1. Project Data

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<th>Operation ID</th>
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<tr>
<td>P147687</td>
<td>WBG - PRDP Support VI</td>
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<th>Country</th>
<th>Practice Area(Lead)</th>
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<tr>
<td>West Bank and Gaza</td>
<td>Macro Economics &amp; Fiscal Management</td>
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<td>40,000,000.00</td>
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</table>

Sector(s)
Central Government (Central Agencies)(88%); Other Non-bank Financial Institutions(12%)

Theme(s)
Public expenditure, financial management and procurement(63%); Tax policy and administration(25%); Infrastructure services for private sector development(12%)

Prepared by: Lev Freinkman
Reviewed by: Clay Wescott
ICR Review Coordinator: Lourdes N. Pagaran
Group: IEGEC (Unit 1)

2. Project Objectives and Policy Areas

a. Objectives

According to the Program Document (PD, p. (i)), the development objectives the operation intended to achieve in each of its specific policy areas were as follows: (1) reducing the Palestinian Authorities’ (PA) recurrent fiscal deficit; (2) improving effectiveness and transparency of public finances; and (3) improving business climate.

The Grant Agreement does not specify a development objective.
b. Were the program objectives/key associated outcome targets revised during implementation of the series?

No

c. Pillars/Policy Areas

The Development Policy Grant (DPG) VI operation was designed to provide selective support to the Palestinian Authority (PA) in its implementation of the National Development Plan 2014 - 2016 and focused on the following three policy areas:

1. Reducing the PA’s Recurrent Fiscal Deficit

The program aimed at promoting greater fiscal consolidation and reduction in aid dependency. It focused on improving tax administration by broadening the tax base through the amendments to tax legislation, continued implementation of measures to contain growth of the wage bill and the number of staff on the payroll, and reforming the government’s transportation allowance policy to secure additional budget savings.

2. Improving Effectiveness and Transparency of Public Finances

The reform actions under this policy area were expected to contribute to more effective control over budget execution. It focused on strengthening the public procurement law and its implementation regulations, implementing a monthly rolling cash plan to improve control over the budget commitments, and strengthening the arrangements for monitoring and reporting on budget arrears based on adding functionality to the Integrated Financial Management Information System (IFMIS).

3. Improving the Business Climate

The program focused on a particular area of business climate related to the improved private sector access to credit. The specific reform measure supported under the program aimed at enhancing the conditions for secured lending through adoption of the new Law on Leasing. The Law (and supporting asset registration infrastructure) would enable leasing companies to use leased assets as collateral to borrow funds.

d. Comments on Program Cost, Financing, and Dates

The Palestine DPG VI (P147687) was appraised in April 2014 and approved by the Board of Executive Directors on May 20, 2014 in the original amount of US$40 million. On October 30, 2014, the Board approved Supplemental Financing for Gaza Emergency Response (P152527) to augment the DPG VI by additional US$41 million in support of the authorities’ reconstruction effort after the Gaza conflict in July-August 2014. The operations became effective on July 9 and November 26, 2014 and disbursed in full on July 22 and December 3, 2014, respectively. The closing date for both operations was March 31, 2015 (the original closing date for P147687 was December 31, 2014).

3. Relevance of Objectives & Design

a. Relevance of Objectives

The operation’s objectives were fully aligned with the Bank’s Interim Strategy Note (ISN) for FY2012-14 and the Assistance Strategy (AS) for FY2015-16. The DPG VI contributed to Pillar 1 of the ISN, aimed at strengthening the institutions of a future state to efficiently manage public finances and ensure services to citizens, as well as to Pillar 2, aimed at supporting the creation of an enabling environment for private sector led growth. The ISN explicitly mentioned (p.19) that “the ongoing series of development policy grants will maintain their focus on fiscal management and public financial management”. The Pillars of the more recent AS, while slightly modified, remained substantively the same as they were emphasizing (1) strengthening institutions of a future state and (2) supporting private sector led growth. The DPG’s objectives were also relevant to the Palestine National Development Plan (NDP) 2014-2016. In particular, it was designed to support the first two objectives of the NDP, which are (1) growth and competitiveness, and (2) better governance in public institutions. However, the operation’s third objective to “improve business climate” was too broad relative to the scope of the underlying reform program and a narrower objective related to “improved access to finance” would have been more appropriate.
b. Relevance of Design

The results framework broadly presented a logical causal chain between budget and policy support from the Bank and other partners, operation's prior actions, and intended outcomes. The operation was a logical extension of prior DPGs for West Bank and Gaza, had broadly a similar design, and supported continuation of several reforms initiated earlier. Despite a clear link to the multi-year government reform program, the DPG VI was appropriately designed as a single-tranche operation because of the fragile and uncertain territory’s security and policy environment, preventing an effective medium-term programming.

However, the operation’s design showed three shortcomings, which were inter-related. First, the proposed set of prior actions, while well intended, appeared to be insufficiently robust. For three (out of eight) prior actions, the Government’s performance after the Grant approval presented various types of backsliding. Specifically, the Government breached its own policy of net zero hiring, while the introduction of 10% tax on distributed dividends was suspended (despite being approved by the Law earlier), and effectiveness of the new Procurement Law was postponed until July 2016. Such backsliding was largely driven by unanticipated force majeure events (Gaza war, withdrawal of clearance revenues by Israel), but it also might reflect insufficient buy-in from powerful local stakeholders and inadequate reflection in the design of critical political economy constraints. Second, the operation's target in the area of procurement reform was too ambitious. The Bank could have learned from its own experience under the previous operation (DPG V), which faced very similar problems in this area. Third, the risk analysis in the Program Document did not identify the particular risk of weakening government’s commitment to reforms, especially in such politically sensitive areas as public procurement and payroll control. This risk materialized: in the deteriorated security environment of the second part of 2014 and the related fiscal crunch, the Government’s appetite for structural reforms has diminished, which became a major factor responsible for weaker than expected program’s outcomes.

Macroeconomic framework. The Bank assessed the macroeconomic policy framework as being adequate at the time of Board approval. Meanwhile, the team recognized that the territory’s macro stability is subject to a number of risks, many of them beyond the PA’s control, including a risk of sharp drop in donor budget support. Meanwhile, the short-term macro and fiscal trends prior the operation were encouraging. The PA’s strengthened control over budget spending and its efforts to improve revenue performance brought about a decline in the recurrent deficit by two percentage points of GDP in 2013 vs. 2012, in spite of the sharp slowdown in economic growth. Inflation was expected to remain low. The Palestinian banking sector stayed healthy and well regulated. The most recent Debt Sustainability Analysis (DSA) indicated that though debt was sustainable in the medium term under the baseline scenario, it remained sensitive to shocks. Still, the PA continued to depend on arrears as a significant source of financing for its budget deficit. The West Bank and Gaza is not a member of the IMF and its does not have the program with the Fund. However, the IMF provides regular technical assistance to the PA. The Bank reflected on the IMF recommendations in the DPG’s design, in particular, in selection of supported revenue measures.

4. Achievement of Objectives (Efficacy)

Objective 1

Objective 1: Reducing the Palestinian Authorities’ recurrent fiscal deficit

Rationale

Reduction in the recurrent fiscal deficit (on a commitment basis) was achieved: from 11.1% in 2013 it declined to 10.4% and 9.9% in 2014 and 2015, respectively. However, the deficit reduction in 2014 could not be attributed to the implementation of policies supported under DPG VI, as explained below. The decline in 2015 deficit could be attributed to the program only partially. The budget consolidation in 2014-15 was driven by other government’s efforts, both on the revenue and expenditure side. Specifically, the PA has finalized a new revenue strategy and started implementing it, which allowed inter alia for more effective tax enforcement and registration of additional small
taxpayers (9,000, according to the IMF). The authorities also improved taxation of imports, reduced losses in the power sector, made some rationalizations in the health referral system, etc.

There were two specific indicators to measure progress under this DPG objective, none of which directly reflected the changes in the PA’s fiscal deficit:

**Tax revenue increase.** The targets were to increase domestic tax revenue from VAT, customs, and income taxes in 2014 in both nominal terms (by at least 8 percent compared to 2013) and as percentage of GDP (by at least 0.1 percent of GDP to reach 4.9% of GDP). This target was effectively achieved in 2015, i.e. with one year delay. In 2014, the revenue performance was significantly below the program targets, which largely could be explained by the destabilizing impact of Gaza crisis. Domestic tax revenue declined by 0.4 percent in nominal terms and to 4.7% of GDP in 2014. Revenue performance recovered strongly in 2015: nominal domestic tax revenue increased by 9.5 percent and amounted to 4.9% of GDP (in line with the program target). However, this achievement cannot be attributed to the domestic revenue policy measures supported under the program because, as explained in the ICR (p. 16): (i) Implementation of the new tax on dividends was suspended because of the strong private sector’s opposition, and (ii) While cuts in tax incentives provided by the Investment Promotion Law did bring some improvements in 2015 revenue collection, this effect cannot be quantified due to lack of data.

**Wage bill control.** The target was to reduce the growth rate of the government wage bill to ensure that (i) its nominal growth in 2014 would not exceed 4.9%, and (ii) its share in GDP would decline from 15.4% in 2013 to 15.2% in 2014. This target was not achieved. In 2014 the Government has breached its own zero net hiring policy (introduced in 2012) and increased its headcount by almost 1,300 (mostly security personnel). As a result, nominal growth in the government wage bill reached 5.9% in 2014 and its share in GDP increased to 16.1%. The Government re-introduced its control over hiring in 2015 and achieved a modest decline in headcount. This helped to reduce its annual nominal growth in wage bill to 1.4%, while the share of government wage bill in GDP declined to 15.5% in 2015 (which is still above the original program target of 15.2%).

Rating

Modest

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**Objective 2**

**Objective**

**Objective 2: Improving effectiveness and transparency of public finances**

**Rationale**

Under this objective, the program aimed to advance specific steps to accelerate implementation of procurement reforms and strengthen the government’s control over the budget execution. The results were mixed. Implementation of procurement reforms was delayed, while progress in the area of fiscal management was broadly satisfactory.

There were three specific indicators to measure progress under this DPG objective.

**Implementation of procurement reforms.** The targets were to start using standard bidding documents (SBDs) for procurement and launch publication of procurement-related information on a single dedicated website. This was not achieved. While the amended procurement law was approved, its effectiveness was extended till July 1, 2016 because the operating budget for the Higher Council for Public Procurement Policy (HCPPP), the agency in charge of law implementation, was only approved in January 2016. At the time of ICR review (August 2016), HCPPP was not fully functional. While some preparatory steps were taken, SBDs have not been used yet and information on procurement opportunities and contract awards have not yet been published online. It was expected that these two targets would be fully met before the end of 2016.

**Strengthening cash flow management.** The target was to improve the score for PEFA indicator 16(i) on cash flow planning and monitoring from D to C. This was achieved. The PA established its Cash Committee, headed by the Ministry of Finance, which introduced practice of monthly adjustments and implementation of the Annual Cash Plan, using the template developed with technical assistance from the Bank. The new arrangements proved to be robust during the liquidity crisis in early 2015 caused by Israel’s withholding for four consecutive months of clearance revenue (VAT and import duties collected by Israel on behalf of the PA). The Bank supervision mission assessed these new arrangements and practices in July 2015 based on the PEFA methodology and upgraded the respective score from D to C.
Furthermore, recently (in the framework of preparing the DPG VII) the PA implemented a complementary policy to introduce a commitment control system in a number of line ministries. This should reduce further a possibility of generating new budget arrears.

Upgrading monitoring and reporting on budget arrears. The target was to improve the score for PEFA indicator 4(ii) on access to reliable information on budget arrears from D. This was achieved, but with some delay. The Government made fully operational a new IFMIS module with adequate functionality for regular generation of detailed reports on budget arrears. The design of the new module was done with technical assistance from the Bank. Technical work to implement it was completed in April-May 2015. However, only in 2016 the Ministry of Finance started to make public monthly budget execution reports that contain sufficiently detailed information on both stocks and flows of budget arrears. The Bank team decided to upgrade the respective PEFA score to B in 2016 based on the standard PEFA methodology. The upgrade was confirmed by the same Bank team, which was in charge of the original PEFA (2013) scores.

**Rating**
Substantial

**Objective 3**

**Objective**
Objective 3: Improving business climate

**Rationale**
As mentioned above (Section 3a), this objective was formulated too broadly and was too ambitious. The Program Document for the DPG VI made a special emphasis (pp. 20-21) on improvements in the particular area of investment climate, which was access to credit. In this specific area, in recent years substantial progress was registered: according to the Doing Business (DB) ratings, the global ranking of West Bank and Gaza improved from 159th in DB2013 to 109th in DB2016, exceeding the average for MENA region. However, the improvements could not be fully attributed to the DPG VI.

There was a single specific indicator to measure progress under this DPG objective.

**Expansion in leasing activity.** The target was to increase the number of outstanding lease contracts and their values above the end-2013 baseline level (198 lease contracts valued at US$7.64 million). This was achieved. Enactment of the new Leasing Law (took place in May 2014) allowed for strong expansion in operations of leasing companies as the Law allowed the use of leased assets (primarily cars) as loan collateral. At the end of 2014, the total number of leased contracts reached 446 (2.3 times growth against the baseline) valued at US$24.3 million (3.2 times growth). There is also evidence (ICR, p. 18) that the sector continued to expand strongly in the first half of 2015. Moreover, additional boost to the sector’s activity is expected following the launch in February 2016 of the online registry of moveable assets, introduced with IFC support.

IEG notes that this indicator is limited in scope and is not sufficient to measure the achievement of the very broad policy objective.

**Rating**
Modest

**5. Outcome**

The outcome rating of the program is Moderately Unsatisfactory reflecting substantial relevance of objectives, modest relevance of design, and modest achievement in two objectives and substantial in one operation’s objective.

The program helped the borrower to make some progress in the areas of fiscal consolidation and effectiveness and transparency of public finance, but actual performance against specific program targets was mixed, with several outcome measures either not achieved or achieved...
with a delay. In the area of investment climate, the operation’s objective was too broad and ambitious relative to the scope of actual policy reform program. The performance under the program was seriously affected by the security crisis in Gaza in the second half of 2014, which understandably diverted attention of the policy makers from implementing the structural reform agenda.

a. Outcome Rating
   Moderately Unsatisfactory

6. Rationale for Risk to Development Outcome Rating

The risk to the development outcome of the program is rated High. Despite some recent progress with structural reforms, sustainability of the reform achievements is subject to high security, political, economic and institutional risks. Overall conditions on the ground remain volatile. Primary risk factors include high dependency of donor support, which levels have become increasingly unpredictable; Israel’s control over a significant share of the PA’s revenue flows; uncertain prospects for the peace process with Israel; internal divisions within the PA itself; deterioration of the overall regional security situation, etc. Adverse developments in any of these areas could result in weakening Government’s commitment to sustain a reform momentum. Moreover, the Government’s recent track record has been insufficiently robust and reversals of the earlier reforms were not uncommon. Under these circumstances, the World Bank’s budget and policy support through the DPG series had been a significant mitigation factor, as it demonstrated ability to encourage and assist the authorities with implementing the medium-term governance reform program even at the times of acute security and political crises.

a. Risk to Development Outcome Rating
   High

7. Assessment of Bank Performance

a. Quality-at-Entry
   Preparation of the DPG VI reflected the recommendations of the Bank’s prior analytical work, including a Public Expenditure and Financial Accountability Report (PEFA, 2013); Report on civil service reform (2012); and assessment of the PA’s public procurement system. The macroeconomic framework was assessed in close collaboration with the IMF. The operation was well integrated with the PA’s national development plan and addressed some of its key reform priorities. The DPG VI was designed in a way to directly leverage the support from other donors through the Palestinian Reform and Development Plan Multi-Donor Trust Fund (PRDP-TF) in the amount of roughly US$200 million per year.

   The Bank also provided critical pieces of technical assistance directly linked to the development and adoption of several core policy measures supported under the program, and then to their implementation. Those included technical assistance on PFM (cash management, IFMIS upgrade), IDF Grant on Public Procurement, and IFC Project to expand secured lending.

   However, there were three modest shortcomings in the design of the operation as explained in Section 3b. In particular, the operation's target in the area of procurement reform was too ambitious. The effect of these design weaknesses was aggravated by the force majeure event of the second part of 2014, which could not be anticipated during the preparation.

   Another weakness of Quality-at-entry relates to the modest shortcomings in the program’s results framework as explained in Section 9.

   Quality-at-Entry Rating
   Moderately Satisfactory

b. Quality of supervision
   During the supervision, the team continued its intensive program of technical assistance, especially in the PFM, procurement, and secured lending policy areas. Its supervision effort was undertaken in close coordination with other development partners, including through the
regular consultations with members of the PRDP-TF steering committee. The Bank managed to mobilize some additional bilateral funding to facilitate the implementation of DPG-supported policies. For instance, support for the development of the single procurement portal was provided through the United States Agency for International Development funded program and the Norwegian trust fund. The Bank also responded promptly to the emergency crisis triggered by the conflict in Gaza in summer of 2014 by providing supplemental financing to the DPG VI.

The Bank team prepared the detailed quarterly supervision reports (not posted at the Operations Portal of the Bank). These reports covered a broader policy agenda of PRDP-TF, but some of them (e.g. the Q4 report for 2014) had a section to report on progress against specific DPG VI targets. Supervision of the DPG VI also benefitted from the simultaneous preparation of the DPG VII, which helped to ensure the continuity of policy dialogue and incorporate some lessons from the DPG VI into the design of the follow-up operation. The recently completed Public Expenditure Review (2015) provided additional insights for the policy dialogue on PFM during the supervision.

The only supervision mission for the DPG VI took place (and the only Implementation Status and Results (ISR) Report was prepared) in July 2015, after the Grant closing date (March 2015), and that mission focused on the preparation of ICR for DPG VI, not on proper program supervision.

**Quality of Supervision Rating**

Satisfactory

**Overall Bank Performance Rating**

Moderately Satisfactory

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### 8. Assessment of Borrower Performance

#### a. Government Performance

The Government showed some ownership and commitment to the reforms supported under the program. It managed to make necessary fiscal adjustments in the process of preparation of DPG VI, which strengthened the policy environment for reforms. However, the Authorities’ commitment to the reforms was insufficiently robust, as demonstrated by reversal and/or delayed effectiveness of the measures supported by three DPG’s prior actions – new tax on dividends was suspended, net zero hiring policy was violated, and effectiveness of the new Procurement Law was postponed. In the event of severe security crisis in the second part of 2014, the Government’s attention was diverted from advancing the agreed structural reforms to short-term measures in support of rehabilitation and humanitarian relief. At the same time, as suggested by the ICR (p. 24), the Government could have had a more effective communication strategy to reduce resistance from private sector stakeholders, specifically in the cases of the agreed tax and procurement reforms. The reform momentum was partially restored in 2015, helped by the intensive policy dialogue with the development partners, including the Bank.

The Government made a significant contribution to regular monitoring of developments under the program. Beginning Q1, 2014, the Ministry of Finance, based on the inputs from other agencies, prepared quarterly reports that contained the data for M&E indicators related to the PA’s fiscal performance and reform progress in the areas covered by the DPG VI.

**Government Performance Rating**

Moderately Unsatisfactory

#### b. Implementing Agency Performance

N/A

**Implementing Agency Performance Rating**

Not Rated

**Overall Borrower Performance Rating**

Moderately Unsatisfactory
9. M&E Design, Implementation, & Utilization

a. M&E Design

The design of the M&E arrangements was built upon those developed under the earlier DPGs and was finalized in consultation with the authorities and other development partners. There was full agreement with the Government on both the results framework and responsibilities for collecting the monitoring data. The results framework for the DPG VI was shared with the Multi-Donor Trust Fund, PRDP-TF, which is a major source of donor budget support. Such M&E arrangements helped to increase leverage of the DPG VI.

At the same time, there were three modest shortcomings in the M&E arrangements. First, the set of indicators did not include a direct measure of budget deficit, which would allow for more explicit monitoring of the progress towards the first policy objective ("reducing the recurrent budget deficit"). Second, there was disconnect between the broad third policy objective ("improving investment climate") and the selected indicator in this policy area, which was narrowly focused on volume of leasing activities. Third, the M&E design did not plan for arrangements to quantify a revenue effect of amendments to the Investment Promotion Law, which was one of the prior actions under the program that was supposed to contribute to the policy objective on budget consolidation.

b. M&E Implementation

The Ministry of Finance, based on the inputs from other agencies, prepared quarterly reports with the data for M&E indicators, which were used by the Bank for preparation of its own quarterly supervision reports that were posted online. The monitoring data were also reported in the single ISR, prepared by the Bank team after the program closure.

c. M&E Utilization

The monitoring results were used in the discussions with both the Government and the donor steering committee to review the pace of structural reforms. Under the shared M&E arrangements, the monitoring results were also utilized to administer quarterly disbursements under the PRDP-TF. The ICR states (p. 14) that such M&E arrangements contributed to building stronger institutional capacity for monitoring reform progress within the PA.

M&E Quality Rating

Substantial

10. Other Issues

a. Environmental and Social Effects

No safeguard policies were triggered by this operation.

b. Fiduciary Compliance

The ICR admits (p. 13) that the operation had a high fiduciary risk due to the weaknesses of the PFM systems, which could not be fully mitigated. But the ICR does not raise any specific fiduciary issue related to the program implementation.

c. Unintended impacts (Positive or Negative)

No
11. Ratings

<table>
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<th>ICR</th>
<th>IEG</th>
<th>Reason for Disagreements/Comment</th>
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<tbody>
<tr>
<td>Outcome</td>
<td>Moderately Satisfactory</td>
<td>Moderately Unsatisfactory</td>
<td>The rating was downgraded, given modest relevance of design, modest achievement of two operation’s objectives and substantial of the third one, as explained in Section 6.</td>
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<tr>
<td>Risk to Development Outcome</td>
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<td>High</td>
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<tr>
<td>Bank Performance</td>
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<td>Borrower Performance</td>
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<tr>
<td>Quality of ICR</td>
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Note
When insufficient information is provided by the Bank for IEG to arrive at a clear rating, IEG will downgrade the relevant ratings as warranted beginning July 1, 2006.

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

12. Lessons

The following lessons are taken from the ICR with some adaptation of language:

- Designing and implementing a sequence of inter-related single-tranche operations brings considerable benefits in a highly uncertain country environment. Such a lending strategy could serve as a robust platform for the reform dialogue and support continuity of reforms, while helping to preserve flexibility.

- The government’s commitment to a reform process in a fragile political and institutional environment cannot be assumed to remain robust. The risk of weakening the client’s ownership under such circumstances is usually high, which requires a development of relevant mitigation measures, including inter alia an adequate public communication strategy.

- Undertaking a political economy analysis to inform the design of reforms that affect vested interests could be a critical input to the program design, especially in the cases of reforms that in the past proved to be difficult to implement due to strong domestic political opposition. A proposed major reform in public procurement could be a good candidate for such a political economy study.

13. Assessment Recommended?

No

14. Comments on Quality of ICR
The ICR provides a thorough and frank assessment of the operation’s results and implementation experiences, and links them well to the complex political and institutional settings of the Palestinian territory. The ICR also suggests several useful insights regarding the lessons learned from the operation. However, the ICR has one significant and two modest shortcomings. The most important weakness relates the inconsistency of the ratings suggested in the ICR. The ICR’s Outcome rating, which is “Moderately Satisfactory”, does not follow the rating guidelines in light of the ICR’s individual ratings for Relevance (Modest) and Efficacy (two out of three objectives rated modest). In addition, the ICR does not provide sufficient discussion of policy developments in the areas supported by the DPG VI that took place after its Board approval, in particular, in the course of the preparation of the follow-up operation (DPG VII). Furthermore, the ICR presentation of program indicators (pp. vi – vii) is not accurate and sometimes confusing. This especially relates to the timing of data reported (the dates for both the baseline and reported outcomes).

a. Quality of ICR Rating
   Substantial