Document of
The World Bank

FOR OFFICIAL USE ONLY

Report No: PGD405

INTERNATIONAL DEVELOPMENT ASSOCIATION

PROGRAM DOCUMENT FOR A

PROPOSED GRANT

IN THE AMOUNT OF US$30 MILLION TO

THE PALESTINE LIBERATION ORGANIZATION
(FOR THE BENEFIT OF THE PALESTINIAN AUTHORITY)
FOR THE

Development Policy Grant 13
February 17, 2023

Macroeconomics, Trade And Investment Global Practice
Middle East And North Africa Region

West Bank and Gaza

GOVERNMENT FISCAL YEAR

January 1 – December 31

CURRENCY EQUIVALENTS

(Exchange Rate Effective as of February 16, 2023)

Currency Unit New Israeli Shekel (NIS)

US$1.00 = NIS3.5540

ABBREVIATIONS AND ACRONYMS

ACH	Automated Clearing House system	IPSAS	International public sector accounting standards
AHLC	Ad Hoc Liaison Committee	ISSAIs	International Standards of Supreme Audit Institutions
AM	Accountability Mechanism	LMIC	Lower Middle-Income Countries
AML/CFT	Anti-Money Laundering and Combating Financing of Terrorism	MAC	Market Access Countries
ASYCUDA	Automated Systems for Customs Data	MDTF	Multi-Donor Trust Fund
BoI	Bank of Israel	MENA	Middle East and North Africa
BoP	Bank of Palestine	MFIs	Microfinance Institutions
CBRs	Correspondent Banking Relationships	MoF	Ministry of Finance
CCDR	Country Climate and Development Report	MTEF	Medium-Term Expenditure Framework
CE	Citizen Engagement	NCTP	National Cash Transfer Program
CPF	Country Partnership Framework	NDP	National Development Plan
DESA	Debt Sustainability Analysis	NIS	New Israeli Shekel
DFS	Digital Financial Services	NPLs	Non-performing Loans
DPG	Development Policy Grant	PA	Palestinian Authority
DRU	Dispute Resolution Unit	PACC	Palestinian Anti-Corruption Commission
E-GP	Electronic government procurement	PDO	Program Development Objective
EIA	Environmental Impact Assessment	PEFA	Public Expenditure and Financial Accountability
ESPERE	European Union for the Palestinian Economy and Resilience	PER	Public Expenditure Review
EU	European Union	PFMI 2	Public Financial Management Improvement Project Phase 2
E-VAT	Electronic-VAT	PMA	Palestine Monetary Authority
FATF	Financial Action Task Force	POS	Point of Sale
FCDO	Foreign Commonwealth and Development Office	PPL	Public Procurement Law
FCV	Fragility, Conflict and Violence	PPP	Purchasing Power Parity
FinTech	Financial Technology	PSP	Payment Service Providers
GCRF	Global Crisis Response Framework	PURSE	Palestinian Umbrella for Resilience Support to the Economy
GDP	Gross Domestic Product	RMIS	Revenue Management Information System
GIZ	German Agency for International Cooperation	ROF	Results-Oriented Framework

GNP	Gross National Product	SCD	Systematic Country Diagnostic
GPC	General Personnel Council	SDR	Special Drawing Rights
GRM	grievance redress mechanism	TA	Technical Assistance
GRS	Grievance Redress Service	USAID	United States Agency for International Development
H1	First Half	VAT	Value Added Tax
HCPPP	Higher Council for Public Procurement Policies	WB	World Bank
HR	Human Resources	WBG	World Bank Group
IBRD	International Bank for Reconstruction and Development	WHO	World Health Organization
IDA	International Development Association	WOBs	Women-Owned Businesses
IFC	International Finance Corporation	Y-o-Y	Year-on-Year
IMF	International Monetary Fund		

Regional Vice President:	Ferid Belhaj
Country Director:	Stefan W. Emblad
Regional Director:	Nadir Mohammed
Practice Manager (s):	Eric Le Borgne, Irina Astrakhan
Task Team Leader (s):	Nur Nasser Eddin, Abdalwahab Khatib

WEST BANK AND GAZA

DEVELOPMENT POLICY GRANT 13

TABLE OF CONTENTS

This operation was prepared by a World Bank Group team led by Nur Nasser Eddin (Senior Economist and TTL, EMNMT) and Abdalwahab Khatib (Senior Financial Sector Specialist and Co-TTL, EMNF2) and consisting of Luan Zhao (Senior Economist, EMNMT), Lina Tutunji (Senior Procurement Specialist, EMNRU), Riham Hussein (Senior Governance Specialist), EMNGU), Najm-Ul-Sahr Ata-Ullah (Senior Social Development Specialist, SMNSO), Manal Taha (Environmental Specialist, SMNEN), Samantha Constant (Consultant, EMNPV) and Zein Azzam Ibrahim Daqqaq (Team Assistant, MNCO4). The team gratefully acknowledges the support and guidance provided by Stefan Emblad (Country Director, MNCO4), Nadir Mohammed (EFI Regional Director, EMNDR), Eric Le Borgne (MTI Practice Manager, EMNMT), Irina Astrakhan (EFI, Practice Manager, EMNF2), Gianluca Mele (EFI Program Leader and Lead Economist, EMNDR), and Mariana Montiel (Senior Counsel, LEGAM). The team expresses its gratitude to the Palestinian Authority (PA) Ministry of Finance, Prime Minister Office, and other PA staff for their collaboration in the preparation of this operation.

SUMMARY OF PROPOSED FINANCING AND PROGRAM

BASIC INFORMATION

Project ID	Programmatic
P179609	No

Proposed Development Objective(s)

The Development Objectives of the proposed operation are: (i): to improve the structural fiscal balance and strengthen the effectiveness of public procurement, and (ii) to strengthen the integrity of the financial sector and pursue digital transformation.

Organizations

Borrower:	PALESTINE LIBERATION ORGANIZATION (FOR BENEFIT OF THE PALESTINIAN AUTHORITY)
Implementing Agency:	Ministry of Finance

PROJECT FINANCING DATA (US$, Millions)

SUMMARY

Total Financing	**30.00**

DETAILS

Trust Funds	30.00
Special Financing	30.00

INSTITUTIONAL DATA

Climate Change and Disaster Screening

This operation has been screened for short and long-term climate change and disaster risks

Overall Risk Rating

High

Results

Indicator Name	Baseline	Target
Domestic VAT collections as a share of domestic tax revenues	37 percent December 2022	39 percent December 2024
Number of newly hired civil and security personnel on the PA's payroll as a share of total exits in the same year	221 percent December 2022	50 percent December 2023
Share of public procurement staff who completed the procurement training program	Zero percent of procurement officers December 2022	80 percent of procurement officers December 2024
PMA conducting on-site inspections of banks' AML/CFT internal controls, to ensure compliance with newly mandated procedures on collecting, verifying, and maintaining beneficial ownership information	Onsite inspections controlling the collection, verification, and maintaining of beneficial ownership information do not exist October 2022	PMA conducted on-site inspections of licensed banks accounting for 85 percent of total bank assets, controlling the compliance with new procedures on beneficial ownership information, December 2024
Number of cashless transactions	Two million transactions June 2022	Number of cashless transactions increasing by 150 percent December 2024
The number of women-owned businesses accessing microfinance according to the new definition	Unmeasured	1500 women-owned businesses, December 2024

IDA PROGRAM DOCUMENT FOR A PROPOSED *GRANT* TO
The *WEST BANK AND GAZA* FOR
Development Policy Grant 13

1. INTRODUCTION AND COUNTRY CONTEXT

1. **Despite reform efforts, the Palestinian territories continue to face significant development challenges.** The Palestinian Authority (PA) has carried out reform efforts in recent years focusing on enhancing revenues, rationalizing spending, and strengthening Public Financial Management (PFM). As a result, the PA successfully managed to reduce the fiscal deficit (before grants) from 21 percent of GDP in 2006 to an estimated 3 percent in 2022. Nevertheless, the fiscal situation remains difficult. This is mainly due to the dire situation in Gaza, while fiscal operations in the West Bank break even. Even though in 2022 the economy continued to rebound from the COVID-19 shock, growth slowed down compared to 2021, and the overall fiscal situation remained challenged by historically low donor aid and continued Israeli deductions from revenues collected on behalf of the PA (clearance revenues). Following the election of a new Israeli Government, tensions have increased as has uncertainty regarding political and security developments, which could exacerbate macro and fiscal risks. Given the lack of alternative financing instruments, the PA is expected to continue to rely on domestic bank financing, additional arrears to the private sector and the pension fund, and partial salary payments for public servants, which it has been implementing since November 2021. The proposed DPG will provide much needed financing to ease some of the fiscal stress, while reinforcing necessary fiscal reforms as outlined above.

2. **Latest estimates suggest that poverty slightly dropped in 2021, after peaking in 2020.** Based on the latest available official data, 22 percent of Palestinians lived below the US$5.5 2011 purchasing power parity (PPP) a day poverty line in 2016/17. In the West Bank, poverty rates are lower but sensitive to shocks in household expenditures, while in Gaza any change in social assistance flows can significantly affect the population's wellbeing. World Bank estimates, based on GDP per capita growth, suggest that in 2020 the poverty rate spiked to 29.7 percent - an increase of nearly 8 percentage points from 2016. As the impact of the pandemic receded, the poverty rate is estimated to have declined to a still significant 27.3 percent in 2021. This represents a poor population of about 1.5 million people.

3. **In 2021, the PA launched a new version of the National Development Plan (NDP), for the years 2021-2023, aiming to tackle some of the challenges faced by the Palestinian territories.** The development plan is entitled "Resilience, Disengagement, and Cluster Development Towards Independence" and it aims to: 1) achieve national unity by upholding democratic principles and broadening the Palestinian territories' international participation, 2) provide excellent public service provision, and 3) achieve sustainable development, through adopting an all-rounded approach that focuses on enhancing the business environment, strengthening social protection, and promoting inclusive health and education systems. The NDP also focuses on institutionalizing gender mainstreaming and promoting gender equality and women empowerment through enforcing laws that abolish gender-based discrimination and punish violence against women.

4. **The World Bank Assistance Strategy for the West Bank and Gaza (FY22-25) responds to the NDP's vision and builds on successful reforms in areas supported under previous Development Policy Grants (DPG)**. Through giving priority to strengthening institutions, developing human capital, and building a more resilient economy, the current World Bank's program is in complete harmony with the NDP's priorities**.** One of the tools used by the

World Bank, over the years, to support the PA's reform agenda has been the DPGs. The World Bank has worked closely with the PA since 2008 through twelve DPGs to support reform efforts in critical areas. Despite being standalone operations spanning over a period of one year each, the DPGs have been de facto programmatic given their focus on the continuum of reforms over the years. The PA achieved multiple results in key sectors supported by the DPGs. In the fiscal sector, the PA unified different tax departments enhancing the efficiency of the collection efforts. Increasing government transparency and accountability through improved PFM has been another reform area supported by the DPGs. The operations also supported the PA's efforts in various sectors including energy, water and health with the aim of enhancing the efficiency and efficacy of service delivery. The PA also implemented a number of business environment reforms, supported by the DPGs, including the adoption of a companies' law and, more recently, a telecommunications law, both aligned with best practice.

5. **The proposed DPG 13, in the amount of US$30 million, is designed to support the PA in achieving strategic reform priorities**. The proposed operation includes two pillars: (i) to improve the structural fiscal balance and strengthen the effectiveness of public procurement, and (ii) to strengthen the integrity of the financial sector and pursue digital transformation. Under the first pillar, the operation supports efforts to (1) structurally enhance domestic revenues through the establishment of an online portal that crosschecks domestic Value Added Tax (VAT) submissions by businesses; (2) contain the wage bill by introducing an attrition target for public employment in 2023; and (3) improve the professional quality of the public procurement workforce through introducing a procurement training program and an independent certification mechanism to strengthen the effectiveness of the procurement function and, hence, accountability. Pillar two focuses on the financial sector and supports efforts to upgrade the Anti Money Laundering and Combating Financing of Terrorism (AML/CFT) legal framework in the Palestinian territories through the enactment of a modern AML/CFT law, aligned with international best practice. This pillar also supports the PA's efforts in advancing the digital transformation agenda through the enactment of a national payments law regulating the use of e-money. It also supports efforts to improve financial inclusion by requesting all Microfinance Institutions (MFIs) to adopt a single definition for female owned enterprises and to start reporting on the number and size of financing provided to these enterprises on a regular basis.

6. **Reforms supported by the proposed DPG 13 contribute to the implementation of the NDP.** Under the first Program Development Objective (PDO) of the DPG, prior actions one and two that aim to structurally enhance domestic revenues and control wage bill spending will contribute towards a more efficient management of available resources – subitem 3 under the NDP's second pillar. Also, prior action three focused on improving the effectiveness of public procurement will contribute to strengthening transparency and accountability in public institutions thereby contributing to subitem 1 under the NDP's second pillar. Prior actions under pillar two supporting the banking sector and financial inclusion for women contribute to the NDP's third pillar, focused on sustainable development through improving the business environment (subitem 15) and supporting gender equality and women's empowerment (subitem 20).

7. **To maintain a long-term perspective, the proposed DPG focuses on the continuum of reforms and builds upon efforts supported by previous operations**. For example, pillar one, which supports the enhancement of the effectiveness of the public procurement function complements efforts by previous DPGs that have supported the PA's reforms in public procurement. Previous DPGs supported the very early stages of the adoption of the 2014 procurement law until the institution of electronic government procurement (e-GP) – a reform supported by the latest DPG (12). Pillar two focuses on upgrading the AML/CFT legal framework building on efforts supported by DPG 10 which, at the time, supported strengthened AML/CFT internal controls for banks. The digital

transformation agenda in the financial sector, also supported by pillar two, builds on efforts included in DPG 11 to roll out e-wallets. DPG 11 supported the climate change agenda through supporting efforts to amend the Palestinian environment protection law to include aspects of climate change. This proposed DPG also supports prior actions that contribute to addressing the impact of climate change, albeit indirectly. Additional climate change reforms are anticipated to be included in future operations, based on recommendations from the ongoing Country Climate and Development Report (CCDR).

8. **Both pillars of the proposed DPG serve the governance and transparency agenda.** One of the main areas of focus of previous DPGs has been strengthening the accountability of the PA and improving governance and transparency. The proposed DPG complements these efforts through both its pillars. For example, prior action three focuses on enhancing the effectiveness of the public procurement workforce and this is expected to strengthen accountability in the public sector. Studies have shown that one of the main causes of waste in government spending is often pertaining to incompetence-driven inefficiencies. Hence, it is indeed crucial that the workforce which is appointed for procurement-related tasks is well trained and experienced both in the knowledge of the related legal environment and of the managerial and technical issues that pertain to each tender. This will ensure adequate procurement procedures during all phases of the procurement process. Prior action four under pillar two focused on upgrading the AML/CFT legal environment is also a very important step in enhancing the integrity of the sector. AML/CFT controls, when effectively implemented, reduce the negative impact of criminal economic activity and promote integrity and stability in financial markets. Raising the requirements on financial sector transparency beyond the basic "legal ownership", which is supported by prior action four, has also become an important policy measure for combating corruption through greater scrutiny of legal structures potentially used to conceal proceeds of corruption.

9. **The proposed operation is aligned with the World Bank's twin goals, its Strategy for Fragility, Conflict, and Violence (FCV) 2020-2025,[1] and with the World Bank Group's enlarged Middle East and North Africa (MENA) Strategy (March 2019).** DPG 13 is aligned with the World Bank Group's strategic objectives of ending extreme poverty and promoting shared prosperity in a sustainable manner. The operation is designed in a way that aims to address the needs of the poor while contributing to the promotion of a sustainable and robust shared prosperity. DPG 13 is also aligned with the World Bank's FCV Strategy goal of enhancing effectiveness by strengthening resilience, especially for the most vulnerable and marginalized populations. Reforms aimed at increased fiscal resources through improved revenue mobilization and rationalized spending are expected to create fiscal space that can be used for poverty reduction, productive investments and for addressing the needs of vulnerable groups. The operation also supports the World Bank Group's enlarged MENA Strategy. Specifically, measures aimed at enhancing governance and transparency, under both pillars of the DPG, contribute to the social contract.

10. **The proposed DPG contributes to the World Bank's Global Crisis Response Framework (GCRF).** The operation was specifically designed to maintain development gains achieved over the years, whether through the DPG series or other PA efforts, despite multiple ongoing crises. Through its six prior actions, the DPG supports three of the GCRF's four pillars.[2] Pillar two, aiming at "Protecting People and Preserving Jobs", is supported through promoting gender equality (prior action 6) and financial market stability (prior action 4). Pillar three of the GCRF, which is focused on "Strengthening Resilience", is supported through better fiscal sustainability

[1] Report No. 146551.
[2] The World Bank's Global Crisis Response Framework focuses on four pillars including: 1) Responding to Food Insecurity, 2) Protecting People and Preserving Jobs, 3) Strengthening Resilience, and 4) Strengthening Policies, Institutions and Investments for Rebuilding Better.

achieved by prior actions one and two. Finally, pillar four of the GCRF, which is focused on "Strengthening Policies, Institutions and Investments for Rebuilding Better", is supported through institutional strengthening and capacity building in public procurement (prior action 3) and digital development (prior action 5).

11. **This operation directly leverages financial support from donors through the Palestinian Umbrella for Resilience Support to the Economy (PURSE) Multi-Donor Trust Fund (MDTF),** which includes support from the European Union for the Palestinian Economy and Resilience (ESPERE) Associated Trust Fund. The PURSE MDTF is administered by the World Bank and disburses funds based on satisfactory progress of the reform program supported by DPGs and an adequate macroeconomic policy framework. The proposed operation will also provide a positive signaling effect to other donors at a time when direct donor assistance to the PA is of utmost importance for the Palestinian economy and public finances. It is expected that around US$23 million will be provided through the PURSE in calendar year 2023, and the donor co-financing amount may increase depending on donors' contributions.

2. MACROECONOMIC POLICY FRAMEWORK

2.1. RECENT ECONOMIC DEVELOPMENTS

12. **In 2022, the Palestinian economy continued its rebound from the COVID-19 shock, although at a slower rate compared to 2021**. Real Gross Domestic Product (GDP) growth in the Palestinian territories reached 3.6 percent, year-on-year (y-o-y), in 2022 – down from 7.1 percent in 2021. In the West Bank, the easing of COVID-related measures allowed the economy to expand in 2022, driven by consumption, which in turn prompted the growth of the wholesale and retail trade sector, as well as services. The increase in the number of West Bank Palestinians working in Israel and the settlements also aided the recovery, as the average daily wage of these workers is more than twice the average daily wage in the West Bank, implying a larger impact on aggregate demand. Similar to the West Bank, growth in Gaza was mainly driven by private consumption as COVID-related restrictions remained fully relaxed and as the impact of the latest hostilities in Gaza started to ease. Despite this positive trajectory, the economy is yet to rebound to its pre-pandemic level.

13. **Inflation increased in 2022, reflecting the domestic demand-pull pressure as well as rising global food and fuel prices.** CPI rose by 3.7 percent, y-o-y, in 2022, up from 1.2 percent during the same period in 2021. This reflects a pickup in demand as well as rising global food and fuel prices, mainly driven by Russia's invasion of Ukraine. The mild depreciation of the Israeli Shekel, the main currency in circulation in the Palestinian territories, mitigated inflationary pushes relative to other MENA countries.

14. **While employment increased in 2022, the unemployment rate remained high.** Employment rose in 2022, largely driven by increased labor force participation, as more workers returned to the labor market after the COVID-19-related lockdowns eased. The number of Palestinians working in Israel and the settlements has continued to increase compared to 2021. As a percentage of those in employment, 22.5 percent of Palestinians in the West Bank worked in Israel and the settlements in 2022 compared to 0.8 percent of Gazans. Despite a decline from 26.4 percent in 2021, unemployment in the Palestinian territories remained as high as 24.4 percent in 2022. The overall rate masks a wide regional divergence whereby unemployment in the West Bank reached 13.1 percent in 2022 while in Gaza it was 45.3 percent, reflecting the difficult social and economic conditions in the Strip caused by the ongoing Israeli movement and access restrictions.

Table 1: Palestinian territories: Key Macroeconomic Indicators, 2019-2026

	2019	2020	2021	2022e	2023f	2024f	2025f	2026f
Real economy, annual percent change, unless indicated otherwise								
Real GDP	1.4	-11.3	7.1	3.6	3.0	3.0	3.0	3.0
Nominal GDP	5.3	-9.3	16.1	7.6	4.5	3.9	3.9	3.8
GDP Per Capita (nominal)	2.7	-11.6	13.3	5.0	2.0	1.4	1.4	1.4
Real GDP growth, at constant market prices								
Private Consumption	4.1	-13.1	6.3	4.8	4.1	3.2	3.2	3.2
Government Consumption	-3.5	0.3	11.1	-3.1	-2.6	2.2	2.3	2.3
Gross Fixed Capital Investment	-2.6	-20.9	14.7	6.4	5.0	3.5	3.5	3.5
Exports, Goods and Services	2.0	-11.2	18.8	4.2	3.8	3.8	3.8	3.8
Imports, Goods and Services	1.4	-14.2	16.6	4.0	3.6	3.6	3.6	3.6
Real GDP growth, at constant factor prices								
Agriculture	0.9	-9.1	-2.3	-2.6	-2.0	-1.0	0.0	0.0
Industry	-0.5	-19.4	6.2	6.0	3.0	3.0	3.0	3.0
Services	2.0	-10.0	7.3	3.6	3.5	3.4	3.2	3.2
Labor force participation rate (%)	44.3	40.9	43.4	45.0	45.0	45.0	45.0	45.0
Unemployment Rate (%)	25.3	25.9	26.4	24.8	24.8	24.8	24.8	24.8
GDP Deflator	2.9	-1.3	1.8	3.8	1.4	0.9	0.9	0.8
CPI (year-average)	1.6	-0.7	1.2	3.7	1.6	1.2	1.2	1.2
Overall Fiscal Balance	-7.5	-7.5	-5.7	-1.8	-1.4	-1.2	-0.9	-0.7
Current Account Balance	-10.4	-12.3	-8.2	-8.9	-8.6	-8.5	-8.5	-8.5
Memorandum items:								
Nominal GDP (US$ million)	17,134	15,532	18,037	19,400	20,265	21,048	21,862	22,679

Source: PCBS, PMA, and MoF for history and World Bank staff for projections.
Note: e = estimate, f = forecast.

15. **The current account deficit widened in the first three quarters of 2022, primarily due to rising imports driven by stronger domestic demand**. While both imports and exports have increased, exports continue to be constrained by the trade restrictions and have remained low and stagnant, resulting in a 38 percent y-o-y widening of the trade deficit, from US$5.0 billion in the first three quarters of 2021 to US$6.9 billion over the same period in 2022. During this period, net income from abroad improved, driven by increased private transfers. This is because the compensation of employees working abroad rose by 30 percent, y-o-y, to US$3.4 billion in the first three quarters of 2022, boosted by an increase in the number of Palestinian workers in Israel. Overall, the current account deficit widened from US$1.1 billion in the first three quarters of 2021 to US$2.0 billion in the same period in 2022. The current account deficit was mostly financed by net bank credit recorded in the category of other investment.

Table 2: Palestinian territories: Balance of Payment Financing Requirements and Sources of Financing, 2019-2026

	2019	2020	2021	2022e	2023f	2024f	2025f	2026f
Percent of GDP, unless indicated otherwise								
Financing Requirements	9.9	8.6	8.2	8.9	8.6	8.5	8.5	8.5
Current Account Deficit	10.4	12.3	8.2	8.9	8.6	8.5	8.5	8.5
Net Errors and Omissions	-0.5	-3.7	0.0	0.0	0.0	0.0	0.0	0.0
Financing Sources	9.9	8.6	8.2	8.9	8.6	8.5	8.5	8.5
Capital Account Balance	1.7	2.8	2.4	2.4	2.4	2.4	2.4	2.4
Net Foreign Direct Investment	1.1	0.9	1.0	1.0	1.0	1.0	1.0	1.0
Net Portfolio Investment	-0.2	0.4	-0.4	-0.4	-0.4	-0.4	-0.4	-0.4
Net Govt Foreign Borrowing	1.1	0.7	0.0	-0.2	0.0	0.0	0.0	0.0
Net Other Investment	6.9	4.0	6.1	5.0	5.5	5.4	5.4	5.4
Change in Reserve Assets	-0.7	-0.2	-1.0	1.0	0.0	0.0	0.0	0.0
External Financing Gap	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Memorandum items:								
Gross Reserves (US$ million)	658	697	873	679	679	679	679	679

Source: PCBS and PMA for history and World Bank staff for projections.
Note: e = estimate, f = forecast.

16. **Public revenue mobilization experienced a significant boost in 2022**. Domestic tax collections grew by 19 percent, y-o-y, reflecting the improvement in economic activity and efforts to expand the revenue tax force which resulted in an increase in the number of taxpayers. During this period, non-tax revenues increased by 18 percent, y-o-y, driven by an increase in domestic fees and charges, and also by the equalization levy collected by Israel from Palestinian workers and transferred to the PA.[3] Clearance revenues also increased by 20 percent, y-o-y, in 2022, driven by higher customs and VAT collections as well as increases in petroleum excise. The increase in VAT collections was aided by the electronic-VAT (e-VAT) system piloted by the PA and the GoI since March 2022, which helped reduce VAT evasion. The fuel subsidy, classified as a negative tax item, grew by 191 percent in 2022 following global fuel inflation, although this was offset by the growth in revenue collections.

17. **Recurrent public spending in 2022 was maintained at 2021's level, in nominal NIS terms, as increases in certain spending items were offset by a strong drop in transfers.** Government transfers declined by 16 percent as the PA only provided one payment to poor beneficiaries through the National Cash Transfer Program (NCTP) in 2022. The strong decline in transfers offset the increase in other spending items. Mainly, the wage bill rose by about 4 percent y-o-y, on a commitment basis, in 2022 due to the implementation of the yearly step increase and the cost-of-living allowance. On a cash basis, the PA has been paying around 80 percent of the salaries of public employees, while protecting the lowest earners, since November 2021. Net lending, reflecting unplanned

[3] Palestinians employed in Israel are only entitled to basic insurance benefits. Hence, their contribution to the Israeli national insurance system is lower than Israeli workers who are fully ensured. To keep the wage costs of Palestinian labor equal to those of Israeli workers and avoid any preference towards cheaper labor from the Palestinian territories, the GoI introduced the so called "equalization levy" to the income of Palestinian workers to offset the difference between their reduced contribution to the national insurance system and the full amount paid by Israeli workers.

subsidies to LGUs covering utility bills to Israeli suppliers, remained roughly at its previous year level in 2022.

18. **Given stronger revenues and stable spending, the PA's deficit significantly dropped in 2022.** The total deficit (before grants) reached US$526 million in 2022, almost 60 percent less than in 2021. Donor financing was US$349 million (US$244 million in budget support and US$106 million in development financing) in 2022, as some of the European Union funding was disbursed. After accounting for deductions made by the GoI from clearance revenues, the PA ended with a financing gap of US$351 million (or 1.8 percent of GDP) in 2022.

19. **The PA relied on arrears to the private sector, the pension fund, and public employees to make ends meet.** Even though comprehensive data on arrears is not available, the current stock of arrears to the private sector is estimated at US$1 billion, while arrears to the pension fund are around US$3 billion only for civil schemes, while data is unavailable on the security schemes. The PA has also been accumulating arrears to public employees, as mentioned above, estimated at US$0.4 billion in 2022. The large stock of arrears causes a risk to macroeconomic stability as it pulls out liquidity from the market and can eventually also negatively impact the banking sector.

Table 3: Palestinian territories: Key Fiscal Indicators, 2019-2026

	2019	2020	2021	2022	2023f	2024f	2025f	2026f
Percent of GDP, unless indicated otherwise								
Overall Balance	-7.5	-7.5	-5.8	-1.8	-1.4	-1.2	-0.9	-0.7
Primary Balance	-7.2	-7.1	-5.1	-1.1	-0.7	-0.5	-0.2	-0.0
Total Revenues and Grants	21.8	25.2	24.6	25.8	25.8	26.0	26.1	26.3
Domestic Tax Revenues	4.5	4.7	5.5	5.9	6.0	6.1	6.2	6.3
Income tax	1.2	1.2	1.2	1.4	1.4	1.4	1.4	1.4
Value added tax	1.8	2.0	2.1	2.2	2.3	2.3	2.4	2.5
Customs	1.1	1.0	1.6	1.7	1.6	1.6	1.6	1.6
Excises on beverages	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Excises on tobacco	0.4	0.5	0.6	0.5	0.6	0.6	0.7	0.7
Property tax	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Non-Tax Revenues	2.1	2.4	2.2	2.4	2.3	2.3	2.4	2.5
Earmarked collections	0.5	0.6	0.8	0.9	0.9	0.9	0.9	0.9
Clearance Revenues	12.9	15.0	15.4	16.2	16.2	16.2	16.3	16.4
Grants	2.9	3.1	1.8	1.8	1.7	1.7	1.6	1.5
Tax Refunds	-1.0	-0.7	-1.0	-1.3	-1.2	-1.2	-1.2	-1.1
Total Expenditures	29.3	32.6	30.4	27.6	27.2	27.1	27.1	27.0
Current Expenditures	24.8	27.9	26.1	23.3	23.0	23.0	23.0	23.0
Wages and Compensation	13.0	14.1	14.6	13.7	12.9	12.8	12.7	12.6
Goods and Services	3.8	4.2	4.5	4.2	4.0	4.0	4.1	4.1
Interest Payments	0.3	0.4	0.7	0.7	0.7	0.7	0.7	0.7
Current Transfers	7.7	9.1	6.3	4.7	5.4	5.5	5.5	5.6
Capital Expenditures	2.1	2.0	1.5	1.5	1.6	1.5	1.5	1.4
Net lending	1.9	2.2	2.1	1.9	1.8	1.8	1.7	1.7
Earmarked Payments	0.5	0.6	0.8	0.9	0.9	0.9	0.9	0.9
Government Financing	7.5	7.5	5.8	1.8	1.4	1.2	0.9	0.7
External Borrowing (net)	1.1	0.7	0.0	-0.2	0.0	0.0	0.0	0.0

Domestic Borrowing (net)	3.6	2.9	0.5	-0.6	0.0	0.0	0.0	0.0
Domestic Arrears (net)	2.8	3.9	5.3	2.6	1.4	1.2	0.9	0.7
General Government Debt[4]	40.9	55.5	56.0	52.6	52.0	51.5	50.8	49.8
Memorandum items:								
Stock of Arrears	24.7	32.1	34.7	34.8	34.8	34.7	34.3	33.8

Source: MoF for history and World Bank staff for projections.
Note: f = forecast.

20. **The financial sector continues to recover from the negative impacts of the COVID-19 pandemic, but sustained fiscal challenges heighten stability risks**. Banking sector profitability has rebounded, with improvements in returns on equity and assets. However, the lingering effects of compounding crises and the continuation of partial salary payments by the PA contribute to risks across loan portfolios in the banking and microfinance sectors. Non-performing loans (NPLs) and classified loans have risen since 2018. The NPL ratio, which represents the percentage of NPLs out of all direct loans, stood at about 4.1 percent as of Q3 2022 up from 3 percent in 2018. While the official NPL ratio seems manageable, local banks and microfinance institutions have expressed concerns about NPL composition and underestimation.

21. **The banking system's exposure to the public sector increased substantially during the COVID-19 crisis, and bank loans to PA employees and promissory notes create additional indirect pressure.** The PA had significantly increased borrowing from domestic banks since 2020, reaching US$2.5 billion in December 2021. Preliminary data for 2022 indicate that direct borrowing by the PA gradually declined to US$2.3 billion in November 2022. Yet, PA and public sector employees combined still account for close to 40 percent of total banking sector credits. This poses systemic destabilization risks, and Palestinian policymakers will need to balance fiscal, monetary, and financial considerations in responding to economic shocks.

22. **The stability of cross-border payments remains a concern for the sector, as joint progress on a more stable arrangement for correspondent banking relationships (CBRs) continues to be slow.** Citing money-laundering and financing of terrorism concerns, key Israeli banks have repeatedly signaled plans to limit or terminate correspondent banking services to Palestinian banks in recent years. Disruptions to CBRs are likely to significantly impact the Palestinian economy, due to Israel being its primary trade partner, and the reliance on the Israeli Shekel as the primary currency in the cash-based Palestinian economy. An example of this is the current complexity associated with the repatriation of NIS cash from Palestinian banks to Israel, contributing to the accumulation of excess NIS liquidity in Palestinian banks which is estimated to have reached NIS5 billion (equivalent to 7.2 percent of assets) at end-June 2022. In 2017, the GoI approved a temporary indemnity and immunity package for Israeli banks working with Palestinian banks, thereby taking on part of the risks, to alleviate the potential for immediate disruptions to CBRs between the two banking systems. The GoI has repeatedly extended this temporary package, now set to expire in March 2023, while a more stable arrangement for cross-border payments is being jointly developed by the Bank of Israel (BoI) and the Palestine Monetary Authority (PMA). Progress, however, has been slow. Furthermore, there has been slow progress toward implementing cashless payments for Palestinian workers in Israel.

[4] General Government debt figures include foreign debt, domestic debt and arrears.

2.2. MACROECONOMIC OUTLOOK AND DEBT SUSTAINABILITY

23. **Growth is projected to soften over the forecast period.** Under a baseline scenario which assumes a continuation of the restrictions on movement and access, persistence of the internal divide between the West Bank and Gaza and stagnating aid levels, growth of the Palestinian economy is expected to hover around 3 percent over the forecast period. Growth will mainly be driven by a continued recovery in private consumption and contact-based service sectors as the economy continues to regain what was lost due to the COVID-19-related restrictions. More importantly, growth is expected to be driven by a continuous increase in the number of Palestinians working in Israel, both from the West Bank and from Gaza, resulting in a further push to demand. Simultaneously, downward pressure on growth may come from a decline in public consumption as the PA is expected to further cut expenditures, including continuing paying partial salaries to its employees. Further, although inflation is likely to gradually moderate in the coming period, any additional shock may reverse this expected trend, which will weigh on demand. Finally, if the recent clashes escalate, extending over a period of several months, and result in further restrictions by the GoI, including on the movement of workers, this may exacerbate the risks.

24. **The fiscal situation is projected to improve in the medium term.** Fiscal revenues as share of GDP are projected to further grow over the forecast period driven by the PA's continued efforts to implement the new revenue strategy (2022-2025). The strategy focuses on boosting domestic revenues through horizontal expansion and identifying unregistered taxpayers, establishing a revenue risk management department, strengthening coordination with relevant government agencies to exchange information, and developing a new VAT law, as well as a new customs law and amending the 2011 income tax law. The strategy also focuses on digitization and developing and promoting the use of electronic portals for taxpayers. The digitization efforts are supported by the proposed DPG's prior action one, which mandates businesses to submit their monthly domestic VAT invoices, for purchases and sales, through an online portal to be reconciled with those submitted by other businesses. This effort is expected to reduce tax evasion and contribute to a 16 percent nominal increase in domestic VAT collections by end-2024. This increase assumes that nominal GDP growth will average 4 percent in 2023 and 2024 (see table 1) and that no changes are applied to the Israeli tax policy that may affect domestic collections. In total, and as the implementation of the revenue strategy matures, the PA's revenues and grants as a percentage of GDP are expected to increase from 25.8 percent in 2022 to 26.3 percent in 2026. Grants are expected to increase (in nominal terms) as the European Union budget support has been reinstated since August 2022.

25. **On the spending side, fiscal expenditures are projected to decline gradually as a percentage of GDP.** The PA has plans to adopt reforms to control the wage bill, some of which are supported by this operation (prior action 2). Specifically, the PA passed a Cabinet decision to formalize workforce planning procedures with the aim to re-deploy excess staff. This decision requests each PA department to determine its HR needs and submit a workforce needs plan to the Cabinet by October of each year. The plan would need to identify skills that are in shortage and skills that are superfluous. Based on these submissions, the GPC will develop plans to re-skill and re-deploy surplus staff with the aim to reduce overall new hiring into the public sector and address issues surrounding over-staffing. Building on this, the Cabinet adopted a second decision specifying an employment attrition target requesting that yearly recruitments do not exceed 50 percent of retirement-related and other kinds of departures from the PA, until the fiscal stress eases. This is expected to result in savings estimated at around NIS94 million in 2023. The PA also plans to reduce the cost of outside medical referrals specifically through standardizing prices to be paid for all private and non-governmental organization hospitals in East Jerusalem, West Bank, and Gaza for 81 procedures which constitute the highest referral expenditures. As a result,

the fiscal expenditures are expected to decline further from 27.6 percent of GDP in 2022 to 27.0 percent in 2026.

26. **The overall fiscal deficit, including grants and the deductions from clearance revenues, is thus expected to reach 0.7 percent of GDP in 2026, down from 1.8 percent in 2022**. The financing requirement is expected to gradually decline over the forecast period and will reach US$156 million in 2026, down from US$350 million in 2022. As in previous years, a majority of the financing need is expected to be financed through domestic sources. However, domestic bank borrowing already exceeds the limit set by the PMA, eliminating the viability of this financing option going forward. Hence, the PA would be forced to accumulate additional arrears to the pension fund (de facto borrowing from the pension fund), to the private sector, and maybe to its employees.

27. **The current account deficit is projected to remain persistently high.** Constrained by movement and access restrictions, export growth is expected to remain sluggish. Import bills are likely to remain high due to elevated commodity prices after Russia's invasion of Ukraine. In addition, despite the growing number of guests from outside of the Palestinian territories as travel restrictions ease, the recovery in tourism earnings is expected to remain slow, mainly hampered by Russia's invasion of Ukraine, as Russian tourists comprised the third largest group of tourists to the Palestinian territories prior to the pandemic. Consequently, the trade deficit will remain extremely high at around 40 percent of GDP. In addition to official inflows, the trade deficit will continue to be financed through net income and transfer inflows, which are expected to improve as the demand for Palestinian workers in Israel is expected to continue to grow. Overall, the current account deficit is projected to narrow from 8.9 percent of GDP in 2022 to 8.5 percent of GDP in 2026.

28. **Downside risks remain elevated, related to further potential negative impacts from Russia's invasion of Ukraine and an escalation of clashes in the Palestinian territories.** As a net oil and food importer, the Palestinian economy could be susceptible to additional pressure as long as Russia's invasion of Ukraine continues. In this context, if there is another surge in commodity prices, consumption patterns indicate that these price shocks will harm particularly poorer households. While fuel subsidies may limit the pass-through of higher global oil and wheat prices to the consumers, this will adversely impact the Palestinian Authority's budget. Besides, any escalations in the clashes between Palestinians and the Israeli forces in the West Bank and Gaza, or any restrictions on the movement of Palestinian workers to Israel, would leave little-to-no room to absorb any external shocks, with potentially severe consequences on growth and poverty reduction outcomes.

29. **The financial sector is expected to remain largely stable as it has generally recovered from the COVID-19 effects.** Financial sector indicators suggest that the banking sector has rebounded from the COVID-19 related shock as the growth in NPLs has stabilized at approximately 4.1 percent. While private sector portfolios may deteriorate further due to growing arrears (and NPLs being a lagging indicator), the high NPL coverage ratio of 97 percent provides a significant stability buffer. The banking sector's exposure to the public sector must be carefully managed by the PMA (as a supervisor and regulator), to mitigate potential financial stability risks. Recent data indicates a gradual but steady decline in PA borrowing from the 2021 peak, and this trend is expected to continue in the short-medium term. The stability of cross-border payments remains in doubt, as progress on developing a more stable arrangement for CBRs has been slow.

30. **Under the baseline scenario, the PA's public debt-to-GDP ratio is projected to gradually decline in the forecast period.**[5] The PA's public debt stood at 52.6 percent of GDP at the end of 2022. It consisted of foreign debt (6.6 percent of GDP), borrowing from the domestic banking sector (11.2 percent of GDP), and domestic

[5] Based on debt sustainability analysis (DSA) for market access countries (MAC DSA) conducted by the World Bank.

arrears (34.8 percent of GDP). It is important to note, though, that arrears to the Palestinian Pension Fund represent about one third of the PA's public debt (18.3 percent of GDP). This has not been codified as a debt instrument, but it is counted as public debt. The pressure that this liability poses is not an immediate threat to loss of access to financing. The PA's public debt-to-GDP ratio increased sharply in 2020 and 2021, driven primarily by large deficits. Starting 2022, an improved primary balance reflecting fiscal consolidation measures, announced by the authorities and explained earlier, is expected to gradually improve public debt dynamics. Under the baseline assumptions that nominal GDP growth will average about 4 percent annually and efforts to increase revenues and control spending will reduce the fiscal deficit, public debt is expected to gradually decline to 48 percent of GDP in 2027. This would still be substantially higher than the 40 percent limit permitted by the law on public debt. Eventually a solution to the pension fund debt will need to be identified, but the uncertainty about this eventual solution is not seen as an immediate source of macroeconomic instability. It is also important to note that actions by the PA alone are not sufficient to stabilize debt. Stabilizing and subsequently bringing down debt is contingent on contributions by the GoI and donors. For example, monthly deductions from clearance revenues and the lack of stability in these transfers weighs heavily on the PA's finances. Also, the decline in donor aid has played a key role in larger than expected financing requirements. Therefore, PA reforms are a necessary but not sufficient condition for debt stabilization.

31. **Risks to debt sustainability continue to be substantial**. The PA's financing requirement (after grants) continues to be large, and this is one of the main drivers behind the risk to debt sustainability. Under a combined macro fiscal shock, with nominal GDP growth 1 percentage point lower than the baseline projections while the primary balance (including grants) 1 percent of GDP higher, the public debt-to-GDP ratio is projected to continue increasing throughout the medium term, reaching as much as 57 percent by 2027 (almost 9 percentage points higher than in the baseline scenario). Vulnerabilities associated with the composition of debt are moderate, with foreign currency denominated debt and debt held by non-residents only representing 20 percent and 13 percent of total debt in 2022, respectively.

32. **With continued fiscal reform efforts by the PA and anticipated inflows of donor aid, the macroeconomic policy framework is adequate.** The banking sector has repeatedly proven its resilience to severe shocks including conflict, and exchange rate risks are minimized with the use of NIS, which is appropriate given that nearly 90 percent of Palestinian trade is with Israel. As long as restrictions outside the control of the PA continue to restrain growth, the PA will continue to rely on grant assistance to cover the sizable financing gaps. This is expected to be associated with modestly declining deficits over the medium term driven by the PA's reform efforts as the PA is expected to continue with measures to boost revenues and limit public expenditure growth. The grant from the proposed DPG operation will contribute to the reduction in the PA's fiscal deficit and is expected to leverage additional amounts of grant assistance through the PURSE MDTF, which will altogether significantly help fill the PA's financing gap and improve debt sustainability prospects, along with the ongoing and planned reform efforts by the PA. Dialogue between the PA and development partners will be critical in designing and mobilizing effective support for dealing with the difficult fiscal situation and preserving macroeconomic stability. In addition, it is crucial that donors continue supporting the PA with stable and predictable budget support as this will reduce some of the short-term negative impacts that sharp fiscal consolidation may have on the economy.

Figure 1: Public Debt by Maturity

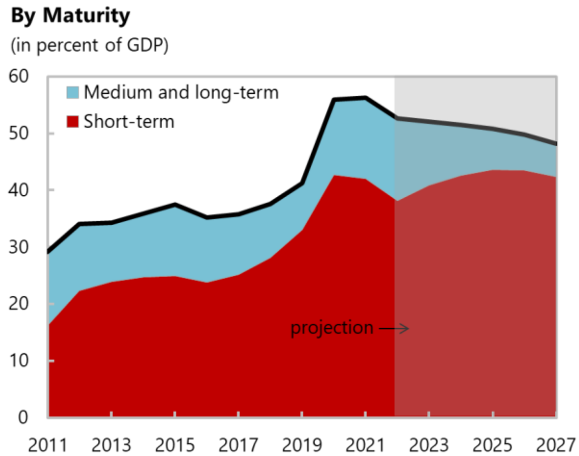
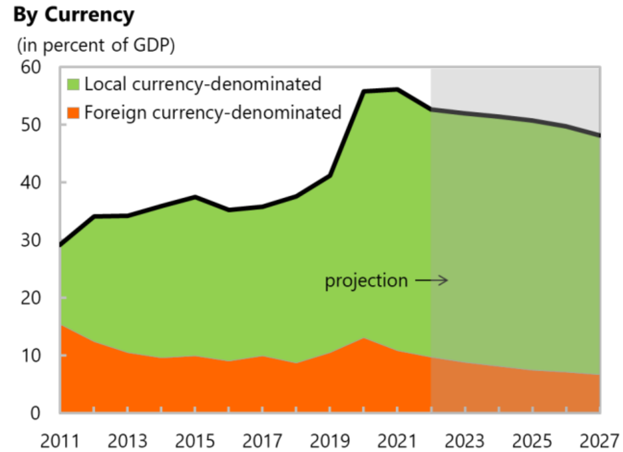


Figure 2: Public Debt by Currency



Source: MoF for history and World Bank staff calculations based on MAC DSA template.

2.3. IMF RELATIONS

33. **West Bank and Gaza is not a member of the IMF.** However, since the Oslo Accords, IMF staff have assisted the Palestinian Authority by providing policy advice and technical assistance (TA) to design and implement economic reforms and strengthen institutions. IMF TA has focused on taxation, revenue administration, public financial management, national accounts, banking supervision and regulation and AML/CFT. Staff prepares biannual reports to the Ad Hoc Liaison Committee (AHLC) donor group on economic conditions, policies, and financing needs. The IMF has a Resident Representative office in West Bank and Gaza.

3. GOVERNMENT PROGRAM

34. **As the National Development Plan "Putting Citizens First" for 2017-2022 reached its mid-point in 2019, the PA launched a review process to update its priorities and the new version of the NDP was launched in 2021 entitled "Resilience, Disengagement, and Cluster Development Towards Independence" 2021-2023.** One of the main changes to the NDP is the adoption of a "cluster" approach that aims to capitalize on the comparative strengths of each Palestinian region. With this approach, the PA aims to encourage investments in the sector of agriculture in the Jordan valley, tourism in the governorate of Bethlehem, and industry in Hebron and Nablus. This approach involves investment in basic infrastructure, supporting public-private partnerships, and the provision of government subsidies to businesses that make the designated regions/sectors a focus of their operation and investment. Rooted in the cluster approach, the new NDP consists of three main pillars: 1) Ending the occupation, with the aim to achieve national unity by upholding democratic principles and broadening the Palestinian territories' international participation and expanding bilateral relations, 2) Excellent public service provision, which focuses on citizen-centered public institutions that are accountable and transparent and that manage available resources efficiently, and 3) Sustainable development, which adopts an all rounded approach that focuses on enhancing the business environment, strengthening social protection, and promoting inclusive health and education systems to create better job opportunities and meet the needs of the communities. The NDP also focuses on institutionalizing gender mainstreaming and promoting gender equality and women empowerment through enforcing laws that abolish gender-based discrimination and punish violence against women.

4. PROPOSED OPERATION

4.1. LINK TO GOVERNMENT PROGRAM AND OPERATION DESCRIPTION

35. **The proposed operation has been designed to support the implementation of key policy and institutional reforms defined in the second and third pillars of the PA's NDP.** The second pillar of the NDP - Excellent public service provision - will be supported through actions to improve the PA's structural fiscal balance and to strengthen the effectiveness of public procurement. The third pillar of the NPA - Sustainable Development - will be addressed through actions aimed at strengthening the integrity of the financial sector in addition to financial inclusion for women.

36. **The Program Development Objectives (PDO) of this operation are aligned with the key PA priorities**. The PDOs of the proposed operation are: (i) to improve the structural fiscal balance and strengthen the effectiveness of public procurement, and (ii) to strengthen the integrity of the financial sector and pursue digital transformation. Under the first PDO, prior actions one and two that aim to structurally enhance domestic revenues and control wage bill spending will contribute towards a more efficient management of available resources – subitem 3 under the NDP's second pillar. Also, prior action three focused on improving the effectiveness of public procurement will contribute to strengthening transparency and accountability in public institutions contributing to subitem 1 under the NDP's second pillar. Prior actions under pillar two supporting the banking sector and financial inclusion for women contribute to the NDP's third pillar, focused on sustainable development through improving the business environment (subitem 15) and supporting gender equality and women's empowerment (subitem 20).

37. **Lessons learned through previous DPGs, in particular the need for strong government ownership and flexibility in a high volatile context, have informed the preparation of this DPG**. Standalone operations have allowed adequate flexibility in the choice of prior actions from one operation to the next, which has proved advantageous within a highly volatile security and political context that often leads to reprioritization of reforms. At the same time, the programmatic nature of certain reforms has not been neglected. For instance, this operation supports recent progress in complex reform efforts in the areas of procurement, digital transformation and AML/CFT in the financial sector and financial inclusion building on earlier stages of reforms that were supported through previous DPGs. This DPG is entirely based on the PA's reform program to ensure full ownership in all areas of reform. The choice of prior actions takes into consideration not only the PA's reform priorities, but also its technical capacity, as well as the social and security risks that might be triggered by pursuing certain reforms. Also, even though some priority reform areas were not included in this operation, they have been supported by other World Bank operations using different instruments, including IPFs. The complementarity of various World Bank instruments throughout different stages of the reform process increases the chances of success. Another important lesson learned from previous DPGs is that for individual reforms to take hold, ongoing commitment from the authorities is critical, including at the highest levels. This became very clear as the implementation of certain reforms in DPG 10. For example, the implementation of the commitment control system at line ministries needed a political decision to enforce its use. This challenge could be overcome with direct support from the relevant highest level of authority. For example, in the case of wage bill reform in this DPG, the reforms supported by the operation have been discussed and agreed with the MoF as well as the Prime Minister Office to ensure highest levels of commitment. Another important lesson learned to support reform progress in the FCV context is that it is critical that prior actions are supported by technical assistance and/or capacity building. In the case of this operation, the reforms supporting the AML/CFT agenda have been

supported by technical assistance from the World Bank that has been ongoing for years, since the PA's first National Risk Assessment.

38. **The proposed DPG contributes to the World Bank's Global Crisis Response Framework (GCRF).** Prior actions one and two, which aim to improve the fiscal balance through enhanced revenues and controlled spending contribute to the third pillar of the GCRF, focused on "Strengthening Resilience", through better fiscal sustainability. Prior action three, aimed at improving the professional quality for the public procurement workforce, and prior action five, supporting the use of e-money, contribute to the fourth pillar of the GCRF, focused on "Strengthening Policies, Institutions and Investments for Rebuilding Better", through contributing to institutional strengthening and capacity building and digital development – two subitems under the GCRF's pillar four. Finally, prior action four, supporting the AML/CFT agenda, and prior action six, focused on efforts to improve financial inclusion for women, contribute to the second pillar of the GCRF, focused on "Protecting People and Preserving Jobs", through promoting gender equality and financial market stability.

4.2. PRIOR ACTIONS, RESULTS AND ANALYTICAL UNDERPINNINGS

Pillar 1: to improve the structural fiscal balance and strengthen the effectiveness of public procurement

39. **The first pillar of the operation contributes to an improvement in the structural fiscal balance and a more effective public procurement function, through three prior actions**. The improvement in the fiscal balance is supported through an online portal to crosscheck VAT submissions by businesses and reforms to maintain wage bill spending. A more effective public procurement function will be achieved through instituting a permanent procurement training program for procurement staff in the PA.

Prior action 1: **To improve revenue mobilization and reduce tax evasion, the Recipient, through its revenue directorate at the Ministry of Finance, will strengthen cross checks on VAT invoices by mandating businesses to use an online portal to submit their monthly VAT invoices for purchases and sales to be reconciled with those submitted by other businesses, as evidenced by instructions by the Director General of revenues issued on October 30, 2022.**

Indicator: Domestic VAT collections as a share of domestic tax revenues

Baseline: 37 percent, December 2022

Target: 39 percent, December 2024

40. **Despite the challenges, the PA's revenues fare well compared to other comparators.** In 2021, the PA's revenue (excluding grants) to GDP ratio was around 23 percent. This is higher than the share for Lower Middle-Income Countries (LMICs) which stood at 14.8 percent and higher than regional comparators including Jordan and Egypt, whose shares stood at 20.1 and 20.9 percent, respectively, in recent years.[6] This is impressive especially since the PA collects minimal revenues from Gaza due to the internal divide and it does not collect any taxes in the so-called Area C—60 percent of the West Bank.

[6] The data can be accessed here: https://data.worldbank.org/indicator/GC.REV.XGRT.GD.ZS?locations=PS-ZQ. The data for LMICs is for 2018, for Egypt it is for 2015 and for Jordan it is for 2020.

41. **More can still be done to further boost revenues and the PA is aware of this.** The MoF has, therefore, drafted a new revenue strategy (2022-2025) that aims to boost tax revenues through horizontal expansion and identifying unregistered taxpayers, establishing a revenue risk management department, strengthening coordination with relevant government agencies to exchange information, developing legislation and regulations governing e-commerce and developing and promoting the use of an electronic portal for taxpayers. The strategy also focuses on developing a new VAT law, as well as a new customs law and amendments to the 2011 income tax law.

42. **The PA's efforts to fight tax evasion are supported by this operation**. One of the main areas of focus of the revenue strategy, as mentioned above, is digitization and the establishment of online portals to offer electronic services to taxpayers and to fight evasion. The MoF has, therefore, launched an online portal where businesses are mandated to submit their domestic VAT invoices for sales and purchases. The system then automatically cross checks these submissions to ensure that the information reported by the selling business fully coincides with that provided by the buyer and *vice versa*. In cases where the cross checks do not match, audits and follow ups are carried out by the MoF staff to tackle potential tax evasion. As a result of this portal, it is expected that the share of domestic VAT collections to domestic tax revenues will increase from 37 percent in 2022 to 39 percent, by end 2024.

43. **The GoI and the PA are also cooperating to reduce tax evasion related to VAT on trade between Israel and the Palestinian territories**. An e-VAT system has been piloted since March 2022 whereby Israeli and Palestinian traders are granted the option to voluntarily issue transaction receipts digitally through the system. The system has so far resulted in an increase in VAT collections, but it is yet to reach its full potential as its use remains voluntary. It is hoped that all traders and transactions will be brought into the system gradually, with the aim of eventually moving toward the exchange of real-time information that could greatly reduce VAT leakages.

44. **The reform supported by this operation builds on previous efforts by the DPG series to enhance revenues and is supported by other donors**. DPG 7, for example, supported the PA's efforts in amending the income tax law to authorize tax payment violations to be settled through the Execution Court. The same operation also supported unifying the collection departments for the VAT and income taxes into a single unit. DPG 9 built on these efforts and focused on improving tax collection and operational efficiency by connecting existing management information systems for domestic taxation (RMIS-Revenue Management Information System) and border taxation (ASYCUDA-Automated Systems for Customs Data). In addition to the reform supported by this DPG, through its new revenue strategy, the MoF plans to reduce the number of unregistered taxpayers by more than fifty percent, and fully digitize the tax payment procedures by end-2025. In addition, the MoF plans to focus its efforts on adopting a risk-based approach for the large taxpayer unit and strengthen cooperation with other relevant government agencies to enhance the exchange of information to fight tax evasion. Some of these efforts are supported by other donors including the Foreign Commonwealth and Development Office (FCDO) through their project "Takamol", which is providing support on the drafting of the VAT law, developing a roadmap for the implementation of the risk management department, and supporting the MoF's digital transformation efforts.

Prior action 2: To renew the impetus on wage bill reform, the Recipient, through its cabinet, has: (1) adopted an attrition target for net public employment whereby yearly civil and security personnel appointments do not exceed 50 percent of retirement-related and other kinds of departures from the PA during the same year, as

evidenced by Cabinet decision No. (18/181/01) dated November 14, 2022, and (2) requested all government agencies to assess their Human Resources (HR) needs and skills, on a yearly basis and submit a list to the Cabinet identifying employee surplus and shortages of skills, with the purposes of reallocating and/or training surplus employees, to enhance efficiency, as evidenced by Cabinet decision No. 18/178/19 dated October 10, 2022.

Indicator: Number of newly hired civil and security personnel on the PA's payroll as a share of total exits in the same year

Baseline: 221 percent, December 2022

Target: 50 percent, December 2023

45. **The PA's spending on its wage bill is out of step with indicators of fiscal affordability and the situation is expected to worsen if core drivers of wage bill spending are not urgently addressed.** Over the last decade, the PA's wage bill averaged 14 percent of GDP and 46 percent of central government expenditure. The equivalent figures for the MENA region were 11 and 30 percent respectively. Similarly, for countries affected by fragility, conflict and violence, the averages were 8 and 29 percent. On average, the PA spends more on its wage bill as a share of GDP and central government expenditure than countries such as Jordan, Egypt, Morocco and Tunisia. If the PA does not address the core drivers of wage spending, its wage bill is likely to become even more fiscally unaffordable. Simulations run by the World Bank team indicate that if employment and wages are allowed to grow based on the 2016-2021 averages, the increase in the wage bill will represent a 14 percent change from the 2021 baseline by 2026, which will translate into a 2-percentage point increase in the wage bill's share in GDP.

46. **Given current fiscal constraints, the PA has re-dedicated itself to wage bill and public employment reform and established a national committee to create an action plan.** In October 2021, the government formed a national committee comprising representatives from the MoF, the General Personnel Council (GPC), the Pension Authority, the Ministry of Justice and the Security Forces Financial Administration to study salaries and employment in the public sector and submit reform options to the cabinet. In addition, the government's reform agenda document titled 'Economic and Financial Recovery, Strengthening Resilience, and Restoring Trust' published in May 2022 stated the priority to engage in large-scale wage bill and civil service reforms in order to rationalize expenditure and improve government service delivery.

47. **The proposed DPG aims to support the PA's efforts in controlling wage bill spending**. The operation supports the PA's decision to adopt an attrition target for net public employment in 2023 to ensure that recruitments do not exceed 50 percent of the number of retirement-related and other kinds of departures from the PA. This new policy represents a departure from policies exercised in recent years when net staff increases were witnessed annually. This action is seen as an encouraging first step that will help stop the drain, especially as recent analytical work by the Bank has shown that even though public employment under the PA is not very large relative to comparator countries, there seem to be areas of over-staffing. This is a short-term action in nature as effective and efficient service delivery will eventually require an increase in PA staff, especially given the high population growth in the Palestinian territories. Hence, this reform will need to, and is expected to, be supported by further reforms (see below).

48. **Experience in other countries has shown that to successfully reform the wage bill, governments need**

to use a mix of short and long-term measures. Therefore, in addition to the attrition target for net employment, the DPG supports the PA's efforts to update its Human Resource (HR) needs on a yearly basis. To do so, the cabinet has instructed each government agency to submit, by October of every year, a list of surplus staff whose skills are no longer needed and a list of skills in shortage. The GPC will then cross-check the submissions to reallocate staff within PA institutions. To help staff with the reallocation and to update their skills according to the needs, the GPC is requested to provide 3 to 6-month trainings. This is expected to enhance the overall efficiency of the public system and eventually result in a reduction in the wage bill in the medium term.

49. **To further build on these efforts and given the importance of wage reform in the Palestinian context, the World Bank plans to continue its engagement with the PA in this area.** Following the initial Wage Bill Diagnostic that was conducted in 2022, the World Bank plans to do more analytical work in this area including functional reviews and wage structure analysis. The knowledge generated is expected to guide the choice of additional reforms to be adopted by the PA, as mentioned in the Letter of Development Policy, and supported by future DPG operations. This area of reform is supported by other donors, including the European union, who through their conditional budget support also aim to support the PA' s wage bill reform.

Prior action 3: To improve the professional quality of procurement staff in the Palestinian Authority, and enhance the effectiveness of public procurement, the Recipient, through its Cabinet, approved the "Procurement Capacity Building and Professionalization Strategy" which recognizes procurement as a distinct profession in civil service, institutes a permanent procurement training program and establishes an independent certification mechanism for procurement staff, as evidenced by cabinet decision No. (18/186/03) dated December 19, 2022.

Indicator: Share of public procurement staff who completed the procurement training program

Baseline: Zero percent, December 2022

Target: 80 percent, December 2024

50. **Building on reforms included in previous DPGs, this operation supports efforts by the PA to push forward public procurement reform.** The Bank has been supporting reform efforts in this area for at least a decade. Through DPG 5,[7] the Bank supported the establishment of the Higher Council for Public Procurement Policies (HCPPP), which is the entity in charge of the development of the procurement system, as well as for oversight of all public procurement activity. Through DPG 6,[8] the Bank supported the PA's efforts in amending the Public Procurement Law (PPL) and adopting its implementing regulation, consistent with international best practices. Through DPG 10,[9] the Bank supported reforms to mandate all procuring entities to use a single procurement portal and Standard Bidding Documents. DPG 11[10] supported the institution of a Dispute Resolution Unit (DRU) to carry out administrative reviews of appeals from aggrieved bidders. Finally, DPG 12[11] supported the institution of an end-to-end electronic Government Procurement (e-GP) system automating all aspects of the government procurement process, from planning to tendering, contract monitoring and eventually payment.

[7] Approved by the World Bank's Board in May 2013.
[8] Approved by the World Bank's Board in May 2014.
[9] Approved by the World Bank's Board in May 2020.
[10] Approved by the World Bank's Board in May 2021.
[11] Approved by the World Bank's Board in June 2022.

Overall, progress in these reforms has been on track. For instance, the DRU is now fully operational, and it has already received 14 appeals since its establishment All were resolved within the period stipulated in the law and resolutions are published on the single procurement portal. The e-GP system is under bidding and proposals are expected towards the end of January 2023, as planned. The online portal and the e-procurement system make data publicly available, which can help reinforce public perception of the transparency and effectiveness of public spending. In addition, the availability of data and oversight could leverage feedback loops between the government, suppliers, and other actors, helping hold everyone mutually accountable and deliver stronger outcomes. The establishment of the DRU has created a credible dispute review mechanism through which administrative reviews of appeals from aggrieved bidders are carried out. The reporting of violations could also encourage good practices across the procurement cycle.

51. **Building on these reforms and to improve public resource management and accountability, the PA is prioritizing efforts to improve the professional quality of procurement staff through a certification process.** This is being done through institutionalizing the PA's approach for the professionalization of the procurement function. This approach is built on the PA's "Procurement Capacity Building and Professionalization Strategy", prepared by the HCPPP with support from the World Bank, in close cooperation with the GPC and other stakeholders. The strategy seeks to enhance the effectiveness of the public procurement function in the Palestinian territories through transforming procurement from an administrative and compliance role to a strategic government function, with highly qualified personnel. The strategy's objectives include: (i) the recognition of procurement as a distinct profession in civil service with well-defined proficiency levels, skills, and competences; training requirements; job profiles; and levels of remuneration; (ii) the development and delivery of a permanent, substantive procurement training program suited in quality and content to the needs of the procurement system; and (iii) the establishment of a certification mechanism by which an entity independent of employers, employees and training providers recognizes that a procurement staff member has met the specified training and competency requirements for the performance of a procurement function.

52. **The support for procurement policy reform under the DPG is complemented by a Bank IPF operation in the sector.** The adoption of the "Procurement Capacity Building and Professionalization Strategy", supported by the DPG, will lay down the policy change needed for the PA to recognize procurement as a distinct profession in civil service and to start efforts for the certification of procurement professionals. These efforts are supported by the Word Bank's Public Financial Management Improvement Project Phase 2 (PFMI 2) (P177742) 2022-2027. The project will support (i) developing a permanent modular procurement training program that includes the development of training modules (combining face-to-face and e-learning) and training of trainers; (ii) delivering training through selected training institutes to around 1,800 public staff (including procurement practitioners, auditors, financial controllers, and contract managers) at central and local levels of government and to 600 suppliers/contractors, journalists, and civil society activists; (iii) establishing and implementing a certification mechanism for procurement practitioners; and (iv) equipping the HCPPP with tools to oversee Strategy implementation, including hiring a resident expert and developing a learning management system.

53. **These efforts are expected to strengthen accountability and efficiency in the public sector.** The target for this prior action is to have 80 percent of public procurement employees complete the training by end-2024 (up from 0 percent in 2022).[12] This will enhance accountability and efficiency as studies have shown that one of

[12] It is expected that around 1040 out of a total of 1300 procurement staff will complete the training.

the main causes of waste in government spending is often pertaining to "incompetence-driven" inefficiencies.[13] Hence, it is indeed crucial that the workforce which is appointed for procurement-related tasks is well trained and experienced with the necessary technical, managerial and soft skills to achieve value for money in the procurement processes. This will significantly increase the prevalence and accuracy of procurement procedures. Other efforts supported by the PFMI 2 IPF, and which are expected to go on until 2027, will build upon the result achieved by the DPG as they will ensure that all procurement practitioners that have completed the training program also get certified. This is expected to achieve an improvement in the performance of the government procurement system with respect to value for money, efficiency, and transparency.

54. **Even though the World Bank is the main donor supporting procurement reform in the Palestinian territories, its efforts have been supported by other donors.** The EU has included procurement indicators (on the portal and the DRU) as part of its support and it has been indirectly involved, together with Denmark, through financing the Procurement Modernization ASA (P169263) under the Public Financial Management Improvement (PFMI) MDTF. The EU expressed interest in continuing to support procurement reforms through the ESPERE Associated Trust Fund to the PURSE MDTF. For next DPG operations, the focus of the reforms will be on "sustainable procurement", with the aim to ensure that the public procurement system supports the Sustainable Development Goals and inclusive and sustainable growth (economic development, social inclusion, green procurement, etc.)

Pillar 2: to strengthen the integrity of the financial sector and pursue digital transformation.

55. **The second pillar of the operation contributes to financial sector development by enhancing transparency and advancing digital transformation.** Improvement in financial sector integrity is supported through enhanced internal controls on transparency and beneficial ownership. Greater financial access will be achieved by modernizing the regulatory framework for national retail payment systems while creating a level playing field by closing the regulatory gap between traditional financial service providers and new non-bank entrants. In addition, this pillar supports the development of the data infrastructure needed to advance financial inclusion of women through targeted gender outreach and evidence-based programming. Notably, financial sector reforms supported under this operation contribute to containing the divide between the West Bank and Gaza. Despite the political divide within Palestinian institutions and the spatial separation of the territories, there continues to be a single financial space.

Prior Action 4: To modernize the Anti-Money Laundering and Combating Financing of Terrorism legal framework, and to align it with international best practices, the Recipient, upon recommendation of the Council of Ministers on July 4, 2022 and through its President, enacted a new AML/CFT law No. 39 published in the official gazette No. 193 on August 14, 2022, and AML/CFT instructions for financial institutions licensed to operate in the Palestinian territories, as evidenced by Instructions No. 2, issued by the National Committee for AML/CFT and published in the official gazette No. 192 of June 30, 2022.

Indicator: PMA conducting on-site inspections of banks' AML/CFT internal controls, to ensure compliance with newly mandated procedures on collecting, verifying, and maintaining beneficial ownership information

[13] Coppola, M. A, and Piga, G. (2019). The Impact of Professionalization in Public Procurement - evidence from a case study. *The European Journal of Public Procurement Markets*. 2nd Issue (December 2019).

Baseline: Onsite inspections controlling the collection, verification, and maintaining of beneficial ownership information do not exist, October 2022

Target: PMA conducted on-site inspections of licensed banks accounting for 85 percent of total bank assets, controlling the compliance with new procedures on beneficial ownership information, December 2024

56. **The PMA and Financial Follow-up Unit[14] have been taking steps towards upgrading the Palestinian AML/CFT regime to be more in line with international practices**. In the context of increasingly volatile cross-border correspondent banking relationships, and de-risking behavior potentially jeopardizing connectivity with the primary trading corridor for the Palestinian private sector and the stability of remittance flows, the authorities have been making steady progress towards upgrading integrity standards across the financial sector. In 2018, the local authorities conducted their first self-assessment with the aim of enhancing the ability of relevant AML/CFT stakeholders towards identifying, assessing, understanding, and mitigating the money laundering and terrorism financing risks they face. The assessment was officially endorsed by the Palestinian Cabinet in October 2018, followed by the adoption of the national AML/CFT strategy by the Cabinet in November 2018. During 2022, with technical assistance from the IMF, the authorities enacted a new AML/CFT law (No. 39/2022) and issued instructions (No. 2/2022), defining “beneficial ownership transparency” for account holders, and establishing systematic procedures for financial institutions to collect, verify and maintain beneficial ownership information.

57. **The adoption of the new AML/CFT law and instructions, as supported by this prior action, represents a key milestone towards the implementation of recommendations defined in the national AML/CFT strategy, along with other reforms implemented across both the financial and real sectors of the economy**.[15] The target for this DPG is on-site inspections of licensed banks accounting for 85 percent of total bank assets, with the understanding that a full inspection cycle[16] will cover the remaining bank assets, under a risk-based approach. Based on the new regulations, financial institutions are required to comply with a more systematic procedure for collecting and maintaining information on both legal and beneficial ownership. These procedures have been developed by the national AML/CFT committee, chaired by the Financial Intelligence Unit, which may also provide technical guidance to the relevant supervisory authority tasked with enforcement, in this case being the PMA. This represents a step towards the commitment to and implementation of the Financial Action Task Force (FATF) AML/CFT standard conditions of the West Bank and Gaza membership in the MENA-FATF. MENA-FATF’s first mutual evaluation of the Palestinian territories was planned for 2020 but has been delayed initially due to Covid-19, then due to security developments on the ground.

58. **A stronger and modern AML/CFT legal framework contributes to enhanced accountability – a key priority for the PA**. Raising the requirements on financial sector transparency beyond the basic “legal ownership” has also become an important policy measure for combating corruption, through greater scrutiny of legal structures potentially used to conceal proceeds of corruption.

Prior Action 5: The Recipient, through the Palestine Monetary Authority, further advanced the digital transformation agenda in the financial sector and enhanced public confidence in electronic transactions by enacting a national payments law regulating the use of e-money and strengthening the PMA’s authority over

[14] This corresponds to the Palestinian Financial Intelligence Unit.
[15] Including designated non-financial businesses and professions.
[16] PMA supervision department conducts on-sight inspections for all 13 licensed banks on a regular basis, based on an inspection cycle that accounts for systemic importance, risk profile, and date of previous onsite inspection.

entities providing e-money services, as evidenced by presidential decree No. 41 dated August 8, 2022, published in the official gazette No. 193 on August 14, 2022.

Indicator: Number of cashless transactions[17]

Baseline: Two million transactions, June 2022

Target: Number of cashless transactions increasing by 150 percent, December 2024

59. **The PMA is leading an ambitious financial sector digital transformation strategy, with an emphasis on developing the market for digital finance and reducing the reliance on cash.** At a time where the emergence of non-bank payment and Financial Technology (FinTech) players has become a regional priority and a global trend, it is important for financial sector regulators to have effective policy and regulatory guidelines that enable the licensing, operation and oversight of emerging e-money players. The development of a diverse ecosystem of traditional and new financial service providers, backed by the appropriate legal provisions, will contribute to the competitiveness of the Palestinian economy, in terms of facilitating digital domestic and cross-border payments, in a fast, secure and cost-efficient way.

60. **The proposed operation supports the advancement of the digital finance legal framework, through the adoption and implementation of a new national payments law.** The new payments law is intended to close the gap between banks and the non-bank market players, while enhancing the PMA's licensing and supervisory powers over entities which provide e-money products and cashless payment services. In addition, it will create a level playing field in the retail payments market. This, ultimately, will benefit the end users by generating competition and innovation, by enabling market entry and the deployment of a variety of e-money based services/products, including targeting the needs of the vulnerable and financially excluded population segments. The emergence of new types of players with the enactment of the provision is expected to contribute to financial access as well, given that the provision of e-money accounts can, in many instances, be a good alternative to those that might not qualify or might not opt for a bank account. The PMA is taking steps towards the implementation of the new law by developing new regulations, also benefiting from World Bank Technical Assistance. The legal provisions will provide a much-needed element that will help create legal certainty among new players (e-money issuers) that want to operate (or expand their operations) in the economy, and further advance the payments modernization agenda.

61. **The law also provides a legal basis for the establishment of Payment Service Providers (PSP) trust accounts, and the issuance of digital financial ID (for electronic Know Your Customer objectives, e-KYC), both of which are critical reforms needed for advancing cashless payments through digital financial services.** The proposed prior action also builds on previously supported DPG reforms focusing on the licensing and market entry of e-wallets (DPG 11) and is complimentary to ongoing reforms focusing on financial inclusion accounts (DPG 12). Among the lessons learned from previous operations is the detriment of excessive regulation to the sustainability of nascent industries such as digital payments. Building on private sector feedback to previous reforms, the proposed prior action supports a less prescriptive regulatory approach, by defining a broader range of allowable Digital Financial Services (DFS) activities for the private sector to engage in as needed, instead of

[17] Cashless payments are defined as transactions processed through one of the following channels: Point of Sale terminals (POS), e-wallets, or the Automated Clearing House system (ACH).

regulating each specific DFS activity, effectively banning non-listed activities. Future reform plans by the PMA include expansion of the national payment infrastructure, including the implementation of an Instant Payment System, and a National Bill Presentment System, both of which complement the legal reforms supported under Prior Action 5 by providing the payment rails needed for the deployment of more advanced payment solutions. While World Bank support has mainly focused on the legal framework and payment infrastructure, parallel yet complementary donor engagements supporting private sector innovation are also ongoing, including the German Agency for International Cooperation's (GIZ) intervention on fostering alternative approaches to financial inclusion, and the United States Agency for International Development's (USAID) intervention on scaling up DFS.

Prior Action 6: To support women empowerment through financial inclusion, the Recipient, through the Palestine Monetary Authority, issued circular No. 201/2022 dated September 6, 2022, adopting a single definition for female-owned enterprises applicable to all Microfinance Institutions, and introducing the obligation to disclose the number and size of financing provided to these businesses on a regular basis, in order to strengthen the role of MFIs in supporting women.

Indicator: The number of women-owned businesses accessing microfinance according to the new definition

Baseline: Unmeasured

Target: 1500 women-owned businesses, December 2024

62. **The gender gap in access to credit remains to be a chronic feature of the Palestinian microfinance sector, reflecting similar gender disparities observed in labor force participation and employment.** Noting the consistently low rates of female labor force participation in the West Bank and Gaza, women also disproportionately face financial access barriers that prevent them from participating in the formal economy. Access to credit can open-up economic opportunities for women-run and women-owned microenterprises, but a more gender-inclusive, evidence-based approach is also needed to strengthen financial institutions' commitment to female entrepreneurship. According to International Finance Corporation (IFC) studies, 60 percent of women-owned businesses (WOBs) in the Palestinian territories have unmet financing needs, which is on par with global estimates.[18] [19] Recent data shows that among the top reasons why WOBs in the Palestinian territories do not have access to financing is because they lack information regarding how to access customized financial/non-financial products and services as well as the know-how to become bankable. Despite the stated social objectives of microfinance institutions relating to closing the gender gap and serving underrepresented segments, effective outreach to female borrowers in the Palestinian market remains lacking, along with the availability of gender disaggregated data required for identifying women as a dynamic consumer base. In general, while there are robust statistics on the role of women in the economy and demand-side data on women's market opportunity, there is very little supply side data derived from financial institutions to help inform access and use

[18] Bank of Palestine Evaluation Report, December 2017 accessed here: *https://www.ifc.org/wps/wcm/connect/85ab284b-12a5-4345-ad8b-4a41131cf0d9/Bank_of_Palestine_Eval_Report_FINAL.pdf?MOD=AJPERES&CVID=m6mdDM1*

[19] MSME Finance Gap: Assessment of Shortfalls and Opportunities in Financing Micro, Small and Medium Enterprises in Emerging Markets, World Bank Group accessed here: *https://www.smefinanceforum.org/sites/default/files/Data%20Sites%20downloads/MSME%20Report.pdf*

of services.[20] [21] This is particularly the case in the Palestinian context, where MFI reporting of transactions and operations by gender of business owner was previously based on arbitrary definitions, rendering the aggregate market data inaccurate. Available data estimates a baseline of 500 WOB active borrowers in the microfinance sector, but with inconsistent methodologies across financial institutions. The availability of standardized, sex-disaggregated data at the financial institution level is necessary to help establish a sector-wide baseline of female owned enterprises (currently benefiting from financial access) in order to better define the gap that remains for this segment. In a context of protracted fragility and conflict, having access to the latter is a critical first step towards creating innovative products and services that can lend themselves as gender-transformative solutions in the financial sector.

63. **The operation supports the development of the data infrastructure needed to advance financial inclusion of women through targeted gender outreach and evidence-based programming that encourages financial institutions' commitment to increase the share of WOBs in their respective portfolios.** The target of this prior action is to strengthen WOBs access to microfinance - which has been historically deficient in the Palestinian context according to available data, with only 0.7 percent of active borrowers being women owned businesses.[22] The new circular issued by the PMA requires all MFIs to adopt a uniform definition[23] of WOBs and report against this definition in a periodic fashion, ultimately creating a sector-wide baseline for better understanding, and reducing, the gender gaps in MFI access and financing. The new circular comes at the heels of World Bank and IFC ongoing outreach and capacity building exercises for the PMA and MFIs to raise awareness of this issue, promote women as dynamic financial consumers, and discuss the importance of tailored products and services that meet the various needs of different population groups. The proposed prior action also builds on lessons learned from similar regional experience, [24] which emphasized the importance of financial institutions investing in their information and data management systems, to enable the timely reporting on gender disaggregated data. To that end, ongoing World Bank and IFC technical assistance has delivered a series of "data clinics" for participating financial instructions, to mitigate implementation risks related to data limitation. Trainings have also included a deep dive on the full range of non-financial services (information, networking, advisory, coaching, digitization, education) with regional and global case studies demonstrating the positive impact on WOBs. With the new circular in place coupled with the trainings carried out to date, the PMA (or MFIs) will be better positioned to use the data generated to develop policies or build a business case for a meaningful program that targets female entrepreneurs with potential for replication and scale up. Therefore, to ensure that the adoption of the circular and gender reporting translates into practice, the PMA will develop a framework, with World Bank assistance, requiring the MFIs to use and submit sex-disaggregated data quarterly. In turn, the MFIs will adjust their internal documentation and procedures to reflect the new sex-disaggregated requirements in loan applications. Building on past capacity building efforts, the PMA, with World Bank support, will conduct additional workshops focusing on strengthening MFI outreach to female borrowers in order to complement the data collection efforts and enable gender sensitive product design and services.

[20] Finequity Brief: Gender Data in Financial Inclusion, Bank of New York Mellon, November 202o accessed here: *https://www.findevgateway.org/sites/default/files/publications/2020/FinEquity_GenderDataBrief_Final.11.06.2020.pdf*
[21] CGAP Report: Gender Data in Financial Inclusion (2020).
[22] Source: Palestine Monetary Authority data.
[23] Women Led Enterprises definition: Meeting one of the conditions below:
1. ≥51.0 percent ownership/stake held by a woman/women; Or
2. ≥20.0 percent ownership/stake held by a woman/women And ≥1 woman as President or CEO/COO
[24] Kingdom of Morocco: Financial Inclusion and Digital Economy DPF, P168587.

Table 4: DPF Prior Actions and Analytical Underpinnings

Operation Pillar 1: to improve the structural fiscal balance and strengthen the effectiveness of public procurement	
Prior action #1	International Monetary Fund report to the Ad Hoc Liaison Committee, September 2022. Key findings: The PA's tax revenue collection is already well-above peers. But more can be done and the PA's revenue strategy for 2022-2025 appropriately focuses on broadening the tax base through combating tax and customs evasion.
Prior action #2	Palestinian Authority Public Sector Wage Bill and Employment Diagnostic, The World Bank (expected to be published in 2022). Key findings: The PA's wage bill is higher than wage spending in all comparator countries. The overall size of public employment under the PA is not very large relative to comparator countries, although there may be areas where there is over-staffing. If the PA does not address the core drivers of wage spending, its wage bill is likely to become even more fiscally unaffordable. Global experience indicates that governments that have successfully rightsized their wage bill have typically combined short-term controls to rein in spending with medium-to-long term structural reforms to improve overall wage bill management.
Prior action #3	Modernizing Public Procurement in the Palestinian Authority, ASA (P169263)", World Bank (ongoing, expected to be finalized in December 2023) Public Financial Management Improvement- 2 (P177742), World Bank (ongoing) Key findings: Professionalization of public procurement will translate into the transformation of the staff that practice public procurement, from simple execution and compliance with regulations, to professionals who use knowledge, skills, abilities, and judgement specific to the public procurement profession. Within the framework of core principles defined in the public procurement law and its implementing regulations, public procurement professionals will be able to decide strategies, select tools, establish and implement courses of action, consider the risks, the operational context and the dynamics of the market to obtain the best results for citizens. This transformation will improve the performance of the public procurement system with respect to value for money, efficiency and transparency which in turn will support fiscal stability.
Operation Pillar 2: to strengthen the integrity of the financial sector and pursue digital transformation	
Prior action #4	FATF Guidance Note on Transparency and Beneficial Ownership, 2014. Key findings: Legal and beneficial ownership information will assist law enforcement and other competent authorities by identifying those natural persons who may be responsible for the underlying activity of concern, or who may have relevant information to further an investigation. This allows the authorities to "follow the money" in financial investigations involving

	suspect accounts/assets held by corporate vehicles. World Bank Global Report. "Enhancing Government Effectiveness and Transparency: The Fight Against Corruption". Chapter 9: Beneficial Ownership Transparency, 2020. Key findings: The Guidance Note issued by the Financial Action Task Force (FATF), which sets global standards on anti-money-laundering, requires that countries "take measures to prevent the misuse of legal persons and trusts for money laundering or terrorist financing and to ensure that there is adequate, accurate and timely information on the beneficial ownership and control of legal persons that can be obtained or accessed in a timely fashion by competent authorities."
Prior action #5	CGAP Report: Basic Regulatory Enablers for Digital Financial Services, 2018 Key findings: The report identifies the e-money regulatory framework as the first enabler to unleashing the DFS market and enabling it to achieve scale. Absent a framework for e-money issuance, DFS would continue to rely on banks, which face heavy prudential and operating requirements, have high costs and limited outreach. Banks may also focus on higher-income market segments, to offset high operational costs.
Prior action #6	CGAP Report: Gender Data in Financial Inclusion (2020) Key findings: From a policy maker's perspective, it is necessary to establish a baseline by collecting, aggregating, and analyzing gender data at the national level. A baseline enables evidence-based policy-making and effective monitoring of progress against concrete targets. Financial institutions that collect and analyze gender disaggregated data develop a more accurate picture of the market opportunity for serving women. They also build a better business case for developing products and services tailored to women's needs.

4.3. LINK TO CPF, OTHER BANK OPERATIONS AND THE WBG STRATEGY

64. **The proposed operation is aligned with the World Bank Group's strategic objectives of ending extreme poverty and promoting shared prosperity in a sustainable manner.** The operation is designed in a way that aims to address the needs of the poor while contributing to the promotion of a sustainable and robust shared prosperity. Reforms to strengthen the structural fiscal balance, under pillar one, are expected to create the fiscal space needed for productive investments and increased social spending. The reform aimed at improving the effectiveness of public procurement will put in place systems that could contribute to a more effective and higher quality service delivery by the PA. Reforms under pillar two to strengthen the integrity of the financial sector and support financial inclusion will open advancement opportunities for the poor and disadvantaged segments of the population, specifically women.

65. **The operation contributes to the implementation of the World Bank Group's Assistance Strategy for the West Bank and Gaza (FY22-25).** Procurement reform supported by this DPG will enhance resource management and transparency in the public sector. This links to the first focus area of the Assistance Strategy, "Strengthening Institutions for Economic and Social Prosperity", especially through objective 1.1 which aims at strengthening

Institutions' accountability and transparency. The prior action focused on updating the AML/CFT laws and instructions is expected to eventually contribute to an overall improved operating environment for the private sector contributing to Objective 2.1 of the Assistance Strategy which aims to "Stimulate Inclusive Private Sector Development". Under pillar 2, the prior action supporting the payments law and the use of e-money and the one aimed at better financial inclusion for women contribute to the Assistance Strategy's cross cutting themes, including "Leveraging Digital Technology" and "Narrowing the Gender Gaps".

66. **DPG 13 is also aligned with the World Bank Group's enlarged MENA Strategy (March 2019), and it supports the World Bank's FCV Strategy (2020-2025).** The operation supports the enlarged MENA strategy, specifically the pillar focused on renewing the social contract. Measures aimed at enhancing governance and transparency, under both pillars of the DPG, contribute to this goal. For example, procurement reform is expected to enhance resource management in the public sector and could contribute to a more effective and higher quality service delivery by the PA, strengthening the social contract. The proposed operation also supports the World Bank's FCV strategy goal of enhancing effectiveness by strengthening resilience, especially for the most vulnerable and marginalized populations. The DPG aims to address some of the key challenges faced by the Palestinian territories. For example, in response to the complex challenges faced by the PA on the fiscal accounts, pillar one includes prior actions that are expected to lead to increased fiscal resources through improved revenue mobilization and rationalized spending. The increased fiscal space may be used for poverty reduction, productive investments and for addressing the needs of vulnerable groups. Financial inclusion may be another route for addressing the needs of the vulnerable groups and this is supported by prior action six under pillar two which aims to strengthen the role of MFIs in supporting women. The political instability affects all aspects of the economy including the financial sector as Correspondent Banking Relationships (CBRs) between Palestinian banks and their Israeli counterparts continue to be threatened due to AML/CFT concerns. Prior action four is expected to lessen some of these concerns through the enactment of modern AML/CFT law in the Palestinian territories that is aligned with international best practice.

67. **The proposed DPG contributes to the World Bank's Global Crisis Response Framework (GCRF).** Through its six prior actions, the DPG supports three of the four pillars supported by the GCRF including pillar two aiming at "*Protecting People and Preserving Jobs", pillar three focused on "Strengthening Resilience"* through better fiscal sustainability, and finally pillar four focused on "*Strengthening Policies, Institutions and Investments for Rebuilding Better"* through contributing to institutional strengthening and capacity building and digital development.

68. **The operation complements several World Bank-financed projects**. The DPG supports institutionalizing the PA's approach for the professionalization of the procurement workforce. This is also supported under the Public Financial Management Improvement Project Phase 2 (P177742) currently under implementation. The project will help implement the "Procurement Capacity Building and Professionalization Strategy" through developing the training program, delivering it and establishing a certification mechanism. On the financial sector front, the DPG supports the advancement of payments and digital financial services through policy and regulatory reforms. This is also supported by the ongoing Programmatic Financial Sector ASA (P169932), providing technical assistance to the PMA on the modernization of the national payment infrastructure, and the streamlining of the regulatory framework. The DPG also supports the roll out of systematic data collection on access to finance by women owned businesses, with the objective of improving financial access to this underserved segment. This is also supported under the Regional Financial Inclusion and Jobs for Middle East and North Africa project (P176046), which provides Technical Assistance on microfinance access and outreach through the establishment

of a knowledge base on female borrowers in the West Bank and Gaza.

4.4. CONSULTATIONS AND COLLABORATION WITH DEVELOPMENT PARTNERS

69. **The proposed operation supports the PA's NDP 2021-2023, which was shaped through a consultative process involving various stakeholders.** At various development stages, formal consultations were held with representatives from the private sector and the civil society, with feedback reflected in the NDP. The PA also consulted with beneficiaries and vulnerable groups, and the feedback received informed the formulation of the NDP, and hence, the reforms supported by this operation. Furthermore, major donors to the PA were consulted during the strategy preparation process and had an opportunity to comment on the draft NDP. As stated in the NDP, the consultations will continue throughout its implementation to maintain a constant feedback loop in regard to the decisions taken.

70. **The preparation of the proposed operation, including reform measures supported, was informed by PA and Bank consultations with a wide range of stakeholders.** As previously stated, development partners supporting the PURSE MDTF continue to rely on the operation's policy and results matrix as the criteria to evaluate the PA's performance in implementing the NDP. The Bank maintains a feedback mechanism, through consultations with the PURSE MDTF donors, to ensure that reforms supported by this DPG incorporate donor feedback. Further, the Bank consulted with the European Union (EU) to ensure that reform areas supported by the DPG are aligned with the EU's Results-Oriented Framework (ROF), through which conditional budget support is provided to the PA. The consultations also included colleagues from the FCDO. Furthermore, and equally important, the PA also holds parallel consultations with donors on measures supported by this operation. This two-pronged approach has proven to be an efficient and effective way to leverage donor budget support on key structural reform agenda.

4.5. CLIMATE CO-BENEFITS

71. **The Palestinian territories suffer from a water shortage which is likely to persist.** According to the Water Resources Status Summary Report,[25] 90 percent of water from the Gaza aquifer has nitrate concentrations exceeding the 50mg/l World Health Organization (WHO) limit. This situation is not expected to improve in the near term and may further deteriorate. The water shortage in the West Bank is relatively less severe than in Gaza, but it comes with a set of unique challenges, such as the agribusiness sector growing water-intensive crops for export, the prevalence of unsustainable water use practices, and groundwater pollution. The shortage of water and substandard water quality disproportionally affect disadvantaged segments of the population living below the poverty line, since their ability to secure alternative sources of water is limited.

72. **New research[26] predicts a decrease in seasonal precipitation in the north and central Mediterranean climate parts of the area, with reductions reaching about 40 percent, and increases of the same percentage in the most southern arid parts (but not the area close to Gaza) during winter and spring.** This change in precipitation patterns is likely explained by a decrease in cyclone occurrences. The same research also predicts shorter winters and longer summers, under increased greenhouse gas concentrations.

[25] http://www.pwa.ps/userfiles/server/المركز%20الاعلامي/تقارير/تقرير%20الوضع%20المائي%20في%20قطاع%20غزه.pdf
[26] "High-resolution projection of climate change and extremity of Israel using COSMO-CLM" International Journal of Climatology.

73. **The forecasted climate change is expected to have a negative effect on the population and economy of the West Bank and Gaza.** Rapid population growth alone is sufficient to result in further deterioration of the water crisis. Furthermore, increased agricultural activity due to the population growth will result in greater groundwater pollution. Lack of water and substandard water quality will have further negative impacts on human health (e.g., anemia in children and pregnant women). This may potentially create epidemiological hazards due to decreased hygiene standards, and the associated costs of healthcare provision will further marginalize the poor. The population of the West Bank and Gaza is young and both pregnant women and infants will be especially vulnerable to the effects of climate change. DPG 11 supported the climate change agenda through supporting efforts to amend the Palestinian environment protection law to include aspects of climate change. This proposed DPG also supports prior actions that contribute to addressing the impact of climate change, indirectly. Additional climate change reforms are anticipated to be included in future operations, based on recommendations from the ongoing Country Climate and Development Report (CCDR).

74. **This DPG will contribute to addressing the anticipated physical and economic impact of climate change on the population of the West Bank and Gaza**. The first pillar will increase the resilience of the population to climate change in various ways. The VAT portal, supported by prior action one, could be utilized to track the carbon footprint of businesses and adjust their taxes accordingly. This could incentivize low-carbon activities. Conducting a human resource needs assessment, supported by prior action 2, can help PA agencies better align their workforce with the skills needed to transition towards a low carbon economy. The assessment could also identify employees who have skills that are currently not fully utilized and train them to transition towards climate change-related jobs. The certification of the procurement workforce, supported under prior action three, adds a layer of safety that ensures public procurements are tendered according to guidelines and stated policy goals and funds used as designated. Such guidelines or goals could promote climate change adaptation or mitigation, for example through requirements that any public procurement considers climate impact to some degree as part of the offering and evaluation process. This prior action will also pave the way to train staff on carrying out sustainable procurement, with the aim to ensure that the public procurement system supports the Sustainable Development Goals and inclusive and sustainable growth focusing on economic development, social inclusion, and green procurement.

75. **Reforms to strengthen the banking sector, supported under pillar two, will contribute to addressing climate vulnerabilities by making the economy more resilient, and capable of withstanding macroeconomic shocks and unfavorable events**. Predicted climate change and water shortages carry a clear and direct impact on several sectors of the economy, including agriculture, the energy sector, and beyond. Strengthening the resilience of the pillars of the economy before the deterioration of environmental conditions (and anticipated economic impacts), is an adaptation measure. Further, the framework for implementing digital financial services, which enhances the safety, reliability, and efficiency of the payments system supported under prior action five, could also enable both climate change mitigation and adaptation. The adoption of e-payments, for example, makes it possible to transfer funds without the need to open bank accounts or the need to have brick-and-mortar branches - thereby contributing to lower carbon emissions. E-money is also useful during unanticipated events, such as natural disasters like floods and droughts, by making available funds for disaster preparedness and emergency relief. The increasing likelihood of climate-related disasters make digital financial services an essential tool to transfer funds to affected areas where they are urgently needed and where traditional payment systems can be disabled.

5. OTHER DESIGN AND APPRAISAL ISSUES

5.1. POVERTY AND SOCIAL IMPACT

76. **The overall poverty and social impact of the prior actions supported by this operation is expected to be largely positive or neutral.**

77. **The poverty and social impact of reforms under pillar one is expected to be positive.** Efforts under pillar one aim to improve the fiscal balance and strengthen the effectiveness of public procurement. Applying stronger controls over spending and increasing revenues while enhancing the accountability of the public system may increase the PA's fiscal buffers which in turn would enable it to increase financing for social assistance programs. This would potentially have a positive impact on poverty. Notably, the civil service law in the Palestinian territories only allows for the termination of staff in very specific cases, mostly related to performance.[27] Hence, prior action two focused on the reallocation of public staff, is not expected to result in employees losing their jobs. The reform is also expected to be applied uniformly across the board, without potential higher negative implications for female staff. When implementing prior action two, it is recommended that an information sharing or communication mechanism regarding the scheme is put in place to ensure transparency and avoid resistance due to misinformation or misunderstanding. Given the risk of certain staff disagreeing with the choice of sector they are reassigned to, it is also recommended that a grievance redress mechanism (GRM) is in place under the GPC to mitigate this risk. Requisite personnel and resources (e.g. dedicated phone lines, operators, mechanism for submitting online complaints etc.) should be made available for the GRM, and complaints resolution should be managed by a committee that must also include female representatives. The GRM must allow staff to raise concerns without fear of reprisal. Standardized presentations, providing details of the scheme (e.g. the need and process for reallocation, the training program for reskilling, the availability of the grievance mechanism etc.) may be prepared by the GPC and then delivered during consultation sessions for staff across concerned ministries and departments. A schedule for these consultations should be made available for all staff in advance. These sessions may be conducted (in-person and online) between December and June 2023, and prior to the preparation of the departmental staff reallocation lists and the start of the reallocation process. Staff concerns and questions, including regarding retrenchment, should also be addressed during these sessions. Information regarding the scheme, also including answers to questions commonly raised by staff, the GRM and its performance, and other relevant details such as upcoming schedule of reskilling trainings etc. should also be made available on departmental/government websites in an accessible format and updated periodically. As for prior action three, improved procurement increases value for money, which disproportionally benefits the poor, since lower quintiles rely more on public spending. Improved public financial management also creates fiscal space and allows for consolidation, which enhances fiscal sustainability and reduces the risks of major macroeconomic imbalances that disproportionally impact the poor.

78. **The poverty and social impact of reforms supported under pillar two is expected to be neutral or positive.** Measures to strengthen the integrity of the financial system are expected to have a neutral poverty and social impact. Prior action five aimed at pursuing digital transformation and the use of e-money is expected to

[27] According to article 42 of the civil service law, if an employee receives three "weak" yearly performance reports, only then would a committee consider his/her termination. A weak report requires a performance rating below 50 percent. Also, termination is the tenth and last option in a group of penalties that can be applied if an employee contravenes the laws, regulations, instructions, and resolutions in force in the Civil Service, according to article 68.

have a positive poverty and social impact as digital technologies are making it possible to bring these services to people who lack access. Technology is lowering costs by maximizing economies of scale. It is increasing the speed, security and transparency of transactions and allowing for development of sustainable financial products tailored to the needs of people with very low, erratic incomes.[28] Prior action 6 which supports financial inclusion for women is expected to have a positive poverty and social impact. It will enable the PMA and MFIs to better target and reach women owned businesses which in turn should increase their opportunities for accessing financial and non-financial services. According to the literature, financial inclusion may alleviate poverty and inequality by facilitating the use of financial services such as loans, deposits, and the access to credit. This may result in investments in health, education and even new businesses, which is expected to have a positive poverty and social impact.

5.2. ENVIRONMENTAL, FORESTS, AND OTHER NATURAL RESOURCE ASPECTS

79. **The Palestinian environmental regulatory framework is modern and comprehensive, covering environmental protection, conservation of natural resources, preservation of biodiversity, and was recently amended to address climate change.** The recently amended Palestinian Environmental Law focuses on enhancing national capacity to tackle climate change, adapting to the adverse climate effects and on mitigating greenhouse emissions to prevent interference with the climate system. The Law addresses various environmental issues, including Environmental Impact Assessment (EIA) and auditing, permitting of development projects, monitoring of environmental compliance, and enforcement. Furthermore, the NDP 2021-2023 policy interventions are aimed at environmental sustainability and adaptation to climate change, via: (i) reducing pollution and greenhouse emissions, (ii) expanding wastewater management, treatment, and reuse, (iii) increasing energy efficiency and expanding renewable energy resources, and (iv) conserving biodiversity and expanding green spaces.

80. **Progressing towards sustainable development, the Palestinian Cabinet issued decree No. (02/113) on "Adopting the General Policy for the Disposal and Treatment of Electronic Waste" in June 2021.**The Palestinian Authority issued this decree to set the requirements for the management and disposal of e-waste generated from governmental and public institutions and to provide the definition of e-waste as a hazardous waste. The decree sets forward the collection, storage, transportation, auctioning, and disposal requirements.

81. **Reforms supported by this operation are not expected to have a significant negative environmental impact.** The prior actions supported under pillar 1 aim to strengthen the structural fiscal position and enhance the effectiveness of public procurement. This will be done through actions focused on strengthening cross checks on VAT invoices submitted through an online portal, renew the impetus on wage bill reform, and improve the professional quality of procurement staff in the Palestinian Authority and none of those actions are expected to have any negative environmental impacts.

82. **The prior actions covered by pillar 2 supporting the integrity of the financial sector and supporting financial inclusion for women are also not expected to have any negative environmental impact**. In fact, advancing the digital transformation agenda in the financial sector, and enhancing public confidence in electronic transactions through regulating the use of e-money and strengthening the PMA's authority over entities

[28] *https://blogs.worldbank.org/voices/expanding-digital-financial-services-can-help-developing-economies-cope-crisis-now-and-boost-growth-later*

providing e-money services, is expected to contribute to minimizing excessive paperwork, thereby contributing to lower carbon emissions which could have a positive environmental impact. This pillar may involve a minor increase in procuring electronic devices on the long term, where the PA applies the e-waste policy to manage the collection, storage, transportation, auctioning, and disposal requirements, as mentioned above. This policy is not expected to impact resources efficiency or cause an increase in energy demand, where also, the PA follows good energy efficiency practices in compliance with Law No.14 for the year 2015, related to renewable energy and energy efficiency application in the country. Finally, different projects implemented under the World Bank's Environmental and Social Framework have also addressed enhanced energy efficiency clauses under the procurement technical specifications, and the safe handling and disposal of the e-waste.

5.3. PFM, DISBURSEMENT AND AUDITING ASPECTS

83. **The fiduciary risk related to the proposed DPG is considered substantial.** The PFM system is strained by the recourse to arrears as a result of a large financing gap and limited ability to raise financing in an optimal manner, which manifests itself in weak budget execution. Despite previous delays, the issuance of financial statements is now up to date with the 2020/2021 joint audit published in February 2023. PFM deficiencies in some sectors (e.g., education, health, local governments) impact budget implementation and service delivery.

84. **Momentum around improvements in public procurement has strengthened and will be reinforced by this operation.** Key aspects of the Public Procurement Law including mandating the use of a single procurement portal, standard bidding documents including standard forms of contract for works, goods and consultants' services, and the institution of a mechanism for administrative review of bidder complaints (Dispute Review Unit) have all been implemented, and an e-GP system is being procured. All these efforts were supported by previous DPGs. Areas where work is underway include professionalization of the procurement function, supported by this operation, through instituting a sustainable program for strengthening the capacity of the procurement workforce and establishing an independent certification mechanism for procurement practitioners and establishing an effective procurement monitoring and reporting system using the data generated from the single procurement portal. These are supported by the Bank-funded Public Financial Management Improvement Project Phase 2 and the associated ASA funded by the European Union and Denmark.

85. **Overall, the PFM system of the West Bank and Gaza is operating at a satisfactory level despite some weaknesses as shown in the last Public Expenditure and Financial Accountability (PEFA) assessment from 2018.** Fiscal discipline is appropriate in the context within which the PA has to operate. On the expenditure side, aggregate estimates are reasonable, even though there are at times large differences between the original estimates and the actual expenditure composition. One of the weaknesses identified by the PEFA is about the budget not following the policy priorities set out in the NDP 2021-2023. Technical aspects of the budget preparation process work well, although the absence of a functioning legislature impacts the overall rating of this indicator. Other PEFA indicators related to resource allocation are evaluated as satisfactory or better. For aspects related to resource use efficiency, the public financial management system is satisfactory; financial relationships between agencies are transparent and the score of the 'performance information' indicator is good. In addition, the mechanisms to minimize the risk of losses, such as payroll controls, procurement, and internal control all appear to be working at a satisfactory level, although the public asset management indicator is evaluated as weak. The internal audit function is well supported by sound accounting control mechanisms. SAACB has full legal, financial and administrative independence, as well as unrestricted access to records, documentation and information. External audits of most expenditures and revenues were conducted during the last three fiscal years

using the International Standards of Supreme Audit Institutions (ISSAIs).

86. **The Bank-funded Public Financial Management Improvement Project (P162850), effective since July 2018, is addressing some of the risks in the PFM system** by: (i) improving budget expenditure management and control, (ii) improving financial accountability of the PFM system, and (iii) modernizing public procurement. A multi-donor trust fund alongside the project provides complementary assistance centrally and in municipalities, supporting analytical work, citizen engagement (CE), and anti-corruption. The project aims at strengthening the *downstream* cycle of the PFM system with emphasis on effective implementation, building on the previous technical assistance while broadening it to other line ministries (education, health and local governments). The project is also supporting the modernization of financial control, intergovernmental fiscal transfers, and improvement of payroll management. The project has been also supporting the implementation of key aspects of the public procurement law (SBDs, single portal, Dispute Review Unit, etc.) aimed at improving the efficiency, accountability and integrity of the public procurement system and creating equal opportunities for private sector enterprises. A second phase of the PFMI project has become effective as of July 2022 and is continuing work in the same areas in addition to reforms in tax administration, anti-corruption and data production. With respect to improving financial accountability, work is ongoing on the implementation of the main recommendations related to the lack of accuracy and timeliness in the final account preparation process which is crucial for the accountability of the PFM system. Training was provided to pilot ministries in order for them to produce financial statements in order to improve accountability and accuracy of final accounts. A Cabinet decree was passed in July 2022 to make it mandatory for line ministries to produce financial statements annually. The project will continue support in this area. On procurement, the project will support the professionalization of the Government procurement workforce, enhancing monitoring and reporting on the performance of the public procurement to ensure value for money and promote fiduciary integrity and improving procurement practices in specific sectors (e.g., procurement of medicines in the health sector).

Flow of Funds and Auditing Requirements

87. **No IMF Safeguard Assessment is available for the West Bank and Gaza since there is no full-fledged Central Bank. The PMA is an independent public institution.** In the absence of a national currency, it has no monetary policy role but is responsible for formulating and implementing banking policies and safeguarding the banking sector. The PMA performs several central banking duties such as prudential and integrity supervision over banks, money changers, payment service providers, and microfinance institutions, organizing the payment services, and spreading financial awareness. In 2014, the PMA adopted a Corporate Governance Guide for banks to ensure that banks implement sound corporate governance practices and therefore maintain public trust and confidence in the Palestinian banking sector.[29] The guide has been set at a high standard, consistent with the international best practices. The guide is based on the principles of Basel Committee on Banking Supervision's paper on enhancing corporate governance for banking organizations that introduced principles for sound corporate governance practices for banks.

88. **As with previous DPGs, the DPG proceeds will be deposited in a single tranche to a US dollar dedicated account that forms part of the PA’s official foreign exchange reserves.** The dedicated account will be held at the Bank of Palestine (Ramallah), which is part of the MoF single treasury account and where previous DPG proceeds had been deposited. Then, an equivalent amount in local currency will be credited to the single treasury account

[29] The guide can be accessed here: *http://www.pma.ps/Media/PressReleases/TabId/343/ArtMID/957/ArticleID/492/PMA-Issues-Guide-to-Corporate-Governance-for-Bank-Rules-and-Best-Practices.aspx*

of the PA to finance budgeted expenditures. The conversion will be based on the prevailing exchange rate on the date that the funds are credited to the Treasury Account.

89. **The Bank of Palestine (BoP) financial statements for the year ending December 31, 2021 were audited by Ernst and Young.** No key issues were identified in the management letter. The financial statements for the year ended December 31, 2021 are published on the BoP's website.[30]

90. **The MoF will confirm to the World Bank, within 15 days of disbursement, the receipt of the grant funds and that the grant proceeds have been credited to the Central Treasury Account at the BoP to finance national budget expenditures, including the date and number of the Treasury Account in which the funds have been deposited as well as the exchange rate applied.** If any portion of the grant is used to finance ineligible expenditures as defined in the Grant Agreement, the Bank will require the PA to refund the ineligible amount and the amount will be canceled from the grant.

Figure 3: Flow of funds diagram

External Auditing of the Grant Deposit Account

91. **The PA will hire an independent external auditor acceptable to the Bank to perform an audit of the deposit account.** The audit will be conducted in accordance with International Standards on Auditing and with the terms of reference acceptable to the Bank. The audit report will be approved by the MoF before it is submitted to the Bank. The audit report will be submitted to the Bank within six months of the release of the single tranche payment. The audited financial statements for the previous DPG financing releases to the designated account were submitted in a timely manner. The audit opinions received for the previous DPG were unmodified confirming the acceptable presentation of the DPG financial statements, compliance with the legal agreement, the proper use of the dedicated account, and the use of the MoF accounting system to record the financial transactions. The auditor will be required to:

(i) Validate the transfer and deposit transactions into the dedicated account relating to the DPG funds,

(ii) Verify that no funds are kept in or paid into the dedicated account other than those disbursed by the Bank for this operation,

(iii) Confirm that all payments out of the dedicated account were not made for any excluded expenditures as defined in the Grant Agreement, and

(iv) Ensure that the MoF follows adequate disbursement procedures as per PA standards, including accuracy of the exchange rate prevailing at the date of conversion from the US dollar to the NIS, and deposit to the Central Treasury Account used to finance budget expenditures within one week of the receipt of funds in the dedicated account.

92. **The PA publishes its yearly budget online where it is easily accessible for the public**. Given that the

[30] *https://bopwebsitestorage.blob.core.windows.net/assets/documents/oGU219yx5UvSaeC8t84Ada0SrTLsH4af8sYK8vZM.pdf*

legislative council has not been operational for about 15 years, the budget is adopted by the Cabinet and then approved by the President. According to the law, the budget needs to be passed before end-March of the same year. The 2023 budget is currently under preparation and is expected to go through three readings at the Cabinet before it is enacted by the president by March 31, 2023. It will then be made publicly available.

5.4. MONITORING, EVALUATION AND ACCOUNTABILITY

93. **The design of the M&E approach adopted under this DPG builds upon lessons learned from the earlier operations**. The proposed results framework was discussed and agreed to with the authorities and developed in consultation with other development partners. In line with previous operations, the results framework was designed to account for progress achieved under both the DPG and the implementation of the PURSE MDTF, which is a major source for donor funding to the budget, aligned to the NPA. Since both the DPG and the PURSE MDTF support the implementation of selected key objectives of the PA's strategy and aim to provide stable and predictable financial support to the PA budget, a shared results framework for both has provided additional leverage to reform implementation. The indicators used are direct measures of development objectives, the data is collected by the statistics agency, finance and line ministries, and the monetary authority, and enjoys full ownership of the authorities.

94. **The monitoring arrangements have been institutionalized in the Palestinian Ministry of Finance**. Based on the inputs from line ministries and other agencies, the PA prepares quarterly reports on a regular basis to monitor the performance under both the DPG and the PURSE MDTF. The same arrangement is utilized to monitor progress against the PA's medium-term program. The monitoring arrangements developed in the context of DPGs and PURSE MDTF have not only been used for the purposes of those operations, but there is evidence that these arrangements have contributed to building stronger institutional arrangements for monitoring PA's broader reform efforts.[31]

95. ***Grievance Redress.*** Communities and individuals who believe that they are adversely affected by specific country policies supported as Prior Actions or tranche release conditions under a World Bank Development Policy Financing may submit complaints to the responsible country authorities, appropriate local/national grievance mechanisms, or the Bank's Grievance Redress Service (GRS). The GRS ensures that complaints received are promptly reviewed in order to address pertinent concerns. Project affected communities and individuals may submit their complaint to the Bank's independent Accountability Mechanism (AM). The AM houses the Inspection Panel, which determines whether harm occurred, or could occur, as a result of Bank non-compliance with its policies and procedures, and the Dispute Resolution Service, which provides communities and borrowers with the opportunity to address complaints through dispute resolution. Complaints may be submitted at any time after concerns have been brought directly to the World Bank's attention, and Bank Management has been given an opportunity to respond. For information on how to submit complaints to the World Bank's corporate Grievance Redress Service (GRS), please visit http://www.worldbank.org/GRS. For information on how to submit complaints to the Bank's Accountability Mechanism, please visit https://accountability.worldbank.org.

96. **The absence of a legislative council since 2007 has undermined checks and balances within the institutional and political systems**. An anti-corruption law and the Palestinian Anti-Corruption Commission (PACC) have been in place since 2010 but subsequent surveys of the public raised doubts about the credibility of

[31] Based on the findings of the Implementation Completion and Results Report for the PRDP Trust Fund produced in July 2019.

the commission's efforts to enhance accountability. There are certain challenges in the anti-corruption area, including the lack of access to information legislation, which affects transparency and citizen engagement.

97. **Since 2019, the PA has taken a more proactive approach to investigating and prosecuting corruption.** A strategy was drafted, the National Cross-Sectoral Strategy to Bolster Integrity and Combat Corruption (2020-2022) – which was adopted in December 2019, and which is in the process of being updated. The PACC followed an inclusive approach in drafting the strategy. It held discussions with stakeholders and invited inputs from civil society organizations, which were used to inform the strategy. After adopting the strategy, the PACC has continued to push forward this important agenda and worked with development partners on asset declarations for senior officials in the PA and has drafted a new law to allow for electronic filing of declarations. PACC has adopted a new conflict of interest regulation and prepared a manual and a training plan and will work with development partners to implement it. PACC has also started work on a national observatory for assessing corruption, all of which is part of the strategy

6. SUMMARY OF RISKS AND MITIGATION

98. **The overall risk of this operation is high. Areas of concern include risks related to the political and governance, and macroeconomic aspects.**

99. **The political and governance risks are high, as the situation in the Palestinian territories remains fragile.** In Israel, the coalition government that was sworn in in June 2021 continued to face internal challenges and lost its majority in April 2022. This caused the parliament to vote to dissolve itself and resulted in the country having its fifth election in the span of three years in November 2022. The elections resulted in an Israeli Government that has taken actions and used rhetoric seen as more at odds with the PA and the status quo, leading to high uncertainty regarding the future of the political context. On the Palestinian front, the legislative council has been inactive for more than 15 years undermining checks and balances. The recent months have seen sporadic clashes in the West Bank and the last conflict in Gaza took place in August 2022. Political instability and the long-lasting restrictions on movement, access, and trade continue to be major impediments to development. In the recent months, security incidents have escalated. In case those extend over a period of several months and result in further restrictions by the GoI, including on the movement of workers, this may exacerbate risks. The volatility may affect the PA's ability to implement fiscal reforms and if the situation escalates, the budget may be utilized to address emerging needs, which could derail efforts away from reforms to raise revenues and control the wage bill. In general, heightened political and governance risks may hamper the PA's reform appetite and thus the achievement of the PDO. As part of risk mitigation, political and security developments are monitored routinely by the World Bank Group to remain constantly informed of any situation that may require adjustments to its operation. Despite the challenging context, the PA remains committed to the implementation of structural reforms, many of which are within the PA's control and less affected by external factors. The Bank's financing and technical assistance sends a critical signal to all development donors on the need to continue assistance to the Palestinians. Ongoing dialogue and close engagement by the donor community at the overarching level as well as at the sector level is also key. These measures mitigate the risks to the achievement of the PDO.

100. **The macroeconomic risks are high.** Following good growth in 2021 after the 2020 COVID-19-induced recession, economic activity in 2022 has slowed down. Fiscal demands remain very high as the PA has depleted its financial buffers to finance its deficit in 2021 relying on borrowing from domestic commercial banks. Also, given that donor support has been continuously declining in recent years, the PA may continue the accumulation

of arrears to the pension fund and to the private sector which may result in liquidity shortages in the economy. This may be exacerbated by the PA only paying 80 percent of public salaries, which may start to gradually affect consumption. Slower growth and mounting fiscal stress may distract the PA from reform implementation, especially reforms supported by the DPG that would have a less immediate fiscal impact. This may negatively impact the achievement of the PDO. The proposed DPG sends a strong signal to donors that the World Bank places great importance on progress in implementing the PA's development plan. Moreover, the operation will leverage additional resources through the PURSE MDTF. This will mitigate the risk of reduced donor assistance on the PA's finances. Reforms supporting the financial sector, and hence the business environment, supported by this and other recent operations would encourage additional private investment and eventually lead to better economic outcomes. A simple design of this operation and strong PA ownership of the reform program, are also mitigating factors to the risks of not achieving the PDO.

101. **The fiduciary risk is substantial**. This risk rating has improved with respect to the previous operations, when it was high due to the large backlog of financial statements and slow PFM reforms. The situation has recently changed. The issuance of financial statements is now up to date with the 2020/2021 joint audit published in February 2023. PFM reforms have also recently accelerated, and the PA has been implementing a new PFM strategy (2021-2023), which incorporates the findings of the latest Public Expenditure and Financial Accountability (PEFA) assessment. Procurement reform has also progressed, as the PA has been able to implement important provisions of the procurement law including mandating the use of a single procurement portal and standard bidding documents and establishing a mechanism for administrative review of bidder complaints and more recently the institution of e-GP.

102. **The PFM system continues to be strained by the recourse to arrears as a result of a large financing gap and limited ability to raise financing in an optimal manner, which manifests itself in weak budget execution**. PFM deficiencies in some sectors (e.g., education, health, local governments) impact budget implementation and service delivery. The shortfalls in these areas may all stand in the way of the PA's ability to achieve results supported by the operation and the overall PDO. To help mitigate these risks, the Bank and other donors have been providing technical assistance to the MoF over recent years, aimed at strengthening the accountability of the PFM system. Further, the Bank has continued to support PFM related reforms through several DPGs over the years covering the budget preparation process, higher transparency in fiscal reporting and stronger commitment controls. The Bank has also been providing capacity building and training to help the PA meet international public sector accounting standards (IPSAS) and to accelerate the preparation of financial statements. A World Bank-funded project (Public Financial Management Improvement Project) (P162850) has been providing support with a focus on budget execution, financial accountability, and procurement. A second World Bank project (Public Financial Management Improvement Project Phase 2) (P177742) became effective on June 29, 2022, with a continued focus on budget execution, financial accountability, and procurement as well as a new focus area of anti-corruption. The project is also supporting the modernization of financial control, intergovernmental fiscal transfers, and improvement of payroll management. A PFM project funded by the FCDO continues to focus on budget management, revenue administration, and improving the policy development/planning processes led from the Prime Minister's Office.

Table 5: Summary Risk Ratings

Risk Categories	Rating
1. Political and Governance	High
2. Macroeconomic	High
3. Sector Strategies and Policies	Moderate
4. Technical Design of Project or Program	Moderate
5. Institutional Capacity for Implementation and Sustainability	Moderate
6. Fiduciary	Substantial
7. Environment and Social	Low
8. Stakeholders	Moderate
9. Other	High
Overall	High

.

ANNEX 1: POLICY AND RESULTS MATRIX

Pillar 1: to improve the structural fiscal balance and strengthen the effectiveness of public procurement			
Prior actions	**Results Indicators**		
	Indicator	**Baseline**	**Target**
Prior action #1: To improve revenue mobilization and reduce tax evasion, the Recipient, through its revenue directorate at the Ministry of Finance, will strengthen cross checks on VAT invoices by mandating businesses to use an online portal to submit their monthly VAT invoices for purchases and sales to be reconciled with those submitted by other businesses, as evidenced by instructions by the Director General of revenues issued on October 30, 2022.	Domestic VAT collections as a share of domestic tax revenues	37 percent, December 2022	39 percent, December 2024
Prior action #2: To renew the impetus on wage bill reform, the Recipient, through its cabinet, has: (1) adopted an attrition target for net public employment whereby yearly civil and security personnel appointments do not exceed 50 percent of retirement-related and other kinds of departures from the PA during the same year, as evidenced by Cabinet decision No. (18/181/01) dated November 14, 2022, and (2) requested all government agencies to assess their Human Resources (HR) needs and skills, on a yearly basis and submit a list to the Cabinet	Number of newly hired civil and security personnel on the PA's payroll as a share of total exits in the same year	221 percent, December 2022	50 percent, December 2023

identifying employee surplus and shortages of skills, with the purposes of reallocating and/or training surplus employees, to enhance efficiency, as evidenced by Cabinet decision No. 18/178/19 dated October 10, 2022.			
Prior action #3: To improve the professional quality of procurement staff in the Palestinian Authority, and enhance the effectiveness of public procurement, the Recipient, through its Cabinet, approved the "Procurement Capacity Building and Professionalization Strategy" which recognizes procurement as a distinct profession in civil service, institutes a permanent procurement training program and establishes an independent certification mechanism for procurement staff, as evidenced by cabinet decision No. (18/186/03) dated December 19, 2022.	Share of public procurement staff who completed the procurement certification program.	Zero percent, December 2022	80 percent, December 2024
Pillar 2: to strengthen the integrity of the financial sector and pursue digital transformation			
Prior action #4: To modernize the Anti-Money Laundering and Combating Financing of Terrorism legal framework, and to align it with international best practices, the Recipient, upon recommendation of the Council of Ministers on July 4, 2022 and through its President, enacted a new AML/CFT law No. 39 published in the official gazette No. 193 on August 14, 2022, and AML/CFT instructions for financial institutions licensed to operate in the	PMA conducting on-site inspections of banks' AML/CFT internal controls, to ensure compliance with newly mandated procedures on collecting, verifying, and maintaining beneficial ownership information	Onsite inspections controlling the collection, verification, and maintaining of beneficial ownership information do not exist, October 2022	PMA conducted on-site inspections of licensed banks accounting for 85 percent of total bank assets, controlling the compliance with new procedures on beneficial ownership information, December 2024

Palestinian territories, as evidenced by Instructions No. 2, issued by the National Committee for AML/CFT and published in the official gazette No. 192 of June 30, 2022.			
Prior action #5: The Recipient, through the Palestine Monetary Authority, further advanced the digital transformation agenda in the financial sector and enhanced public confidence in electronic transactions by enacting a national payments law regulating the use of e-money and strengthening the PMA's authority over entities providing e-money services, as evidenced by presidential decree No. 41 dated August 8, 2022, published in the official gazette No. 193 on August 14, 2022.	Number of cashless transactions	Two million transactions, June 2022	Number of cashless transactions increasing by 150 percent, December 2024
Prior Action #6: To support women empowerment through financial inclusion, the Recipient, through the Palestine Monetary Authority, issued circular No. 201/2022 dated September 6, 2022, adopting a single definition for female-owned enterprises applicable to all Microfinance Institutions, and introducing the obligation to disclose the number and size of financing provided to these businesses on a regular basis, in order to strengthen the role of MFIs in supporting women.	The number of women-owned businesses accessing microfinance according to the new definition.	Unmeasured	1500 women-owned businesses, December 2024

ANNEX 2: FUND RELATIONS ANNEX[32]

INTERNATIONAL MONETARY FUND

WEST BANK AND GAZA

REPORT TO THE AD HOC LIAISON COMMITTEE[1]

September 13, 2022

KEY ISSUES

The Palestinian economy is facing formidable challenges. The fiscal situation, high political, security and social tensions, rising inflation, movement and access restrictions and an unfinished structural agenda all weigh on the medium-term outlook. Under unchanged policies, debt is unsustainable and per capita GDP is projected to decline. The situation is particularly dire in Gaza with persistently high unemployment and poverty.

Overcoming these challenges will require transformational reform with efforts required from the Palestinian Authority (PA), Israel, and the donor community. A comprehensive and joint effort would strengthen macroeconomic stability and pave the way for faster economic growth, job creation and poverty alleviation.

This IMF report focuses on fiscal reform policies and banking sector issues. Following our May 2022 Report that laid out the broad contours of a reform scenario, this report discusses fiscal reform options in more depth. It also focuses on correspondent banking relations and the issue of excess cash in Palestinian banks.

Key recommendations

- Improve the quality of spending by implementing ambitious reforms centered on the wage bill and net lending, and raise domestic tax revenue via base broadening.
- Seek understandings with the Government of Israel to resolve fiscal files and reduce impediments to the movement of goods and people and on investment, including in Area C.
- Implement additional reforms to improve the business environment and tackle structural impediments to growth.
- Intensify oversight of banks, continue to push for alternative arrangements to replace current shekel correspondent banking relations, and advance digital payments to reduce excess physical shekel cash.

[1] The IMF provides technical services to the West Bank and Gaza, including policy advice in the macroeconomic, fiscal, and financial areas, as well as technical assistance, with a focus on tax administration, public financial management, public expenditure management, banking supervision and regulation, and statistics. See www.imf.org/wbg for previous AHLC reports and Annex III for a list of TA provided.

[32] The full report can be accessed here: *file:///C:/Users/wb403773/Downloads/1WBGEA2022002.pdf*

ANNEX 3: LETTER OF DEVELOPMENT POLICY

State of Palestine
Prime Minister

دولـــة فلســـطين
رئيس الوزراء

8 February 2023

Mr. David Malpass
President
The World Bank Group
1818 H Street, NW
Washington, DC 20433
USA

Subject: Letter of Development Policy

Dear President Malpass,

This letter of Development Policy lays out the key elements of the Palestinian Government's National Development Plan (NDP) for 2021-2023 and the proposed policy and institutional reform program for this year and beyond.

The Palestinian Government requests the assistance of the World Bank Group in the form of the Development Policy Grant (DPG) instrument for $30 million. The assistance from the World Bank Group is needed to especially support the government's efforts towards improving the structural fiscal balance, strengthening the effectiveness of public procurement and the integrity of the financial sector while pursing digital transformation.

Building on the momentum and the lessons learned from the past DPG operations, the Government of Palestine believes that the instrument is highly useful in facilitating reforms in Palestine on a continuum basis. Therefore, the Government of Palestine requests selective support of the NDP and is committed to implementing the institutional and policy reforms described in the policy and results matrix of the DPG 13 as they are aligned with

State of Palestine
Prime Minister

دولـــة فلســـطين
رئيس الوزراء

the priorities in NDP 2021-2023. *Specifically, the following two pillars are addressed in this DPG: 1) improve the structural fiscal balance and strengthen the effectiveness of public procurement and 2) strengthen the integrity of the financial sector and pursue digital transformation.*

1) **Improve the structural fiscal balance and strengthen the effectiveness of public procurement**

A commitment to an effective and inclusive government is a cornerstone of the NDP 2021-2023, and the Government of Palestine has taken several significant steps to achieve this. This includes strengthening the public procurement system and improving the structural fiscal balance.

By December 2024, our Ministry of Finance is committed to increase the Domestic VAT collections to around 39 percent of domestic tax revenues. This goal is in line with the overall government policy to improve revenue mobilization and reduce tax evasion. To achieve this goal, our MoF will strengthen cross check on VAT invoices by mandating businesses to use an online portal to submit their monthly VAT invoices for purchases and sales to be reconciled with those submitted by other businesses.

In line with the Palestinian Government's reform agenda, focusing on the wage bill reform, the Government decided last November (2022) to adopt an attrition target for net public employment whereby yearly civil and security personnel appointments do not exceed 50 percent of retirement-related and other kinds of departures from the PA during the same

State of Palestine
Prime Minister

دولـــة فلســـطين
رئيس الوزراء

year, until the fiscal stress eases. Additionally, the Council of Ministries requested all government agencies to assess their Human Resources (HR) needs and skills, on a yearly basis and submit a list to the Cabinet identifying employee surplus and shortages of skills, with the purposes of reallocating and/or training surplus employees, to enhance efficiency. Given the importance of wage bill reform, we would like to continue working with the World Bank on this agenda and commit to further wage bill reforms to be supported by future DPG operations.

Also, in order to improve the professional quality of procurement staff in the Palestinian Authority, and enhance the effectiveness of public procurement, last December (2022) the Cabinet, approved the "Procurement Capacity Building and Professionalization Strategy" which recognizes procurement as a distinct profession in civil service, institutes a permanent procurement training program and establishes an independent certification mechanism for procurement staff. By December 2024, 80% of public procurement staff will complete the procurement training program.

2) Strengthen the integrity of the financial sector and pursue digital transformation

In a spirit of collective and global responsibility, and in order modernize the Anti-Money Laundering and Combating Financing of Terrorism legal framework and align it with international best practices, the PMA through the Financial Follow Up unit, enacted a new AML/CFT law No. 39 published in the official gazette No. 193 on August 14, 2022, and AML/CFT instructions for financial institutions licensed to operate in Palestine. By December 2024 the PMA will conduct on-site inspections of licensed banks accounting for

State of Palestine
Prime Minister

دولـــة فلســـطين
رئيس الوزراء

85 percent of total bank assets, controlling the compliance with new procedures on beneficial ownership transparency.

Additionally, the PMA will further advance the digital transformation agenda in the financial sector and enhanced public confidence in electronic transactions by enacting a national payments law regulating the use of e-money and strengthening the PMA's authority over entities providing e-money services. By December 2024 the PMA aims to increase the Cashless the transactions by 150 percent.

In order to support women empowerment through financial inclusion, the PMA issued circular No. 201/2022 dated September 6, 2022, adopting a single definition for female-owned enterprises applicable to all Microfinance Institutions, and introducing the obligation to disclose the number and size of financing provided to these businesses on a regular basis, in order to strengthen the role of MFIs in supporting women. By December, 2024 we aim to increase the number of women –owned businesses accessing microfinance according to the new definition to 1500.

Finally, the Government of Palestine would like to thank the International Bank for Reconstruction and Development for providing extensive support through the DPG instrument. Previously, the Government of Palestine has benefited from the use of the DPG instrument on 12 occasions with the most recent operation being approved by the Board of Directors of the World Bank in June 2022. All these operations helped to deepen policy and institutional reforms in the country and have been crucial in mobilizing additional donor support. Furthermore, a successful implementation of the proposed DPG sends an

State of Palestine
Prime Minister

دولـــة فلســـطين
رئيس الوزراء

important signal to the international donors to resume their funding to Palestine, especially now that US has resumed its official assistance.

The Government of Palestine is highly committed to our reform progress supported by the proposed DPG operation and determined to move forward with our comprehensive structural reform agenda to continue building strong public institutions and strengthen our fiscal position.

We wish to express here our sincerest appreciation for the generous support and the assistance extended by the World Bank Group to Palestine's socio-economic development. Similarly, we are fully committed to maintaining our cooperation, thus seeking to achieve the objectives prescribed in our reform plans. We look forward to the continued support and fruitful collaboration in the years to come.

Please accept, Your Excellency, the renewed assurances of my high consideration and cordial thanks to you and your team for your continued support to Palestine and the Palestinian people.

Sincerely,

Dr. Mohammed Shtayyeh

Prime Minister

Government of Palestine

ANNEX 4: ENVIRONMENT AND POVERTY/SOCIAL ANALYSIS TABLE

Prior Actions	Significant positive or negative environment effects	Significant poverty, social or distributional effects positive or negative
Operation Pillar 1: to improve the structural fiscal balance and strengthen the effectiveness of public procurement		
Prior action #1	No environment effect	Positive poverty, social and distributional effect
Prior action #2	No environment effect	Positive poverty, social and distributional effect
Prior action #3	No environment effect	Positive poverty, social and distributional effect
Operation Pillar 2: to strengthen the integrity of the financial sector and pursue digital transformation		
Prior action #4	No environment effect	Neutral poverty, social and distributional effect
Prior action #5	Positive environment effect	Positive poverty, social and distributional effect
Prior action #6	No environment effect	Positive poverty, social and distributional effect