Long-Term Policy Options for the Palestinian Economy

The recently released World Bank study *Long-Term Policy Options for the Palestinian Economy* compares potential alternative approaches to economic relations between the West Bank and Gaza (WBG) and Israel, exploring which type of economic policy regime would offer the most benefits to Palestinians in the context of future statehood.

As the Interim Period neared the end of its prescribed five-year lifespan in 2000 and negotiations on final status arrangements got underway, the Palestinian Authority (PA) and the Government of Israel considered potential policy regimes to succeed the 1994 Paris Protocol. While such discussions have been temporarily submerged by today’s tide of violence, there is a need to return to the issue of basic economic relations between Israel and an eventual Palestinian state. The World Bank’s new study therefore examines the pros and cons associated with a range of alternative approaches to economic relations between Israel and the future Palestine.

Establishing a Palestinian state would likely afford a range of policy choices to the Palestinian authorities that has been hitherto unavailable. Today, for example, a lack of clearly defined borders with Israel and Israel’s control over Palestinian borders with Jordan and Egypt restrict Palestinian access to third-party trade partners, and largely limit Palestinians to trading with Israel within the current customs union. Israeli closure policies have also significantly reduced Palestinian capacity to produce as well as to trade. An amicable final status agreement, by contrast, could open up alternative production and trade policy options, assuming that Palestinians exercise effective economic control over their borders as well as their policies.

This study considers policy alternatives relating to trade, labor and investment, and their implications for Palestinian economic growth. In looking to the future, the analysis draws lessons from past experience, specifically from the economic outcomes associated with the Paris Protocol era.

Palestinian GDP growth in real terms averaged 5.4 percent per year between 1968 and 2000, but post-Oslo economic output was erratic and averaged only 2.5 percent growth between 1994 and the eve of the *intifada* in September 2000, compromised as it was by periods of severe closure-induced contraction. Conflict apart, however, growth in Palestinian capital stock never took off as expected after Oslo, in spite of large inflows of foreign assistance, and most investment has been devoted to construction rather than more productive activities. Even when the Palestinian economy was relatively free from mobility restrictions, average Palestinian incomes did not converge with those in neighboring Israel, which by end-2000 enjoyed a per capita income level more than ten times that of WBG.

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1 To access the full report, go to: www.worldbank.org/ve

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West Bank and Gaza Update

Explanations for this disappointing outcome vary. Apart from the obvious impact of conflict and closure, some observers stress technical flaws in the Protocol (such as loopholes in trade rules and inadequate dispute settlement mechanisms), Israeli reluctance to implement aspects of the agreement and weak efforts by the PA to develop a climate attractive to investors. It has been argued that the Protocol was destined to disappoint since it encouraged the Palestinian economy to persist with low value-added activities beneficial to Israel. This limited growth opportunities and left the Palestinian economy highly vulnerable to political factors that could, and did, impede transactions. Others suggest that the Paris Protocol amounted to an incomplete contract between unequal partners which relied excessively on well-intentioned Israeli interpretation. The overall environment of uncertainty was compounded by inadequate Palestinian legal, regulatory and financial institutions, further hampering private sector development - including between Palestinians and Israelis at the firm level. Together these factors undermined Palestinian economic growth.

Given the problems associated with the existing policy framework, the Bank’s report examines options that will face Palestinian policymakers in the event of a peace agreement with Israel. The analysis is conducted in two stages: first, each policy area is analyzed separately in a partial equilibrium context, without accounting for broader intersectoral relationships; second, these separate areas are brought into a comprehensive and integrated framework. A range of assumptions vis-à-vis the nature of borders between WBG and Israel is delineated, tying together trade, labor and private sector development considerations to measure their combined impact on growth prospects. The study develops scenarios to reflect different combinations of future policy options linked to the nature of borders with Israel. The simulation exercise is used to illustrate the relative merits of each scenario, associated trade-offs, and the prospects for economic growth in the event of a peace agreement and a completion of final status negotiations.

Trade Policy Options

Israel is by far WBG’s most important trade partner, dominating both imports and exports. The modified customs union currently in place is one-sided, favoring Israel in several ways. The external tariff on third-party countries is set by Israel without regard to Palestinian comparative advantage. Although Israeli tariffs plus purchase tax average 11 percent, the effective rate is a much higher 16.6 percent on Palestinian imports, due to the types of goods imported into WBG. Furthermore, the Paris Protocol allows only limited Palestinian access to Egyptian and Jordanian markets. Because Israel controls all borders in the Palestinian Territories, Palestinian trade must be conducted through Israel rather than directly with third-party countries. This creates at least two problems: first, Palestinian traders incur higher transport costs than if trading directly; and second, the PA loses out on trade tax and VAT revenue from goods nominally imported into Israel but subsequently re-exported to the West Bank and Gaza without being properly accounted for - and taxed - as a trade transaction.

This lost revenue associated with indirect imports amounts to an estimated US$174 million per year (see Table 1). Additional welfare losses are incurred by WBG because the US$900 million trade deficit with Israel constitutes a negative net transfer (as compared to a non-discriminatory trade policy). In other words, Israel gains more than WBG from preferential access to Palestinian markets under the customs union.

On the other hand, WBG gains certain advantages from being in a customs union with Israel, such as preferential access to the large Israeli market, although this advantage is much attenuated during closures. In addition, Israel’s recent trade liberalization allowed liberalization for Palestinian imports as well. And the Israeli tax authorities collect taxes on behalf of the PA and remit the proceeds to the PA, greatly simplifying the PA’s role and reducing its administrative costs by an estimated US$48 million annually (Israeli payments have been largely suspended during the intifada, however).

Comparing a Customs Union (CU), Free Trade (FTA) Area and Non-Discriminatory Trade Policy (NTDP). In Table 1, the costs and benefits of a CU are compared to alternative trade regimes possible under a final status agreement, namely an NDTP and an FTA. Using 1998 data to quantify the costs and benefits of an NDTP compared to a CU, the losses incurred by the Palestinian economy under the existing customs union are estimated at US$225-266 million annually (depending on the degree of smuggling).

An NDTP is also superior to an FTA (see Table 1). Under an FTA, trade between WBG and Israel is still free, implying the same welfare loss from the trade deficit as under a CU (ranging from US$99-140 million). But there are additional costs for complying with the rules of origin necessary to avoid trade deflection under an FTA. These costs are borne by the PA in

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terms of border administration, as well as by exporters and consumers through higher import prices. Moreover, there are no border savings to offset these losses. Thus an FTA would cost at least US$184-225 million annually in net terms (depending on the degree of smuggling). The costs of an FTA would likely be even higher in light of potential trade diversion, welfare losses due to WBG’s higher propensity to import, and enforcement complications resulting from multiple and overlapping FTAs.

When a CU is weighed against an FTA, the CU is superior from the perspective of tax revenues and administrative costs. An FTA would require setting up and administering customs border stations, and this added cost would not be accompanied by any benefit from tax revenues on Israeli imports, which would continue to be free. Moreover, introducing rules of origin would reduce Palestinian access to Israeli markets. Efficiency and welfare losses would also arise under an FTA from trade diversion (Palestinian producers would use more expensive Israeli imports rather than less costly alternatives from third-party sources in order to meet rules of origin criteria for exporting final goods to Israeli duty-free).

Analyzing trade policy choices in a partial equilibrium framework - that is, from a tax revenue and welfare perspective, independent of other sectors of the economy - indicates that an NDTP is superior to both an FTA and the existing customs union, assuming open and transparent trade policy enforced by credible lock-in mechanisms. If for political reasons the CU remains in effect under final status, several improvements could be made to counter Palestinian losses, such as adopting a macro-based revenue sharing formula, and/or direct Israeli compensation of WBG for the losses it incurs under a CU.

### Table 1: Net Gain of CU, FTA Compared to NDTP (US$ million per year)

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<tr>
<th></th>
<th>No Smuggling</th>
<th>Smuggling</th>
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<tr>
<td><strong>CU:</strong></td>
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<tr>
<td>Indirect imports (taxes)</td>
<td>-174</td>
<td>-174</td>
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<tr>
<td>Trade deficit (welfare)</td>
<td>-140</td>
<td>-99</td>
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<tr>
<td>Border cost savings</td>
<td>48</td>
<td>48</td>
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<tr>
<td><strong>Net Gain of CU</strong></td>
<td>-266</td>
<td>-225</td>
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<tr>
<td><strong>FTA:</strong></td>
<td></td>
<td></td>
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<tr>
<td>Trade deficit (welfare)</td>
<td>-140</td>
<td>-99</td>
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<tr>
<td>Rules of Origin</td>
<td>-85</td>
<td>-85</td>
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<tr>
<td><strong>Net Gain of FTA</strong></td>
<td>-225</td>
<td>-184</td>
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### Labor Market Outcomes

The costs borne by WBG through its membership in a CU with Israel are partly offset by Palestinian access to the Israeli job market, which increases aggregate employment and raises incomes. On the other hand, this access distorts wages within the Palestinian economy, hurting competitiveness. In the past, rapid population growth strained the capacity of the Palestinian economy, leading to excess labor supply despite low labor force participation rates (particularly among women). As a result, many workers sought employment elsewhere, primarily in Israel. Prior to the ongoing crisis, nearly a quarter of Palestinian employment was in Israeli jobs with wages significantly higher than in WBG. Israel began to restrict Palestinian labor inflows in the early 1990s by introducing work permit requirements. But the Oslo accords marked a fundamental shift in Israeli labor policy, as mobility restrictions were enforced, including periodic border closures and at times extreme restrictions (i.e. internal closures), during which Palestinians could not leave their villages\(^2\). During closures, very few workers from Gaza could reach their jobs in Israel or the settlements, but West Bankers had slightly more flexibility due to the porous border with Israel.

Closures were particularly severe in 1995 and 1996, leading to a drop in labor flows to Israel and high Palestinian unemployment, which spiked to 25 percent in 1996 (see Figure 1). This was a dramatic change from the 1980s when unemployment was negligible and movement restrictions did not exist. The PA responded to skyrocketing unemployment by creating jobs in the civil service. Although this strategy coincided with the PA’s expanded responsibilities post-Oslo and the need to set up the main institutions of governance and public service delivery, public employment grew faster than necessary, engendering an undesirably large wage bill. As the security climate improved, labor flows to Israel regained much of their earlier importance in providing Palestinian jobs, and unemployment declined in 1998 and 1999, falling below 10 percent in mid-2000. The September 2000 outbreak of the intifada then led to sharply higher unemployment as closures precluded workers from reaching their jobs, and prolonged civil strife disrupted domestic economic activity.

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\(^2\) The situation is much more extreme today, particularly under curfews that prohibit individuals from leaving their houses.
Labor force survey data from the Palestinian Central Bureau of Statistics provides information on the characteristics of the employed and unemployed. For example, unemployed men tend to have less education than unemployed women, and almost 80 percent of Palestinians working in Israel have only 6 years of schooling, reflecting a lower education level than among those employed within the domestic Palestinian economy. The data also indicate that government employees are more educated than those in the private sector, with 52 percent holding a post-secondary degree or higher, compared to only 14 percent among non-PA workers. Similarly, government employment employs a majority of the highly-skilled, suggesting little private sector demand for such skills.

**Palestinian wages in WBG and Israel.** Micro-analysis on the determinants of earnings indicates that the returns to working in Israel are extremely high. For example, a worker from Gaza earns 85 percent more in Israel than if employed domestically in Gaza, and a West Banker working in Israel earns 61 percent more than if employed within the West Bank. In this environment, the domestic economy struggles to create adequate jobs for a fast-growing but fairly well-educated labor force, putting pressure on the PA to step in by creating more civil service jobs. Although the returns to education are positive and increasing, they are fully offset by the returns to working in Israel. Moreover, the higher Israeli wage actually pulls up domestic wages in WBG, making them less competitive and dampening domestic labor demand. This distortion arising from limited access to Israeli jobs hurts Palestinian economic development by creating a labor market that specializes in low value-added activities. This in turn does not facilitate skills acquisition through knowledge-sharing or learning-by-doing - the expected gains from labor migration. In addition, the relatively high wage does not attract investors or technology to increase productivity in export sectors. During the Oslo period, Palestinian growth and economic development was not export-led but rather was driven by consumption through higher incomes from workers’ remittances from Israeli jobs. The positive consequences of this growth model include higher household incomes and lower poverty when labor can move relatively freely. But the downside - especially during periods of closure - involves uncertainty, income volatility, high unemployment and poverty, non-competitive domestic wages, and substantial vulnerability to external shocks.

**Business Environment**

The existing trade and labor distortions described above both lead to low-productivity, low-growth outcomes through export and labor specialization in low value-added activities. This distorted incentive framework was exacerbated by high risk and uncertainty linked to the interim political arrangements, the unclear nature of future economic and political arrangements, and a lack of reliable property rights. Almost 80 percent of Palestinian private firms responding to a survey on the business environment in WBG prior to the intifada reported policy instability and uncertainty as their greatest impediment. In addition, Israeli security measures resulted in crippling transactions costs. Taken together, these features do not create an environment conducive to private investment in start-
ups or expansion of existing businesses. Although the Paris Protocol attempted to address some of these constraints, any potential progress and improvements were severely compromised by the uncertainty, mobility restrictions and high transactions costs attendant on security measures. The economy’s growth prospects are brighter under scenarios of normalization with Israel, assuming a resolution of the ongoing conflict. But addressing trade and labor policies alone will not automatically trigger a large private sector response, even though a negotiated settlement would greatly improve the business environment by reducing the risk associated with political and, ultimately, economic uncertainty. The current prospects for extensive job creation in the constrained Palestinian business environment are dim, especially in view of rapid labor force growth. The PA lacks the resources and capacity to continue absorbing job seekers, implying that the private sector will need to pick up the slack in order to support improved Palestinian economic performance.

In addition to the high cost of Israeli security procedures, other distortions raise production costs, diminishing Palestinian competitiveness. High transportation costs for the effectively land-locked WBG raise the final price of exports as well as the cost of imported inputs. The relatively high market wage renders Palestinian labor-intensive products more expensive. Palestinian producers also face relatively high prices for production facilities such as land, electricity, and water. The expensive cost structure faced by manufacturers in WBG severely limits Palestinian competitiveness.

Corrective policies. The PA nevertheless has some tools at its disposal to ease constraints facing private agents, improve the institutional framework for investment, and enhance public-private interactions. These include policy measures to address areas currently within Palestinian control - namely, strengthening the Rule of Law, promoting a strong financial system, reducing anticompetitive practices, increasing the accountability of the public sector, improving revenue administration, and raising the efficiency of the public sector by allowing the private sector to compete in service delivery.

Future Growth Prospects

In light of the distortions described above, the realities of the post-Oslo experience must be taken into account in designing future policies. The study therefore asks several key questions. Would alternatives to the existing customs union be better for Palestinian trade in the long run? What are the costs and benefits associated with Palestinian access to Israeli jobs, and what degree of access would best support Palestinian economic development? If a peace agreement is concluded and borders are defined, what type of economic relationship with Israel would maximize Palestinian economic growth? Would increased economic integration with Israel work better than economic separation?

To approach these questions, the study assesses the economy’s growth prospects under five economic and political scenarios, since realism requires that the two factors be considered side-by-side. The five scenarios reflect varying degrees of cooperation between the two parties, and no particular likelihood is attached to any one scenario. The scenarios do not purport to represent an exhaustive list of possible future outcomes, but rather attempt to portray a reasonable set of possible growth path expectations for the Palestinian economy. The scenarios reflect continued crisis (Scenario 1), a return to pre-crisis conditions (Scenario 2), continued post-crisis economic integration with Israel but with a well-implemented customs union (Scenario 3), separate economic development featuring a non-discriminatory trade policy (Scenario 4), and Palestinian policy autonomy in a cooperative environment featuring a free trade area between the Palestinian state and Israel (Scenario 5).

The projected outcomes of these five scenarios are as follows:

1. A continuation of the crisis would have dire consequences for the Palestinian economy and its population, including declining per capita incomes, stagnant exports, and poverty rates increasing well beyond 50 percent of the population.

2. A return to the situation prevailing in September 2000 would amount to a middle-through solution embodying stagnation and increased reliance on Israel.

3. A successfully-implemented Paris Protocol would lead to higher per capita incomes and a significant reduction in unemployment, but would fail to generate sustainable high economic growth due to a lack of incentives to develop exports and thereby achieve significant productivity gains.

4. Economic separation via a more neutral trade regime aimed at diversifying the Palestinian economy away from Israeli dependence in favor of greater integration with global markets.
would bring important dynamic gains in terms of investment and productivity, and would lead to strong export-driven GDP growth. However, this scenario is associated with significant unemployment.

(5) Greater economic autonomy via the cooperative development of a free trade area with Israel would lower unemployment, but would lead to only mediocre GDP and export growth and would increase long-term Palestinian economic dependence on Israel. The resulting outcomes associated with the five scenarios are illustrated in Figures 2, 3, 4 and 5 below.
Scenario 1 has nothing to recommend it. Scenario 2 represents a political rapprochement without any fundamental changes in the policies governing economic relations between WBG and Israel, and is likely to trap the Palestinian economy in a low-growth, low-income equilibrium.

Scenario 3 represents no real change in trade policy, but improved mobility and lower transactions costs offer the most rapid path to a recovery of Palestinian incomes; this approach is associated with only minor improvements in output growth, however, as well as weak export performance and continued dependence on Israel.

The two scenarios characterized by new trade policies - either through economic separation and a non-discriminatory trade regime (Scenario 4) or through a free trade area and continued labor market integration (Scenario 5) - involve varying degrees of decision-making flexibility on the Palestinian side, and different degrees of economic dependence on Israel. Scenario 4 shifts to a higher export/productivity path through trade diversification, but employment recovers more slowly due to smaller labor flows to Israel. With the free trade area posited in Scenario 5, continued dependence on Israel through trade and labor flows leads to only modest dynamic income gains from Palestinian trade with other countries, although employment recovers more rapidly.

Comparing the results of the different policy scenarios does not point to a unique or optimal solution. Importantly, real GDP growth does not differ significantly in the long run (other than under the dismal Scenario 1), but the factors driving growth vary significantly. With increased economic integration and limited policy autonomy, slow productivity growth and capital accumulation are compensated for by greater access to the Israeli labor market. Under economic separation, by contrast, reduced access to the Israeli labor market and higher transaction costs are offset by a more neutral trade regime that reduces trade diversion, promotes competition and encourages investment and more productive technologies, but with social costs in the form of higher unemployment.

The choice of future trade and labor policies will ultimately depend on the nature of the political relationship between WBG and Israel. The post-Oslo experience generated mediocre growth outcomes due to distortionary trade and labor policies as well as excessive Palestinian dependence on Israel. The resulting lack of risk diversification made the Palestinian economy vulnerable to external shocks, thus contributing to fluctuating economic performance in response to Israeli closure policy and other factors beyond Palestinian control. The pros and cons of future policy options will need to be clearly considered in light of recent history - a history which, in the minds of many Palestinian policymakers, now argues for a policy of economic separation.

This article was written by Elizabeth Ruppert Bulmer, Senior Country Economist, Social & Economic Development Group, World Bank
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TECHNICAL ASSISTANCE TRUST FUND (TATF)

The TATF received US$23 million in grants from twelve donors. The trust fund was administered jointly by the World Bank and PECRAR.

Effective Date: June 1, 1994.
Closing Date: December 31, 2001.

The objective of the TATF was to help the newly emerging Palestinian Authority develop governing institutions, establish policies for key economic sectors, and prepare pre-feasibility and feasibility studies. Seventy-nine projects in various sectors were implemented throughout the lifetime of the TATF.

<table>
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<th>DONOR FUNDING (US$)</th>
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<td>Austria</td>
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<td>Canada</td>
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<td>Denmark</td>
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<td>Finland</td>
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<td>Switzerland</td>
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<td>United Kingdom</td>
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<td>United States</td>
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<td><strong>Total</strong></td>
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**Sector Allocation:** The five sectors that received the largest disbursements through the TATF were:

- Public Economic and Financial Management, which included general public administration training (US$5.7 million);
- Urban and Municipality Development (US$2 million);
- Finance (US$1.4 million);
- Tourism and Culture (US$2 million); and
- Transportation (US$3.8 million).

**Use of TATF Funds By Sector**

The education, health and housing sectors, which were severely undercapitalized, received significant donor support through the Holst Fund (a multi-donor fund administered by the Bank) and other funding mechanisms. The role that the TATF played in these and other sectors was to strengthen the capacity of public sector institutions to improve planning and management for these important sectors.

Examples of the TATF achievements are illustrated below:

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<th>OBJECTIVE</th>
<th>EXAMPLES OF ACHIEVEMENTS</th>
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| Assist in building Palestinian institutions and in enhancing Palestinian capacity for self-government. | ■ Contributed to establishing a number of important PA institutions, such as the Palestinian Monetary Authority (PMA) and capacity building of most PA ministries and other institutions.  
■ Design of a Uniformed Accounting System for Municipalities.  
■ Creation of the Palestine Economic Policy Research Institute (MAS) and preparation of more than 30 widely disseminated and used reports on multiple economic topics. |

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| Facilitate the implementation of investment | Design and institutional support for the establishment of Joint Services Council for Solid Waste and Environmental Management. The Council is currently implementing a US$14 million "Solid Waste and Environmental Management Project (SWEMP)" for the Jenin District, financed by the World Bank and the European Union. |
| Assist the Palestinian Authority in the design of integrated policies and programs. | Virtually all sector studies carried out through TATF addressed issues related to inter-sector planning; in particular: the Agricultural Policy Study; Pilot Urban Planning Study; Water Sector Strategic Planning Study; Wastewater Treatment and Reuse Strategy; Power Sector Policy Study; Cultural Resources Management; and the Institutional and Regulatory Framework for Telecommunications and Postal Services Study. Many of the reports produced by MAS called for integrated economic and social policies and programs. |
| Assess the feasibility of proposed physical investment for the longer term. | While many of the studies supported by the TATF addressed both short and longer term investment, the following four, in particular, focused on the longer term: (1) the Central Roads Administration Project; (2) the Water Sector Strategic Planning Study; (3) the Tourism Strategic Planning Study; and (4) the Pilot Urban Planning Study. Each of these studies resulted in significant donor investments. |
| Encourage the growth of the private sector. | Three of the focus areas of Palestinian economic growth, information systems, tourism, and trade, were among the TATF-supported studies and projects. These were: (1) the National Institute for Information Technology; (2) the Tourism Strategic Planning Study; and (3) the National Trade Dialogue Project. The TATF also supported studies in housing and telecommunications, two important sectors for private sector investment: (1) the Condominium Registration Study; and (2) the Telecommunications and Postal Services Institutional and Regulatory Framework Study, which served as the basis for privatization of the telecommunications system. Strengthening of local consulting firms was also an indirect output of the TATF. Consulting firms became actively involved in the preparation of designs and studies, either independently or as joint venture partners with international firms. |
Training. About 6 percent of the TATF funds (nearly US$1.5 million) were disbursed directly for training. And over 2,000 Palestinians received different kinds of training. However, there was additional extensive training (including "on-the-job" skills development) carried out through the institutional building, design, studies, and technical assistance components of the TATF. Activities such as training in international procurement and project management, as well as decision making for investment in the infrastructure sectors, therefore, dominated the early training agenda. The aim was to help policy makers determine priorities for the use of resources in the infrastructure and the utilities sectors, and to give PA senior personnel the skills and competence to analyze and prepare new projects to a standard acceptable to PA ministries and international financing agencies.

Since its founding, the NIIT has already been recognized by Microsoft as an academic training provider, and has carried out more than 15 short and longer-term courses, training more than 700 students and others with varying degrees of experience in information technology.

One of the last achievements of the TATF was the establishment of The National Institute for Information Technology (NIIT) which was inaugurated in March 2001. The TATF provided seed funds for the NIIT for procurement of equipment and software; furniture; covered recurrent costs for the first year of operationThe NIIT will serve three primary functions: (1) as a lead institution for basic and advanced training in information technology; (2) as a development center for the design and initiation of business incubation and small business "start-ups," and (3) as a center for research in broad areas of information technology. The NIIT has already attracted US$1 million in support from the Kuwait Fund, but plans to be self-sustaining in the longer term, supporting its operation through income-generating training, IT education, and technical assistance projects.

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Recent Economic Developments

**Economic Output.**

Very limited statistical information on the Palestinian economy precludes in-depth quantitative analysis of the impact of the restrictions on movements of goods and people and the destructions of physical capital. But all indicators up to end-September 2002 indicate a strong recession of the Palestinian economy since September 2000. Economic losses, in terms of foregone output and impoverishment of the population are huge, not to mention humanitarian costs.

![Figure 1. Real GNI and GDP per capita](image)

Source: World Bank Estimates. Date excludes East Jerusalem

The World Bank estimates that real GDP declined by 17 percent from 1999 to 2001, and could decline a further 22 percent in 2002. The decline in GNI from 1999 to 2001 is greater - 23 percent - the consequence of a greater relative drop in workers remittances than in GDP. Under a status quo set of assumptions, real GNI is projected to decline another 23 percent in 2002. In per capita terms, the assessment in even worse, as population keeps on increasing rapidly (at a projected 4.4 percent annual growth rate). The share of population under the poverty line could reach 60 percent in end-2002.

Many factors explain this very inferior economic performance, most of them obvious to even the most casual observer of the situation in West Bank and Gaza. Restrictions on the movement of goods and people ("closures" - and in its most extreme form, "curfews") have had a profound negative effect on economic activity across all sectors, as it has reduced the overall productivity of the Palestinian economy through a number of channels: while external closures reduced workers remittances, which entailed a negative multiplier effect on the demand for domestic goods, the combination of internal and external closures led to a sharp increase in transaction costs, which, along with lower productive capacities, reduced productivity and competitiveness of Palestinian firms. The partitioning of the economy into different blocks ("cantonization") also reduce the overall adjustment capacity of the Palestinian economy to the decline in activity and demand. This negative impact of closures is compounded by the structurally high dependency of Palestinian production on imported inputs, which leaves little possibility for substitution in the short run in favor of domestic inputs.

The economic situation was further aggravated by recent developments on the ground. First, the military operation launched by the IDF on March 29, 2002, the Operation Defensive Shield, resulted in considerable destruction of infrastructure and productive capacities. Second, the frequent imposition of curfews in major Palestinian cities since April 2002 has virtually frozen much of economic activities. Third, tighter internal and external restrictions imposed on the movement of goods and people have hampered economies of scale and specialization, and have drained up the possibility of generating incomes abroad (via exports of goods or labor). Fourth, ongoing weakness in the Israeli economy, the depreciation of the Israeli Shekel during the period, and tightened Israeli fiscal and monetary policies have all further impacted the Palestinian economy negatively.

The Palestinian Authority and, to a lesser extent, Palestinian households nevertheless managed to maintain minimum levels of consumption. The former by indebting itself (on the back of the private Palestinian and Israeli sectors and the donor community), the latter by depleting their private savings. The donor community also helped to a significant extent cushioning the negative impact of the crisis on living standards by sustaining public and private consumption. But this inevitably produced negative effects on available savings and investments, which, once combined with the severe physical damages caused on infrastructure and productive capacities by the conflict, led to a large decline in the per capita capital stock. This would definitely affect the capacity of the Palestinian economy to eventually rebound should conditions be met one day.
In such circumstances, foreign assistance, though useful and timely, can just maintain minimum welfare and cannot pretend fostering economic recovery. Only a resolution of the Israeli-Palestinian conflict accompanied by a profound change in the Palestinian economic environment can encourage it.

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<th>Table 1. Estimated Macroeconomic Trends, 1998-2002</th>
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<tr>
<td>Gross National Income (GNI), US$ mill.</td>
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<td>Gross Domestic Product (GDP), US$ mill.</td>
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<tr>
<td><strong>Real annual change:</strong></td>
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<tr>
<td>GNI per capita</td>
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<td>GDP per capita</td>
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<tr>
<td>Private Consumption</td>
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<td>Public Consumption</td>
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<tr>
<td>Total Fixed Investment</td>
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<tr>
<td>Export</td>
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<td>Import</td>
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<tr>
<td><strong>Other items:</strong></td>
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<tr>
<td>Poverty, share of population below poverty line</td>
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<td>NIS/US$, annual average</td>
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<td>CPI, annual change</td>
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<tr>
<td>Population, mid-year (1,000)</td>
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</tbody>
</table>

Sources: World Bank Staff Calculation, PCBS, UNSCO. Note: All data excludes East Jerusalem.

- **Foreign Trade.**

There is no doubt that foreign trade suffered extraordinarily from the closures, due to the extreme difficulties in reaching markets outside the West Bank and Gaza. Various indicators point to substantial decline in both imports and exports. The decline in import appeared almost immediately after the outbreak of the Intifada, in step with the decline in the inflow of remittances from Palestinian workers in Israel. In 2001 and early 2002, imports declined less rapidly, and were by end March 2002 at about 50-55 percent of their pre-intifada levels of September 2000 (in value terms), according to data from the Israeli Central Bureau of Statistics (See Figure 2).

The decline in exports has been more gradual, reflecting continuing loss of market shares abroad. But the data from the Israeli Central Bureau of Statistics suggest that export declined rapidly during the first quarter of 2002.

Trade is unfortunately badly registered, as most of it takes place between the West Bank and Israel, where no custom stations exist (in contrast to trade between Gaza and Israel). The data shown in figure 2 only covers Palestinian trade with Israel, and not with the rest of the world. However, trade with Israel represents the bulk of total Palestinian trade\(^1\) - although a significant share of imported goods from Israel actually originates in third

\(^1\) In 1998, imports from and via Israel represented 75 percent of total imports, while exports to Israel represented 96 percent of total exports (Atrash and Dussas, 2001, Trade Options for the Palestinian Economy: Some Orders of Magnitude, MEAP Discussion Paper Series, 21, The World Bank).

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countries, the so-called "indirect imports". In addition, and even after accounting for the depreciation of the New Israeli Shekel in early 2002, there is no strong reason to believe that the share of trade with Israel in total trade significantly declined with the Intifada.

**Fiscal Accounts.**

The fiscal situation of the Palestinian Authority continues to be in dire straits, in spite of the extraordinary budget support from the international community.

The fiscal accounts have been severely impacted by the crisis, via three main channels. First, the sharp decline in PA revenue collections associated with the decline in economic activity and the disruption of tax administration; second, the suspension since December 2000 by the Government of Israel of the transfer to the PA of the revenues it collects on the PA's behalf (the so-called clearance revenues) - although the Israeli Government transferred a total of US$30 million in July/August 2002 and made an additional transfer in December 2002 - and third, the increase in emergency expenditures.

Central government revenue fell from a monthly average of US$83 million in 1999 to US$29 million by Q3-2002. This collapse in tax revenue was to some extent compensated by emergency budget support from donor countries, of which the PA received $972 million between November 2000 and end-September 2002. Nevertheless there remained an monthly budget deficit of approximately US$20 million, which has been managed through a combination of accumulating arrears to suppliers, taking occasional loans from domestic banks, and delaying the payment of certain non-salary expenses.

By the end of September 2002, the PA had accumulated at least US$577 million in arrears. This level of arrears has had a pernicious impact on the private sector, resulting in liquidity shortage, mounting non-performing loans in the banking system, and an increasing number of insolvencies. Vendors have felt compelled to continue providing credit, but many have reached a point where they are no longer willing, or able, to do so. Settling these arrears will be a matter of top priority once Israeli hands over the withheld clearance revenue (US$684 million in gross terms owed as of end-September 2002).

<table>
<thead>
<tr>
<th>Table 2. PA Fiscal Accounts - Monthly Average (US$ million)</th>
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<td></td>
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<tr>
<td>Revenue</td>
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<td>Domestic</td>
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<td>Clearance</td>
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<td>Current expenditure (commitment basis)</td>
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<td>Wages</td>
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<td>Non-wages</td>
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<td>Recurrent balance</td>
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<td>PA-financed capital expenditure</td>
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<td>Overall balance (commitment basis)</td>
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<td>Expenditure arrears (net accumulation)</td>
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<td>Overall balance (cash basis)</td>
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<td>Financing</td>
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<td>External budgetary financing</td>
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<td>Arab states</td>
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<td>European Union</td>
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<tr>
<td>Others</td>
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<td>Domestic bank financing and residual</td>
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<td>Memorandum items:</td>
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<tr>
<td>Stock of withheld revenue clearances (end of period)</td>
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<td>Stock of expenditure arrears (end of period)</td>
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<td>PA employment (thousand employees, end of period)</td>
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*Source: IMF estimates based on PA.*
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- **Labor Markets.**

  Employment contracted markedly in Q2 and Q3, 2002, as a result of the intensification of the conflict since April 2002. In Q2-2002, it was particular in the West Bank that job were lost, as a result of the re-occupation of most urban centers in the West Bank, curfews, and very tight restrictions on movements between towns and villages in the West Bank. In total, some 37,000 persons in the West Bank lost their jobs during this period. In particular workers in Israel and Israeli settlements (ISI) were hit as 26,000 out of an already strongly decimated Palestinian workforce in Israel lost their jobs, leaving only about 3,000 Palestinians from the West Bank working in ISI. But also domestic employment declined. Within the West Bank, about 11,000 jobs were lost in Q2-2002. In Q3-2002, the number of Palestinians from the West Bank working in Israel recovered somewhat, to about 20,000, but there was no improvement in domestic employment, which remained at a very low level of about 283,000. (see table 3)

  PCBS Data for Q3-2002 show a dramatic decline in employment in Gaza, which was almost halved compared to the previous quarter, to 69,000 persons. Since the PA and municipalities in Gaza together is estimated to employ the vast majority of this number, the implication is that private sector economic activity effectively ceased to exist in Gaza during this period. There is not obvious explanation for the sudden, dramatic decline in private sector employment in Gaza during this period, and it seems questionable that data correctly reflects the economic conditions in Gaza in Q3-2002.

  In total, the number of employed persons in the West Bank and Gaza has declined by 95,000 during the last 6 months, lowering the level of total employment to where it was in the early years of the Peace Process. Since the beginning of the Intifada, a total of about 250,000 jobs been lost, 110,000 of them in ISI and 140,000 within the West Bank and Gaza. Since public sector employment has been more or less stable during the Intifada, the latter figure means that private sector employment within the West Bank and Gaza has dropped about 35 percent since the beginning of the Intifada.

<table>
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<th>Table 3. Number of Palestinian Jobs (thousands)</th>
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<tr>
<td>Workers in West Bank</td>
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<td>Workers in Gaza</td>
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<td>Workers from West Bank in Israel</td>
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<td>Workers from Gaza in Israel</td>
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<tr>
<td>Total</td>
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Source: World Bank estimates based on PCBS. Note: The employment figures reported differs from those published by the PCBS, as they exclude the estimated number of employed persons in East Jerusalem.

It should be noted that the job losses reported above and their impact on productions and living standards are most likely underestimated, for several reasons. First, due to the extremely difficult conditions on the ground, PCBS was not able to complete all the planned interviews for the Labor Force Survey in Q2 and Q3 2002. Only about 4,000-5,000 interviews were completed, which is to be compared with the usual sample size of about 7,500. And since it must be expected that a large share of the people who the interviewers were not able to contact was also unable to work, the estimated number of employed persons is probably too high. In addition, since strict curfews was imposed on most of the urban areas in the West Bank during this period, it may be that some respondents reported that they were employed, but due to the curfews not able to get to their job. In general, the reduction in sample size means that caution must be exercised when interpreting the figures.

The steep drop in the number of employed has direct implications for living standards in the West Bank and Gaza, as fewer income earners have to support a steadily growing population. During the period from 1995 to the outbreak of the Intifada, job creation outpaced population growth, although the latter is among the highest in the world. In Q3-1995, which was the first time that PCBS carried out their labor force, each working
person on average supported 5½ persons (including him/her). At the time of the outbreak of the Intifada this number - the dependency ratio - had declined to 4½. But the dramatic contraction in the level of employment over the last two years means that each employed person in the West Bank and Gaza currently supports more than eight persons.

According to the standard ILO definition, the unemployment rate in the West Bank and Gaza reached 42 percent in Q3-2002, up from 29 percent six months ago. PCBS also publish an alternative measure of unemployment, which includes those respondent who declare that they have withdrawn from the labor force because the do not believe that it would be possible for them to find a job even if they tried. These "discouraged workers" usually make up about 5 percent of the population aged 15 years and above, but in Q2-2002 their share jumped to 8.5 percent. If the discouraged workers are included in the measure of unemployment, the unemployment rate exceeded 50 percent Q3-2002.
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The fact that the labor market adjustment to the sharp contraction in economic activity has mostly taken place through lower levels of employment rather than lower real wage level imply of course that it is the households in which a member has lost his or her job that particularly suffer from the crisis. A higher degree of real wage flexibility would have spread out the negative impact on a larger segment of the population. Moreover, there are indications that in particular poorer households suffer from the contracting labor market. One indication comes from previous World Bank research showing that there is a strong negative link between the risk of being poor and having a family member working in ISI. From 1996 to 1998, the increase in the number of Palestinians working in ISI was the single most important factor behind the observed decline in poverty during this period. Consequently, it must be expected that the virtual diminution of job opportunities for Palestinians in ISI during the Intifada has pushed up poverty significantly.

Further support for the hypothesis that in particular poor households has been hit by the contraction in the labor market comes from the fact that unemployment has in particular increased among persons with low levels of education, who are generally also have lower living standards. Before the Intifada there was only small difference in the unemployment risk between persons with less that 7 years of schooling and those with e.g. 10-12 years of schooling. But during the Intifada, the unemployment rate has especially shot up among persons with less than 7 years of education, from a level of about 10 percent in Q2-2000 to about 40 percent in Q2-2002. By contrast, the unemployment rate in the group with the highest level of education "only" increased from about 10 percent in Q2-2000 to 20 percent in Q2-2002.

Prices.

Consumer price inflation has been gradually increasing during 2002. The most recent figures from PCBS, covering September 2002, show year-on-year changes in consumer prices of 6.6 percent in the West Bank and 5.0 percent in Gaza (see figure 7). This is considerably higher than the trend in recent years during which inflation rates have not exceeded 2 percent.

The sharp depreciation in the New Israel Shekel (NIS) is one straightforward explanation for the pick-up in inflation. Although the NIS has recently strengthened vis-a-vis the US$, it has still lost about 10 percent of its value compared to December last year. (See figure 8). When the NIS loses value, prices of imported goods mechanically increase, and consequently the overall CPI also increases. The magnitude of the increase in the CPI depends partly on how fast consumers and producers switch consumption from imported goods to domestically produced goods. If substitution does not take place to any large degree, the impact on the CPI will be larger than if consumers and producers to a large extent substitute domestic goods for imported goods.

Source: PCBS

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Another contributing factor to the increase in inflation - in particular in the West Bank - is a surge in transport cost. Due to the tight internal closures in the West Bank, the cost of transport has increased by more than 40 percent during the Intifada. In Gaza, where internal closures have been less disruptive, transport costs have only increased about 10 percent. (see figure 9)

It should be noted that in general an increase in the CPI overestimate the impact on the average price of household’s total consumption basket. This is because the calculation of the CPI assume a set of fixed weights for the various consumption items to calculate the average price, while in reality people normally respond to changes in relative prices by consuming more of the good that has become relatively cheaper. For example, in the current CPI calculations, PCBS - based on data collected before the Intifada - assume that transport make up about 13 percent of household’s total consumption. However, since the price of transport has increased much more rapidly than other consumption goods, it is likely that households now have reduced their consumption of transport services.

Financial sector

The Palestinian financial sector has been relatively unaffected by the current economic crisis thanks to the very conservative investment positions it has taken over the years. After an initial drop in the first month of intifada, residents’ deposits remained stable, at about US$ 3.2 billion (see figure 11). They even grew after March 2002, when allegations of Israeli soldiers stealing cash in searched homes started to circulate. This clearly
illustrates the confidence that maintain Palestinian households in their financial sector, perceived as a safe savings’ haven.

Besides, Bank’s made the choice to reduce their lending activity to maintain their solvency. Throughout the intifada, the volume of credit extended to the private sector has continued to decline, as bankers adopted a more conservative posture during the period of economic downturn and political uncertainty. In such a climate, the granting of new credits is scaled back; existing lending and overdraft facilities are rolled-over less automatically; liquidity is increased. Just as deposits took a dramatic downturn in the first month of the intifada, credit to the resident private sector fell by US$91 million, or 7.2 percent, in October 2000. By September 2002, private sector credit had fallen US$242 million or 24.4 percent (13.0 percent annualized) from its level two years prior (see Figure 13). Expressed as a share of total bank assets, private sector credit has fallen from 20.6 percent to 17.1 percent. While the quality of banks’ loan portfolios has suffered, with non-performing loans increasing and some collateral having been destroyed as the result of military operations, the low percentage of loans to total assets mitigates solvency concerns so far for most banks.

Figure 11. Resident Private Sector Deposits (end of period; US Dollars, millions)

Source: Palestinian Monetary Authority

Most bank have remained very liquid (with placements in West Bank and Gaza and abroad), and have even increased their liquidity ratios since September 2000. On the other hand, Banks’ profitability has been severely affected, as the demand for their services, i.e. lending, retail banking, etc. sharply decreased with the crisis. As an illustration, the value of cleared checks declined 48 percent between September 2000 and June 2002 - even more rapidly than GDP, thus reflecting demonetisation of the economy (see figure 12).

Figure 12. Value of Checks Cleared (monthly; US Dollar equivalent, millions)

Source: Palestinian Monetary Authority

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Bank Group Operations

A. Multi-Donor Fund Administration

Palestinian Economic Assistance and Cooperation Expansion (PEACE) Facility

The PEACE Facility, a multi-donor successor to the Holst Fund, was set up in response to the need expressed by a number of donors for a multinational or umbrella facility to support targeted activities in the West Bank and Gaza (WBG), ranging from technical assistance to projects.

Objective: The broad objective of the PEACE Facility is to help relieve the economic and social hardship caused by the current crisis in WBG and the resultant Israeli border closures. The current PEACE Facility donors have focused on projects designed to create short-term employment opportunities for those most affected by the ongoing political crisis.

Project Progress:

- **Canadian International Development Agency (CIDA) - Canadian Contribution**: US$3.25 million Grant. Effectiveness Date: November 14, 2001. Expected Closing Date: March 31, 2003. The estimated total direct employment is 80,000 person-days (+42,000 in the West Bank and 38,000 in Gaza). Ninety-eight percent of the funds have been committed to 47 sub-projects, and 96 percent has been disbursed. Thirty-seven sub-projects have been completed, and to date, 67,000 person-days have been generated.

- **Danish International Development Assistance (DANIDA)**

**Danish Contribution**: US$3.5 million Grant. Effectiveness Date: November 25, 2001. Expected Closing Date: December 31, 2002. The estimated total direct employment is 82,000 person-days. One hundred percent of the funds have been committed to some 32 sub-projects in the middle area of Gaza, and 86 percent of the funds have been disbursed. Twenty-six sub-projects have been completed. To date, 75,601 person-days have been generated.

- **Islamic Development Bank (IDB)**: US$7 million Grant. Effectiveness Date: July 3, 2002. Expected Closing Date: June 30, 2003. The estimated total direct employment is 160-170,000 person-days. Ten percent of the fund has been disbursed. Under PECADAR’s Project Management component, US$1.48 million is committed for 32 sub-projects in WBG. In Gaza, an additional 36 projects in the amount of US$2.75 million are in various stages of tendering and evaluation. Under the Welfare Association Consortium (WAC) component, some US$1.1 million is committed to 21 sub-projects in WBG.

- **Italian Cooperation Contribution**: EURO10 million Grant. Expected Effectiveness Date: December 15, 2002. Expected Closing Date: December 31, 2003. The estimated total direct employment is 210,000 person-days. The project is now fully prepared and the Grant Agreement is expected to be signed by the Palestinian Authority (PA) in the near future.

B. Investment Projects

As of October 2002, the World Bank Group has 20 projects under implementation, eight completed projects, and five projects under preparation.

Ongoing World Bank Projects

Education and Health Rehabilitation Project (EHRP)


Description: The Project consisted of the following components:

1. Upgrade Physical Infrastructure. This component aimed to: (a) rehabilitate facilities, replace dangerous structures and substandard or undersized classrooms at 24 elementary schools, and replace or repair broken furniture; (b) construct and furnish new schools in underprivileged areas; and (c) upgrade, expand, replace, and furnish 10 primary health care facilities.

2. Improve Quality of Services. This component aimed to: (a) initiate a Quality Improvement Program in primary and secondary services through technical assistance and training; and (b) support a Health Education Program for schools.

3. Develop Institutional Capacity. This component aimed to: (a) provide technical assistance to develop a five-year plan for the health sector; (b) conduct a feasibility study on communication links among West Bank and Gaza health facilities to enable the exchange of medical expertise and enhance the referral system; and (c) provide technical assistance and training and operational support to the Project Coordination Units (PCUs).

Latest developments: The World Bank component has been closed and the Implementation Completion Report (ICR) has been completed. Under the Saudi Grant, 13 schools have been built and fully furnished; four clinics, two hospitals (in Dier Elbalah, Gaza, and in Yatta, West Bank) and the extension of Rafidia Hospital in Nablus have been built, fully furnished, and equipment installed. The Ministry of Health’s office building is under construction and is progressing well. Under the Italian Grant, 11 schools and five community centers for the handicapped have been built and fully furnished. Construction of one school, extension of another, and work on two community centers for the handicapped are progressing well. Equipment, and teaching and learning aids have been supplied to the schools and community centers for the handicapped. Under the Australian Grant, strengthening of policy-making, planning, and research capacity within the Ministry of Education, establishment of a school mapping database, and a maintenance scheduling system for the Ministry have all been completed.
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Education Action Project (EAP).
World Bank: US$7 million.
Borrower (PA): US$0.63 million.
Approval Date: July 18, 2001.
Closing Date: September 30, 2004.
Description: The Education Action Project (EAP) aims to support the implementation of the Ministry of Education’s (MOE) Five-Year Development Plan. The objective of the Project is to improve the management capacity of the education system to deliver quality services. The Project has two complementary components. The first directly supports strengthening the management capacity of the Ministry of Education for policy, planning, and budgeting across departments. The second supports specific investments in targeted programs in line with objectives of the MOE’s Five-Year Plan, including a program for school improvement through staff review, a school development program, the development of professional standards for headteachers, and support to Vocational Education.

Latest Developments: Despite the current situation, the Project has made substantial progress on most of its components since credit effectiveness on November 21, 2001. A Project Launch Workshop was held on May 13, 2002. Work has already begun on the following activities: construction of a two-floor extension to the existing MOE building in Ramallah; preparation of a Financial Management Manual; selected training for teachers and supervisors; preparation of materials for training modules for teachers and supervisors; and identification of four sites to build vocational education units. Development of a vocational education curriculum and procurement of equipment and furniture is underway.

Health System Development Project (HSDP).
World Bank: US$7.9 million.
Approval Date: December 9, 1999.
Closing Date: April 30, 2003.
Description: The development objectives of the Project are to enhance the management capacity of the Ministry of Health (MOH) and improve access to high-quality and affordable Primary Health Care (PHC) services, especially in rural and underserved areas. The Project has four components. The first supports the upgrading of the primary health care network by replacing 40 substandard PHC facilities, including equipment and furniture, and developing their functional standards. The second component supports the establishment of a Health Management Information System. The third component supports improvement of the quality and efficiency of health care. The fourth component provides support to the Project Implementation Unit for Project Coordination and Management.

Latest Developments: Due to the current situation, some of the Project components have been facing delays, especially in the West Bank. While the five Primary Health Care centers in Gaza are functioning, construction of the nine PHC centers for the first phase in the West Bank and the Health Information Center in Nablus have been delayed. Despite the delays, the Project has managed to: develop a Management Information System for the Treatment Abroad and Referral Department and the Health Insurance Department; develop the first version of the Clinic Information System; prepare the first version of the Palestinian Data Dictionary; and print and distribute the first version of the Palestinian Essential Drug List and Formularies.

Municipal Infrastructure Development Project (MIDPI).
World Bank: US$40 million.
Greece: US$1.74 million.
Italy: EUR0.67 million.
Approval Date: June 12, 1996.
Closing Date: December 31, 2002.
Description: This Project aims at rehabilitating high priority municipal infrastructure networks and systems in WBG by working directly with five selected municipalities (Gaza, Nablus, Hebron, Rafah and Jenin), the Ministry of Local Government (MLG), the Ministry of Public Works (MoPW), the Palestinian Water Authority (PWA), and PECDar. The focus is on initiating institutional reform and capacity building at the local government level.

The Capacity Building component which involved MLG and five selected municipalities addressed issues related to developing the municipal planning and financial management structures, primarily three-year investment plans, a Financial Management Information System (FMIS), and a Reformed Management Information System (RMIS).

Latest Developments: As the Closing Date approaches, all efforts are being made to commit and disburse all remaining funds. The Implementation Completion Report is currently being prepared by the Bank and the Client and is expected to be completed in February 2003.

Reallocation of remaining funds: To respond to the need for immediate assistance to repair damage incurred by the recent incursions, the Bank has reallocated US$2.5 million of the remaining balance originally designated to Capacity Building for labor-intensive damage repair. The funds have been distributed not only among the five participating municipalities in this Project, but also among 25 smaller communities in need of assistance. All sub-projects are due to be completed prior to the Closing Date. This component, together with the original physical component, is progressing well with all available funding committed to some 356 physical sub-projects, including 260 micro-projects. So far, more than 220 km of roads and 100 km of water and sewage pipelines have been constructed, and the upgrading of three neighborhood areas in Gaza City have been completed.

Reallocation of funds from the co-financing partners has also been completed with US$0.5 million from the Greek Fund and EUR0.2 million from the Italian Fund. Recaptured funds will finance the rehabilitation of much needed infrastructure in West Bank communities.

The Capacity Building component has been delayed as a result of the past 21 months' political instability. To date, only Hebron, Gaza, and Rafah municipalities have successfully completed their three-year investment plans. Nablus and Jenin municipalities have completed the diagnostic studies, but have been unable to continue the tendering process for the three-year investment plans. A Revenue Management Information System for 10 Participating Municipalities (PM) is being implemented. An independent consultant has been appointed to review the ATS contract, visit the implementation at the PM, and advise on next steps to be adopted in MIDPI II. A Geographic Information System

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(GIS) has been implemented in Gaza municipality, but Hebron and Nablus municipalities’ bids were delayed by the incursions. A state-of-the-art computer and network center has been completed in Gaza, Jenin, Nablus and Rafah. An electricity study was completed for the Hebron municipality, but was stopped in Nablus due to the inability to complete the study.

- **Second Municipal Infrastructure Project (MIDP II).**
  World Bank: US$7.5 million.
  Saudi Arabia: US$5 million.
  *(Italy is currently considering contributing a sum of US$5.7 million, of which US$2.5 million will be for roads and US$3.2 million for water).*
  Approval date: June 20, 2000.
  Closing Date: December 31, 2004.
  **Description:** The main objective of MIDP II is to improve infrastructure services (roads, water, and drainage), including high priority sections of the regional road network and rehabilitation of village and municipal water networks in WBG. The Ministry of Public Works, Ministry of Local Government, and the Palestinian Water Authority are the implementing agencies for this Project.

  The Project will also provide support to the Ministry of Public Works to establish its first Road Maintenance Management System. In addition, the Project will continue to provide support to the Ministry of Local Government for an accounting system and institutional reform. The scope of capacity building in the six municipalities in WBG will be reduced and funds reallocated to damage repairs.

  **Latest Developments:** Reallocation of funds has also been performed in MIDP II with a sum of US$3.1 million. The Ministry of Public Works and Housing is currently implementing this component, fixing damaged infrastructure, schools, clinics, and PA institutions, including the Ministries of Local Government, Public Works and Housing, Health, and Education.

  The MoPW is also progressing in implementing the Physical component of the MIDP II. Thus far, US$1.6 million has been committed and implemented for rehabilitation of regional roads. The PWA is ready to award its component of US$0.5 million for water rehabilitation. The MLG’s Capacity Building component has been reduced due to current conditions. Concentration will be on rolling over the Revenue Management Information System (initiated under MIDP I) to cover 15 additional municipalities.

  Identified donors are still in the process of reviewing Project documents for the final decision to transfer funds.

- **Solid Waste and Environmental Management Project (SWEMP).**
  World Bank: US$9.5 million.
  *(US$1.25 million is anticipated from the PA.)*
  Approval Date: October 10, 2000.
  Closing Date: December 31, 2005.
  **Description:** The Project is financing interventions in solid waste collection, transfer, and disposal of waste for the District of Jenin. The Project is managed by the Joint Services Council for Solid Waste Management (JSC) and is being executed through a Project Implementation Unit (JSC-PIU). The Project is assisting in strengthening capacity building of the Environmental Quality Authority.

  **Latest Developments:** Hydroplan (Germany) has been contracted (through the International Competitive Bidding Process) to design the sanitary landfill at Zahrat Al-Finjan. Work is expected to start the first week of November 2002. In consultation with the PA/Environmental Quality Authority (EQA) and Jenin JSC for Solid Waste Management, it was agreed to reallocate US$0.5 million towards damage repair in the environment sector. Considering the current constraints, the JSC-PIU has also focused on closing uncontrolled dumpsites and rehabilitating others in order to extend their operational life until the delayed new regional landfill proposed at Zahrat Al-Fanjan is operational. To date, 20 dumpsites have been rehabilitated and closed, and four dumpsites (Jenin, Srouj, Al Mahata and Arabeh) are being rehabilitated to act as regional controlled dumpsites during the interim period. Access roads to these sites are also being rehabilitated. In addition, the JSC has also been actively involved in cleaning up accumulated waste during the recent closures and military incursions. Furthermore, the JSC-PIU has moved forward in preparing for the proposed construction of the Zahrat Al Fanjan Landfill. Both JSC-PIU and the EQA recognize the importance of public awareness campaigns and are gearing themselves to solicit proposals from NGOs and local consulting firms to carry out this important task.

- **Southern Area Water and Sanitation Improvement Project (SAWSIP).**
  World Bank: US$21 million.
  EIB: EURO30 million.
  Approval Date: June 5, 1999.
  Closing Date: June 30, 2003.
  **Description:** The Project consists of: (a) the provision of an international Operator under a four-year performance based Management Contract to implement a Service Improvement Program for the Governorates of Bethlehem and Hebron in the West Bank; (b) the provision of operating investment funds for the Operator built into the Management Contract, to finance essential operations and maintenance expenditures not covered by the revenues collected and which are required to achieve the yearly performance targets in the Management Contract; (c) the provision of funds (by EIB) to finance design, implementation, and supervision of capital improvements, such as, system rehabilitation and improvement of water supply services; bulk transmission mains; distribution systems restructuring and rehabilitation, as well as an investment in rural water supply; and (d) the provision of technical assistance to support strengthening the institutional capacity of PWA and WSSA, to support implementation and monitoring of the Project and provide independent auditors to monitor the Operator’s technical and financial performance. The implementing agency is the PWA.

  **Latest Developments:** The Project was recently restructured to reflect the termination of the Management Contract Operator due to the Operator’s inability to fulfill contractual obligations because of the continued deterioration in the security situation. The Project objectives remain the same. An Action Plan was put in place to restructure the management of water and sanitation services in the Governorates of Bethlehem and Hebron. The responsibility for implementing the Action Plan will be undertaken by the Project Management Unit (PMU) of the PWA and supported by a team of experts. The Action Plan focuses
on the establishment of an organization to carry out the key functions of a Water and Wastewater Utility. This approach is designed to adapt itself to changing circumstances and to operate in the present period of political uncertainty. Disbursements, as of September 30, 2002 are approximately US$10 million, representing about 48 percent of the Credit.

- **Legal Development Project (LDP).**
  World Bank: US$5.5 million.
  Saudi Arabia: US$12 million.
  Approval Date: June 24, 1997.
  Closing Date: December 31, 2003.
  **Description:** The Project aims to initiate a long-term process of assisting the PA to modernize and harmonize existing legislation, to give rise to a legal framework adequate to support a modern market economy, and to encourage the growth of the private sector. It also supports the training of judges and court personnel in order to increase the efficiency and transparency of the judicial process.

- **Latest Development:** In December 2001, US$2.7 million of the Credit amount was cancelled due to slow implementation of certain Project components. The United Kingdom has provided financing for legislative drafting. As part of the overall program of legal development in WBG, construction of two courthouses is planned (one each in the West Bank and in Gaza), to be funded by the Kingdom of Saudi Arabia. In this regard, the shortlist of Consulting Engineering Firms was established, the Request for Proposals to produce the design and bidding documents was issued to these firms, incoming proposals were evaluated and negotiations with the top ranked firm were concluded. The Bank is awaiting the transfer of funds from the donor to clear contract award.

- **Palestinian Expatriate Professional Program (PEPP).**
  World Bank: US$3 million.
  Netherlands: US$0.3 million.
  Approval Date: May 22, 1998.
  Closing Date: June 30, 2003.
  **Description:** The PEPP supports the recruitment of expatriate Palestinians to key management and senior technical positions in PA institutions as an institution-building measure. Since the Program started in late 1997, 17 persons have been successfully recruited for positions at 11 PA Ministries and Agencies, including: the Ministries of Finance, Health, Higher Education, Housing, the Palestine Broadcasting Corporation, the Palestine Monetary Authority, and the Bethlehem 2000 Committee.

- **Latest Developments:** The current crisis is seriously affecting the ability of current participants in the Program to continue their work effectively, but they have shown extraordinary fortitude and courage to keep working despite these difficulties. Under the circumstances, the Program will support several medical specialists in ear, nose and throat, and eye diseases that will visit the West Bank and Gaza on short-term assignments. These specialists will perform operations that cannot currently be done in Gaza or the West Bank due to the lack of qualified doctors, and provide training to their medical colleagues in their fields of specialization.

- **Palestinian NGO Project (PNGO I).**
  World Bank: US$10 million.
  Italy: US$2.5 million.
  Approval Date: December 1996.
  Closing Date: December 2003.
  **Description:** The Project is aimed at delivering services to the poor and marginalized in Palestinian society through NGOs; improving the institutional capacity of the NGOs which receive grants under this Project; and enhance the working relationship between the PA and the Palestinian NGO sector. The Project had two main Grant-Awarding Schemes: The Development Grants Program and the Block Grants Program. The Project is being implemented by the Welfare Association Consortium, consisting of the Welfare Association, the British Council, and the Charities Aid Foundation (CAF).

- **Latest Development:** The Project is nearing completion, having disbursed a total of 94 percent of the total US$11.24 million that was made available for financing both Grant Schemes. As of July 2002, out of the 111 projects funded from the Development Grant funds of US$7.788 million, 88 have been completed, raising the disbursement rate to 92 percent of total funds available. Of the US$ 2,950,38 million allocated to Block Grants, a total of 195 sub-projects have been funded and completed.

- **Impact Assessment:** The PMO had completed the fieldwork for assessing the impact of both Block and Development Grant Schemes. The results of the fieldwork will serve as a basis for a formal assessment of the impact of the Project on the beneficiaries. The Impact Assessment Report will be made public once it becomes available.

- **Palestinian NGO Project (PNGO II).**
  World Bank: US$8 million.
  UK/DFID: US$7.8 million.
  Italy: US$2.4 million.
  Approval Date: June 21, 2001.
  Closing Date: February 15, 2004.
  **Description:** The Project is aimed at strengthening the capacity of NGOs to deliver sustainable services to the poor and marginalized, while supporting the overall professional and strategic development of the Palestinian NGO sector. The Project is being implemented by the Welfare Association Consortium, consisting of the Welfare Association, the British Council, and the Charities Aid Foundation (CAF).

  The Project has four main components:
  1. The Partnership Grants Program (US$9.5 million) which awards Grants to ‘groups’ of NGOs consisting of strong ‘lead’ NGOs and smaller NGOs who, in partnership, will implement sub-projects that are inter-linked by a common objective, with a strong component of capacity building and networking.
  2. The Development Grants Program (US$2.5 million) which awards grants to NGOs or projects that have demonstrated success during PNGO I and which have a potential of longer-term self-sustainability.
  3. The Sector Support Program (US$1.5 million) works with NGO networks to (a) promote strategic thinking on the role of the sector; (b) sector learning and information exchange; (c) enhanced PA/NGO dialogue and joint programming; and, (d) improved services by the Networks to their constituencies.
  4. An Emergency Grants Program (US$2.5 million) which disburses grants to emergency projects with shorter durations.

**December 2002**
and a direct focus on alleviating hardship and generating employment.

**Latest Developments:**

1. Partnership Grants: Seven Partnership Grant Managers (NGOs) submitted proposals for funding under this component. The submissions were reviewed by WAC's Technical Committee and recommendations for the awarding of Grants was submitted to the Supervisory Board for review in October 2002. Accordingly, it is expected that Grant Agreements with the aforementioned submitting NGOs will be concluded before the end of 2003, allowing for implementation of sub-projects under this component to start, after a few months delay.

2. Development Grants: Short-listed NGOs have submitted proposals for funding. It is expected that a decision of the Supervisory Board on Grants to be awarded will be taken before the end of 2003.

3. Sector Support: Based on the finalization of detailed reviews by commissioned consultants, an action plan for further implementation of this Project component and its four sub-components is expected to be developed/finalized in the coming few weeks.

4. Emergency Grants: As of November 2003, and during the course of the year, the Ad Hoc Committee had approved Emergency Grants in the amount of US$3.4 million. This includes financing from the Islamic Development Bank (US$ 1.1 million) and DFID (US$2.3 million). US$0.5 million of the funds provided by DFID were allocated to repair damage inflicted by a selected number of NGOs as a result of the incursions of 2002. By year-end, the WAC should complete the implementation of emergency projects financed by CID with the total of an estimated US$6000 thousand.

**Additional Italian Co-Financing for the Establishment of a Center for Women with Difficult Circumstances:** A Grant Agreement formalizing the contribution by Italy of a total of US$5 million to the PNO has been concluded. An estimated half of this amount will be used to finance the establishment of a Center for Women with Difficult Circumstances in Bethlehem. The Project has as its objective to provide support, therapy, advocacy, empowerment, and vocational training services to Palestinian females subject to domestic violence. It will be implemented through an Italian-Palestinian NGO partnership and in close cooperation with the Ministry of Social Affairs, who will assume eventual responsibility for the Center. The Italian contribution will also be used to finance the core components of the PNGO II.

**Bethlehem 2000 Project (B2000).**

Norway: US$1 million.
Italy: US$2.26 million.
Austria: US$0.73 million.
Approval Date: November 2, 1998.
Closing Date: June 30, 2003.

**Description:** The Project is composed of the following components:

1. **Celebration Support:** This component provided broad support to the Bethlehem 2000 Project Authority to prepare for and manage the celebrations.

2. **Infrastructure and Cultural Rehabilitation Works:** This component supports physical rehabilitation works and includes two sub-components: (a) Infrastructure Rehabilitation Works—this sub-component provided support to the Bethlehem 2000 Project Authority and Area Municipalities for the rehabilitation of high-priority infrastructure and services, namely roads, water and sanitation; and (b) Support for Cultural Heritage Rehabilitation Works—this sub-component provides support to the Bethlehem 2000 Project Authority, Area Municipalities and Department of Antiquities for the rehabilitation of the historic cores of Beit Sahour and Beit Jala.

3. **Capacity Building Support:** This component provides capacity building support to Area Municipalities and Cultural Heritage Authorities. It includes two sub-components: (a) Support to Bethlehem Area Municipalities—this sub-component provides support to the five Bethlehem Area Municipalities for strengthening their capacity to plan, finance, manage and maintain municipal infrastructure and services; and (b) Support Cultural Heritage Preservation—this sub-component provides support to the Department of Antiquities in the Ministry of Tourism and to the Ministry of Culture for policy and institution reform and development.

4. **Overall Project Monitoring and Reporting Support:** This component provides support to MLG program monitoring, accounting and reporting, and to environmental programming and monitoring activities.

**Latest Development:**

1. **Celebration Support:** The Bethlehem 2000 Project Authority has successfully staged the 1999 Christmas celebrations.

2. **Infrastructure Progress:** (a) Roads—the planned IDA components are 100 percent complete, implementation of activities financed by the reallocated amounts from the Credit proceeds for damage repair is progressing well. The Atris Road, co-financed with Italy is complete. The Shepherds Fields Road, co-financed by Norway, including landscaping works, is complete. (b) Water—the planned components are 100 percent complete. (c) Cultural Heritage—three of the four sub-projects are complete. The fourth one, co-financed by Austria, was recently completed. Little progress was achieved toward the development of the Conservation Master Plan for the Bethlehem Area, co-financed by Italy. Two international experts were fielded into the country to initiate the activities, and a draft Action Plan outlining all activities is being revised.

3. **Building Capacity Support:** (a) Support to Bethlehem Area Municipalities (BAM)—Progress is being achieved on the following sub-components: (i) Three-years Investment Plan: a request for proposals was issued to shortlisted consulting firms, technical and financial proposals are being evaluated, contract award will be executed soon; (ii) Operation and Maintenance Program: a request for Expressions of Interest was advertised, Expressions of Interest were received and currently are being evaluated to establish the shortlist, a draft Terms of Reference (TOR) is being finalized; (iii) Accounting System Reform: the consulting firm, contracted by MLG, visited the BAM and met with the accountants. The firm will draft an Action Plan for this sub-component, outlining all activities by end of November 2002; and (iv) Joint Services Council: discussions with the BAM regarding establishing the JSC are ongoing. (b) Support to Cultural Heritage Preservation—Progress is being achieved on the following sub-components: (i) Legal
and Institutional Reform: The Bethlehem 2000 Project Authority has issued the Request for Proposals for the drafting of Legislation for the Protection of Palestinian Cultural and Natural Heritage to the shortlisted consulting firms, technical and financial proposals were received and evaluated, request for contract award is being cleared by the Bank, individual consultants were selected to conduct Organizational Development and Management Studies; and (ii) Program Development: individual consultants were selected to conduct Documentation of the Palestinian Experience pertaining to Cultural and Natural Heritage Preservation and Adaptive Reuse Feasibility Studies.

**Electric Sector Investment and Management Project (ESIMP).**

World Bank: US$15 million.
EIB: US$38 million.
Italy: US$5 million.
PA: US$3 million.
Approval Date: August 31, 1999.
Closing Date: June 30, 2004.

**Description:** The objectives of this US$91 million Project are to rehabilitate the power distribution systems in the central and southern West Bank, and to address the institutional structure for longer-term sector management.

**Latest Developments:** Despite the present unrest, the implementation of the main activities (JDECo and PEA components) is progressing satisfactorily. Implementation of the HEPco and SELco components is progressing slowly due to the present situation. TA consulting services for SELco is already in place.

In October 2002, a supervision mission took place to follow-up on the start-up of the SELco and HEPco companies. Another mission for a mid-term review is planned for February 2003. About US$8.5 million of the US$15 million has been disbursed to date.

**Emergency Services Support Project (ESSP).**

World Bank: US$20 million.
UK/DFID: US$7.8 million.
Netherlands: US$5.9 million.
EU: US$9.6 million.

Additional Co-Financing Approved:
Sweden (US$4.7 million); Finland (US$1.2 million); Denmark (US$2.7 million); and Italy (US$5 million).

Approval Date: February 28, 2002.
Closing Date: June 30, 2004.

**Description:** The Project aims at enabling Social Service Delivery Ministries and Municipalities at sustaining the provision of basic social services, thereby ameliorating further deterioration in the standard of living of the Palestinian population. The Project focuses on supporting health, education, social welfare, and basic municipal services (solid waste, water, and electricity supply). With its focus on providing operating cost finance, this Project compliments the financing of the national budget that is provided to the PA by the Gulf countries and the European Commission (EU). The Ministry of Finance manages the ESSP, with direct implementation handled by the Ministries of Health, Education, Social Affairs, and Local Government.

**Latest Developments:** As of November 2002, delivery against IDA funds stands at 70 percent; Dutch Funds (20 percent), EC Funds (50 percent) and DFID Funds (20 percent). It is expected that all World Bank funds will be disbursed by year-end while other co-financing will be disbursed within the initial funds of 2003.

**The Integrated Community Development Project (ICDP).**

World Bank: US$10 million.
Approval Date: May 23, 2002.
Closing Date: June 30, 2006.

The Project seeks to improve the quality and availability of basic social and economic services in poor and marginalized communities of West Bank and Gaza. This new Project is a continuation of community development interventions financed through the World Bank under Community Development Projects I and II. Investments will finance rehabilitation of roads, water supply and sanitation systems, schools, clinics, and thereby preserve and extend the capital stock of villages and small municipalities. The Project will also fund interventions in the agricultural sector, including rehabilitation of wells, roads, and terraces. Lastly, the Project would pilot new initiatives in Information and Communication Technology (ICT) by financing the establishment of Multi-purpose Telecenters and thereby improve access to information and training for the poor and marginalized. The first batch of microprojects addressing various infrastructure sectors was tendered last launch.

**Completed World Bank Projects**

**The Second Community Development Project (CDP II).**

World Bank: US$88 million.
OPEC Fund: US$88 million.
Approval Date: March 30, 1999.
Closing Date: October 31 2002.

Under CDP II over 180 infrastructure projects, such as rehabilitation of roads, schools, health centers, and water supply systems have been committed, of which 160 have been completed. The World Bank funds have been fully disbursed. Projects have targeted poor and marginalized communities, including refugee camps. The current crisis has impacted the implementation of CDP II through delays and difficulties within communities to contribute to Project costs. Nevertheless, the Project has continued to make progress and has provided much needed work in villages and small municipalities. On the co-financing side, while OPEC-funded activities are continuing, the EIB contribution has been suspended after disbursement of about EURO3 million. Implementing Agency: PEGDAR.

**Microenterprise Project (MEP).**

World Bank: US$5 million.
IFC: US$7.5 million.
Netherlands: US$3 million.
Participating Banks: US$7.5 million.
Approval date: April 8, 1997.
Closing Date: July 31, 2002.

**Description:** The Project initiated a program to finance microenterprises in the WBG through the banking system in order to: (a) promote employment through private sector development; (b) achieve commercial viability and sustainability for microenterprise lending; and (c) build capacity in both the participating banks and the microenterprises by providing technical assistance.

**Latest Developments:** As of August 29, 2002, this Project was officially closed. A total of over US$2.8 million was disbursed under the Trust Fund Credit in financing a portion of over 1,100 loans valued at over US$12.7 million. The
disbursed loans were estimated to have created over 1,400 new full- and part-time jobs. A Project Implementation Completion Report is now under preparation. The balance of remaining financing has been returned to the Trust Fund for Gaza and the West Bank for future emergency operations.

- **Emergency Response Program (ESRP).**
  World Bank: US$11.61 million.
  Approval and Effective Date: December 6, 2000.
  Closing Date: August 31, 2001.
  The overall objective of the ERP was to alleviate economic hardship through the provision of temporary employment for unskilled and semi-skilled laborers. The implementing agencies included PECDAV, the Ministry of Local Government (MLG), Local Government Units (LGUs) and NGOs.
  The Project was successful in achieving its objectives. More than 246,000 person-days of employment were generated over a period of eight months. The average labor content of the Project was about 28 percent.

A total of 209 sub-projects were implemented. Local NGOs implemented a total of 33 sub-projects. An Implementation Completion Report has been completed.

- **Emergency Rehabilitation Project (ERP I).**
  World Bank: US$30 million.
  Saudi Arabia, Denmark, Switzerland, Kuwait:
  US$63.5 million.
  Approval Date: November 29, 1994.
  Closing Date: December 31, 1998.
  The Project (implemented by PECDAV) financed a total of 140 infrastructure projects, including construction of 418 classrooms, paving of 260 km of roads, and construction of approximately 410 km of water supply pipelines, 80 km of sewer lines and storm water lines and five water reservoirs.

- **Second Emergency Rehabilitation Project (ERP II).**
  World Bank: US$20 million.
  Italy: US$3.7 million.
  Approval Date: May 10 1997.
  Closing Date: June 30, 1999.

All available funding has been committed to 77 sub-projects. All 77 sub-projects in the road, water, wastewater, and school sectors (including 42 labor-intensive micro projects) have been completed. The Project was implemented through PECDAV in coordination with the WBG municipalities. Approximately 123 km of roads and about 110 km of water and sewage pipelines have been constructed. An Implementation Completion Report for the Project has been completed.

- **Community Development Project (CDP I).**
  World Bank: US$10 million.
  OPEC Fund: US$10 million.
  Approval Date: May 15, 1997.
  Closing Date: December 31, 1999.
  About 260 infrastructure microprojects (roads, schools, community centers, sewer lines, and water reservoirs) were implemented. There was strong community participation and ownership, including beneficiary contributions in cash averaging 10 percent of the Project costs. The Project was implemented by PECDAV.

- **Closed Multi-Donor Fund Administration**
  - **Holst Fund.**
    US$291 million from 27 donors.
    Approval Date: July 29, 1994.
    Closing Date: August 31, 2001.
    The multi-donor Holst Fund closed after seven years of operation. US$222.5 million was used to finance the creation and operation of Palestinian institutions - namely, the Ministries of Health and Education. About US$63.2 million was allocated towards funding Employment Generation Programs, targeting areas that were severely affected by border closures and the current sociopolitical crisis. The Holst Fund financed over 1,000 labor-intensive microprojects, and it is estimated that over three million labor-days of employment were generated. The Project Completion Report is expected to be sent to all 27 donors shortly.
  - **Technical Assistance Trust Fund (TATF).**
    See article p.8

- **World Bank Projects Under Preparation**
  - **Proposed Gaza Water and Sanitation Services Project (GWSSP II).**
    This Project is a follow-up to the ongoing GWSSP. The development objectives of this Project are: (a) to develop a sustainable institutional structure of the water and wastewater sector in Gaza by supporting the functional establishment of a Coastal Municipalities Water Utility (CMWU), as well as by enhancing and deepening the involvement of the private sector through an eight-year operating contract and strengthening the regulatory and institutional capacity of the Palestinian Water Authority (PWA); and (b) to continue improving the water and sanitation services by rehabilitation, upgrading and expansion of existing systems and facilities. Project preparation has been delayed because of the deteriorating political situation. The request for pre-qualification for prospective international Operators has been completed and four Operators/joint ventures were pre-qualified. The Request for Proposals will be issued in early 2003. Like the GWSSP, this Project is part of a larger parallel capital program to improve water and sanitation services in Gaza. The Project includes substantial investments in the establishment of a bulk water supply network connecting the various municipalities in Gaza, in the sewerage network, and in wastewater treatment plants. These investments, totaling about US$340 million for 2000-2005, will be financed by soft loans and grants from FIB, USAID, and KFW.
  - **Second Health System Development Project (HSDP II).**
    World Bank: US$8 million.
    Expected Board Approval Date: April 2003.
    The Project objectives are to improve the quality, access, and cost-effectiveness of essential secondary and tertiary care health services for the population residing in the northern Gaza and West Bank regions. In the original plan, the Project intended to replace and upgrade two hospital systems: Al Shifa Hospital in Gaza and Al Watani Hospital in Nablus, and to also build upon...
the experience of the First Health System Development Project to extend the
development of integrated information and management systems to improve the
productivity and quality of health care services in the targeted hospitals.

Due to the current political situation, the preparation work for the Second Health
System Development Project (HSDD II) has been delayed by more than one and
a half years due to the inability of the preparation missions to visit the Project
sites. In addition, the amount of financing available, both from the Bank and from
co-financing sources, has been significantly reduced as a result of the crisis. Consequently, the scope of the
Project has been considerably reduced. The following components from the
original plan will be retained in the revised plan for the HSDD II: (a) a regional
Hospital Rationalization Plan for the Northern West Bank; (b) hospital master plans for Shifa Hospital in Gaza City and
New Watani Hospital in Nablus; (c) a waste management pilot program; (d) a
management information system; and (e) quality improvement.

- **Emergency Municipal Services Rehabilitation Project (EMSRP).**

  Total estimated cost: US$70 million.
  World Bank: US$20 million.
  EU: US$30.5 million.
  Belgium: US$7.2 million.
  PA: US$3 million.
  Expected Board Approval: End of this year.

A two-year Emergency Recovery Grant Loan will include the following components: (a) Emergency Program Assistance (US$67.0 million, of which
US$17.5 million from the World Bank); (b) Municipal Fund Design and Management (US$1.5 million, of which
US$1.5 million from the World Bank); and (c) Technical Assistance and Capacity Building (US$1.50 million, of which
US$1.0 million from the World Bank). In light of the complementary roles performed by the different governmental
bodies involved in the sector, and recognizing the need for coordination at the central government level, a Project
Steering Committee (PSC) was formed by the Minister of Local Government in
October, comprised of MLG, MOF, and MOPIC to ensure a coordinated
programmatic response to emergency assistance needs at the local government
level.

The Project objectives are to: (a) Mitigate further deterioration in the quality and
coverage of municipal services, particularly solid waste collection, electricity, water, and sanitation services;
(b) generate temporary employment opportunities for unemployed workers
who have lost jobs inside Israel, or due to the economic contraction in WBG; and
(c) introduce a mechanism - a Municipal Fund - to link central and local
government budgetary planning processes to strengthen Palestinian emergency response capacity, enhance mobilization
of donor assistance, and improve the efficiency and equity of resource transfers to
local governments.

### Commitments and Disbursements

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<th>Allocated Amount</th>
<th>Disbursed</th>
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<td><strong>354.65</strong></td>
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* The Bank’s US$12 million Grant was channeled through the Holst Fund.

1These figures do not include parallel and IDC financing.

December 2002
West Bank and Gaza Update

- **Proposed Emergency Water Project (EWP).**
  World Bank: US$8 million.
  Please see details under the "Bank Group News" section on p. 29

- **Second Emergency Services Support Project (ESSP II).**
  Please see details under the "Bank Group News" section on p. 29

**World Bank and IFC Joint Projects**

- **Housing Project.**
  IFC: Up to US$4 million in equity investment.
  Approval Date: April 14, 1998.
  Closing Date: March 2004.

  **Description:** The Project’s major component is the Palestine Mortgage and Housing Corporation (PMHC) that facilitates the flow of private capital into housing. PMHC commenced operations in September 2000 and has accumulated a modest portfolio over the past two years. Although the present situation has significantly slowed PMHC’s operations, both affiliates, the Liquidity Facility, providing long-term funds for lending by banks and other primary mortgage lenders in WBG; and the Mortgage Insurance Fund, providing partial risk coverage for primary lenders, continue to increase their respective portfolios. Canada Mortgage and Housing Corporation is the technical partner for the PMHC providing technical assistance and capacity building support. The Project also includes a component for policy and institutional development in the sector that is implemented by the Ministry of Public Works and Housing.

  **Latest Developments:** This Project was recently restructured, and the Closing Date extended two years to March 31, 2004. As part of this process, an Action Plan for business growth for PMHC was agreed, and monitoring targets set. A review of these targets is scheduled for March 2003. The Policy and Institutional component was also extended, with the objective of revisiting housing policy and public sector capacity in the context of the newly merged Ministry.

- **Gaza Industrial Estate (GIE).**
  World Bank: US$10 million.
  IFC: US$9 million; US$7 million syndicated loans.
  EIB, USAID, the PA: US$65.5 million.
  Approval Date: March 24, 1998.
  Closing Date: June 30, 2004.

  **Description:** The GIE is located on a 50 hectare site at Al-Muntar in the northeast of Gaza (adjacent to the Israeli border) and is the first largely export-oriented industrial estate established to generate sustainable employment and stimulate industrial development in Gaza. The Project has attracted foreign and local investment, and has facilitated joint ventures between Palestinians and other investors. The GIE is managed and operated by PIEDCO, a private sector company; regulatory oversight and some offsite infrastructure services are provided by the PIERFAZ. The World Bank and USAID are providing financing for off-site infrastructure and institutional development, while IFC and EIB are planning the developer/operator of the Project.

  **Latest Developments:** Despite the depressed business environment in WBG generally, 18 firms continue to operate at the GIE, with one new tenant entering the site in June 2002 and two additional tenants seriously considering setting up new operations. As of July 2002, just over 800 workers are employed at the GIE. Although further expansion in the development of the site has been postponed, PIERFAZ is considering ways of improving the competitiveness of GIE tenant firms by providing support to upgrade management and production operations through targeted incubation services, particularly focusing on the garment manufacturing cluster.

**MIGA Operation**

- **Investment Guarantee Fund (MIGA).**
  World Bank: US$10 million.
  The Fund, which is administered by MIGA, provides Guarantees in the form of insurance against political risk for private investment in WBG. Under the terms of the Fund, investors who are nationals of, or companies incorporated in a MIGA member country, or who are Palestinian residents of WBG, are eligible to obtain Guarantees, provided that the investment is brought in from outside WBG. The Fund currently has the capacity to issue Guarantees for up to US$5 million per project. If a project requires more insurance capacity, requested by the project sponsor(s), MIGA will explore the possibility of obtaining coinsurance with public and private underwriters, including coinsurance under MIGA’s Cooperative Underwriting Program. During FY99, MIGA issued its first Contract of Guarantee on behalf of the Trust Fund for a project in the tourism industry. However, this contract was cancelled in FY01. The Trust Fund remains open for applications. Since inception of the Fund, over 20 applications have been received for almost US$400 million in investments in WBG’s infrastructure, manufacturing, real estate, services, and tourism sectors. The interest of seeking investment guarantees from the Trust Fund continues to be strong.

**IFC Projects**

**IFC Portfolio**

Including the three joint-projects above, IFC has committed US$25.89 million to three projects under the **Mainstream Program.**

Under the **Extended Reach Initiative,** which supported projects in the US$0.25-5 million range, seven projects were committed for US$7.42 million, out of which US$4.92 million was disbursed. The **Extended Reach Initiative was discontinued in mid-2000.**

All IFC-financed projects have been affected by the ongoing political crisis. Most private sector activity has been noticeably reduced, and most WBG companies are facing liquidity and severe operational difficulties due to the internal border closure.

**Mainstream Projects**

- **Arab Palestine Investment Bank (APIB).**
  IFC approved the US$3.74 million equity investment in May 1994.

  Arab Palestinian Investment Bank was IFC’s first investment in the West Bank and Gaza, and was established in Ramallah in 1996 by the Arab Bank, DEG, Enterprise Investment Company and IFC. APIB was also the first comprehensive commercial and investment
West Bank and Gaza Update

The West Bank and Gaza Update discusses various projects and developments in the region, including:

- **Arab Concrete Products Company (ACPC)**: IFC approved the US$0.8 million loan in June 1997. This project enabled Arab Concrete Products Company to fully utilize its production capacity of ready-mix concrete and expand its distribution capacity. IFC provided a long-term loan of US$0.8 million out of a total Project cost of US$2.6 million. Due to the crisis and mobility problems of labor and raw materials, the project has witnessed a significant drop in operational levels, and at certain times, it has come to a complete standstill.

- **Jericho Motels Company (JMC)**: IFC approved the US$1.17 million loan in August 1998. Developed on 31,000 m2 of land, the Jericho Resort Village consists of a 60-room hotel, 48 bungalows, and recreational facilities. At a total cost of US$8.1 million, IFC provided a 10.5-year, US$1.17 million loan, and the financing plan included long-term loans from two local banks and one other international lending institution. The complex opened for commercial operations in late 1998. However, due to the ongoing crisis and closure, the Project was forced to cease operations in early October 2000.

- **Arab Palestinian Storage Company (APSC)**: IFC approved the US$0.2 million loan in July 1998. The Project consisted of establishing a cold storage facility in Gaza with a capacity to store about 5,000 tons of perishable food products. The storage method included both freezing, as well as chilling, to preserve the products for long periods of time. The Project also involved trading in fruits and vegetables, mainly for sale in the off-season. IFC provided a loan of US$0.2 million out of a total project cost of US$5.9 million. The Project started operations in September 1999. However, the border closures in Gaza, and the ongoing crisis, have significantly reduced the Project's volume of operations, and in some instances, operations were brought to a complete stop.

- **IFC Technical Assistance**: IFC's technical assistance efforts have been aimed at supporting the Palestinian Authority's efforts to further broaden and deepen the Palestinian financial sector. IFC has also worked closely with the Palestinian Authority and the private sector to encourage the emergence of new instruments and players in the financial sector and capital markets through the development of framework laws and institutions. IFC was involved with the preparation of draft laws for Insurance, Securities, Capital Markets Authority, Mutual Funds, Mortgage, Tax, and Competition.

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As of December 31, 2001, APIB approved 27 loans worth US$12.6 million, and had an outstanding portfolio of US$8.8 million. Due to the ongoing crisis, the pipeline for new lending has significantly decreased, and focus has shifted to managing the existing portfolio.

- **Peace Technology Fund (PTF)**: The Project was approved in August 1998, with IFC investing up to US$12.6 million. The Peace Technology Fund was set up with a committed capital of US$63.2 million to provide equity capital for productive investments in the West Bank and Gaza. PTF was to encourage economic cooperation between Palestinian and Israeli companies and, if appropriate, invest in joint ventures between Palestinian companies and Israeli or international companies, thereby encouraging transfer of technology and employment generation in the West Bank and Gaza. PTF was expected to invest primarily in small- and medium-sized companies across a broad spectrum of high value added and/or employment generating industries.

- **Palestine Tourism Investment Company Ltd. (PTIC)**: The Project was approved in April 1999, and IFC invested US$1.35 million in equity and US$8 million in long-term loans.

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**December 2002**
Bank Group News

New World Bank Projects:

- Proposed Emergency Water Project (EWP).

  The main objectives of the project would be to provide small towns and villages in the southern West Bank with additional water supply, and to provide emergency financing for maintaining service levels in Gaza. The project would include the following components: (a) emergency water supply repair and rehabilitation in remote rural areas of the southern West Bank; (b) undertake repair and rehabilitation in order to maintain water and sanitation service levels in the Gaza Strip at the high levels achieved under the Gaza Water and Sanitation Project despite the deteriorating economic and security conditions; and (c) Technical Assistance and Capacity Building provided to PWA and the recently established Coastal Municipal Water Utility (CMWU) in the Gaza Strip and form joint pilot services councils for smaller towns in the southern West Bank. It is anticipated that the project will be appraised in February 2003 and presented for approval in May 2003.

- Emergency Services Support Project - Phase II (ESSP II)

  On 14 November 2002, negotiations were concluded between the World Bank and the Palestinian Authority for an additional financing of a Second Phase ESSP in the amount of US$ 25 million. Like ESSP I, ESSP II will support the financing of the operating budgets of the social ministries thereby helping sustain public services delivery to the Palestinian population. Unlike ESSP I, ESSP II will not provide budgetary support to Municipalities since that will be done through an Emergency Municipal Services Rehabilitation Project that the Bank will launch in the coming few weeks. The ESSP II project will be submitted to the Bank’s Board of Directors for approval in mid-December with an expected project starting date of January 2003. The total budget for the ESSP II program has been estimated at US$84 million, covering a budgetary period of one year.

- Emergency Municipal Services Rehabilitation Project (EMSRRP)

  The project comes in response to a request of the Palestinian Authority. It is expected to be presented to the Board by the end of this year. The total cost of the proposed project is currently estimated to be about US$70 million, out of which US$20 million is proposed to be financed by the World Bank. See more details on p.26 under “World Bank Projects Under Preparation”.

World Bank Missions to West Bank and Gaza

- Pensions Reform

  A World Bank mission visited West Bank and Gaza between Nov 04 - Nov 25th to discuss a report entitled "Pensions in Palestine": Reform in a context of civil unrest' with counterparts and donors, and make progress on the pension reform dialogue currently under way. During the mission the team met with the pension reform committee, the civil service reform committee and the donor community. The team also interacted with another Bank mission on civil service reform. Despite difficult working conditions progress was made on dissemination and on policy dialogues with counterparts in the PA. The key messages that emerged from this mission were: (a) the fiscal imperative to undergo pension reform very soon and the necessity of donor assistance; (b) the necessity of protecting the elderly via an universal old age social pension; and (c) ensuring transparency and efficiency in fund administration. The first draft of an updated report should be ready by December 30, 2002.

- Institutional Reforms for the Palestinian Authority.

  A World Bank mission visited West Bank and Gaza November 12-22 to advance work on ministerial and civil service reform. In particular, the mission sought to deepen the analysis of pay and employment issues. Working jointly with a World Bank pensions reform mission, the mission received further information necessary to provide costed options for civil service re-dimensioning and to analyze the fiscal implications of present civil service wage and employment conditions. Upon receipt of required data from counterparts, modelling exercises and scenario analysis will be conducted.

STAFF NEWS

- New Country Program Officer for West Bank and Gaza Office

  Mr. Kazuki Iiaya joined the WBG Country Office in August 2002. Before taking up his new position, Mr. Iiaya has worked as an economist in the World Bank Institute, and North Africa Department.

New Bank Publications

- A Sourcebook for Poverty Reduction Strategies (2-volume set).

  A Sourcebook for Poverty Reduction Strategies is a guide intended to help low-income countries with the development and strengthening of their poverty reduction strategies. This book has been designed as a resource for analysis and discourse on poverty reduction policies and programs at the country level. Each chapter adopts a layered approach, with a short summary providing overall assistance on issues, a detailed guide providing approaches to analysis and policy development along with supporting materials including country case studies, technical notes, and recommendations for further reading.

- The Right to Tell: The Role of Mass Media in Economic Development.

  The Right to Tell: The Role of Mass Media in Economic Development contains an outstanding list of contributors from Nobel Prize winner and former World Bank chief economist, Joseph Stiglitz to Robert J. Shiller author of Irrational Exuberance, and Nobel Prize winner and novelist Gabriel Garcia Marquez. Contributors to this volume explore the role of the media as a watchdog of government and the corporate sector, and the policies that prevent the media from exercising that role. The Right to Tell assesses the media's function as transmitters of new ideas and information. This book also evaluates the damaging effects that an unethical or irresponsible press can cause to a society.

Several of the book's contributors describe the role of the media and the challenges they face in specific countries including Bangladesh, Egypt, the former Soviet Union, Thailand, and Zimbabwe. These fascinating case studies highlight the media's ability to act as a catalyst for change and growth.
Social Reinsurance: A New Approach to Sustainable Community Health Financing.
Social Reinsurance details community-based approaches to insuring people against medical risk not based on individual risk rating as in private insurance, but rather using decentralized social insurance based on the average risk. This book shows how the concept of social insurance can be implemented in countries that do not have the capacity to finance or organize large-scale systems. It also details the strategies and public policies that countries can use to mitigate the shortcomings of community-financing plans designed along the lines of micro-insurance. Reinsurance is stressed as a tool for enlarging the risk pool and spreading risks across larger population groups, which no single micro-insurance scheme can do on its own. Social Reinsurance also discusses other measures to strengthen micro-insurance-based community-financing programs.

Middle East and North Africa:
- Reducing Vulnerability and Increasing Opportunity: Social Protection in Middle East and North Africa
- Cultural Heritage and Development: A Framework for Action in the Middle East and North Africa
- Globalization and Firm Competitiveness in the Middle East and North Africa

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The ‘West Bank and Gaza Update’ can also be found on the Internet at: http://www.worldbank.org/we

December 2002