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WEST BANK AND GAZA

LOCAL GOVERNANCE AND SERVICES IMPROVEMENT PROGRAM (P148896)

PROGRAM FOR RESULTS

TECHNICAL ASSESSMENT

APRIL 2015

1. As part of the LGSIP Program preparation, the Bank team conducted a Technical Assessment comprising of a (i) Village Council capacity assessment; (ii) joint service provision assessment; (iii) expenditure assessment; and (iv) MoLG capacity assessment. The Technical Assessment also reviewed the PA's strategic framework and development objectives in the Local Government Sector, and was informed by an analysis of the Inter-Governmental Fiscal Relations (IGFR) conducted by the team as part of the programmatic Public Expenditure Review 2014. Findings of the technical assessment have informed program design and are summarized in the following. The full draft assessment reports are included in this Technical Assessment as Appendices 1-4.

1. Strategic framework for LG Sector development

2. The PA strategic framework for the Local Government (LG) Sector in the WBG is found in the following documents:

- PA's National Development Plan 2014-2016 (NDP 2014); and
- MoLG Strategic documents:
  - Joint Services Councils Strategy 2014 to 2016
  - Local Government Cross Sectoral Plan 2014 to 2016
  - The Strategic Framework for the Ministry of Local Government 2015 to 2017.

3. The NDP 2014 is the overall strategic document providing PA's vision for LG development. It identifies LGUs as a critical foundation of the Palestinian society given their functions of local representation and for service delivery. The NDP builds on previous development plans, including the Palestinian Reform and Development Plan 2008-2010, and the NDP 2011-2013. The NDP 2014 includes operational and development expenditures divided into four main sectors, and subsequent subsectors, with total expenditures of around US$12 billion over three years (Table 1).

Table 1. Sectors in the NDP 2014 to 2016 and expenditure frameworks, US$ million

Sectors	Operating	Development	Total
1. Economic Development and Employment	229	287	516
2. Good Governance and Institutional Building	3,905	392	4,297
3. Social Protection and Development	5,995	410	6,405
4. Infrastructure	258	417	675
Total	**10,388**	**1,506**	**11,894**

4. The PA's strategic priorities and development objectives in the local government sector are included under NDP Sector (2) "Good Governance and Institution Building (GGIB)". It aims to support building "[…] effective and efficient sub-national governments that are capable of high quality and proficient public service delivery". Further strategic objectives under this sector include ensuring public participation, decentralized decision making, and public accountability.

The objective to develop more equitable and sustainable service infrastructure for water supply, waste water and solid waste management are included in the NDP Sector (3) "Social Protection and Development". Although the NDP does not make specific reference to LGUs in this context, it is important that LGUs have the legal mandate to provide those critical basic services.

5. The PA's Local Government program is further specified as one of the five sub-sectors under the NDP Sector GGIB. A total budget of respectively US$138 million and US$140 million is allocated for operating and capital expenditures to the Local Government program (see Table 2 below).

Table 2: Sub sectors of the NDP's Good Governance and Institutional Building Sector with sub objectives

Sub-Sector	Budget 2014-2016 million USD		Sub-Sector Objectives
	Operating	Development	
Administrative Development and Public Financial Management	270	67	More effective, efficient and transparent management and allocation of public finances
Local Government	138	140	LGUs throughout governorates are more capable of a better public service delivery
Security	3,151	93	More effective delivery of and equitable access to public services
Justice	127	84.5	Enhanced ability to provide security and access to justice
International Relations	218	7.5	More effective Palestinian presence in Arab and international forums as well as within Palestinian communities in the Diaspora
Total GGIB	**3,905**	**392**	

Source: NDP, 2014-16, p 50.

6. The NDP lacks details on how these figures are allocated further although yearly figures are provided. For the local government sector the yearly figures follow below.

Table 3: Budget for operations (Ope) and developing (Dev) in the NDP for subsector Local Government. USD mill.

	2014		2015		2016		2014-2016	
Operation/Development	Ope	Dev	Ope	Dev	Ope	Dev	Ope	Dev
Local Government sub-sector	44.8	42.0	46.1	43.0	47.5	55.0	138.4	140.0

7. A critical issue is the PA's approach to service delivery. In particular, LGU's role for service delivery hasn't been defined specifically in the NDP. However, some elements of a service delivery strategy can be found in other strategy documents relating to local governments developed by MoLG, in particular the recent Strategic Framework for MoLG 2015-2017, which includes five strategic directions:

(i) Establishment of infrastructure and institutional structures able to provide services and strengthen the citizens' resilience in Area "C".

(ii) Developing local authorities' financial, administrative, and planning capacity in order to be able to fulfill their duties and obligations within the overall orientation towards increasing decentralization.

(iii) Continuous improvement of the ministry's technical, human, and legal structure to be able to respond to new challenges in, and lead, the local governance sector.

(iv) Establishment of an effective and flexible legal environment that enables enhancing partnerships in the provision of services and investments between local authorities and the private sector.

(v) Building the financial and administrative capacity of local authorities to be able to contribute in reconstructing and providing basic services in Gaza.

2. Strategic relevance and alignment of the proposed Program

8. The PforR program has been designed within this context as a part of the PA Strategic Framework to cater for a program for the development of services in villages, which fits into the MoLGs Strategic Framework 2015-2017. The Program would support service delivery improvements and capacity building in large VCs, and institutional strengthening of MoLGs and JSCs. Joint service provision, through JSCs, has been outlined as a PA priority in the recent Joint Services Councils Strategy.

9. The program follows the PA's approach to consolidation in the LGU sector, applying a mix of strategies, including amalgamation, jointly provided services, clustering for joint planning and service delivery and upgrading of a limited number of VCs to municipal status. All these approaches aim to improve the capacity and financial sustainability of service provision in LGUs, especially VCs.

10. A critical element of the West Bank's LG system is the existence of numerous marginalized communities, which cannot be reached by standard approaches, i.e., individual or joint service delivery. Those include communities located in Area C, surrounded by Area C, or cut-off by the separation barrier. Given the particular challenge of those communities, particular attention will be given to marginalized communities within the PA program, financed from Government own funding and other DPs, but outside of the PforR operation.

11. Since no villages exist in the Gaza Strip, the Program will not target Gaza in this first phase. Gaza is comprised of 25 municipalities which receive support through the MDP, including a recent Additional Financing to respond to the Gaza emergency following the war during July-August 2014.

12. The proposed operation is highly relevant to West Bank and Gaza's local government sector and supports the two sector objectives in the NDP 2014-2016: LGUs throughout governorates are more capable of a better public service delivery and more effective delivery of and equitable access to public services. The Program also complements the weaker areas in the PA strategy with a comprehensive approach to service delivery improvement in villages. The program will support MoLG to further define a coherent sector strategy for improved local service delivery and for enhancing MoLG's ability to support the development and planning of service provision in joint arrangements.

13. The technical soundness of the program is assured by an extensive elaboration of lessons learned from PA's previous programs in the local government sector supported by the WB and DPs. A key lesson is that a consolidated and systematic single approach is needed as hitherto many initiatives have been fragmented and less programmatic, when dealing with the smaller LGUs. In contrast to this support, the larger LGUs, i.e., municipalities, have been integrated gradually and systematically into a joint approach and since 2010, within a single program, MDP, achieving good results.

14. The PA's approach to consolidation of the local government sector had mixed results. Lessons learned confirm that top down approaches to amalgamations and mechanic clustering of LGUs for joint service provision has largely resulted in resistance from LGUs and cemented fragmentation instead of supporting consolidation. Hence, the proposed program would focus on voluntary cooperation with strong incentives to consolidate critical service delivery function while allowing more time for consolidation in political representation and investment prioritization. The proposed approach aims at reaching sustainable results, acknowledging that joint arrangements will be crucial to improve service delivery outcomes and financial sustainability in the long term.

15. The program builds on previous successful experience with community based planning. A Community-Driven Development (CDD) approach has been tested effectively in the recently completed Village and Neighborhood Development Project (VNDP) and other similar initiatives supported by DPs. Experience from these programs demonstrate that increased accountability and incentives for collaboration can create the demand for LGUs' consolidation in an organic, demand-driven manner. The program would replicate this experience at a larger scale by putting strong emphasis on incentives for joint service provision and a clear minimum benchmark for viable local authorities.

16. VNDP also promoted a gender-integrated approach to community planning and prioritization, such as minimum requirements for representation of women in project support groups and a requirement that 70% of the implemented community projects would benefit women and other marginalized groups, such as youth. Also the MDP has built in specific requirements for gender-integration in investment planning and citizen engagement to be drawn from.

17. As VNDP mainly financed small-scale community infrastructure and social services a lesson is that most VCs cannot implement critical investments on an individual basis to improve basic service delivery. Therefore, strong incentives are required for joint service delivery and infrastructure improvements beyond the reach of individual VCs. The proposed Program recognizes the need for strong incentives reflected in Sub-Component II providing significant additional funding through a 'top-up' for joint investments.

18. A critical issue in the Program is the approach to capacity building. Experience demonstrates that capacity building can only be effective if provided in conjunction with investment funding, and vice-versa, to allow learning-by-doing. Therefore, the program would follow Government's procedures and delegate to VCs and JSCs all critical responsibilities for the selection of investments, project preparation, procurement, financial management, and contract management. However, to ensure minimum capacity of LGUs to perform those critical functions, including as independent viable entities in the future, VCs will have to meet a set of eligibility criteria as mandatory conditions considered to be a proxy for minimum capacity.

19. During program preparation several assessments have been implemented to assure that the program has the adequate design to deal with the challenges revealed.

3. Joint Service Provision as key pillar for consolidation and financial sustainability

20. Establishing and developing Joint Service Councils has been crucial to improve service delivery in WBG since the approval of the Local Government Act (1997), and an important element of PA's consolidation effort in recent years to leverage economies of scale and sustain the sector's many VCs. Joint service provision for basic infrastructure and services is therefore at the core of the proposed Program. However, the current institutional framework and governance structure for JSCs' service provision face several limitations. Generally, the management and decision making structures, accountability frameworks, financing arrangements, public participation systems and communication are inadequate or unclear. Furthermore, no comprehensive data was available at MoLG on the number of JSCs, members, services provided and whether those JSCs are active or not.

21. Therefore a Joint Services Provision Assessment was carried out as part of the program preparation to get a full understanding of the framework for JSCs in the WBG. This included establishing an adequate good governance (GG) framework, which all JSCs could be assessed against; development of clear models for bylaws/ legal agreements for JSCs' within the GG framework and suggest appropriate JSCs, which could be supported by the program. The Assessment was completed in March 2015. A brief summary of the assessment and main findings follows below:

22. As the MoLG's existing information was incomplete and partly outdated, the first step of the assessment was to identify all 92 existing JSCs – 82 in the West Bank and 10 in Gaza. Basic membership, services, populations and other administrative data was collected through a questionnaire for all 92 JSCs. A summary is presented below:

Table 4. Number of JSCs in WBG with current status (December 2014)

Location	Active	Temporary	Inactive	Total
West Bank	50	13	19	82
Gaza	5		5	10
Total WBG	55	13	24	92

Note: Temporary JSCs will be merged with other JSCs within SW according to a decision from MoLG.

Table 5. List of active JSCs in WBG per activity (December 2014)				
Location	Solid Waste	Water, Waste Water	Planning and Development	Total
West Bank	14	6	30	50
Gaza	2	1	2	5
Total WBG	16 (11)	7	32 (2)	55 (13)

Note: Temporary JSCs are in parenthesis.

23. Further, a more detailed survey was carried out to assess the current performance of JSCs and to rank the 55 active and 13 temporary JSCs. The assessment was done based on a GG Framework for Joint Service Provision with 19 indicators six thematic areas: i) rule of law, ii) effective and efficient service delivery, iii) transparency, iv) accountability, v) responsiveness and vi) participation.

24. 42 JSCs in the West Bank and 5 JSCs in Gaza responded to the second questionnaire. The assessment confirmed the anticipated challenges, including large performance variations within a scoring range from 18 points to a maximum score of 58 points. The average score in the WB was 34 points and in Gaza 32 points. Of the ranked JSCs in the West Bank, 16 JSCs achieved more than 40 points, i.e.38% and 15 JSCs scored below 30 points = 36%. The best sector scoring for JSCs was found in the water sector, with 41 points on average. Solid Waste Management (SW) and JSCs for "Planning and Development (P/D)" scored on average 32 points. A score of more than 40 was assessed as the minimum for a JSC to be considered eligible for the proposed Program. A list of JSCs that scored more than 40 points and which have qualified for the proposed program is included in the following table:

Table 6: Qualified JSCs for the Program				
No.	**Governorate**	**Type**	**JSC Name**	**Score Ranking 2014**
2	Bethlehem	Planning & Development	Joint Service Council for planning and development, West Rural areas, B1	42
9	Hebron	Planning & Development	Joint Service Council for Development and Planning of Al Karmel Cluster	48
10	Hebron	Solid Waste	Joint Service Council for Solid Waste Management , Hebron Governorate	42

11	Hebron	Solid Waste	High Joint Service Council for Solid Waste Management, Hebron Bethlehem Governorate	48
14	Jenin	Solid Waste	Joint Local Council for Solid Waste of Zahret El Finjan	52
15	Jenin	Water & Waste Water	Joint Service Council for Water and waste water management	46
16	Jenin	Water & Waste Water	West Joint Service Council for Water and waste Water	54
29	Jericho & Jordan Valley	Solid Waste	Joint Local Council for Solid Waste Management- Jericho and Al Agwar (Jordan Valley)	54
42	Nablus	Planning & Development	Joint Service Council for Planning and Development/ North West of Nablus	46
50	Qalqilia	Planning & Development	Middle Joint Service Council for Planning and Development	58
55	Ramallah & El Bireh	Solid Waste	Joint Service Council for Planning and development for Beit Leqya cluster	41
73	Salfeet	Solid Waste	Joint Service Council for Solid Waste Management	52
75	Tubas	Planning & Development	Joint Service Council for Planning and Development of Tubas Area	44
78	Tubas	Water & Waste Water	Joint Service Council for Water and waste water management for Tubas Area	44

25. Following the ranking assessment, eight of the better performing JSCs were selected for a subsequent detailed field assessment. This was done to review the information provided in questionnaires and to obtain more detailed information about the GG structures of the selected JSCs.

26. The assessment concludes that the development of joint service cooperation has come a long way in the WBG and a good understanding exists in JSCs and MoLG about its organisation, management and services provided to citizens. On the other hand, GG structures can be developed further in terms of better and clearer agreements between the members and more cost recovery for sustainability of services. Accountability systems are often weak, caused by the indirect accountability between the end users and the management/ board of the JSC.

27. The assessment confirmed that revised JSC Regulation would be needed and strongly advises to establish clear rules for the functioning of JSCs, including a standard by-law as the foundation for a clear agreement between the members. MoLG is currently reviewing the Basic Regulations for JSCs from 2006 and the assessment provided information to the ongoing review by suggesting a structure of a new standard bylaw for JSCs. It is expected that the revised JSC Regulation will be provided by MoLG in May 2015, including a standard bylaw which members

of JSCs should apply. This is critical for the operation and therefore incorporated as one of the DLIs.

28. The JSC assessment provides the critical information needed to select JSCs meeting program eligibility criteria. The assessment also provides crucial information about the kind of capacity building needed to strengthen JSCs by providing detailed information of all active JSCs, in particular the eight JSCs that were subject to the more detailed field assessment. The assessment also provided MoLG with a highly needed database with information about all JSCs in WBG, which can be used for effective support to active JSCs, for consolidation, and for dissolving those that are not active. Building on this 'baseline' assessment, MoLG will carry out on a bi-annual basis, a JSCs assessment to determine the JSCs eligible for funding and support under the program.

4. VC capacity assessment

29. The West Bank has a scattered structure with many small VCs of which most lack capacity and basic staff. Experience from previous programs in WBG and in other countries with similar structures show that LGUs without basic core staff, e.g., technician/planner/engineer, accountant and an administrator/director will not be able to sustain services. Global experience demonstrates that a certain minimum population size of 3,000-5,000 is crucial for having the necessary foundation for service delivery and a local revenue base.

30. To prepare the program, key information on VCs was therefore required to (i) define the program VC target group; and (ii) set program's investment grant eligibility criteria, including basic data on the total number of VCs, population size, poverty level, access and quality of services, population living in Area C, and share of marginalized communities; but also information on the institutional capacity, staffing levels, and financial capacity, including existing DP support. To collect the basic information, the MoLG conducted an in-house data collection exercise through its directorate offices. The World Bank, jointly with KfW provided the MoLG with technical assistance to support carrying out a VCs Assessment for: (i) compiling, reviewing and analyzing existing data; and (ii) identifying critical data gaps that would need to be addressed further during program preparation. The exercise confirmed that over 85 % of VCs have a population size below 4,000 inhabitants, and that 76% of the VCs fulfilled one of the VCs' requirements by the MoLG, namely submission of its budget to the MoLG. Only 39% of the VCs, however, recorded lower or equal amounts of arrears from the previous year. No reliable data was available in terms of availability of access to core staff (accountant/engineer/administrator). Other critical information such as the existence of a simplified development and investment plan was not available either.

31. The exercise enabled identifying two separate groups of VCs to be considered for the program's sub-component I: Large VCs (population above 4,000) that meet the other eligibility criteria would receive a grant allocation transferred directly from the MoLG to their accounts for execution by the individual VC. Small eligible VCs (population below 4,000) would be allocated grants but the funds would not be transferred directly from the MoLG to the VC and the individual projects in small VCs would need to be executed through a qualified JSC. Both groups of VCs will be assessed for their eligibility to respective grant allocation based on the eligibility criteria described in Annex 1. Based on the results of the VCs Assessment, the baseline eligibility assessment will be done by the MoLG as a part of program preparation.

32. The technical assessment also relied on the IGFR policy note to design the fiscal arrangement in the program and the transfer mechanism to VCs and JSCs. The study reviewed the existing inter-governmental fiscal arrangements between the PA and LGUs to identify the main issues and provides recommendations for the PA to adopt policies and practices to improve the financial health of LGUs. The initial findings from this exercise indicated that a vast majority of VCs can barely provide solid waste management service – only one of the 27 expenditure assignments for LGUs – due to the shortage of own-source revenues as well as central transfers. VCs rely largely on local fees and user charges, due to severely limited tax revenue assignments (personal tax and ceiling tax only). VCs' per capita own-source revenues was only half of those for municipalities in 2010 and 2011. VCs also do not have any predictable grants and transfers available from the PA to supplement such grave shortage of own-source revenues. Only two types of transfers are currently implemented from the PA to VCs: namely (i) sharing of the transportation fee (which is however intercepted by the MoF to account for arrears); and (ii) emergency allocations. However, these transfers are neither predictable nor significant enough to finance VCs' service delivery functions. The study also highlighted VCs' low budget planning and execution capability through revealing the large disparity between planned and executed budgets.

5. MoLG Capacity Assessment

33. The technical assessment also included a review of MoLG's capacity. The assessment had the objective to assess MoLG's capacity to perform its mandated tasks, in particular supporting VCs to deliver local services. Findings of the assessment would guide developing capacity building and technical assistance activities under the proposed LGSIP to support the MoLG in carrying out its regular sector oversight and supervision function. The assessment was carried out to ensure that the MoLG has the capacity to provide overall support and guidance to LGUs targeted under the program to help them provide sustainable services to citizens, based on a predictable financing mechanism and in line with GG principles

34. MoLG's mandate has been confirmed in its Mission Statement, which aims at "working on building the capacities of LGUs and enhancing their resources to enable them to achieve the welfare of their citizens/constituencies within the framework of good local governance".[1] Overall, the assessment reviewed the degree to which MoLG is implementing its mandate, but focused particularly on those directorates and units that are expected to play a critical role under the proposed LGSIP.

35. For the proposed LGSIP, the following functions of MoLG are particularly critical:

(i) Perform a sound and transparent selection[2] of VCs and JSCs that would qualify for the annual investment grant cycle, and submitting the selection to the LGSIP Program Committee for approval through the Program Manager (MDLF).[3]

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[1] Ministry of Local Government Public Relations and Media Unit, 2013.

[2] According to the VC Annual Eligibility Assessments to be carried out on an annual basis, and the JSCs eligibility assessment to be carried out in 2016 and in 2018 following the one already carried out in 2014 - 2015 during Program preparation.

[3] Based on the assessment of the MoLG the MDLF confirms the final financial allocations to eligible LGUs and submits the lists for the endorsement of the LGSIP Program Committee.

(ii) Following the Program Committee's approval, announcing to eligible VCs and JSCs the selection, eligibility criteria, financial allocations, and initial capacity building activities;

(iii) Oversight; in terms of receiving and approving Annual Budgets from VCs and JSCs, in accordance with the Annual Budget Cycle, starting on November 1 every calendar year;

(iv) MoLG screening of minimum participatory annual capital investment planning requirements for VCs, and provision of capacity building to VCs in participatory annual capital investment planning;

(v) MoLG support to the VCs that are eligible for implementing individual investments under Sub-Component I in all aspects of investment program cycle, including the review and approval of bidding documents, review of Operations and Maintenance (O&M) plans, providing periodic sight supervision, reviewing site reports, reviewing and approving contractors invoices (for the case of small VCs executing via JSCs), while making sure investment planning, execution, and operation are carried out in accordance with technical requirements/ specifications (including procurement and financial management), in accordance with Annual Capital Investment Plans, and in accordance with sound environmental and social considerations.

(vi) Identification of indicative capacity building needs for VCs and JSCs not yet eligible under the Program, and execution of capacity building activities to support VCs and JSCs to meet minimum eligibility criteria for investment funding under the LGSIP;

(vii) Supporting physical planning activities in VCs, as needed;

(viii) Supporting the improvement of VCs service delivery financial and technical capacity, through (i) the development and implementation of strategies, legal reform, and guidelines, including, but not limited to, a transparent system for the allocation of transportation tax to VCs, guidelines for developing VCs own source revenue, review of VCs' and JSCs' revenues and expenditure assignments to establish a sustainable intergovernmental fiscal framework, guidelines for service tariff structures, the application of GG Framework for joint service provision, and developing a revised policy directive for the consolidation of small, non-viable LGUs; and (ii) consequently, providing needed training to VCs and JSCs by the different MoLG departments.

36. Overall, the assessment confirmed that MoLG has sufficient technical capacity and the PA's formal mandate[4] to provide guidance to and support VCs meeting LGSIP results. MoLG's strength include its capacity to branch out with 201 MoLG staff in 11 West Bank Governorate Directorates, equivalent to about 56% of total MoLG staff with an average of 18 staff per directorate.[5] The capacity assessment confirmed that, in principle, MoLG does not need to hire additional civil servants to support Program implementation, but may need to relocate staff from MoLG headquarters in Ramallah to selected directorates offices to optimize use of the more than 130 MoLG planners and civil engineers. The MoLG may also need to acquire the services of short-term and long-term consultants to support LGSIP oversight activities and policy formulation to

[4] Basic Law of the Palestinian Authority and Local Authorities Law No. 1 of 1997
[5] MoLG Human Resource Development Strategy, 2014.

avoid any gaps. Capacity building and training would also be required, focusing on areas with limited MoLG capacity, e.g., in management of consultancy and training contracts under Sub-Component III. The assessment also noted sub-optimal coordination and knowledge sharing between MoLG Directorates. There is a need to ensure sufficient level of technical coordination between the number of MoLG Directorate and involved technical units to ensure LGSIP results are met.

37. The capacity assessment noted clear shortcomings that would require provision of technical assistance to the MoLG as part of the program, including some that could be provided under Sub-Component III. For instance, field visits to sampled directorates confirmed that key central-level GDs are mirrored in terms of staff and functions. This, in theory, would help decentralize and streamline the MoLG oversight and facilitate interaction with LGUs. In practice, however, the assessment confirmed redundancy in the application of oversight mandated practices at the MoLG directorate and central level. Redundancies should be reduced under the proposed Program MoLG. Specific guidance to relevant MoLG staff would be detailed in the Program Operations Manual.

38. Findings of the assessment also confirmed that those MoLG General Directorates which traditionally received systematic and focused donor funded technical assistance and capacity building are more advanced in terms of preparing their own strategies, as well as technical knowhow and staffing capacities compared to other MoLG departments. Therefore, the Program pre-appraisal launched an exercise, to be confirmed by appraisal, to map out on-going and future capacity building and technical assistance provided to the MoLG with the MoLG Human Resource Development Strategy and Departmental Training Plan for the years 2014 – 2017. Based on this exercise, it has been agreed that the MoLG would prepare a consolidated capacity building plan for the first year of LGSIP implementation, focusing on MoLG's mandated program oversight tasks, including specifying the sources of funding under the Government Program, and funding gaps which need to be covered under LGSIP. As such, the first annual capacity building plan, and hereto each successive annually updated capacity building plan, would optimally attempt to cover on a gradual, prioritized manner, a range of strategies, guidelines, and training (for MoLG and for LGUs) in support of the MoLG's Strategic Framework for MoLG 2015 to 2017.

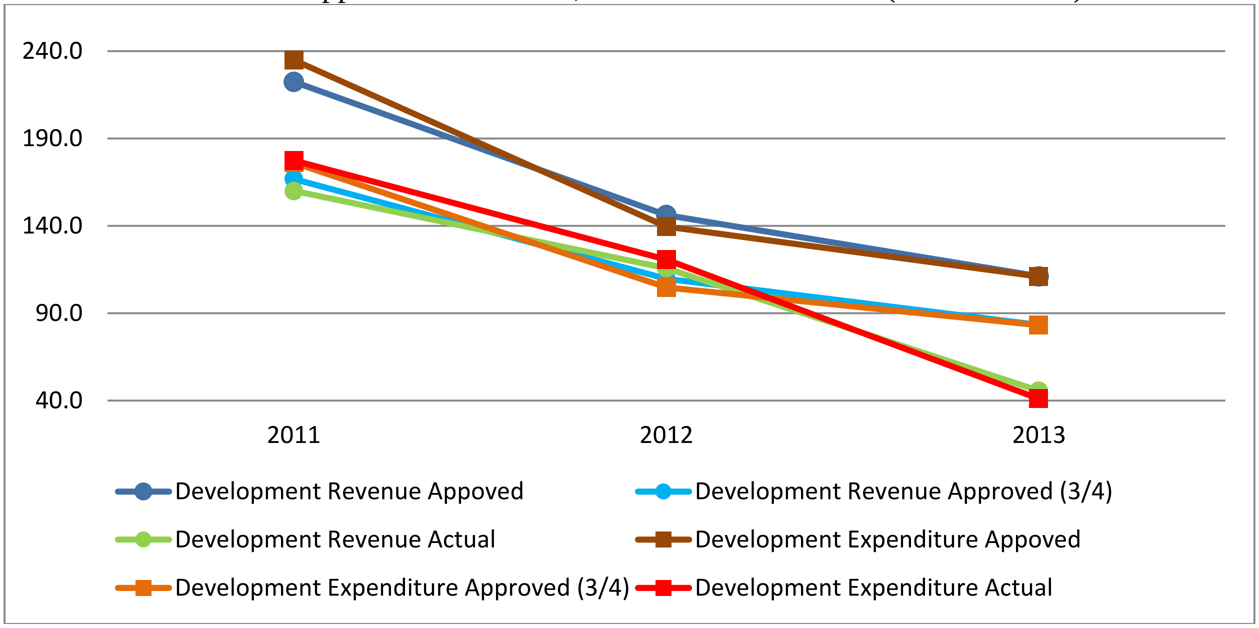
39. The assessment also confirmed that capacity building would be required for higher level oversight institutions to enable them to carry out the independent verification of results met by the MoLG and the MDLF, such as the State Audit Bureau, because the MoLG's GD of Guidance and Monitoring, traditionally tasked with carrying out independent technical, financial and administrative audit on MoLG and LGUs affairs, is not eligible to carry out independent verification tasks under the proposed LGSIP, due to conflict of interest, since it is a GD within the MoLG. The State Audit would also benefit from capacity building support to carry out "value for money" audits in VCs and JSCs.

6. Expenditure Framework Assessment

40. Review of the existing system of financing infrastructure service delivery in village councils: Capital expenditure requirements of Village Councils are financed mainly through Budget allocations from the Central Government as well as through shared taxes. The recurring expenditures are financed through a combination of subsidies from the Central Government as well as through own revenues, mostly from user fees for revenue generating services. Analysis of

the budgets of the previous years (see figure below) shows that budget allocations for development and operating expenditures by VC has been declining and is fluctuating over the years, indicating that there is a significant paucity of resources available to VCs for infrastructure development, operation and maintenance. The ability to finance large operational expenditures has not improved much in recent years. Operational average expenditures per capita (in NIS) for VCs barely moved from 2011 to 2012 –with around 54 NIS and increased some to 64.6 NIS in 2013 Compared to this, operational average expenditures per capita for municipalities steadily decreased from 195 NIS in 2010 to 166 NIS in 2012. Similarly analysis of development budget expenditures show that capital expenditures per capita has also reduced over the years and currently stand at approximately 41 NHS. Enterprise budget expenditures per capita have remained fairly stable for the past three years.

Figure: Village Councils Development Budget per capita averages: Approved 2011-2013; Three-fourths of Approved 2011-2013; and Actual 2011-2013 (first 9 months) in NIS



41. Analysis of VC budgets have shown that VCs quite consistently show on average deficits in the operating and development budgets. This leads to the conclusion that the operating tax and non-tax revenues of LGUs are insufficient to cover the capital and necessary operating costs. Also analysis of the enterprise budgets have shown that the source of the surpluses in the enterprise budget fund is quite fictitious given that many LGUs in charge of electricity and water distribution do not fully pay their providers and have been incurring in large accumulated payment arrears.

42. Resourcing of VC budgets: Analysis of the relative shares of the different types of revenues in the VC budget have shown that the largest share –between 35 and 45 percent – is for "revenues from the PA" which includes revenue sharing and transfers: the transportation fees, government donations as grants in aid, and contingency budget allocations. The second relatively larger—up to 30 percent depending on the year-- is "services revenues" from user charges such as garbage collection fees—by far the most important item here--, parking lot fees, car inspection fees, etc. The third category is "revenues by the Village Council" which includes the taxes collected by the Village Council (the personal tax, the ceiling tax and the education tax) and other fees collected by the Village Council (such as agriculture products and cattle inspection fees, building license fees, and signboard fees). Surprisingly the VCs also report loans (from the PA and other institutions) as operating revenues; supposedly these are short-term cash bridging loans but they are wrongly reported as revenues since they will have to be repaid. Last, the not insignificant "miscellaneous revenues" category varies considerably across VCs and covers any kind of revenues that do not fit in the previous categories, such as interest from bank deposits or the sale of property. The analyses of the operating and development revenues and expenditures show that there is a clear gap. However, at present there are no regular grants or transfers available from the PA to supplement the shortage of LGUs' own-source revenues. Transfers from the central level to LGUs include (i) the transportation fee; (ii) property tax; (iii) professional license fee; (iv) emergency allocations; and (v) capital transfers through the Municipal Development and Lending

Fund (MDLF). However, only the transportation fee and emergency allocations are available to VC, whereas municipalities also benefit from the other sources.

Table 7: Revenue shares: by type of budgets and its share in overall revenue, Approved and Actual 2011-2013 for Palestine Village Councils

	Village Councils					
	Actual 2011	Actual 2012	Actual 2013	Approved 2011	Approved 2012	Approved 2013
Operating Budget Revenue	16.6%	24.1%	21.4%	15.9%	20.5%	22.6%
Enterprise Fund Revenue	60.0%	62.5%	71.0%	63.0%	62.6%	63.3%
Development Budget Revenue	23.4%	13.4%	7.7%	21.1%	16.9%	14.1%

43. The transfer for the transportation fee resembles a form of revenue sharing with a distribution formula to allocate the revenues, which are unconditional in their use. So in that sense this type of funding can be regarded as a means to reduce vertical imbalances. This formula is changed yearly by the MoLG. Of the many factors entering the formula, population, has typically been the most important one, with 55 to 75 percent distributed according to it. The specific criteria and decision making process to arrive at the formula remain quite opaque and the MoLG only releases the formula ex-post after it has been applied. Besides population, other factors that have been used include: Financial and Administrative reform;[6] support of VCs, support of the merging of VCs and joint service councils (JSCs), marginalized areas and Bedouins, support of Jerusalem, etc. This approach leaves LGUs with no means to anticipate and plan accordingly for the revenues they may expect from this transfer. The operation of this transfer gets complicated by the fact that revenues are first collected by the MoT, deposited in the Treasury, with MoF letting MoLG the existing pool of funds for allocations, MoLG deciding on the formula, and finally the MoF typically intercepting the funds to be appropriated to the different LGUs because of the LGUs' arrears for water and electricity.[7] Emergency transfers to LGUs are allocated ad-hoc by the Cabinet of Ministers and no information on the allocation criteria and decision making process are made available on a routine basis.

44. In summary, the current system of transfers in the Palestinian Territories fails to perform in terms of the three objectives typically pursued by transfer systems —vertical balance, horizontal balance and attainment of sectoral objectives. The existing transfers, for the most part, lack predictability and are too small in size to close the existing vertical gaps. They also lack in incorporating explicit objective equalization criteria and the instrument of conditionality is in its infancy.

[6] This item is intended to support LGU's that adopt Financial and Administrative reforms. Examples are LGU's who lay off unproductive employees and need to pay compensation or LGUs that intend to install prepaid meters for electricity.

[7] The property tax interception process only started to get published in quarterly reports at MoF's website in 2013. However, the published reports do not include the intercepted amounts but rather the arrears to be paid to MoF.This information can be obtained at the link:
http://www.pmof.ps/documents/10180/363023/property.tax.Q1.2014.arb.pdf/d541fa4e-e3cb-4219-9a99-05d602ae4409

45. Budget execution systems: This area has seen recent reform efforts including the development of a unified chart of accounts and standard budget guidelines. All VCs are now required to report electronically their annual budgets to the MoLG. Analysis of VC budgets show that there is a consistent variance between planned and actual budgets resulting in a significant financing gap for delivery of local services. The systematic mismatch of planned budget and executed budget tends to nullify the usefulness of budget planning and the prioritization of expenditures. Budget execution on a sequestering basis – depending on cash availability—may negatively affect the efficiency and fairness of actual expenditure allocations. The mismatch problem is more acute with VCs.

46. One last aspect of budgetary performance is the ex-post audit and evaluation. Even though there is some financial audit performed -- the General Control Office (State Audit Office) reviews annually a sample of VCs —there has been little or no performance evaluation of LGUs' budgets to understand to what extent local programs are achieving their intended goals and at what cost. The MoLG has recently issued instructions for all VCs to get themselves audited annually using the services of independent external auditors. This is an excellent step to strengthen local government accountability.

47. Analysis of local government fiscal data and public financial management systems have shown that, while VCs have a rudimentary fiscal and financial management framework in place, there are several gaps and weaknesses that need to be addressed. There is a consistent gap in the resources available to VCs to address their capital and operating expenditure requirements. Even where such funds are available (such as the transportation fee), their allocation and distribution is not transparent nor predictable. The absence of a stable and predictable intergovernmental fiscal transfer system to VCs has resulted in a consistent gap between the planned and actual budgets of VCs, which in turn has affected their capability to address local service delivery and infrastructure development priorities. The recent initiatives by the MoLG to improve the performance and accountability of local government PFM systems by insisting on electronic submission of annual budgets as well as the annual financial audit of LGUs need to be followed up and implemented rigorously. The Program design for the proposed LGSIP has taken into account these issues and the Program design includes several features to address these key issues.

48. The Program Expenditure Framework relies on the country systems and is expected to strengthen the transparency and predictability of financing of VCs along with strengthening accountability and institutional performance of VCs. Recognizing the need for enabling VCs to meet their development requirements in accordance with locally driven priorities, the Program is setting up an intergovernmental fiscal transfer system that will provide resources to VCs on a predictable and transparent manner. As such, the Program will allocate annual capital grants to eligible VCs which will enable them to finance their annual capital investment plans (ACIPs).Consistent with the intention of the PA to strengthen the capacities of large VCs and help them make the transition to become municipalities in the medium term future, the Program will provide capital grants directly to large VCs who will be responsible for the custody, utilization and reporting of the funds.

49. The Annual Capital Grants for VCs will be programmed into the PA budget under the budget head for the MoLG. Within the Budget Head, the budgetary allocations for the three elements of the Program (via capital grant allocations to VCs, allocations for joint projects to the

MDLF and the allocation for capacity building to the MoLG) will be shown under specific budget line items for each. Since the timely allocation and disbursement of the Capital Grants to VCs is critical for the achievement of the Program Results, and previous experience has shown that there are delays in the allocation and disbursement of budget funds, the Program has agreed with the Ministry of Finance (MoF) and the MoLG that the annual Capital grant allocations will be disbursed within a prescribed time period after the approval of the annual budget. In addition, the Program will be incentivizing the timely allocation and disbursement of the annual capital grants through a DLI.

50. Complementing the Program design of setting up of a system of annual capital grants to VCs, the Program will also be supporting the Government to reform the existing system for the allocation and disbursement of the Transportation fee. The Program will support the Government's intention to make the MoLG's inter se allocation of the transportation fee among the VCs to be more transparent and formula based. Considering the potential of the transportation fee to be a stable and predictable source of revenue for VCs, the Program will incentivize the MoLG to move forward quickly on the reform of the transportation fee through a specific DLI.

51. The Program will enable the PA to put in place a stable and predictable channel of financing VCs. The technical assessment undertaken as part of the Program shows that the Program will supplement the existing per capita capital investment allocation of 25 NHS with an additional 25 NHS thereby providing additional resources to the VCs to finance their ACIPs. In addition to the cofinancing brought in by development partners into the Program, the parallel financing provided by development partners such as KfW will also flow to VCs that will supplement the resources available for undertaking infrastructure development and service provision. The reform of the Transportation fee planned to be undertaken as part of the Program, will put in place the foundations for a sustainable source of financing for VCs to undertake their capital and operating investments.

52. The Program will rely on the existing Public Financial Management Systems of the PA for the disbursement, reporting and oversight of the Program funds. The Program funds will be part of the National Budget and will be disbursed following the budgetary allocation and disbursement procedures. The eligibility conditions that VCs are required to comply with for obtaining the capital grants incentivizes VCs to comply with standard good governance practices. The Program will strengthen the MoLG's initiatives for the timely and electronic submission of annual budgets and for the annual external audit of VCs by incorporating them into the Program design and Program Action Plans. The Prior Actions for the Program will put in place the necessary steps for enabling efficient budget execution by VCs through the finalization of the Procurement Instructions by the MoLG.

7. Results framework and monitoring and evaluation (M&E) capacity

53. The MDLF will be responsible for monitoring the achievements of the PDO and result areas as provided in Annex 2. MDLF already uses a Results-Based M&E (RBM) system, which attempts to measure the relevance, effectiveness, efficiency, impact, and sustainability of initiatives implemented by the institution. MDLF has demonstrated its strong M&E capacity through its implementation of MDP and other programs. MDLF will continue to use a web-based Program Management Information System (PGMIS) as well as the Financial Management

Information System (FMIS) to automate data aggregation, storage, and presentation as part of a results-based M&E system. In addition to data collection exercises carried out directly by MDLF for project reports, periodic independent evaluations and assessments will also be outsourced in order to measure achievement of the PDO.

8. Proposed program's economic justification

54. Identification and prioritization of investments funded under the Program for eligible VCs will be made on a demand-driven basis based on participatory planning processes. Therefore, the economic and financial benefits of the investments cannot be measured ex-ante. Once prioritized in Annual Capital Investment Plans, investments will be evaluated based on MDLF guidelines developed for MDP II ("guidelines for the economic and financial analysis of sub-projects"), including smaller investments for public parks, playgrounds, rehabilitation of sanitary units and larger investments within solid waste management equipment (vehicles, containers); water supply (meters, network extension and rehabilitation); and local and inter-village roads (extensions, rehabilitation). The Financial Rate of Return (FRR) will be calculated for revenue generating sub-projects. Cost efficiency (CE) measured by net present value (NPV) per beneficiary will be calculated for the remaining sub-projects.