



Program Information Document (PID)

Appraisal Stage | Date Prepared/Updated: 06-Feb-2023 | Report No: PIDA35485



BASIC INFORMATION

A. Basic Project Data

Country	Project ID	Project Name	Parent Project ID (if any)
West Bank and Gaza	P179609	Development Policy Grant 13 (P179609)	
Region	Estimated Board Date	Practice Area (Lead)	Financing Instrument
MIDDLE EAST AND NORTH AFRICA	23-Mar-2023	Macroeconomics, Trade and Investment	Development Policy Financing
Borrower(s)	Implementing Agency		
Palestine Liberation Organization (for benefit of the Palestinian Authority)	Ministry of Finance		

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.

Financing (in US\$, Millions)

SUMMARY

Total Financing	30.00
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DETAILS

Total Non-World Bank Group Financing	30.00
Trust Funds	30.00

Decision

The review did authorize the team to appraise and negotiate

B. Introduction and Context

Country Context

1. The World Bank has worked closely with the Palestinian Authority (PA) since 2008 through twelve Development Policy Grants (DPG) to support the reform efforts in critical areas. The proposed DPG 13, in the amount of US\$30 million, builds on efforts supported by previous operations and provides timely financing to PA to deal with the current fiscal stress. The operation also maintains a medium-term focus on strategic priorities envisaged in the National Development Plan (NDP) 2021-2023. The DPG includes two pillars, namely (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. The DPG is taking place at a challenging time for the PA as it deals with a very tough fiscal position that has forced it to accumulate large arrears to the private sector and pay partial salaries to its employees since November 2021. The US\$30 million grant will provide some much-needed financing to help the PA address the fiscal needs, especially amid the recently announced increased deductions from clearance revenues¹ by the Government of Israel (GoI). The DPG will also directly leverage other donor financing through the Palestinian Umbrella for Resilience Support to the Economy (PURSE) Multi-Donor Trust Fund (MDTF), including from the European Union (EU) Support for the Palestinian Economy and Resilience (ESPERE) Associated Trust Fund (ATF). The PURSE MDTF and ESPERE ATF are administered by the Bank and disburse funds based on satisfactory progress in reforms covered by the DPG matrix. Despite being a standalone operation, the proposed DPG builds upon reforms supported by previous operations, with both pillars serving the governance and transparency agenda, to maintain a long-term perspective and reform continuity.

2. The Palestinian territories have faced long lasting political instability and periodic episodes of violence over the last two decades, exacerbating macroeconomic volatility. Inflows of transfers, primarily donor financing, have significantly declined in recent years, making it more pressing to unlock growth by alleviating the constraints on the business environment. The trade and movement restrictions have created a high risk of disruption in investment projects and trade and have kept investment levels low, resulting in a bias towards non-traded services which have less potential for productivity growth. Even though the economy continued to rebound from the COVID-19 shock in 2022, growth slowed down compared to 2021 and the economy is yet to rebound to pre-pandemic levels.

3. 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 27.3 percent in 2021. This represents a poor population of about 1.5 million people.

Relationship to CPF

4. 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. Prior action four, which is focused on updating the Anti Money Laundering and Combating Financing of Terrorism (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 two, prior action five which is supporting the payments law and the use of e-money and prior action six, 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".

C. Proposed Development Objective(s)

5. 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.

¹ Revenues collected by Israel on behalf of and transferred to the Palestinian Authority.



Key Results

6. The main results expected from this operation include: 1) the share of domestic Value Added Tax (VAT) collections to domestic tax revenues reaching 39 percent by December 2024, 2) number of newly hired civil and security personnel on the PA's payroll as a share of total exits does not exceed 50 percent in 2023, 3) 80 percent of procurement staff completed the procurement training program by December 2024, 4) the Palestine Monetary Authority 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 by December 2024, 5) an increase in the number of cashless transactions by 150 percent by December 2024 and 6) the number of women-owned businesses accessing microfinance according to the new definition supported by the DPG reaching 1500, by December 2024.

D. Project Description

7. The first pillar of the operation supports efforts to enhance domestic revenues through mandating the use of an online portal that crosschecks VAT submissions by businesses and introduces a 50 percent attrition target on net employment, in 2023, to maintain spending on the wage bill. Pillar one also aims to remedy the lack of certification of the public procurement workforce in the PA by introducing a permanent procurement training program and an independent certification mechanism to strengthen the effectiveness of the public procurement function and, hence, accountability.

8. Pillar two focuses on the financial sector and supports efforts to upgrade the AML/CFT legal framework in the Palestinian territories through the enactment of a modern AML/CFT law, aligned with international best practice. Pillar two 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. This pillar also supports the development of the data infrastructure needed to advance financial inclusion of women through targeted gender outreach and evidence-based programming. 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, and a more gender-inclusive, evidence-based approach, supported by this DPG, is needed to strengthen financial institutions' commitment to female entrepreneurship.

E. Implementation

Institutional and Implementation Arrangements

9. The design of the M&E approach adopted under this DPG builds upon practice from 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 another source for donor funding to the budget, aligned to the National Policy Agenda. 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's budget, complementarities in the results frameworks for both has provided additional leverage to reform implementation. The indicators used are direct measures of development objectives, based on data collected by the statistics agency, finance and line ministries, and the monetary authority, and enjoys full ownership of the authorities.

10. 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 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 the 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 the PA's broader reform efforts.

F. Poverty and Social Impacts, and Environmental, Forests, and Other Natural Resource Aspects

Poverty and Social Impacts

11. The overall poverty and social impact of the prior actions supported by this operation is expected to be largely positive or neutral. 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 could enable it to increase financing for social assistance programs that have a positive impact on poverty. The civil service law in the Palestinian territories only allows for the termination of staff in very specific cases, mostly related to performance.² Hence, prior action two focused on the reallocation of public staff, is not expected to result in employees losing their jobs. The reallocation reform is also expected to be applied uniformly across the board, without potential higher negative implications for female staff. Under the same pillar, improved procurement increases value for money, which disproportionately benefits the poor, since lower quintiles rely more on public spending. 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 have a positive poverty and social impact as digital technologies are 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. Prior action 6 which supports financial inclusion for women is expected to have a positive poverty and social impact. 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.

Environmental, Forests, and Other Natural Resource Aspects

12. Reforms supported by this operation are unlikely to have a significant negative environmental impact. The prior actions supported under pillar one aim to strengthen the fiscal position and enhance the effectiveness of public procurement and are not expected to have any negative environmental impacts. The prior actions covered by pillar two supporting the integrity of the financial sector and supporting financial inclusion for women are also not expected to have any negative environmental impact. The prior action supporting digital transformation and the use of e-money makes it possible to transfer funds without the need for brick-and-mortar bank branches, thereby contributing to lower carbon emissions which could have a positive environmental impact.

G. Risks and Mitigation

13. The overall risk of this operation is high. The political and security risks are heightened. 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 a right-wing government, creating high uncertainty regarding the future of the political context. On the Palestinian front, the president issued a decree in January 2021 setting the timeline for legislative and presidential elections but those were eventually cancelled, keeping the legislative council inactive for more than 15 years and undermining checks and balances. 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

² 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.



workers, this may exacerbate the risks. Political instability and the long-lasting restrictions on movement, access, and trade continue to be major impediments to development. This volatile situation 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 alert to any situation that may require adjustments to its operations. Despite the challenging context, the PA remains committed to the implementation of structural reforms which are within the PA's control and less affected by external factors. The Bank's continued provision of investment financing and technical assistance sends a clear signal to all development partners on the need to maintain assistance to Palestinians. These measures mitigate the risks to the achievement of the PDO.

14. The macroeconomic risks are high. Despite good growth in 2021 following a recession in 2020, economic activity in 2022 has slowed down as the low base effect has waned and as sources of growth remain limited. Fiscal demands remain very high as the PA has depleted its financial buffers to finance its deficit relying on borrowing from domestic commercial banks and the accumulation of arrears. Also, given that donor support has mainly been on a declining trajectory in recent years, this could result in larger than expected financing gaps and a large drop in public consumption. Given the lack of options for alternative financing, 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. Slower growth and mounting fiscal stress may distract the PA from reform implementation, especially actions supported by the DPG, which 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, which the Bank administers. 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 Bank operations would encourage additional private investment and eventually lead to better economic outcomes. The balanced design of this operation and the strong PA ownership of the reform program supported by this DPG, which contributes to fiscal consolidation and reduced reliance on donor assistance over the medium term, are also mitigating factors for the risks to achievement of the PDO.

15. The fiduciary risk is substantial. It has improved compared to the previously high rating as the large backlog of financial statements is slowly being cleared with the issuance of financial statements and the pace of Public Financial Management (PFM) reforms has accelerated. That said, there is ample room for improvement in the PFM system particularly in areas such as budget execution and the recourse to arrears. 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, aiming at strengthening the accountability of the PFM system.

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APPROVAL

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Approved By

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