1. Country and Sector Background

The decline of the Palestinian economy triggered by the Second Intifada in 2000 and compounded by recent events has left per capita GDP at US$1,129 by the end of 2006, about a third less than its level of US$1,612 in the year 1999\(^1\). Since Israel’s disengagement from Gaza in September 2005, its borders have been closed for extended periods, inhibiting trade and movement of people. The unemployment rate in Gaza reached 35% in 2006 compared to 18.6% in the West Bank for the same year. Since June 2007, Hamas took over Gaza and the closure became much tighter where trade and entry of goods became almost impossible.

However and lately, during the donors’ pledging conference in Paris more than US$7.0 billion were pledged to the PA to cover the PA budget for the coming three years. This shows the strong commitment of the donors’ community to continue their support to the Palestinians.

The water and wastewater sector has come a long way since 1995:

1. A capable national institution, the Palestinian Water Authority (PWA), has been built;
2. The foundations for policy and operational coordination with Israel have been established;
3. Several existing municipal distribution networks have been rehabilitated, new networks developed, and supplies improved; and several new wells have been drilled and many rehabilitated;
4. Backbone primary network of bulk-water carriers are under construction in the West Bank and ready to be launched in Gaza;
5. In Gaza not only have municipal networks and systems have been significantly upgraded, under an internationally recruited management contractor, effective managerial and operational systems have been established;
6. A new water law rationalizing the sector has been passed;

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Several studies have been undertaken to evaluate resource availability and quality, supply and demand, well and network conditions, tariffs, technical and financial management, and institutional options; and

A coherent national policy has been laid out and a national plan developed; and

A “Coastal Utility” is being established in Gaza, in an attempt to consolidate the existing small and inefficient municipal water departments into a more efficient operating and service delivery unit.

Despite the considerable efforts and many praiseworthy achievements, the structure and performance of the water supply and delivery system as a whole has not yet changed significantly:

Domestic water production and consumption, in Gaza, at 125 and 75 l/c/d respectively, remains low, well below comparators and Israel; critical water resources are still almost totally under Israeli control;

Palestinian supply and demand in the West Bank is highly constrained by Israeli actions;

Supply in Gaza, while somewhat less constrained than in the West Bank, is of highly variable quality (high salinity and nitrate contents); the Gaza aquifer remains degraded and at risk of irreversible damage;

Adequate wastewater treatment and disposal are still lacking, and the potential for wastewater reuse is not effectively exploited;

Adequate transmission networks and systems have yet to be developed;

The new law and the proposed institutional reforms, while extremely positive developments have yet to be fully implemented;

The institutional framework, while greatly improved, still needs further rationalization;

Distribution institutions and systems are still inefficient, and in need of major reform and rehabilitation, and water losses are unacceptably high;

Tariffs generally do not reflect the cost of operations or maintenance, much less development needs;

Finally, the initiative to establish CMWU is quite a success but still needs to be further supported for the coming few years.

2. Objectives

The Additional Financing will pursue the primary project development objectives which are to:

(i) Improve the provision of adequate water and wastewater services in Gaza; and

(ii) Functionally, strengthen the newly established Coastal Municipalities Water Utility as independent well-run modern utility.

In addition, the project has a secondary objective to strengthen the PWA’s capacity to assume sector regulatory functions.
3. Rationale for Bank Involvement

There are two basic reasons for Bank involvement: one is based on successful Bank leadership and in the water sector in WBG in general followed by the need to follow through on the reforms that were started; the other is based more broadly on the Bank’s role and experience with emergency operations.

Leadership and Staying the Course: As indicated above, the Bank has played a leading, innovative and successful role in initiating change in the water sector in Gaza under WSSP and the current GEWP II. Among the initiatives was the introduction of a private sector operator under a performance-based management contract to operate and manage water and wastewater services throughout Gaza. The establishment of a functional utility in Gaza is being realized under the GEWP II. However, the delay in the utility establishment toward the end of the project necessitates the need to continue support of the CMWU for additional year through the supplemental financing under consideration.

Emergency Experience: The Bank has had considerable global experience in designing and implementing operations in response to natural disasters and emergencies arising in conflict-affected settings. Also, developing countries are becoming increasingly aware of the need to put in place measures to prevent or reduce risks arising from crises. Thus, the number of Bank-supported emergency recovery projects has increased in the past ten years, and the Bank has come a long way in its own understanding of how to operationalize sustainable interventions in emergency situations. In WBG, specifically, the Bank is often relied upon by the PA and donors to lead such efforts, and has done so successfully. The GEWP II sets an excellent example of the capability of the Bank to implement such project under very hard conditions in Gaza and enables the project to act as a vehicle to channel more than US$ 40.0 million by other donors to the CMWU.

4. Description

Institutional Reform and Capacity Building Component (US$1.2 million). This component would finance the expenses of the strengthened PMU to perform operations required as outlined in the Proposal prepared by the CMWU and reflected in the Project Paper. The Additional Financing will be implemented during one year and a half to complement the ongoing 3-year Management Contract which is expected to end by June 30, 2008. The main performance targets for the Proposal are clustered around:

a. Strengthening the newly established utility by implementing the new payroll system, improving human resource management and strengthening the capital investment and planning systems.

b. Improving water quantity by reducing water losses and increasing the supply capacity.

c. Improving water quality via the maintenance and upgrade of the existing disinfection program including improving the performance of the existing wastewater works.
d. Improving the management systems of the water and wastewater services with emphasis on operation and maintenance systems, financial management, customer services, billing and collection, human resources development.

**Capital and Operating Investment Fund Component for Operation and Maintenance** (US$3.8 million). This component would finance the purchase of materials, supplies and equipment essential for operations and maintenance of the water and wastewater systems and which collected revenues are unable to cover. This fund is under the control of the PMU and subject to the approval by the CMWU Board of an annual procurement plan in accordance with Bank Procurement Guidelines, in order to reduce procurement concerns, and provide the Operating Team with funds to direct the achievement of the performance standards set in the Project Paper. This component would also focus on completing a list of activities considered the cornerstones for building the utility such as the systems hardware and software and the preparation of the CMWU premises whether they are new constructions or rented offices.

### 5. Financing

As for the original project, the additional financing will be provided as a Grant from the Trust Fund for Gaza and the West Bank (TFGWB). The project would pursue the original objectives through two main components. The component: Institutional Reform and Capacity Building - includes strengthened Project Management Unit (staffed by the current PMU, the national staff of the operator team of the GEWP II, and external consultants) (US$ 1.2m). The component: Capital and Operation Investment Fund- includes an operating investment fund (US$ 3.8m) to procure the necessary works, goods and services for one additional year including support to functionally establish the CMWU.

<table>
<thead>
<tr>
<th>Source</th>
<th>($m.)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Borrower</td>
<td>0</td>
</tr>
<tr>
<td>Special Financing</td>
<td>5</td>
</tr>
<tr>
<td>Total</td>
<td>5</td>
</tr>
</tbody>
</table>

### 6. Implementation

Following the end of the Management Contract, the CMWU plans to strengthen the project PMU by supporting its staff with additional local experts who are currently comprises the Operator’s expert team. Moreover, the CMWU will utilize part of the grant proceeds to procure the services of external consultants, on short term basis, as needed. This arrangement will give the PMU the capacity and full responsibility to implements all delayed tasks as well the management of all water and wastewater services as will be specified in the CMWU Proposal. The table below outlines the allocation of funds among different components:
### Summary of activities with cost overrun to be financed from the proceeds of the Additional Financing

<table>
<thead>
<tr>
<th>Original Project Components and Activities</th>
<th>Original Amount (US$ m)</th>
<th>Last Reallocation amount (US$ m)</th>
<th>Cost Overrun (US$ m)</th>
<th>Reasons for Cost Overrun</th>
</tr>
</thead>
<tbody>
<tr>
<td>Component 1- Performance-based Management Contract</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Subtotal Overrun for Component 1</td>
<td></td>
<td>0.00</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Component 2- Capital and Operating Investment Fund</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>• Replacement of existing wells, drilling of new wells</td>
<td>1.17</td>
<td>1.17</td>
<td>0.50</td>
<td>Wells are overloaded and require replacement as the water quality deteriorates due to and the demand increases.</td>
</tr>
<tr>
<td>• Replacement of water mains or sewer piping</td>
<td>2.57</td>
<td>1.40</td>
<td>0.3</td>
<td>There is a number of asbestos pipes which need to be replaced. Also to service areas are expanding.</td>
</tr>
<tr>
<td>• Replacement of water and wastewater connections</td>
<td>1.46</td>
<td>0.60</td>
<td>0.40</td>
<td>Expansion of the services and more needs to replace the old connections.</td>
</tr>
<tr>
<td>• Repair and replacement of water meters</td>
<td>0.00</td>
<td>1.30</td>
<td>0.20</td>
<td>Additional meters are needed to comply with the program of continuous meter replacement for an additional year.</td>
</tr>
<tr>
<td>• Repair, maintenance and replacement of electromechanical equipment</td>
<td>0.70</td>
<td>1.60</td>
<td>0.90</td>
<td>Equipment became subject to failures due to frequent power outages and overloading.</td>
</tr>
<tr>
<td>• Supply of chemicals and dosing pumps</td>
<td>1.00</td>
<td>1.10</td>
<td>0.60</td>
<td>Increase in water demand and thus chemicals supplies. Also to cover needs during the one year extension.</td>
</tr>
<tr>
<td>• Purchase systems hardware and software</td>
<td>0.00</td>
<td>.10</td>
<td>0.15</td>
<td>Extra need to purchase the software and hardware needed for the functionality of the CMWU.</td>
</tr>
<tr>
<td>• Incremental costs for the water and wastewater facilities</td>
<td>0.40</td>
<td>1.0</td>
<td>0.40</td>
<td>Mainly finance fuel to run the standby diesel generators especially due to unexpected power outages in Gaz.</td>
</tr>
<tr>
<td>• Construction new administrative facilities</td>
<td>0.60</td>
<td>0.85</td>
<td>0.35</td>
<td>Support the CMWU to pay the rental cost and furnishing the regional offices for an extra year during the extension.</td>
</tr>
<tr>
<td>Subtotal Overrun for Component 2</td>
<td></td>
<td>3.80</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Component 3- Institutional Reform and Capacity Building</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>• Technical Assistance to CMWU</td>
<td>1.2</td>
<td>1.40</td>
<td>1.20</td>
<td>Finance the new management arrangement after the end of the Management contract and during extra year of extension including arranging to implement the EMP.</td>
</tr>
<tr>
<td>Subtotal Overrun for Component 3</td>
<td></td>
<td>1.20</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total Cost</td>
<td>20.00</td>
<td>5.00</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

7. **Sustainability**

The Additional Financing will build on the achieved progress to functionally strengthen the newly established CMWU. It will support further training of the CMWU staff and allow for the completion of the CMWU management systems, particularly in the human resources and payroll aspects. The improvement of the financial management of the CMWU will help the sustainability of the water industry through better cost recovery and increase the capability of the industry to cover its operational and hopefully investment costs.
The Additional Financing will lead to the improvement of the water and wastewater services through proper operation and maintenance of the facilities. It will help the CMWU to maintain the investments made over the last decade in the water services facilities. It will also lead to better supply management and reduction of leaks and thus contributes in the reduction of unnecessary groundwater over-abstraction which in turn will lead to a better control of the seawater intrusion.

On the other hand, the extension will enable the PWA to complete its capacity building sub-component, so that it is able to play its regulatory role.

8. Lessons Learned from Past Operations in the Country/Sector

A number of lessons were learned from the implementation of the project and other projects that the Additional Financing can benefit from. These include:

1. Due to the work under politically unstable conditions in Gaza, procurement must be planned and started as early as possible.
2. The local expertise need to be encouraged and involved in the process of the development of the water sector as much as possible.
3. Private sector can play an important role in developing the water sector. Among other factors, the political stability can hinder the implementation and changes in the implementation arrangement should be expected.
4. In a situation similar to Gaza, close and frequent supervision missions are necessary to follow the dynamic changes and to be able to adjust within the framework of the project document.
5. The competent PMU is the key for the success of the implementation of the project.
6. Institutional reform is a very tedious and lengthy process but a challenging one. It requires resources and determination. Moreover, there is a strong need to continue supporting newly established institutions like the CMWU until it can be self sufficient.
7. Despite the success in improving the level of service, there is an urgent need to address the more serious water resource issues, i.e., water resources protection, development and enhancement.
8. The full cooperation and law enforcement are important to cut the commercial water losses and increase the willingness to pay.
9. Other donors’ contribution deemed necessary. This can be achieved through the continuous discussion, share of information with the donors and increasing the credibility of the CMWU as service provider.

9. Safeguard Policies (including public consultation)

The proposed project has been classified under the environmental category “B” in accordance with the World Bank’s Operational Policy 4.01 on Environmental Assessments Accordingly, and as the activities are of the same nature and continuation to those initiated under the original project, the Environmental Assessment (EA) and Environmental Management Plan (EMP) which
were completed in March 2001 as part of the Project preparation are still valid. Both the EIA and EMP are available on file within the World Bank’s Infoshop. It was agreed during the negotiations that the plan will be reviewed and updated by May 31, 2008. It was also agreed that the PMU will appoint an environment specialist to monitor the implementation of the EMP.

The AF would contribute to improving the environment through improved management of existing water and sanitation facilities, increased expenditure on essential operations and maintenance, and a capital investment program to expand and improve water and sanitation infrastructure. Currently there are no known project proposals whose implementation would require land acquisition or result in involuntary resettlement. No known archaeological or historical sites would be affected by rehabilitation sub-projects, nor does the operating investment component of the project raise any international water issues. The capital investment activities to be supported comprise rehabilitation, upgrading and extension of piped water supply and sewerage services in urban areas and water supply improvements in rural areas. The project does not include new wastewater treatment facilities. The project does not include any component with major environmental impact and will result in significant improvement in environmental quality through improved water and sanitation services.

Environmental impact will be mitigated by improved operations and maintenance of water and sewerage services which will improve the efficiency of water use and reduce the need for tapping new resources. Substantial past and future investments by other donors have provided adequate collection systems to accommodate increased wastewater discharges resulting from this project.

The Additional Financing will lead to enhancing and improving customer satisfaction through the improvement of the level of services. However, there is a need to communicating progress regularly, and establishing mechanisms of consultation, handling of complaints, and a transparent and accountable regulatory environment. Three actions are indicated, which have been included among the service responsibilities:

- **Regular consumer surveys.** These will assess the extent of consumer satisfaction and of trust between consumers and the CMWU. Some of the issues that will be covered by such surveys are consumer feedback on accuracy in metering and billing; service time response to complaints to utility staff, particularly in relation to billing; and the reliability of supply.

- **Targeted Support Payments to the Poor:** Currently, municipalities exempt some consumers from paying their water bills or forgive the accumulated arrears on water bills, presumably on the basis of social need. However, the current practice may not be well targeted to the poor, since these exemptions are apparently often granted as favors to relatives and friends. The newly approved by-laws for the CMWU provide for the development of a more targeted system. The CMWU will reach an agreement with the Ministry of Social Affairs to develop and implement a mechanism to target the poor.

- **Formation of consumer committees in each region.** These committees will serve as an interface between the utility and the consumers, holding public meetings, providing feedback to the CMWU on consumer priorities and concerns, thus increasing transparency.
10. List of Factual Technical Documents

1. Semiannual and Annual Progress Reports
2. Technical Paper developed under the Management Contract

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* By supporting the proposed project, the Bank does not intend to prejudice the final determination of the parties' claims on the disputed areas