium-term recovery, the PA and donor community will need to focus on infrastructure investments through labor-intensive public works (LIPW) for rehabilitation to provide quick relief and job generation. Implementing donor-financed projects for road rehabilitation, particularly inner-city roads, and solid waste recycling and sorting, would have an immediate positive impact on unemployment and the state of infrastructure in Gaza. Donor-financed projects to address housing needs for internally displaced people can provide a boost to the construction sector and create considerable job opportunities. LIPWs should have an explicit focus on gender with the inclusion of activities that will benefit women. The participation of women in LIPWs will allow them to access wage employment, while their participation in the labor force will also contribute to larger improvements in child welfare and in women's health and status. Gender-disaggregated data should be collected on all projects for monitoring and evaluation purposes. The dual-use restrictions applied by the GoI to Gaza would need to be revised and international practices and recommendations adopted to allow for entry of material and equipment to rebuild municipal infrastructure and services as key for the short-term recovery and for sustainable longer-term development.³⁴ The donor community plays a key role in taking this agenda forward. Table 7 summarizes the main priorities to support municipalities as enablers of sustained growth and economic development.

e- Human Capital for Economic Development

90. Reverting the declining development trajectory will create more and better job opportunities in Gaza, especially for women and youth. Reforming the current restrictions and addressing the infrastructure constraints is expected to increase growth and reduce the current unemployment rate of 48 percent (in the first quarter of 2021, prior to the recent conflict). Improving labor market prospects is particularly key to address the high unemployment rate among youth (66 percent) and women (64 percent, compared to 42 percent among men in Gaza)³⁵. External trade and mobility restrictions are among the main constraints to job creation in Gaza. In addition, domestic factors

³⁴ *Economic Monitoring Report to the Ad Hoc Liaison Committee*. Washington, D.C., World Bank Group. April 2019.

³⁵ World Bank. 2021. "Gender as a Cross-Cutting Issue with Focus on Women and Gender-Based Violence." Background Paper to the Gaza Rapid Damage and Needs Assessment, June 2021.

such as poor governance and a fragmented regulatory environment for business exacerbate the lack of jobs.³⁶ While youth struggle to find opportunities, employers in Gaza also complain that workers lack relevant digital, language, and soft skills.³⁷ More and better jobs require solid human capital and a competent workforce that match the skills' requirements of the 21st century labor market needs, especially in ICT. Investing in human capital will support a sustainable growth strategy of a modern knowledge-based economy.

91. By ages 4 and 5, only half of Gazan children receive an early childhood education (ECE).

According to estimates from the Palestinian Ministry of Education (MOE), approximately 49 percent of four-year-old children in Gaza attend Kindergarten Level 1 (KG 1). While this rate increases to roughly 70 percent for five-year-olds attending KG2,³⁸ it is estimated that most children from the two bottom income quintiles³⁹ are deprived from the protective benefits that ECE offers, particularly in mitigating young children's toxic stress, providing for their physical and emotional care, and promoting their healthy development. As such, reaching universal access to quality ECE, and particularly ensuring that the most vulnerable children receive the protective benefits of KG services, is one of the most important education priorities for Gaza in the next five years.

92. Participation in primary and secondary education is high, reflecting the strong value that Gazan families place on education.

In 2020, the primary enrollment rate was virtually universal, with a 99.5 percent completion rate at Grade 4—the last year of the lower basic education level in Gaza. By Grade 9—the last year of upper basic education⁴⁰—completion rate stood at 93.2 percent, and by Grade 12—the last grade of secondary education—65.9 percent of the relevant cohort completed their education cycle.⁴¹ In the next five years, a strong focus should be placed on improving the completion rate at secondary level, which may require targeted demand-side interventions, as well as supply-side investments to improve the quality and relevance of education.

93. Beyond high participation rates in basic education, Gazan students consistently outperform their West Bank peers in Science, Arabic, and Mathematics.

Absent data from international standardized assessments, the Palestinian National Standardized test is the only quantitative indicator of students' learning outcomes in Gaza. The 2018 test results showed that at both the lower and upper basic education levels, Gazan students outperformed their West Bank peers in all assessed subjects: Science, Arabic, and Mathematics (see Table 8). Yet, while learning outcomes in Gaza were higher than in the West Bank, the average performance of Gazan students still falls short of national targets set by the Palestinian MOE for all assessed subjects. The largest gap between MOE targets and Gazan students' performance occurs in Mathematics at Grades 5 and 9, and Science at Grade 9. Overall, the results further suggest that girls significantly outperform boys at both grade levels. In the next five years, educational investments should aim to close this learning and gender gap.

³⁶ World Bank. 2019. "Jobs in West Bank and Gaza – Enhancing Job Opportunities for Palestinians." Washington, DC: World Bank.

³⁷ World Bank. (forthcoming). "Digital Economy Assessment for the West Bank and Gaza." Washington, DC: World Bank.

³⁸ According to the 2019 Statistical Book of the Palestinian Ministry of Education, 26,732 children attend KG1 and 39,455 attend KG2 in Gaza.

³⁹ El-Kogali & Krafft 2015. "Expanding opportunities for the next generation: early childhood development in the Middle East and North Africa." Washington, D.C.: World Bank.

⁴⁰ In West Bank and Gaza, Grades 1 to 4 are referred to as lower basic education, Grades 5 to 9 are referred to as upper basic education, and secondary education is comprised of Grades 10 to 12.

⁴¹ Palestinian Central Bureau of Statistics, 2021.

Table 7: Learning Outcomes of Gazan Students in Basic Education

Region	Grade 5 (Lower basic education)			Grade 9 (Upper basic education)		
	Science	Arabic	Mathematics	Science	Arabic	Mathematics
Gaza	48.8	51	48.5	40.1	57.4	36.4
West Bank	41.5	46.1	37.6	29.1	48.6	25.4
MOE National Target	54.3	58.1	57.2	48.9	61.8	45.1

Source: Palestinian Ministry of Education, 2018.

- 94. At the tertiary education level, three out of four Gazan students graduate, but their employment prospects are bleak.** 2019 MOHE estimates indicate that roughly 55,600 students are enrolled in tertiary education institutions, of which 73 percent pursue a Bachelor's degree and 27 percent a Technical Vocational Diploma. Of these students, 75 percent complete their studies, with 34,939 students graduating with a Bachelor's degree and 6,792 with a Diploma.⁴² Yet, upon graduation, their employment prospects are bleak. Four out of ten higher education graduates in Gaza are unemployed.⁴³ The situation is particularly dire for women: almost two-thirds of women with postsecondary education are out of work, compared to 36 percent of men with the same education background.⁴⁴ The substantial gender disparities are also manifested in labor force participation rates. Women in Gaza are more likely to be part of the labor force the more educated they are. However, even among those with 13 or more years of schooling, only 39 percent participate in the labor force, compared to 64 percent of educated men.⁴⁵ The reasons are manifold and range from social norms to structural barriers such as lack of childcare, inadequate public transportation, and unfavorable labor regulations.⁴⁶ Improving the education-to-work transition in Gaza will require a dedicated focus on establishing an enabling, safe labor market environment for women.

Table 8: Simulation of Learning Losses due to COVID-19 pandemic

	Learning-Adjusted Years of Schooling (LAYS), by Scenario			
	Baseline	Optimistic	Intermediate	Pessimistic
West Bank and Gaza	8.1	7.5	7.3	7.0

Source: World Bank, UNICEF, and UNESCO (forthcoming).

Notes: LAYS is a measure that combines the quantity and quality of education by adjusting the average number of years of schooling attained in a given country by the quality of education received according to the results of learning assessments. The assumptions underlying the scenarios differ in terms of the assumed length of school closures and effectiveness of mitigation measures such as distance learning.

- 95. Learning losses caused by the COVID-19 pandemic need to be mitigated to maintain and improve learning outcomes at all education levels in Gaza.** The impact of the pandemic risks holding back progress in the education sector for years to come. A World Bank simulation of the potential impact of COVID-19 suggests that the pandemic may have reduced learning-adjusted years of schooling (LAYS) by up to 1.1 years (see Table 9). To determine students' knowledge and skills after the prolonged learning disruptions, teachers will need to be trained on how to prepare, implement, and make use of frequent formative assessments. To achieve MOE's learning targets

⁴² 2019 Ministry of Higher Education Statistical Book.

⁴³ According to PCBS, the 2019 unemployment rate amongst tertiary education graduates in the 22-29 age group stood at 46 percent

⁴⁴ PCBS. 2021. "Palestinian Labor Force Survey 2020 Data", Table 7. Postsecondary education defined as 13+ years of schooling based on available PCBS data.

⁴⁵ Ibid.

⁴⁶ World Bank. 2018. "Enhancing job opportunities for skilled women in the Palestinian territories." Washington, DC: World Bank.

for the core subjects, students will also require extensive remedial education and tutoring, especially those from disadvantaged households.

- 96. Ensuring access to education for all children and youth in Gaza requires urgent action to address the immediate needs created by the recent conflict.** The Gaza RDNA indicates that more than 300 educational institutions sustained damage to their infrastructure, including private kindergartens, public schools, UNRWA schools, and universities.⁴⁷ In addition, the conflict has further exacerbated the need for mental health and psychosocial support services (MHPSS) among children and youth, who have been suffering from toxic stress and repeated trauma for years. Repairing the educational infrastructure and providing MHPSS to all children in need is of utmost priority to meet the medium- and long-term aspirations for the Gazan education sector, in particular with regard to improving completion rates at the upper secondary and tertiary education levels.
- 97. To address immediate needs as well as medium-term priorities, concerted actions are required by different stakeholders.** Table 10 provides a summary of these key priorities and actions.

⁴⁷ World Bank, European Union, and United Nations. 2021. “Gaza Rapid Damage and Needs Assessment - June 2021.” Washington, DC: World Bank.

Table 9. Education Sector: Priorities and Actions

Key priorities	Key actions by different stakeholders
Short-term	
<p>Address immediate education sector needs identified in the Gaza Rapid Damage and Needs Assessment:</p> <ul style="list-style-type: none"> • Repairing damaged education infrastructure • Providing MHPSS to children and youth 	<ul style="list-style-type: none"> • GoI to facilitate import of necessary construction materials for rehabilitation of damaged schools and education facilities. • PA to effectively collaborate with MOE and MOH counterparts in Gaza to set up MHPSS services that can be implemented at scale to reach all children and youth in need. • Donors to coordinate the various emergency support initiatives to avoid duplication and ensure the most vulnerable are targeted.
Mitigate learning losses caused by COVID-19 school closures	<ul style="list-style-type: none"> • PA to develop a strategy to mitigate learning losses in key subjects (Arabic, math, science), with a focus on: (1) ensuring students in the early grades develop foundational literacy and numeracy skills, and (2) vulnerable students at all education levels who could not benefit from distance learning are provided with the necessary support to catch up. • Donors to provide technical assistance on emerging lessons learned from other countries on effective school reopening; donors to provide funding for remedial education and other priority programs.
Medium-term	
Achieve universal enrollment of KG2	<ul style="list-style-type: none"> • PA to develop strategy to universalize access to KG2 in Gaza by 2025, with a focus on reaching the most vulnerable children first, and ensuring high quality of service provision. • Donors to increase funding for KG2 services and explore innovative cost-effective service delivery modalities that can be sustainable in the medium and long terms.
Increase completion rates in secondary education	<ul style="list-style-type: none"> • Donors to conduct analytical work to identify key demand- and supply-side drivers behind low secondary education completion rates and provide technical assistance on effective interventions proven to increase secondary completion. • PA to pilot key interventions to improve secondary completion in Gaza and evaluate its effectiveness for potential scale-up.
Improve education-to-work transition, especially for women	<ul style="list-style-type: none"> • PA and donors to develop a comprehensive education-to-work transition strategy for Gaza that focuses on creating more job opportunities for youth and facilitating women's entry into the labor force. To establish a more enabling environment for women, the education sector can play a central role in reducing stereotypes and biases. For example, a careful review of the curriculum to ensure gender sensitivity, along with targeted professional development for teachers could have the potential to contribute to a gradual, long-term shift in social norms. • GoI to reduce trade and mobility restrictions to facilitate job creation in Gaza. • PA to address governance challenges and improve regulatory environment to facilitate job creation in Gaza and create opportunities for university graduates. PA to improve higher education relevance (particularly in digital, language, and soft skills) to meet employers' demands.

ANNEX I: Stocktaking of World Bank recommendations to the AHLC meetings over the years

1. **The Palestinian economic outlook is worrying, and bold actions are needed from all parties to get the Palestinian economy out of its deteriorating trajectory.** Several necessary actions have been identified in previous reports by the World Bank to the AHLC meeting, but implementation has been limited. In the World Bank's September 2016 report to the AHLC, a stocktaking of all previous World Bank recommendations to the meeting was conducted. This exercise was intended to provide a baseline for evaluating progress in achieving the Palestinian territories' development priorities. In addition, it was expected to galvanize the reform efforts of all parties to address the immediate need while setting in place reforms that will deliver over time. In this report, the stocktaking is updated to show progress since June 2021 using the same three pillars: (1) fiscal sustainability, (2) economic development, and (3) Gaza reconstruction and recovery.
- A. Fiscal Sustainability
2. **The ongoing COVID-19 pandemic and tough fiscal situation make it difficult for the PA to embark on challenging expenditure reforms, but once the situation improves the PA needs to start addressing several longstanding areas of ineffective expenditure for long-term fiscal sustainability.** In particular, the PA needs to adopt a comprehensive plan for civil service reform that looks at inefficiencies and overstaffing – especially in the West Bank. Parametric reforms are also needed to support the public pension system's sustainability. Progress has been made on steps to control electricity net lending – although the problem is increasing with other utility payments, mainly water and sewerage. The net lending situation for the water sector continues to face challenges: i) net lending for water and sanitation is at NIS30 million per month; ii) Israel charges the Palestinian Ministry of Finance NIS110 million per year to treat the transboundary wastewater. There is no agreement on accounting principles for these costs; and iii) service providers continue to accumulate debt, which has increased due to COVID-19. All stakeholders need to agree on a new mechanism to ringfence water revenues and increase payments of bulk water purchases from the Israel water utility Mekorot. Outside medical referrals (OMR) also represent an ongoing fiscal burden for the PA, but steps have been taken to control this category of spending including introducing a digitalized system to monitor OMRs and linking this e-referral system to the MoF's Integrated Financial Management Information System (IFMIS) which will enhance transparency regarding OMRs and allow for better financial planning.
3. **After declining in 2020 due to the COVID-19 crisis, data for the first eight months of 2021 shows that domestic revenue collections have started to recover but risks remain high and efforts are still needed to bring revenues close to their potential.** As the PA has eased COVID-19 containment measures in 2021, domestic revenues increased by 29 percent in the first eight months of the year. Despite this impressive performance, efforts are still needed by the PA to improve tax administration. For instance, tax avoidance is still widespread, particularly among high earning professionals, and the PA needs to focus efforts on this group of taxpayers. Encouragingly, the MoF has recently prepared a three-year revenue strategy (2021-2023) that focuses on tax administration and improving compliance. Progress has also been made on updating public fees and charges with a notable decision to increase the license fee for petrol stations. Further, the PA and the Government of Jordan have agreed to further cooperation on customs through electronically linking their customs systems, which is expected to significantly reduce smuggling. These efforts have recently slowed due to COVID-19 but are expected to pick up again as the crisis eases.
4. **Cooperation by the GoI to offset fiscal leakages remains key as additional deductions from clearance revenues have worsened the fiscal situation.** The GoI has increased monthly deductions from clearance revenues from NIS40 million in previous years to NIS50 million in April 2021 and further up to NIS100 million in August 2021 planned for 4 months. This has placed large stress on the PA's financing situation. Hence, there is an urgent need to resolve outstanding issues related to the revenue sharing arrangements. Efforts should focus on implementing existing agreements that

provide for full information sharing on trade that takes place between both parties, including Israeli sales to Gaza. The parties could also reach an agreement regarding the sharing of Allenby Bridge exit fees. Talks have been under way for some time between the GoI and the PA to initiate the introduction of bonded warehouses for Palestinian imports and the transfer of some customs authority to the PA over the coming years. Even though there were encouraging talks about exempting fuel taxes from the clearance process, this did not materialize as these taxes are still collected by the GoI and then transferred to the PA after deducting a 3 percent handling fee. Recent talks between the two parties have also focused on implementing an E-VAT system in December 2021, which would be a very positive step if, indeed, implemented.

5. **The PA is continuing to make progress on improving the public financial management (PFM) system.** The PA has a comprehensive PFM strategy, which has been updated to incorporate the findings of the latest Public Expenditure and Financial Accountability (PEFA) assessment. A World Bank-funded project is providing support with a focus on budget execution, financial accountability, and procurement. Good progress was achieved during 2019-2020 on the implementation of the procurement law with the single procurement portal operational, new standard bidding documents approved by the Council of Ministers, a capacity-building program of the procurement workforce launched, and the operationalization of the complaint mechanism under way. The pace of implementation has slowed down over the past few months following the change in High Council for Public Procurement Policies (HCPPP) leadership. Priority actions going forward include enforcing the use of the single portal and Standard Bidding Documents (SBDs) by all procuring entities and equipping HCPPP with the qualified human resources that are necessary to effectively assume its role in the development of the procurement system, policy-making and oversight of all public procurement activity. Progress has also been made on addressing major delays in the production and audit of financial statements. The 2016 and 2017 financial statement audits were finalized in December 2020 by the State Audit and Administrative Control Bureau and the 2018 and 2019 financial statements have been submitted by the MoF for audit. In line with the PFM strategy, support continues on the commitment control system (CCS). While some ministries have already implemented a CCS under a pilot program, the project supported expansion for all ministries to implement a CCS which should be implemented during the last quarter. The project is also supporting the modernization of financial control, intergovernmental fiscal transfers, and improvement of payroll management. New procedures were introduced to ensure that all health referrals are reflected in the financial management information system in a timely manner. A FCDO-funded PFM project continues to focus on budget management, revenue administration, and improving the policy development/planning processes led from the Prime Minister's Office.
6. **Budget support from donors has significantly declined in recent years and funds remain insufficient to close the large financing gap.** As a share of GDP, aid to the budget fell from 27 percent in 2008 to 3 percent in 2020 and to around 1 percent projected for 2021.

B. Economic Development

7. **The constraints on movement, access, and trade continue to be the main impediment to economic growth in the Palestinian territories.** Area C remains key to Palestinian economic development but access to this area for Palestinian economic activity remains severely limited. Further progress has been made on the piloting of door-to-door transport through the West Bank crossings, with the initial Hebron pilot being extended to Nablus and Qalquilia regions, however the current scope of this activity remains limited. Building power networks in the West Bank, particularly for increasing imports from Jordan, unavoidably involves some segments traversing Area C and continues to suffer from approvals being opaquely delayed for years. The long list of dual-use items key for the development of the economy and whose access is restricted has been updated but not significantly eased. With time, and as more incentives are put in place to promote compliance, access to dual-use items should be based on a risk-based criterion rather than a blanket approach. For instance, all Palestinian businesses that have established a strong track record of their ability to safely and securely handle hazardous materials and dual-use goods should be granted access to these goods without the need for cumbersome licensing procedures. Encouragingly, the

GoI has recently announced that some restrictions on the movement of goods and people in and out of the Strip will be eased. For example, some 50 Businessman Card (BMC) holders were allowed to exit Gaza in early August. It was also announced that the number of Palestinian workers in Israel will be increased by 15,000.

8. **At a domestic level, the PA has initiated steps to improve the business climate, but these have yet to be fully implemented.** With technical assistance from the World Bank, the Ministry of National Economy finalized a new draft of the Companies Law that was approved by the Cabinet and signed by the President on October 2nd, 2021. Similarly, a draft Competition Law was approved by the Cabinet and is now awaiting the President's signature. With support from the World Bank, the PA has also updated the Law of Crafts and Industries of 1953 to facilitate municipal business licensing through simplifying the approval process and reducing the cost. The amendments took effect from January 1, 2019, and the focus has more recently been on removing administrative obstacles to faster processing of municipal business licenses and automate the process. To establish strategic and policy oversight of institutions in land administration, in November 2018 the Cabinet of the previous administration adopted a draft Amendment to the Palestinian Land Authority (PLA) Laws. The amendment calls for the establishment of a Board of Directors that would oversee the operations of the PLA and would facilitate increased transparency in the land sector in line with the ongoing reform process. The legal amendment remains pending for ratification by the executive branch. In 2020, the President's Office sent the PLA Law back to the Council of Ministers with comments in relation to the financial implications of the law. The PLA and LWSC addressed all the comments, and the text of the law was reformulated accordingly and sent back to the Council of Ministers for approval. The draft law was sent to the Presidency again in April 2021 for enactment, but still awaits the President's signature. Land registration is proceeding in the West Bank under the mandate and direction of the Land Water Settlement Commission (LWSC) in cooperation with local government units (LGUs). However, registration activities continue to be hampered by the pandemic, experiencing delays as a result of the corresponding closures and travel restrictions within the West Bank. In addition to national closures, there have been numerous localized closures at the land agencies from COVID-19 outbreaks among staff. A new Telecommunication law was approved by the Cabinet and signed by the President on October 2nd, 2021. The new law provides for the establishment of the Palestinian Telecommunications and Information Technology Regulatory Authority, which will serve as an independent regulator of the sector. The implementation of the new Telecommunication Law and the establishment of an independent regulatory authority would boost competition in the Palestinian telecommunications sector and provide a strong catalyst for its enhancement.
9. **Progress in the energy sector continues in the shadow of COVID-19.** The interim Power Purchase Arrangements (PPA) between the GoI and the PA continue to be implemented. Based on these arrangements, the Palestinian Electricity Transmission Company (PETL) has started managing electricity supply from the Israeli Electricity Company (IEC) through the four high-voltage substations in the West Bank. PETL is also providing solar energy, supplied by independent power producers (IPPs) in the Northern West Bank. PETL has a good payment record under the interim arrangements and solar PPAs. Increasing supply through the high voltage substations will contribute to alleviating supply constraints and improving quality across the West Bank. The Palestinian Energy and Natural Resources Authority (PENRA) continues to implement reform measures to improve collection, efficiency, and payment-related performance. The pandemic and economic slowdown continue to cast a shadow in terms of reduced financial flows across the energy supply chain, which is affecting all energy sector institutions. A Revenue Protection Program, along with updated management information systems, continues to be rolled out to the distribution companies in the West Bank and Gaza. However, improvements in the sector continue to be hampered by a lack of progress in other areas - particularly those related to electricity infrastructure in Area C. Diversification of electricity supply from neighboring countries and distribution grid reinforcements are needed to enable stable supply but are hindered primarily by land access issues. Construction restrictions in Area C continue to pose major obstacles to strengthening the energy supply and sustainability through renewable IPPs and interconnections. The need for a

comprehensive energy action plan for Gaza to enable increased supply, improved operations, and institutional reforms remains urgent. The recently concluded institutional review and audit of energy sector finances in Gaza provides comprehensive recommendations and their implementation is a priority in addressing the energy crisis and managing the electricity sector's fiscal impact.

C. Gaza Reconstruction and Recovery

- 10. The 11-day Gaza conflict that took place in May 2021 resulted in severe damages across all sectors in Gaza and, hence, the recovery and reconstruction needs are estimated to be large.** Based on the findings of the Rapid Damages and Needs Assessment (RDNA) conducted by the UN, EU, and the WB, the immediate and short-term recovery and reconstruction needs (during the first 24 months) are estimated between US\$345 – 485 million. This assessment includes a focus on Building Back Better (BBB), an approach that ensures that recovery and reconstruction efforts factor in resilience and sustainability, moving beyond simply rebuilding the assets and networks destroyed or damaged to pre-conflict levels. In the immediate term (0-6 months), from the time of the conflict until the end of 2021, the recovery needs are estimated at between US\$125 – 195 million; thereafter, the short-term recovery and reconstruction needs (6- 24 months) amount to between US\$220 – 290 million. The social sectors including Housing, Health, Education, and Social Protection and Jobs, bear the largest share, representing some 36 percent of immediate needs and 52 percent of short-term needs. The immediate needs for the infrastructure sectors range between US\$ 35 – 60 million, and short-term needs at between US\$50 – 75 million. The needs of the productive and financial Sectors are estimated at between US\$70 – 95 million, while the cross-cutting sector needs are estimated between US\$30 – 45 million for recovery and reconstruction.⁴⁸
- 11. The immediate humanitarian response has started, and efforts are needed by all parties to ensure that this response lays the groundwork for medium and long-term reconstruction and recovery phases.** There is a need for action by the PA, GoI, and international community to address the needs and ensure that this reconstruction process paves the way for an efficient recovery and a more sustainable trajectory for Gaza. The PA needs to take on an active approach in leading the reconstruction efforts, building on experience from previous conflicts, namely in 2014. The PA will also need to take prompt actions to ensure sustainability of governance arrangements in Gaza as the current situation of dual administrative systems results in complicated public service arrangements and is not sustainable. Access to materials for reconstruction should be eased to allow for an efficient and speedy reconstruction, while also addressing legitimate security concerns. Efforts also need to focus on easing constraints that currently stifle private activity and setting the enabling conditions for private investment, as achieving a sustainable growth path for Gaza cannot happen without allowing its economy to connect to the outside world. Finally, sizable and predictable donor support will not only be crucial to implement reconstruction activities, but Gaza's economy will continue to depend critically on donor support for several years to come, until gradually the tradable sectors replace the role of donor aid as the key source of foreign exchange to fuel the economy.

⁴⁸ The RDNA report can be accessed here: <https://documents1.worldbank.org/curated/en/178021624889455367/pdf/Gaza-Rapid-Damage-and-Needs-Assessment.pdf>

Table A. Summary of World Bank Recommendations to AHLC meetings

Actions	Responsible Party	Progress as of Sept 2016	Progress as of June 2021
<u>FISCAL SUSTAINABILITY</u>			
Expenditures			
Control the oversized wage bill	PA		
Control medical referrals to Israel	PA		
Control medical referrals to local facilities	PA		
Implement administrative reforms for the pension system	PA		
Implement parametric reforms to restore the pension system's sustainability	PA		
Reduce the size of net lending	PA		
Revenues			
Enhance the PA's tax effectiveness in Gaza	PA		
Increase the number of registered large taxpayers	PA		
Strengthen legislation to penalize non-compliant taxpayers	PA		
Revise government fees and charges upwards	PA		
Transfer to the PA fiscal losses accumulated over the years	GoI		
Implement institutional measures to reduce fiscal losses on clearance revenues	PA and GoI		
Public Financial Management			
Improve budget preparation procedures	PA		
Align budget execution with available resources	PA		
Clear the backlog of outstanding financial statements	PA		
- 2012-2017			
- 2018-2019			
Develop systems for monitoring and reporting expenditure arrears	PA		
Budget support			
Provide sizable, predictable, and timely support to the PA's budget	Donors		
<u>ECONOMIC DEVELOPMENT</u>			
Area C			
Expand spatial plans for Palestinian villages in Area C	GoI		
Increase number of building permits approved in Area C	GoI		
Grant approval to Palestinian business projects in Area C	GoI		
The Gaza economy			
Allow exports out of Gaza to reach pre-2007 level	GoI		
Significantly reduce items on restricted dual-use list for Gaza	GoI		
Create a unified legal system in the West Bank and Gaza	PA		
The business climate			
Adopt the Secured Transactions Law and establish a movable asset registry	PA		
Adopt the new Companies Law and the Competition Law	PA		
Accelerate land registration in Areas A and B	PA		
Improve access to finance for SMEs	PA		

Actions	Responsible Party	Progress as of Sept 2016	Progress as of June 2021
Reform the education system to bridge gap between graduates' skills and labor market needs	PA		
Securing energy for development			
Sign interim PPAs to energize high-voltage substations	GoI and PA		
PETL operating on commercial basis	PA		
Diversify electricity supply	GoI and PA		
Access to dual-use items			
Make the process to import dual-use goods more transparent	GoI		
Allow access to potent fertilizers in the West Bank	GoI		
Facilitate access to machinery in the West Bank	GoI		
Adopt a risk-based approach in the West Bank and Gaza to control dual-use items	GoI		
Meet international standards for controlling and regulating dual-use goods	GoI and PA		
<u>GAZA RECONSTRUCTION AND RECOVERY</u>			
Complete a DNA to guide reconstruction and recovery following May 2021 conflict	PA, donors		
Establish and monitor timeline indicators for review and approval of dual-use items	GoI		
Include delivery monitoring in GRM system	GoI and PA		
Establish Gaza import mechanism able to handle long-term recovery needs	GoI and PA		
<u>Gaza Development</u>⁴⁹			
Streamline trade procedures at commercial crossing and expand capacity	GoI		
Expand Gaza's fishing zone	GoI		
Implement donor-financed labor-intensive projects	PA, GoI, donors		

Legend

	On track
	Some progress achieved
	No progress

⁴⁹ These are additional recommendations that were made in the World Bank's March 2018 report to the AHLC.