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Contact Numbers

West Bank Office Numbers:

Switchboard 02-2366500
Fax: 02-2366543

Country Director
A. David Craig
Tel. 02-2366506

Deputy to Country Director
Faris Hadad-Zervos
Tel. 02-2366549

Education
Adriana Jaramillo
02-2366514

Health
Imad Dweik
02-2366501

Legal Reform
Paul Prettitore
02-2366534

Water and Energy
Khairy Al-Jamal
08-2823422

Infrastructure Development
Ibrahim Dajani
Tel. 02-2366553

Financial Management
Siaka Bakayoko
Tel. 02-2366541

External Affairs
Saida Hamad
Tel. 02-2366504

Public Information
Mary Koussa
Tel. 02-2366529

Gaza Office:

Coordinator
Husam Abu Dagga
Tel. 08-2823422/2824746
Fax: 08–2824296

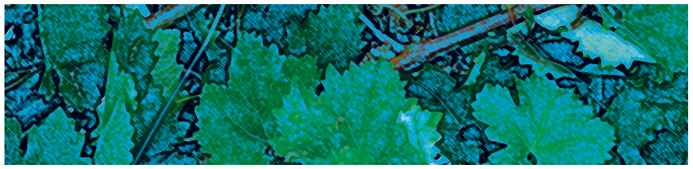
International Finance Corporation

Country Officer
Youssef Habesch
Tel. 02-2366517
Fax: 02-2366521

Free Subscription: mkoussa@worldbank.org
Newsletter at Internet: http://www.worldbank.org/ps

Cover Photo: Dave Mckee

Editorial: Solidarity and Hope



We are now facing a severe economic crisis in Gaza and the West Bank -- one that risks reversing the combined efforts of the past thirteen years towards a sustainable economy. In fact, a recent World Bank study predicts that, if the current situation continues throughout 2006, this may be the worst year in the Palestinian economic history. The average Palestinian's personal income will fall by 40%, and 67% of the population will fall into poverty.

Since 1994 and still today in the midst of the current crisis, the World Bank remains on the ground, working with our partners in the Palestinian and donor community to implement nine ongoing projects worth almost USD 100 million -- bringing our total assistance over the years to 34 projects worth about $500 million. Current projects include grants for Water and Sewage Treatment in Gaza, Solid Waste Management in Jenin, Electricity Sector Investment, Social Safety Nets and Tertiary Education, among others. We regard these projects as vital to improving the living conditions of the population

Our mission remains clear. In a recent international forum, the President of the World Bank reiterated the institution's goal "to continue implementing all […] projects and that it will do so with its Palestinian counterparts." Our main objective, he added, is that "Palestinians would not suffer from a lack of social services, particularly in the health and social sectors."

In addition to our nine active projects, we have been working with our Palestinian counterparts and the UN on an Avian Flu Project. This project will provide grants to help tackle a possible outbreak of Avian Influenza when migrating birds pass through Palestine again in the fall. We will finance urgent equipment and materials to ensure that the Palestinians authorities are ready to contain the outbreak and provide compensation to poultry farmers.

We have also reinstated one of our previous projects that has offered a critical lifeline for the health, education and social service sectors since 2002. Thanks to the support of the European Commission, Austria, UK and Spain and other donors, we are managing an Emergency Services Support Multi-Donor Trust Fund (ESSP) that is now financing urgent supplies and running costs in schools, hospitals, primary health clinics and shelters. These include emergency drugs and vaccines, school supplies, utility bills for schools and hospitals, and operating costs for shelters, among many other expenses.

These projects are just one part of the overall partnership that the World Bank, the donors and the Palestinians have embarked on over the years. The overall goal must remain that of a strong and sustainable economy, where Palestinians are free to exploit their immense talent for private business and trade, with the support of their own public and private institutions. Despite the recent setbacks, a great deal has been achieved since 1994. And the World Bank Group will remain a committed partner as this journey continues.

A. David Craig

The World Bank's Country Economic Memorandum for the West Bank and Gaza

In June 2006, the World Bank issued a Country Economic Memorandum (CEM) on the Palestinian Economy. The CEM consists of a detailed analysis of the status, prospects and challenges of the Palestinian Economy, and presents recommendations to address these issues. The World Bank prepares CEMs for all of its member countries and territories. These documents are used a key tools by World Bank staff, donors and Government Policy makers.

Summary

More than five years after the outbreak of the second Intifada, the West Bank and Gaza (WBG) remains mired in an economic crisis. Israeli military and security measures have imposed major costs on the WBG economy, undercutting its current and future development prospects. The closure regime—i.e. the system of restrictions on the movement of goods and people both within the WBG and through Israel to the rest of the world—along with the construction of the separation barrier have fragmented the Palestinian economy and reduced its potential. Recent decisions by the Government of Israel to suspend the transfer of clearance revenues collected on behalf of the Palestinian Authority (PA), and by donors to cease budget support, have led to a fiscal crisis that may undermine public institutions and send the already fragile economic recovery of 2003-2005 into a tailspin.

The current situation presents the WBG with two challenges; one short term and one medium-to-long term. In the *short run* the key problem is that WBG has few, if any, policy tools to deal with the volatility and low level of economic activity; and the current fiscal crisis can easily bring down the machinery of government, undoing almost all of the post-Oslo institutional gains.

First, the number of Palestinian workers in Israel has declined substantially in response to closures and the reduction in work permits issued by the Israeli authorities. *Second*, while fiscal policy is typically used to tide over "periodic" fluctuations in the economy, this tool has been exhausted- most public spending goes to the expanding public employment and wage bill, and the PA has become the "financier of last resort" to cover unmet obligations of Palestinian utilities and public institutions. As a result, public spending is around 50 percent of GDP. *Third*, while exchange rates provide an effective way to deal with shocks in the economy, this tool is also not available—the WBG is in a currency union with Israel and monetary policy is beyond the PA's authority.

In the *medium term*, the WBG economy faces many challenges. *First*, the labor link with the Israeli economy has not generated sustainable gains due to the absence of movements of 'capital' to the WBG, but has raised domestic wages above a healthy level. As a result, the WBG economy faces high production costs and low productivity, which severely undercuts its competitiveness.

Second, the political insecurity and uncertainties have prevented the WBG economy from tapping into financial resources and investments from neighbouring countries and from Palestinians living abroad. The investment environment is perceived as being too uncertain, too lacking in infrastructure and not sufficiently attractive.

Third, the recent conflict in Gaza and parts of the West Bank does not fare well for the WBG's economic future. In fact, the combination of internal instabilities and funding problems has threatened the PA's capacity to govern. It also threatens to undo any progress so far on institutional reform.

Particularly damaging to Palestinian businesses is Israel's control over their access to Israeli and other external markets. International evidence suggests that economic welfare of small countries goes hand in hand with a country's involvement in the global economy. Palestinian recovery and medium term productivity growth critically depends on establishing stable and reliable foreign trading relations. The closures regime makes it extremely difficult, if not impossible, to achieve this.

The CEM'S Main Findings and Recommendations

Economic growth over the last fifteen years has been dismal, with the high population growth outstripping the real GDP growth during most of this period. Looking forward, economic prospects remain grim, and highly dependent on political outcomes. Unfortunately, there are signs of a reversal of economic gains realized in the second half of the 1990s, eroding the WBG's capacity to generate economic growth even if the Israeli closure regime is loosened.

First, as the economy has become more inward-oriented, its industrial capacities have been depleted. Consumption rather than exports has been the key source of growth of the economy. At the same time, the export of labor has declined with workers' remittances from Israel steadily declining. The export of labor has historically crowded out the export of goods. Together with the considerable donor fund inflows over the years, this delayed Palestinian industrialization by driving up the cost of labor and nontradables.

Second, the economic recovery in 2003-05 revealed some structural weaknesses in the economy. The construction and agriculture sectors, along with public administration, have emerged as key sources of growth in the economy. Although manufacturing has also contributed to recovery, its share of GDP increased modestly and remained below its level in 1995, with competitiveness of the sector deteriorating throughout the decade.

Thirdly, changes in the types of exports and imports reveal a progressive deindustrialization of the Palestinian economy, as both of them have moved to goods at lower levels of the technology ladder. Furthermore, many businesses have lost external markets due to uncertainty of their deliveries and growing transport costs due to the closure regime.

Last but not least, the fiscal crisis has forced the PA to spend on 'pro-social stability' rather than 'pro-growth' areas. This has led to a worsening business climate and reduced investments—placing more obstacles to fiscal adjustment.

Therefore, the key challenges and priorities facing the Palestinian economy include:

- *The need to shift from 'interindustry' to 'intraindustry' trade, requiring a more sophisticated division of labor based on a narrower industrial specialization of Palestinian firms.* Providing specialized inputs into the global economy and its 'supply chains' requires short and predictable delivery schedules which are difficult under the current closure regime. So far, Palestinian firms have focused exclusively on supply chains in Israel—the main destination for their exports. Moving forward, these firms have to establish direct commercial contacts with global retailers. Benefits from a direct relationship can be significant, as global retailers often provide assistance in organizing production and management systems that can improve the productivity and competitiveness of Palestinian firms.
- *The need for foreign and domestic investment in more sophisticated manufacturing.* This relies on the ability to import inputs. However, the need for Palestinian firms to maintain large inventories of imported inputs to ensure smooth production makes it non-competitive. For instance, firms operating in the wood furniture industry now export and import only a few times a year, which leads to high inventories of both inputs and final products.
- *Competing on a level playing field.* Whereas their location within the existing "customs envelope" with Israel might imply that Palestinian firms can compete with their Israeli counterparts in domestic and international markets, the security regime puts Israeli and other firms in a far more advantageous positosition. Moreover, local firms remain small and use outdated technologies, whereas Israeli firms operate in larger markets, have access to modern technology and expertise, and therefore tend to have significant cost and productivity advantages over WBG firms.
- *Expansion of existing firms through tapping economies of scale.* Without easy access to external markets, firms operating in small markets cannot grow, as is the case in WBG economy, where most

firms are small, family-owned businesses.

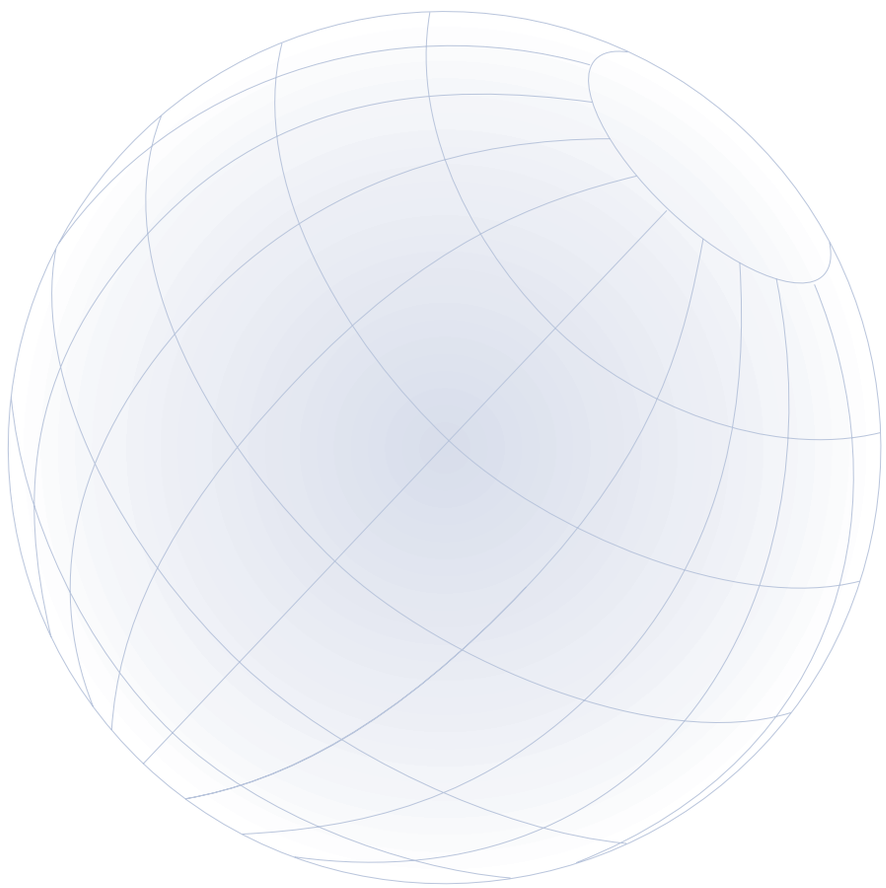
While prospects for growth are few in the absence of a relaxed closure regime, the critical next steps are primarily related to the political situation. Implementation of the November Agreement on Movement and Access is a key first step, combined with a rethinking of the balance between security and trade facilitation of border crossing facilities.

So would be the implementation of the Paris Protocol governing the customs and trade regime with Israel. This is essential for the Palestinian economy, despite some weaknesses in the Israeli structure of tariff protection (e.g., high levels of protection of agriculture driving up their prices).

Other key measures are also inexorably linked to the political situation. The Gaza Strip, for instance, is a landlocked economy politically, but not geographically. Leaving aside the contentious issue of opening its seaport and airport, a key priority may be to enable the Rafah Crossing to be used for exports through Egypt. This would require agreements with the Egyptian government for a transit regime from Rafah to East Port-Said port or Al-Arish.

On its side, the Palestinian Authority must continue its reforms in areas critical to the quality of governance and the business climate. Considering that Palestinian businesses already bear much higher trading costs than their Israeli counterparts and other competitors, every measure should be taken to lower the cost of doing business. The PA should take further steps to enhance its laws and regulations, improve its dispute resolution mechanisms and its judicial system.

Lastly, the PA and donors should shift their focus to the transfer of technology to Palestinian firms—defined broadly to include new ideas, equipment, management practices, marketing strategies, and the like—from other countries. Ultimately, the competitiveness of Palestinian firms relies on their ability to acquire, adapt, and efficiently use new capital equipment and new ideas.



Fighting Avian Influenza: A challenging Threat in West Bank and Gaza

The volatile political and security situation in West Bank and Gaza continue to block conditions for economic revival. Under these conditions, the agricultural sector in large, and poultry production in particular, offer more secure sources of income and nutrition for Palestinians. Many families, especially the poor, depend on poultry as their most main source of protein. Almost 88% of the total animal protein intake for Gazans is derived from poultry. According to the World Food Programme (WFP), the lack of affordable alternative protein sources can have potentially severe nutritional implications, particularly on children. An outbreak of Avian Influenza (AI) in Gaza, with its associated economic, social and environmental risks, is likely to compound an already fragile situation.

A Challenging AI Agenda

From the viewpoint of AI risk management and control among poultry, the West Bank and Gaza need to be dealt with as two distinct areas in terms of geography, logistics and the risk profiles for each.

The West Bank is situated in the zone of major bird migration routes, positioning certain areas at high risk for virus introductions. No outbreaks have been reported so far. Yet, one case was reported by the Israeli authorities in an area located very close to the border, and another one in an Israeli settlement on the West Bank. Within the surveillance zone, the PA may not always have the full authority nor the financial means to operate effectively. As a consequence, full compliance with the World Organization for Animal Health (OIE) rules might not be possible. Some culling has been done, but could not be fully completed. Clinical surveillance on the West Bank was conducted to a considerable extent with small-scale antigen testing carried out using services offered by the Kimron Veterinary Institute in Israel.

In Gaza, the threat of virus introductions from wild birds is also significant. The borders of the area are almost completely inaccessible to any direct contact by people, animals or materials, but poultry farms in Israel are very nearby. Clinical surveillance has been conducted to some extent but no laboratory testing could be carried out.

Despite a willingness to cooperate between the Israeli and Palestinian veterinary authorities, extremely strict safety procedures on the Israeli side render adequate testing and confirmation very difficult for Palestinians to undertake.

The Initial Outbreak: What Next?

Since the first outbreak in Gaza at the end of March 2006, eight cases have been confirmed in chicken holdings and among ducks, with additional unconfirmed clinical cases. Culling was performed on 400,000 farm birds. FAO experts confirmed that administration and culling procedures and disposal of carcasses were completed according to international standards, despite difficulties imposed by the current situation.

Nevertheless, any new outbreak, of a major magnitude in the near future, particularly in Gaza, could lead to a humanitarian disaster. At direct risk will be people involved in backyard farming, followed by children who will suffer the nutritional consequences of the lack of dietary protein.

The authorities in Gaza have recently put in place, in cooperation with the local medical laboratory, a temporary mechanism to protect against a possible human outbreak. Additional aid, however, is urgently needed for training and to ensure an adequate supply of test kits and expendables.

As a follow up and before restocking of farms can start, an AI control policy among animals needs to be clearly defined. Among its key features, the policy should address vaccination, taking into account the capacity of veterinarian institutions to guarantee vaccination and reduce virus spread among chickens, and hence reduce possible transmission to humans.

Clearly, the capacity of the PA to address the AI threat is seriously constrained due to, largely, the international response to the transition in government. Despite the situation, coordination on the AI agenda between the Palestinian ministries of Health and Agriculture (MoH, MoA) and relevant regional and international organizations has been remarkably efficient. MoH is taking the lead -given its relatively more developed infrastructure and capacity of public health institutions- while MoA as well as veterinary institutions are responsible for the main operations on the ground.

The AI National Committee -headed by the MoH- is currently playing a leading role in coordinating national and international efforts to combat AI. The Committee also coordinates the development and communication of policies, assessment reports, protocols and guidelines, as well as follow-up measures to carry out the National Plan. Brochures and telephone hotlines have been set up to respond to public and animal health inquiries, yet a stronger public awareness and communications campaign is required.

Challenges to a Sustainable AI Response in West Bank and Gaza

Providing an effective response to an Avian Influenza outbreak under these circumstances is, and will continue to be, a major challenge. Ensuring speed, flexibility and close coordination in intervention is critical.

The Ministry of Agriculture (MOA) does not yet have the adequate capacity to contain the spread of an Avian Influenza outbreak throughout the WBG areas. This is mainly due to shortages in human and financial resources to implement activities of such magnitude. While the institutional capacity of the Ministry of Health – as part of an effective Avian Influenza response- is somewhat better, the current fiscal crisis has taken its toll.

Successful containment of the outbreak relies primarily on the massive culling of poultry. During the initial outbreak, culling was successfully completed. Nevertheless, the PA suffered a partial loss of credibility due its initial inability to fully compensate farmers for their economic losses. Much of the farmers' trust has been restored as a result of a recent initiative–financed by the Russian Government- that supported the PA to complete compensation payments of US$1.7 million to poultry producers.

In addition, a UN interagency plan was prepared by UNDP -in cooperation with other UN Agencies such as FAO, WHO, UNICEF, WFP, among others. The plan is based on a comprehensive approach that addresses food security, public and veterinary health control, risk management, and finally restructuring of the poultry sector.

Within the context of an internationally-supported response, several organizations undertook assessments to identify areas in need of support. These included a Rapid Expert Mission by WHO and a FAO mission to address veterinary health aspects.

The Islamic Development Bank (IDB) financed the purchase of equipment for the MOA veterinary labs. Cash compensation was provided by the Russian Government. FAO and WHO have also been using their own funds to assist the PA in carrying out capacity building activities, staff training, and the provision of specialized technical advice.

The World Bank conducted a Rapid Assessment based on extensive consultations with several UN agencies (including WHO, FAO, UNRWA and UNDP) in order to

consolidate efforts. As an output, the UN Interagency Framework for Avian Influenza and Pandemic Response was developed; yet with modest funds to implement it.

The UN Interagency Framework for Avian and Pandemic Response includes a budget of around US$30 million. Within this framework, the World Bank will provide a grant of US$10 million which will be implemented through the Palestinian line ministries in cooperation with the Avian Influenza National Committee. In addition, the Bank will provide US$3 million from its Avian and Human Influenza Facility Trust Fund to address emergency needs. The latter will be implemented directly through the UN system.

The World Bank resources will be used to limit the spread of AI to humans through better preparedness, control, and response. The resources are also intended to partially contribute to farmers' compensations. Beyond the Bank's funding, medium and long term investments are needed to restructure the poultry sector and the supply chain of poultry products. Building cold stores and cold chains offer a sustainable tool for a better level of food security, food safety and self support in the West Bank and Gaza strip.

Long Term Challenges to the Poultry Sector

International experience highlights the need to focus, on the long term, on the rehabilitation of the Palestinian poultry sector. For example, FAO experts recommend that the Palestinian Authority and donors work together to facilitate the creation of the Guarantee or Collateral Fund needed to kick-start microfinance schemes. In addition, technical assistance in quality management needs to be addressed within the scope of microfinance lending schemes. The establishment of farmers' associations and the creation of an Agricultural Marketing Company offer opportunities for trade partnerships between Israeli and Palestinian agricultural industries, and for secure marketing through Israel.

There is clearly an urgent need for resources to support the PA's efforts in financing and managing a comprehensive and long-term national surveillance, culling, and compensation program. The regional impact of a possible spread of Avian Influenza may not be fully overcome by the initial UN Interagency Framework. This calls for more regional cooperation in addressing this public health and economic threat.

Photos: Avian Flu Control Committee, Gaza Governorate

Recent Economic Developments

Economic Output

Recent economic data from a variety of sources (Palestinian imports from and exports to Israel through the first quarter of 2006; Palestinian employment data through the first quarter of 2006; banking sector data through end-May; fiscal data through end-April; price data through June 2006) suggest that the economic slowdown that began in the second half of 2005 continues.

Looking forward, continued restrictions on movement between Gaza and the West Bank and, in particular, on goods both to and from Gaza through Israel, suspensions in the transfer of clearance revenues (import tariffs and VAT collected by Israeli customs on behalf of the Palestinian Authority) by the Government of Israel and reductions in donor assistance to the Palestinian Authority, as well as likely reductions in the number of Palestinian workers granted work permits for work inside Israel all point to a further decline. As a consequence, economic performance in 2006 is expected to fall at rates similar to those witnessed during the early years of the *Intifada*, particularly in the Gaza Strip.

In March 2006, World Bank staff undertook an analysis of the potential macroeconomic impact of a number of measures then under active consideration (and now being implemented) by Israel and the donor community.

Under this scenario, real GDP per capita declines by 27 percent in 2006 and personal incomes (real GDI per capita) by 30 percent – a one-year contraction of economic activity equivalent to a deep depression. Further declines in the next two years bring unemployment to 47 percent and poverty to 74 percent by 2008. By 2008 the cumulative decline in real GDP since 1999 would reach 55 percent (Table 1).[1]

Table 1. Macroeconomic Projections 2005-2008

	2005	2006	2007	2008
GDP (US$ million)	4,044	2,910	2,835	2,851
real growth rate	6.3%	-24.5%	-4.3%	-1.0%
GDP per capita (US$)	1,152	802	754	735
real growth rate	2.7%	-27.1%	-7.4%	-4.2%
GDI per capita (US$)	1,657	1,199	1,089	1,020
real growth rate	4.3%	-30.0%	-10.8%	-8.3%
Unemployment Rate	23%	40%	44%	47%
Poverty Rate	44%	67%	72%	74%

World Bank staff projections, March 2006. Gross Domestic Product (GDP) measures productive activity within West Bank and Gaza; Gross Disposable Income (GDI) measures total income, including workers' remittances, foreign aid, and other current transfers.

[1] For further information regarding this scenario and its underlying assumptions, see "Economic Update and Potential Outlook", World Bank, March 15, 2006 and West Bank and Gaza Update, April 2006. Unfortunately, this estimated decline may, in fact, turn out to be too optimistic given the extent of Israeli military operations in Gaza and the impact of the PA's inability to pay salaries of government workers; as data from the second quarter becomes available, the World Bank's projections will be revised.

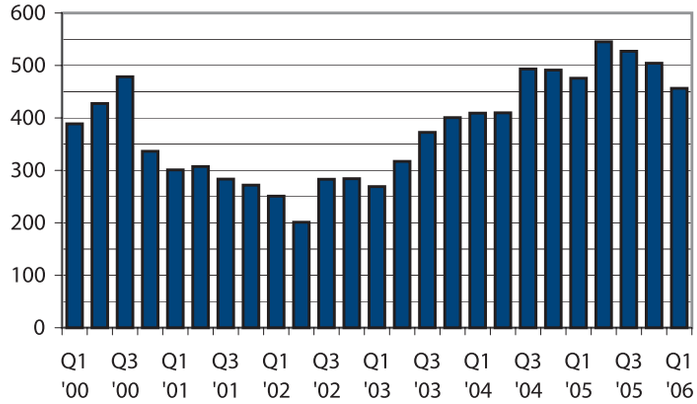
Foreign Trade

The importance of trade in promoting economic growth has been demonstrated time and time again, particularly for small, developing countries. For West Bank/Gaza, international trade is already important and is destined to play an ever increasing role in the future. During the past six years, imports of final goods, services, equipment, and intermediate inputs used in domestic production represented approximately 70 percent of GDP, while exports of goods and services represented between 15 and 20 percent of GDP. Such a large degree of openness is not without risk, however, leaving West Bank/Gaza vulnerable to external closures by Israel under the current security environment – thereby cutting off a vital lifeline to the outside world.

Unfortunately for statistical analysis, trade is badly registered since most of it takes place between the West Bank and Israel where no custom stations exist to record the quantity and value of goods that cross (unlike trade between Gaza and Israel which can be counted). Nevertheless, the Israeli Central Bureau of Statistics estimates such flows, and we rely on their data to help understand the evolution of trade since 1998. Although ICBS estimates only cover Palestinian trade with Israel and not directly with the rest of the world, trade with Israel represents the bulk of total Palestinian trade.[2] Furthermore, significant shares of imported goods from Israel are actually originating from third countries – "indirect imports".

The impact of closures that followed the outbreak of the *Intifada* in September 2000, and their progressive tightening through summer 2002, was clearly reflected in the reduction of Palestinian trade with Israel. Merchandise imports, which had reached their peak in third quarter 2000 at NIS 1.9 billion (US$478 million equivalent), fell below the NIS 1 billion level (US$201 million) in second quarter 2002. From that point on, import growth was consistently steady, reaching NIS 2.4 billion (US$545 million) in second quarter 2005. From that point on, however, the value has declined to stand at NIS 2.1 billion (US$456 million) in first quarter 2006 – an 11 percent decline in shekels (16 percent in US dollars) – evidence of weakened demand (*Figure 1*).

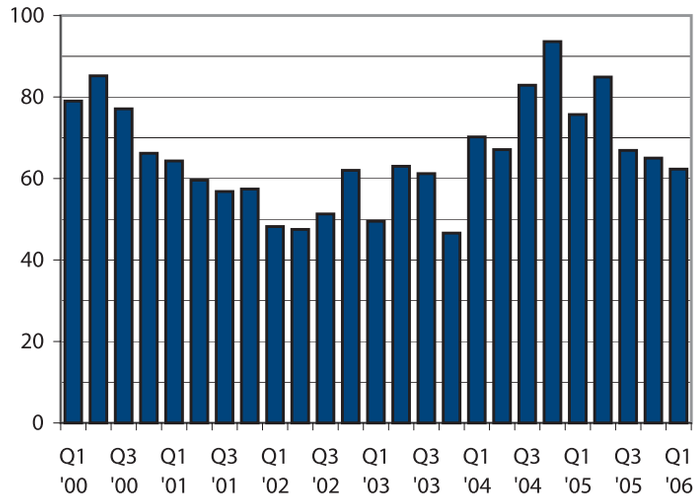
Figure 1. Merchandise Imports from Israel (million US Dollars equivalent)



Source: Israeli Central Bureau of Statistics.

Trends in merchandise exports to Israel have followed a somewhat similar trend, although at much lower levels. Averaging approximately NIS 325 million (US$80 million equivalent) in pre-*Intifada* 2000, exports decline steadily through summer 2002 before rebounding in the second half of that year and in 2003 – only to hit their low point in the fourth quarter 2003 at NIS 207 million (US$47 million). As with imports, 2004 saw very strong growth – over 40 percent compared to 2003. Peaking in second quarter 2005 at NIS 374 million (US$85 million), three continued quarters of decline has brought the export level to NIS 291 million (US$62 million) in first quarter 2006 – a drop of 22 percent (27 percent in US dollars) over nine months. (Figure 2).

Figure 2. Merchandise Exports to Israel (million US Dollars equivalent)



Source: Israeli Central Bureau of Statistics

[2] In 2002, exports from West Bank/Gaza to Israel represented 90 percent of total exports, while imports from or via Israel amounted to 98 percent of total Palestinian imports. (Approximately 55 percent of these imports were of Israeli goods, with the rest coming from third countries.)

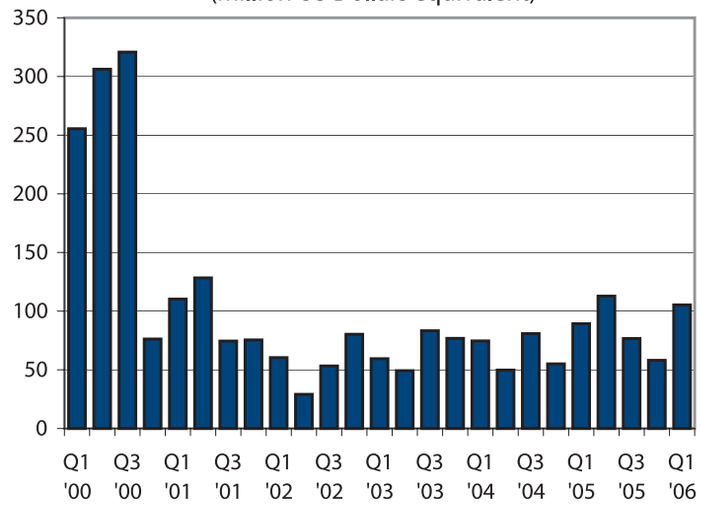
At least three factors explained the reduction in exports witnessed during the first three years of the *Intifada*: increased costs in transportation resulting from internal closure made Palestinian products less competitive (*see Figure 14*); in the face of production and shipping interruptions due to both internal and external closure, foreign purchasers switched to more reliable, alternative sources of supply; and Palestinian producers switching to service domestic markets. Although the closure regime remained in place in 2004, its administration by then had become far more predictable – a key factor in the economic recovery of these years. Since then, closures again tightened. Looking forward, the degree of external access permitted by the Israeli authorities – particularly out of Gaza – will determine whether the fall in Palestinian exports witnessed in the second half of 2005 and first quarter 2006 will continue or if export growth rates can be reversed and then sustained.

Employment and Unemployment

As a result of external closures nearly 100,000 Palestinian workers have lost their jobs in Israel since September 2000. According to Palestinian Central Bureau of Statistics (PCBS) data, 146,000 Palestinians (116,000 from the West Bank, incl. East Jerusalem, and 30,000 from Gaza) were working in Israel and Israeli industrial estates and settlements during the third quarter 2000. At its low point during the second quarter of 2002, this number had fallen to 33,000 before rebounding in the following quarter to 53,000; since then, the number of Palestinian workers in Israel and settlements has been relatively stable, increasing (or decreasing) with the extent of closure imposed in the wake of specific terror incidents. In second quarter 2005 their number peaked at 67,000; by first quarter 2006 it had fallen to 60,700 (virtually all from the West Bank including East Jerusalem) (*Table 2*).[3]

Fewer jobs in Israel have meant a significant decline in workers remittances. According to the Israeli Central Bureau of Statistics, third quarter 2000 remittances totaled US$321 million. In first quarter 2006, US$105 million – a decline of 67 percent (*see Figure 3*) – was remitted. The considerable decline during the second half of 2005 completely erased the growth in remittances seen in the first two quarters: second quarter 2005 remittances were US$113 million (their highest level in four years); the increase in first quarter 2006 is somewhat surprising and merits closer attention as more data becomes available.

Figure 3. Workers' Remittances from Israel (million US Dollars equivalent)



Source: Israeli Central Bureau of Statistics.

The decrease from pre-*Intafada* levels has had considerable direct consequence on the income of Palestinian households; workers' remittances from Israel represented some 18 percent of total disposable incomes in 1999. Reduced income, in turn, meant reduced demand for domestic goods, and therefore lower levels of domestic employment within the West Bank and Gaza.

This negative impact that job losses in Israel has had on domestic employment was aggravated by the difficulties in conducting business within the West Bank and Gaza as a result of internal closures and curfews, particularly in 2002, which resulted in significant increases in transaction costs, disruptions in production cycles, losses of perishable output, and lower economies of scale.

At its low point in third quarter 2002 domestic employment stood at 387,300 – a drop of 25 percent from pre-*Intifada* third quarter 2000. By second quarter 2003 domestic employment had recovered to the extent that the number of Palestinians employed within the West Bank and Gaza surpassed the levels prior to the *Intifada*. At the same time, however, the number of unemployed grew considerably, from 73,600 in the pre-I*ntifada* third quarter 2000 to 210,300 currently *(see Table 2)*.

[3] Of these 60,700 nearly half held an Israeli-ID or foreign passport; the World Bank estimates that 85 percent of Israeli-ID holders reside in East Jerusalem. The balance in the number of workers in Israel from the West Bank excluding East Jerusalem are believed to be divided roughly equally between those holding work permits (estimated at 15,700 in first quarter 2006) and those working illegally ("clandestine" workers, estimated at 14,500).

In first quarter 2006 the number of Palestinians working inside the West Bank was 392,100 compared to 357,500 just before the *Intifada*, an increase of 9.7 percent. At its low point in second and third quarter 2002, their number had fallen to 282,200 and 280,900 respectively. Although generally growing from that point forward, seasonal variations can be seen.

Inside the Gaza Strip 157,700 Gazans were employed during third quarter 2000. By third quarter 2002, the low point during the *Intifada*, this number had fallen to 106,500 (a 33 percent decline). Four quarters (one year) of continuous job growth found 170,900 Gazans employed domestically, before the decline registered during the fourth quarter of 2003 reduced the number of employed to 163,200.

Since then job levels within Gaza have fluctuated (falling as low as 146,100 in second quarter 2004 due to a severe deterioration in the security situation during that period), before resuming an upward path. By the fourth quarter 2005, domestic employment in Gaza had reached 187,700 only to fall back again to 168,200 in first quarter 2006.

Despite the recent increases in employment, with population growing at just above 4 percent per year, dependency ratios – the total population divided by the number of employed persons – have increased significantly over the *Intifada* period.

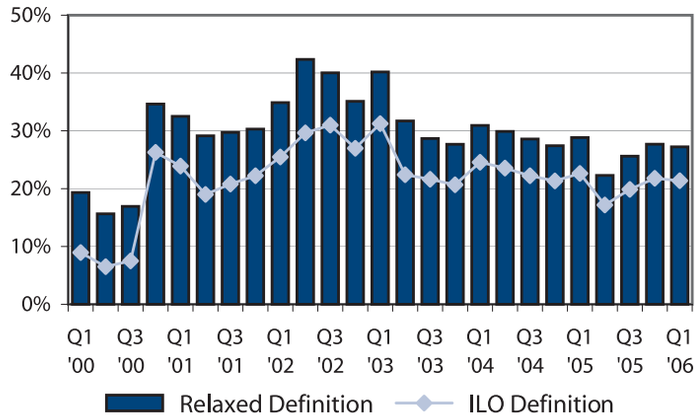
Whereas in the third quarter of 2000 each job holder in the West Bank was supporting 4.3 persons, by the first quarter of 2006 each employed person was supporting 5.6 persons. In Gaza the dependency ratio increased more dramatically, from 5.9 in the last quarter prior to the *Intifada* to 8.2.

A growing population, declining levels of Palestinian employment in Israel and Israeli settlements, and a lack of domestic job creation during the first two years of the *Intifada*, led to dramatic increases in unemployment and unemployment rates. Despite the job growth in recent years, the absolute number of unemployed remains far in excess of pre-*Intifada* levels. (Under International Labor Organization (ILO) standard definitions, a person must be actively seeking work in order to be considered "unemployed".)

The unemployment rate in the West Bank peaked at 31.2 percent in the first quarter 2003. For the next two years, the rate fluctuated between 21 and 25 percent, falling below the 20 percent line in second quarter 2005. Such a level was short-lived, however, as unemployment rates grew in the second half of the year, reaching 21.4 percent in first quarter 2006 (*Figure 4*).

Because a large number of persons without employment have stopped looking for jobs (so-called "discouraged workers"), they are not considered part of the labor force and not included in ILO-standard definition unemployment rates. If such persons are counted, the "relaxed definition" unemployment rate for the West Bank during first quarter 2006 was 27.2 percent. (This rate reached its highest level in second quarter 2002, at 42.4 percent.)

Figure 4. West Bank Unemployment Rates

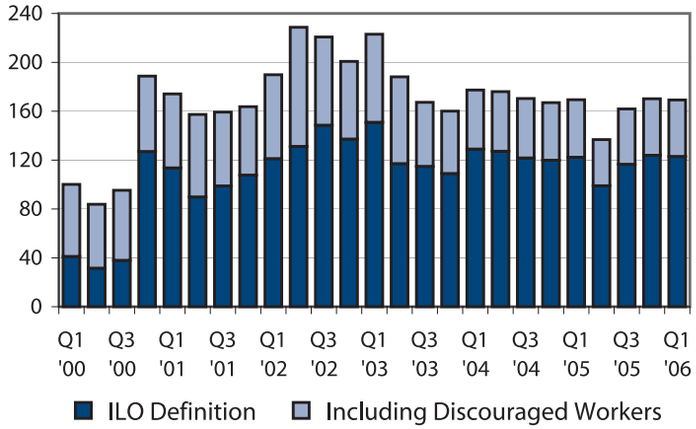


Source: PCBS. Data for West Bank includes East Jerusalem

Focusing instead on the number of unemployed and the number of "discouraged workers" rather than on unemployment rates shows how much joblessness has grown. From a total of 95,300 in pre-*Intifada* third quarter 2000 (37,900 unemployed and 57,400 discouraged), their number peaked at 228,700 in second quarter 2002 (131,200 unemployed; 97,500 discouraged).

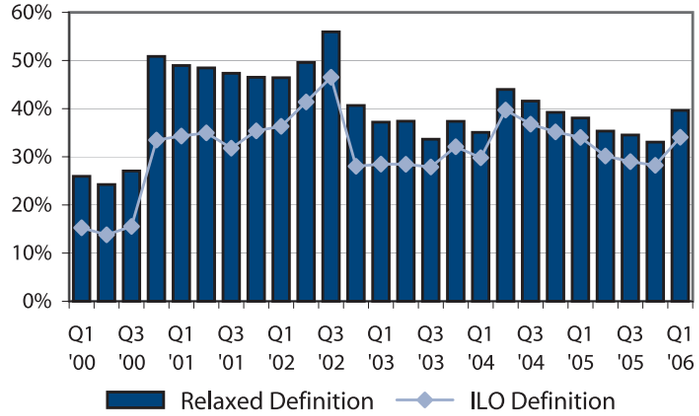
Despite recent employment growth (and declining unemployment rates), their number remains large – in fact, grew significantly in the second half of 2005. By first quarter 2006, 122,900 West Bankers were unemployed, and a further 46,300 had stopped looking – a "relaxed definition" unemployment level of 169,200 (*Table 2 and Figure 5*).

Figure 5. West Bank Unemployment (thousands of persons)



Source: PCBS. Data for West Bank includes East Jerusalem.

Figure 6. Gaza Strip Unemployment Rates



Source: PCBS.

In Gaza, the first quarter 2006 unemployment rate increased to 34.1 percent (87,400 individuals). This followed six consecutive quarter of reduced unemployment, both in terms of rates and absolute numbers. (Second quarter 2004 saw the highest number of unemployed in Gaza – 96,600 – and a near record unemployment rate of 39.7 percent) .Prior to the *Intifada* the unemployment rate in Gaza was 15.5 percent (35,700 persons) (*Figure 6*).

Including "discouraged workers" produces a relaxed definition unemployment rate of 39.6 percent in Gaza for first quarter 2006; the number of unemployed by this definition increases from 87,400 to 111,200. As mentioned above, such numbers are only slightly below the 115,100 in second quarter 2004 and approach the peak levels recorded during the first two years of the Intifada (*Figure 7*).

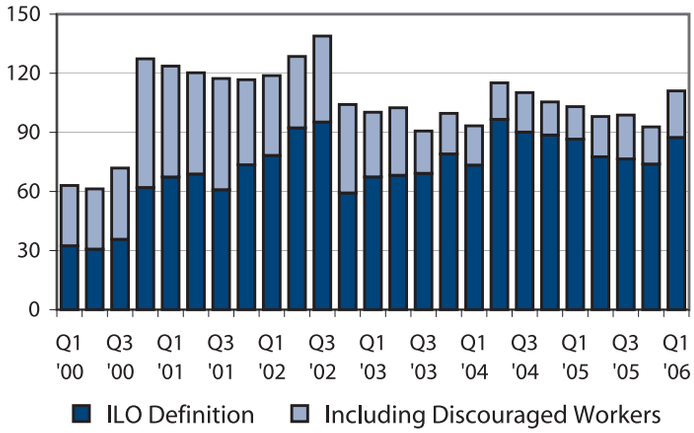
Table 3. Number of Palestinians Employed and Unemployed (thousands)

	Q-1	Q-2	Q-3	Q-4	Q-1	Q-2	Q-3	Q-4	Q-1	Annual Averages					
	2004	2004	2004	2004	2005	2005	2005	2005	2006	2000	2001	2002	2003	2004	2005
Employment															
Working in West Bank	349	367	371	394	359	412	405	384	392	334	310	297	343	370	390
Working in Gaza	167	146	154	163	167	177	186	188	168	145	125	128	166	157	180
Working in Israel – from West BankWorking in Israel	47	45	53	48	60	65	64	60	60	94	67	45	49	48	62
– from Gaza Strip	6	0	1	1	0	2	1	0	1	22	2	3	5	2	1
Total Employed	**569**	**559**	**581**	**605**	**586**	**656**	**657**	**632**	621	**595**	**505**	**474**	**565**	**578**	**633**
Unemployed (ILO)	**202**	**224**	**212**	**208**	**209**	**176**	**193**	**198**	210	**100**	**170**	**216**	**194**	**212**	**194**
Discouraged Workers	68	67	69	64	64	58	68	65	70	98	113	117	89	67	64
Total, Unemployed and Discouraged	**271**	**291**	**281**	**272**	**272**	**235**	**261**	**263**	280	**198**	**283**	**333**	**283**	**279**	**258**
Dependency Ratios															
West Bank	5.7	5.6	5.4	5.3	5.6	5.0	5.1	5.4	5.6	4.7	5.6	6.3	5.7	5.5	5.2
Gaza Strip	7.6	9.1	8.7	8.3	8.2	7.7	7.4	7.5	8.2	6.6	9.1	9.3	7.5	8.4	7.7

Source: PCBS. Note: Employment data for workers in Israel includes employment in Israeli settlements and industrial estates. West Bank data includes East Jerusalem. Annual averages are averages of the four quarters that year. Due to rounding errors, totals in table may not equal sum of components.

Wage employment represents approximately 55 percent of total employment in the West Bank, and two-thirds of total employment in Gaza – percentages that have remained fairly stable since the outbreak of the *Intifada*.[4]

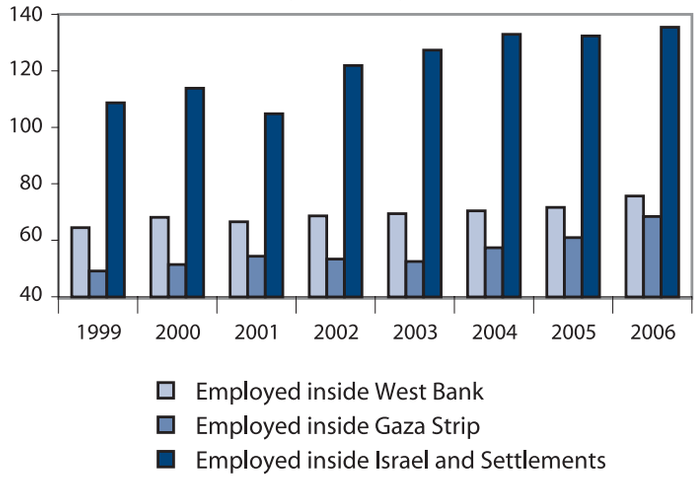
Figure 7. Gaza Strip Unemployment
(thousands of persons)



Source: PCBS

Prior to the Intifada nominal wages were rising steadily; with the economic growth witnessed from summer 2003 through summer 2005, average daily wages again rose (see Figure 8). By first quarter 2006 the average daily wage received by wage employees working in the West Bank was NIS 73.3 (equivalent to US$15.73); for wage employees working in Gaza, the average daily wage stood at NIS 66.6 (equivalent to US$14.29); by comparison, wage employees working in Israel and Israeli settlements received on average NIS 129.1 (US$27.70) daily.[5]

Figure 8. Average Daily Wages
(NI Shekels)



Source: World Bank staff calculations based on PCBS data. West Bank includes East Jerusalem. Averages are 95 percent trimmed means; see footnote 4. 2006 data is for first quarter only; other years are averages for all four quarters.

Wage behavior in 2001, 2002, and the first half of 2003 is less obvious, as employers adopted a combination of strategies to cope with the considerable drop in demand witnessed during this period. Some employers reduced salaries in order to try and preserve their workers' jobs – in effect, trying to share the pain.

Most, however, reduced employment. Between third quarter 2000 and fourth quarter 2000 the number of wage employees working in the private sector in the West Bank fell by 28,500; by second quarter 2002 a further 27,900 West Bank private sector wage employees were no longer working – a decline of 48 percent from the last quarter prior to the *Intifada* when 117,600 workers enjoyed regular wage employment.

[4] The other three types of employment (broken down by status) are "employer", representing approximately 5 percent of total employment in the West Bank and 3 percent in Gaza; "self-employed", amounting to roughly 28 percent in the West Bank and 23 percent in the Gaza Strip; and "unpaid family member", approximately 11 percent of employment in the West Bank and 9 percent in Gaza. Nearly 70 percent of unpaid family members are engaged in agricultural work (for women, roughly 90 percent); roughly 20 percent work in commerce (e.g., a family member's store or repair shop). The rest are scattered among the remaining economic sectors.

[5] Because a "simple average" can be strongly affected by large or extreme values ("outliers"), this section uses a "95 percent trimmed mean" in order to reduce their impact. The top 2-1/2 percent and bottom 2-1/2 percent of the data are excluded (thereby removing the most extreme responses, which in some cases are simply the result of incorrect data entry), and the remaining 95 percent of observations are then averaged.

[3] The other three types of employment (broken down by status) are "employer", representing approximately 5 percent of total employment in the West Bank and 3 percent in Gaza; "self-employed", amounting to roughly 28 percent in the West Bank and 23 percent in the Gaza Strip; and "unpaid family member", approximately 11 percent of employment in the West Bank and 9 percent in Gaza. Nearly 70 percent of unpaid family members are engaged in agricultural work (for women, roughly 90 percent); roughly 20 percent work in commerce (e.g., a family member's store or repair shop). The rest are scattered among the remaining economic sectors.

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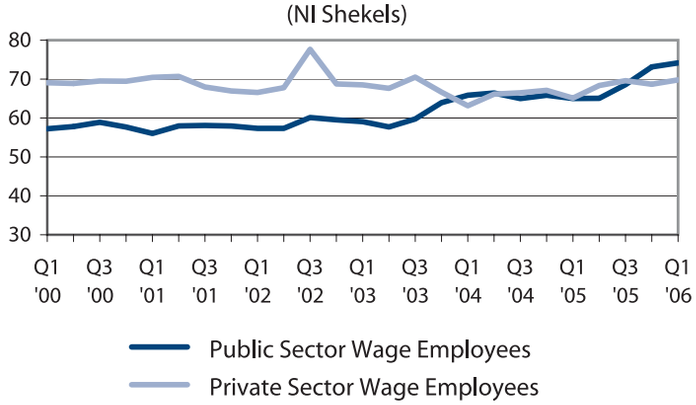
In Gaza, the reduction was more sudden: whereas 43,000 Gazans held regular wage employment in third quarter 2000, that number fell to 22,600 in the fourth quarter 2000; a further 2,900 were without regular private sector wage jobs by third quarter 2002 – a decline of 59 percent.

Often it was lower skilled (and lower paid) workers, or workers with fewer years of job experience (again, often lower paid as a result of less time on the job), who were the first to be dismissed. Consequently, the average daily wage received by those who continued to be employed could actually increase from one quarter to the next.

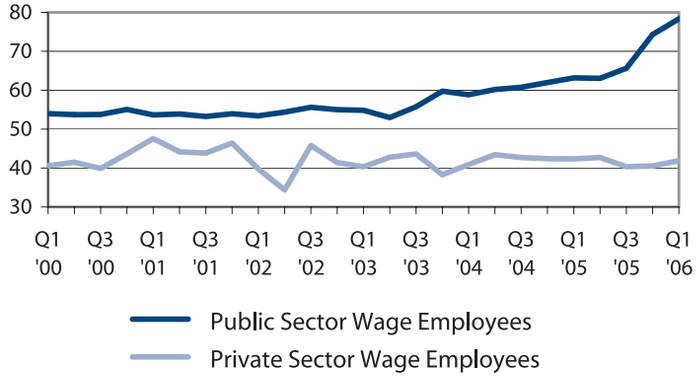
Focusing on average wage data for all wage employees, therefore, can be a somewhat misleading indicator because it does not take into consideration what is known as the "composition effect" – the impact of changes in the number of persons employed, or changes in the distribution of wage employment by sector (for example, agricultural workers receive lower salaries than do manufacturing workers), or by type of employer (PA vs. private sector for example; see *Figures 9 and 10*).

Figure 9. Average Daily Wages in West Bank (NI Shekels)



Source: World Bank staff calculations based on PCBS data. West Bank includes East Jerusalem. Averages are 95 percent trimmed means; see footnote 4.

Figure 10. Average Daily Wages in Gaza Strip (NI Shekels)



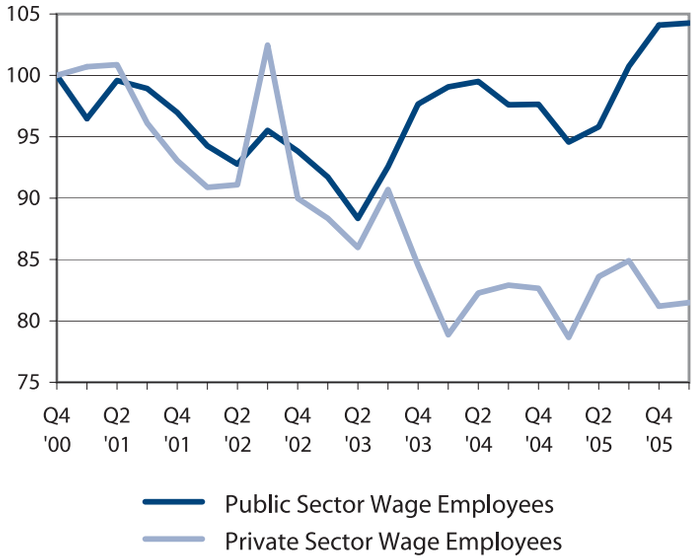
Source: World Bank staff calculations based on PCBS data. Averages are 95 percent trimmed means; see footnote 4.

This is particularly true in Gaza where there has been not only a large increase in PA employment (which occurred in the West Bank as well) but also a significant difference in PA versus private sector wages.[6] Thus, looking at the average wage rate overall in Gaza blurs together two very different dynamics.

For wage earners who continued to be employed, the impact of the increase in dependency ratios during the course of the *Intifada* (and the implied obligation on working Palestinians to support greater numbers of extended family member) was exacerbated by the decline in average real wages over much of the period. Inflation has meant a considerable reduction in purchasing power for private sector wage employees although their nominal wages remained roughly steady, while the increase in public sector wages over the past two years has more than made up for inflation's impact.

[6] In the West Bank, the average daily wage for PA employees was roughly NIS 11 below the average of private sector wage employees through the third quarter of 2003. For the next two years they were approximately equal. In the fourth quarter of 2005 a gap appeared in favor of PA wage employees, with a daily wage NIS 4.4 higher than that of private sector workers; this spread continued in first quarter 2006. In Gaza, the PA average daily wage was NIS 12 above the private sector average through third quarter of 2003. Starting in fourth quarter 2003 the difference between PA and private sector wages widened, until it reached NIS 33.8 in the fourth quarter of 2005 and NIS 36.5 in first quarter 2006. PA daily wages in West Bank have generally exceeded PA wages in Gaza by about NIS 4 throughout the past six years, although this spread narrowed – and then reversed – in 2005. By fourth quarter 2005 PA wage employees in Gaza received on average NIS 1.2 more than their West Bank counterparts; in first quarter 2006, the spread widened further, to NIS 4.2.

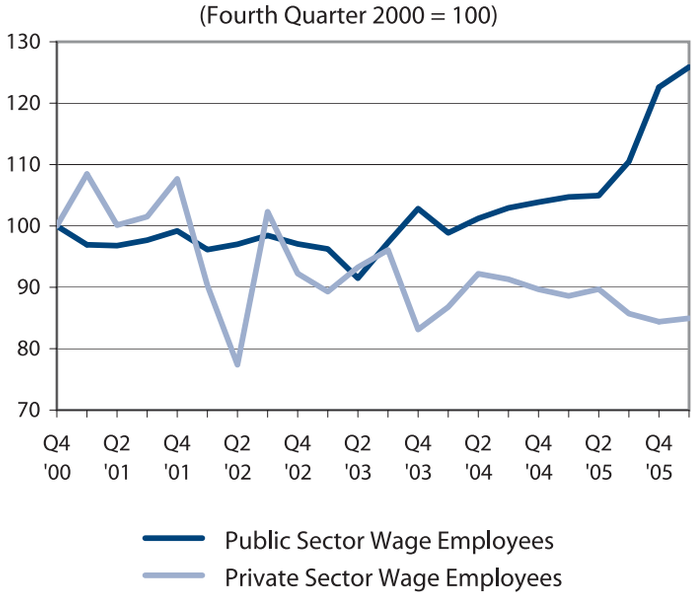
Figure 11. West Bank Real Wage Indices
(Fourth Quarter 2000 = 100)



Source: World Bank staff calculations based on PCBS wage data. West Bank includes East Jerusalem. Averages are 95 percent trimmed means, deflated by PCBS consumer price indices for Remaining West Bank and re-based to Fourth Quarter 2000 = 100.

In the West Bank, average private sector real wages have declined 18.5 percent since fourth quarter 2000 while average public sector real wages increased by 4.3 percent (*Figure 11*); in Gaza, the decrease for the private sector was 15.1 percent against an increase of 25.9 percent of public sector wage employees (*Figure 12*).

Figure 12. Gaza Strip Real Wage Indices
(Fourth Quarter 2000 = 100)

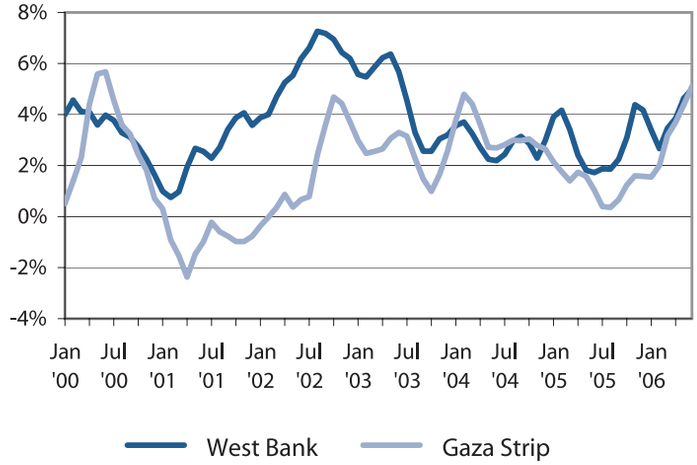


Source: World Bank staff calculations based on PCBS wage data. Averages are 95 percent trimmed means, deflated by PCBS consumer price indices for Gaza Strip and re-based to Fourth Quarter 2000 = 100.

Prices and Inflation

Consumer prices (measured in NI shekels) increased in both the West Bank and in Gaza in 2005, by 2.9 percent in the West Bank and 1.2 percent in Gaza. This represented no change from 2004's inflation rate in the West Bank (also 2.9 percent), and a decrease from the 3.2 percent recorded in 2004 in Gaza.

Figure 13. Consumer Price Inflation
Rate of Change from Preceding Year



Source: World Bank calculations based on PCBS data. Figure shows changes in three-month moving averages, relative to previous year.

During the first six months of 2006, consumer price inflation rates in the West Bank and Gaza have been virtually identical (4.2 percent in the West Bank and 4.1 percent in Gaza, compared to the January-June 2005 period.) However, these are noticeable increases compared to the 2004 and 2005 full year rates, especially in Gaza (*Figure 13*).

Leading the increase in the overall CPI for 2005 in the West Bank were Beverages and Tobacco (up 5.7 percent), Miscellaneous Goods and Services (up 4.1 percent), and Housing (up 4.0 percent). This is the first year since the *Intifada* that the Transport and Communications price index has not been either the number one or number two contributor to West Bank consumer inflation. In 2004 this component was up 5.6 percent; in 2002 it rose 21.9 percent largely due to the impact of internal closure (*see below*).

For the first six months of 2006, Transport and Communications costs have again accelerated, up 6.1 percent compared to the first six months of last year. (Much of this year's increase to date appears to be the result of increasing world prices for gasoline.) Other

leading contributors thus far in 2006 continue to be Miscellaneous Goods and Services (up 7.7 percent), Beverages and Tobacco (up 6.1 percent), and Food (up 4.3 percent) compared to January-June 2005.

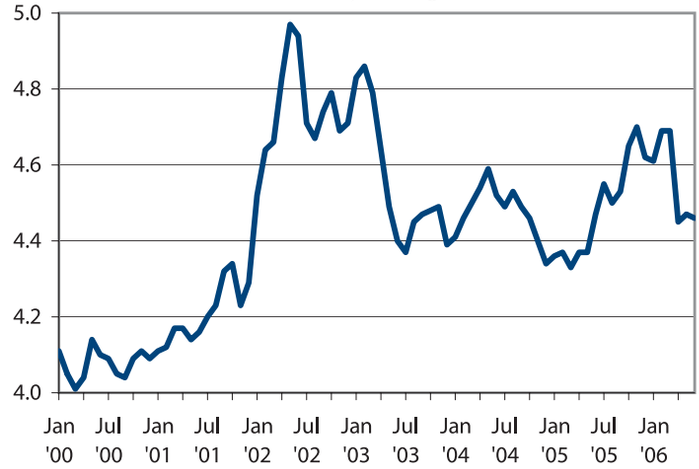
In 2004 in Gaza, the Food Index represented the second largest increase among the components of the consumer price index, rising 4.8 percent (compared to a 3.5 percent increase in 2003.) Food costs stabilized in 2005, increasing just 0.5 percent above 2004's level. Leading the increases this past year were Housing and Beverages and Tobacco; both components were up 5.0 percent. The Transport and Communications price index rose 2.8 percent, a rate roughly half of what was witnessed in 2004 when this component led the increase in Gaza's CPI, increasing by 5.7 percent. Thus far in 2006, Transport and Communications prices and Food prices are again the leaders, both up 6.4 percent compared to the first six months of 2005.

Because so much of what is consumed in West Bank and Gaza are imported goods, changes in the shekel-dollar exchange rate can impact prices domestically. For example, the depreciation of the Israeli shekel in 2001 and early 2002 (particularly strong in the period November 2001-April 2002; depreciation is represented as an upward movement in *Figure 14*) and its subsequent appreciation (especially in the period February-July 2003; seen as a downward movement in the figure) corresponds to a period of accelerating inflation during 2002 and its subsequent slowing down in 2003.

From December 2000 to December 2001 the shekel lost 4.9 percent of its value with respect to the US dollar; from December 2001 until May 2002 the Shekel weakened a further 15.9 percent. As a result, prices of goods that are imported into Israel from overseas – and by extension, into the West Bank and Gaza – go up when expressed in shekels. Similarly, the consumer price index (which is also measured in shekels) increases, not only because the CPI market basket contains a number of imported goods, but some non-traded services that priced in dollars (such as many rents and education fees).

With an appreciating shekel – from February 2003 through December 2003 the shekel strengthened 9.7 percent against the dollar (11.7 percent since the shekel's weakest point in May 2002) – imports become cheaper and, to the extent that importers actually pass on these reductions to consumers as opposed to increasing their profit margins, inflation measured in shekels lessens.

Figure 14. NI Shekel-US Dollar Exchange Rate (monthly average)



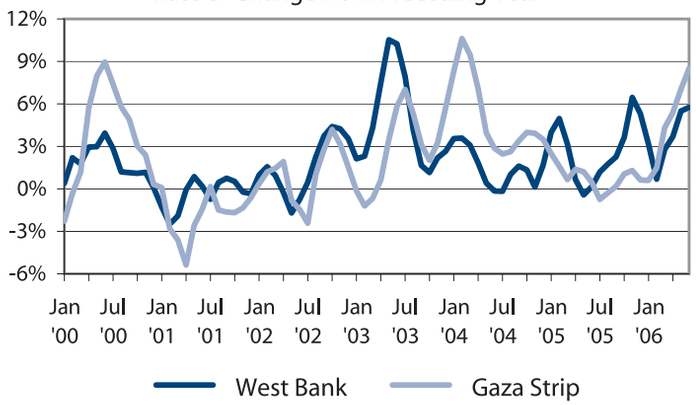
Source: Central Bank of Israel.

During 2004, the shekel first weakened against the dollar, depreciating by 4.6 percent through May, and then strengthened; by year's end, the shekel had gained 1.2 percent. In 2005 the shekel's value against the dollar was largely stable during the first half of the year and then weakened, losing 6.5 percent from December 2004 to December 2005. For the first three months of 2006 the NIS-USD exchange rate has been largely stable, appreciated in April to 4.45 and remained roughly at that level, closing at 4.46 end-June. Should this rate not hold, and NIS depreciation again accelerate, inflation tendencies in the West Bank and Gaza might be expected to pick up as well.

As Figure 13 indicated, there is a degree of regularity and seasonality in the pattern of price increases during the course of the year.

Food prices generally exhibit strong seasonality effects, peaking during the first quarter followed by declines in the second and third quarters before rising modestly in the final quarter of the year – a pattern that is likely to continue through 2006. Over the course of 2005, the food price index increased 2.7 percent in the West Bank and 0.5 percent in Gaza; comparing January-June 2006 to the first six months of 2005, food prices have increased 4.3 percent in West Bank and 6.4 percent in Gaza (*Figure 15*).

Figure 15. Food Price Inflation
Rate of Change from Preceding Year



Source: World Bank calculations based on PCBS data. Figure shows changes in three-month moving averages, relative to previous year.

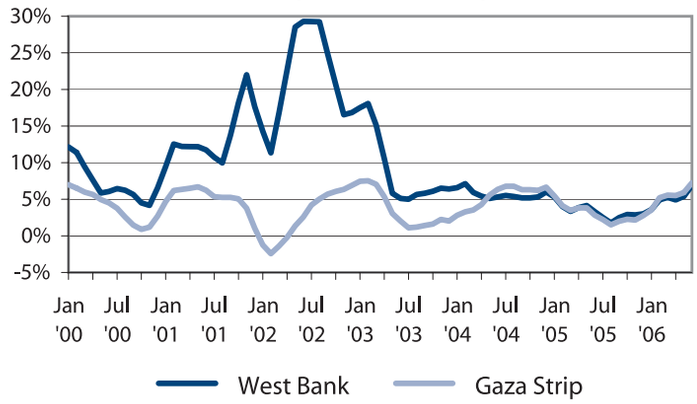
While food prices explain much of the seasonality reflected in the CPI and exchange rate movements help explain basic trends in tradable consumer goods prices (particularly in non-food prices, which are less affected by seasonality), tightened closure also impacts consumer prices overall.

This effect comes through both direct and indirect channels: directly through changes in the transportation component of the consumer price index (which measures transportation prices that have increased as a result of heightened closure, such as taxi fares) and indirectly through increased costs of shipping for producers and distributors, which are in turn passed on as increases in the final price of all goods faced by consumers in the market place. These effects can be seen as increases in other CPI components' price indices (for example, increases in the price of food resulting from higher shipping costs and greater perishability because of delays and damage due to off- and on-loading at back-to-back platforms). Finally, to the extent that closure policies lead to supply shortages in local markets, prices (and price indices) will also rise.

The tightening of closure associated with the outbreak of the *Intifada* in fall 2000 affected both Gaza and the West Bank, while relatively more intense Israeli military interventions in the West Bank (compared to Gaza) in autumn 2001 and spring 2002 explain the difference in movement in the transportation price index in the West Bank and Gaza during these years.

In effect, these were negative shocks that raised the level of the West Bank transportation price index (seen as upward steps in *Figure 16*). In 2004, both West Bank and Gaza witnessed proportional increases in transportation prices: 5.6 percent in the West Bank, and 5.7 percent in Gaza. In 2005, roughly parallel increases of 2.8 percent in Gaza and 3.0 percent in the West Bank were observed. Thus far in 2006, the transportation index is up 6.1 percent in the West Bank and 6.4 percent in Gaza – higher than last year and comparable to those seen in 2004.

Figure 16. Transportation Price Inflation
Rate of Change from Preceding Year



Source: World Bank calculations based on PCBS data. Figure shows changes in three-month moving averages, relative to previous year.

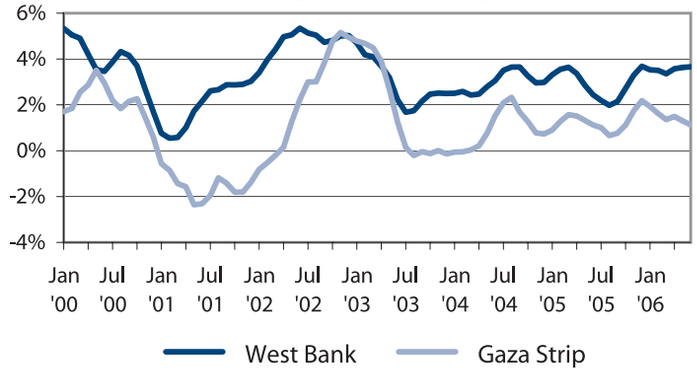
Excluding food (in order to remove the impact of food's seasonality), the consumer price index in the West Bank rose by 4.0 percent in the first half of 2006 and by 2.4 percent in Gaza, compared to the first six months of 2005. Although these non-food CPI inflation rates are higher than those recorded for the full year 2005 (compared to 2004) of 2.8 percent in the West Bank and 1.5 percent in Gaza, they are comparable to non-food CPI increases in recent years. (In 2001, non-food prices rose 4.4 percent in the West Bank and fell 0.2 percent in Gaza; in 2002, non-food prices rose 8.6 percent in the West Bank and by 2.3 percent in Gaza; in 2003, 4.4 percent in the West Bank and 2.1 percent in Gaza; in 2004, they rose 3.7 percent in the West Bank and 1.9 percent in Gaza.)

When the Transportation and Communication price index is also excluded – transportation prices being most affected by changes in the closure regime (and also by changes in world energy prices, which can be quite volatile) – a clearer portrait of general price changes emerges. Such an index can be seen as a measure of "core inflation." Non-food, non-transportation prices in the West Bank increased 3.5 percent during the January-June 2006 period and 1.5 percent in Gaza; these are slight accelerations over the full year figures for 2005 (2.9 percent in the West Bank and 1.3 percent in Gaza).

These core inflation rates are in line with those of previous years. In 2004, non-food, non-transportation prices rose 3.0 percent in the West Bank and 0.9 percent in Gaza; in 2003, they rose 2.9 percent in the West Bank and 1.8 percent in Gaza. (During 2002, non-food, non-

transportation prices rose 4.7 percent in the West Bank and 2.2 percent in Gaza; the higher rate in the West Bank was largely the result of the indirect impact on prices due to closures. In 2001, non-food, non-transportation prices rose 2.0 percent in the West Bank and fell 1.6 percent in Gaza). (*Figure 17*).

Figure 17. "Core" Price Inflation
(CPI excluding Food and Transportation)
Rate of Change from Preceding Year



Source: World Bank calculations based on PCBS data. Figure shows changes in three-month moving averages, relative to previous year.

West Bank and Gaza: Fiscal Developments in 2006

By the International Monetary Fund

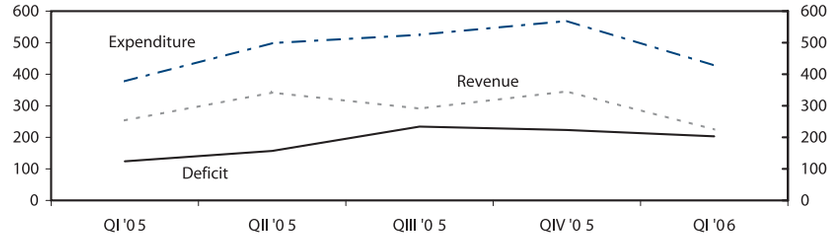
During the first quarter of 2006, the fiscal position of the Palestinian Authority (PA) was shored up by a relatively generous level of donor support, which somewhat compensated for the suspended payments of indirect taxes collected by the Government of Israel (GoI) on behalf of the PA—in response to the victory of Hamas in the January legislative elections. The situation deteriorated quickly following the transfer of powers to the Hamas government at end-March 2006. Not only did key donors withdraw their support to the PA, but domestic banks reduced unsecured overdrafts and refused to operate the PA's Single Treasury Account. As a result, government wages were not paid and other expenditures were dramatically compressed. At the end of 2005, the deficit for 2006 was projected at about US$1 billion; however, no clear deficit projection now emerges from the currently complicated fiscal situation.

I. First Quarter Developments

A. Overview

1. **By the end of 2005, the PA's fiscal situation had already become unsustainable due to the full year effect of the mid-2005 wage increases, larger social transfers and pension contributions, and the high costs of energy consumption (Figure 1)**. With unchanged policies, the fiscal deficit for 2006 was projected, at end-2005, at close to US$1 billion—almost three times the annual amount secured in external budget support in 2004 and 2005. This would likely have resulted in considerable arrears accumulation. Projected gains in revenue would have been more than offset by higher expenditures.

Figure 1. Fiscal Position, 2005-06
(In millions of US dollars)



2. **Following the victory of Hamas in the legislative elections of January 2006 and its formation of a cabinet at end-March, key donor countries reevaluated their support of the PA**. After the elections, the Quartet—representing the UN, the US, the EU, and Russia—stated that a new government must recognize Israel, renounce violence, and accept all previous agreements between Palestinians and Israel. At the same time, the Quartet urged support for the caretaker government. The government program presented along with the new cabinet in late March fell short of the Quartet conditions. Consequently, lead donors decided not to provide the PA with budgetary assistance and started exploring alternative ways to provide humanitarian and

[1] The full year effect of the wage increase was estimated, at end-2005, at about $170 million

project assistance that would bypass the Hamas-led PA (see section II).

3. **The GoI considered Hamas to be effectively in control of the Palestinian government with the inauguration of the new legislature in mid-February**. In response, it stopped the transfer of indirect tax revenues (so-called clearance revenues) it collects on behalf of the PA, thereby depriving the PA of one month of clearance revenue during January–March 2006. The impact of the Israeli decision was large, since clearance revenues amount to almost two-thirds of the PA's budget revenues and had, on a gross basis, averaged some $65 million per month in 2005.

4. **Donors, however, increased their financial support to the caretaker government**. OECD donors disbursed $76 million in the first quarter, including $42 million from the World Bank-administered Reform Trust Fund. Arab League countries increased their support to $78 million in the first quarter, up from $46 million in the last quarter of 2005. As a result, the total envelope of revenues and external budget support available to the PA in the first quarter of 2006 was only slightly lower than in the last quarter of 2005.

5. **Despite this still relatively strong resource envelope, the PA was already forced to compress non-wage expenditures, since access to domestic financing sources became increasingly problematic**. Domestic banks also began to reevaluate their relationship with the PA, initially largely out of concern over the PA's financial viability, but increasingly also out of fear over possible legal repercussion under foreign anti-terror laws. Banks required the caretaker government of the PA to reduce unsecured overdrafts. Adding to this was the repayment of $50 million of unused project financing to the US[2], which had, in effect, functioned as collateral for earlier bank financing. Thus, from a source of finance, the domestic banking system became a drain on the budget. Furthermore, resources from the Palestine Investment Fund (PIF) were becoming scarcer following the large advances and dividends received from the PIF in 2005.[3] In the face of a tighter financing constraint, the PA assigned priority to wages and utility expenditures, at the expense of operating expenditures and transfers. Average monthly non-wage expenditures were cut in half compared to the second half of 2005.

6. **Overall, the PA's average monthly fiscal deficit was lower in the first quarter of 2006 than in the second half of 2005, but higher than the monthly average of $61 million for 2005 as a whole (Table 1)**. The deficit would have been higher in early 2006, however, if net lending and operating expenditures had been fully accounted for on a commitment basis. While the wage bill and pension contributions are recorded on a commitment basis, payments to suppliers, some transfers, and net lending expenditures are recorded on a cash basis. Data on new arrears are not available.

Table 1. Central Government Fiscal Operations Monthly averages 2005–2006

	2005 July-Dec	2006 Jan.-March	2006 April
	(In millions of U.S. dollars)		
Net revenue 1/	105	79	16
Expenditure, of which	152	124	116
Wages	88	93	95
Operations	18	7	5
Transfers	41	24	16
Net Lending	32	23	4
Balance	-79	-68	-104
External budget support	17	51	41
Total other financing, of which:	62	16	63
Net domestic bank financing	21	-7	-30
Exceptional profits and advances	29	25	0
Other, including arrears 2/	12	-2	93

Source: Ministry of Finance, and IMF estimates.

1/ Net of deductions for VAT refunds.

2/ In 2005, includes a monthly average of US$14 million in clearance revenue previously withheld by the Government of Israel.

7. **The deficit was financed mostly by external budget support and some advances, including from the PIF**. Three-quarters of the recorded budget deficit were covered by external grants, which totaled $154 million in the first quarter, with about half, as noted, provided by Arab League

[2] Previously lent to the PA by USAID for infrastructure development.

[3] Additional PIF resources were used to repay a large part of the US funds.

countries and the other half by OECD countries (Table 2). This compares with only $52 million per quarter of external budget support during the second half of 2005. Advances from the PIF and the local telecommunications company Paltel reportedly totaled $76 million, while on balance $21 million in loans were repaid to banks. The latter was the balance between some additional bank financing obtained in the first two months and large repayments in March.

Table 2. External Budget Support, 2004–06

	2004	2005	2006 Jan.-March
	(In millions of U.S. dollars)		
Total Budget Support	353	349	154
Multilateral assistance	333	349	144
Arab league, *of which:*	98	194	78
Saudi Arabia	77	31	57
Kuwait	0	40	0
Oman	0	1	7
Qatar	0	11	14
Libya	14	0	0
Egypt	3	1	0
Algeria	0	104	0
Tunisia	2	0	0
Other Arab	2	7	0
European Union 1/	50	0	24
World Bank (ESSP)	67	23	0
World Bank Reform Trust Fund	118	132	42
Bilateral assstance	20	0	10

Source: IMF staff, and Ministry of Finance.

1/In March 2006, includes about EUR 20 million for the purchase of fuel for the production of electricity.

B. Revenues

8. **Despite still relatively strong domestic tax collections in the first quarter, budgetary revenues suffered significantly from a lack of dividends from the PIF and the withholding of clearance revenues by Israel since mid-February**. Total revenues fell by over 30 percent in U.S. dollar terms compared to the last quarter of 2005. Overall, domestic revenues (tax and non-tax) averaged $33 million per month during the first quarter of 2006. The interruption in clearance revenue transfers deprived the PA Treasury of one full month of these revenues in the first quarter, which had averaged over $60 million during January–February 2006. In addition, the PIF was not in a position to disburse dividends, in contrast to 2005, as PIF profits were not yet assessed.[4] Yet, the performance of domestic tax revenues was stronger relative to end-2005, owing to large prepayments of estimated income tax liabilities by key large enterprises, as well as the impact of the mid-year salary increases for PA employees on their income tax liabilities.[5]

C. Government Wage Bill and Employment

9. **The wage bill has remained at its end-2005 level in the first quarter of 2006 even though the number of government employees seems to have increased further**. The number of PA civil servants was reported to have increased by 1,338 persons between end-December 2005 and end-March 2006, while there was apparently no net increase in security personnel—not counting security trainees who are not included in the payroll but whose numbers continued to rise sharply.[6] This rise in employment reflects mostly the recruitment of new teachers, hired in September 2005 and confirmed in early January 2006. The PA wage bill was 26 percent higher, in local currency, than in the first quarter of 2005, following the mid-year salary increases granted to both civilians and security personnel.[7]

10. **Since March 2006, due to the shortfalls of budgetary revenue and financing resources, the wage bill dramatically exceeded revenue and could not be paid**. Without the transfer of clearance revenues and PIF dividends to the PA, the wage bill was almost three times total revenues in March. But even with the receipt of clearance revenues, the wage bill would now broadly

[4] In 2005, the PA received $10 million in PIF dividends in the first quarter and $60 million in the final quarter.

[5] The income tax on the salaries of PA employees is withheld at source.

[6] There were 13,966 security trainees at end-2005; 20,839 trainees at end-January; and 20,793 trainees at end-March 2006. Payments for security trainees are recorded as transfers.

[7] The increases in civilian and security wage bills from the first quarter of 2005, in NIS, were 19 percent and

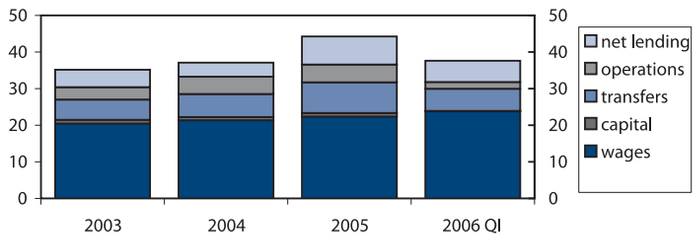
39 percent, respectively.

equal revenues, underscoring the importance of measures to reduce the wage bill after the situation normalizes. The last actual full payment of the wage bill was in mid-March, shortly before the new cabinet was sworn in, aided by the large external budget support disbursed that month.[8]

D. Non-wage Expenditures

11. **The PA responded to the growing financial crisis by compressing operating, capital, and transfer expenditures (Figure 2)**. Total non-wage expenditures were cut by half, from a monthly average of $60 million in the last quarter of 2005 to $31 million in the first quarter of 2006. Interest payments on PA debt, at $3.5 million per month for January–March 2006, accounted for an increasing share in operating expenditures from about 20 to 50 percent between these two quarters. Spending agencies that suffered a proportionally smaller cut in operating expenditures were the President's office, the Ministry of Interior, and social ministries.

Figure 2. Composition of Expenditures
(Percent of GDP)



12. **Social safety net programs bore the brunt of the financial squeeze faced by the PA in early 2006**. Total transfers were cut by almost half. Transfers for the temporary unemployment program (which averaged about $8 million per month in late 2005), along with those from the Financial Reserve and for the families of detainees were reduced the most.[9] Partial data indicate that social safety net transfers amounted to at least $9 million in the first quarter. Transfers to the ministry of interior, which include amounts for training security recruits, averaged about $5 million per month in January-March 2006.[10]

E. Net lending

13. During the first quarter of 2006, net lending expenditures[11] were lower than in late-2005. The shortfalls in resources forced the PA to delay paying suppliers of energy products and utilities. It is therefore likely that pending bills were accumulating without being reflected in net lending accounts.[12] Some payments have not been recorded by the PA, but have been added in this note.[13] These include an amount of about $24 million paid out in March by the EU for the delivery of fuel to the Gaza Electricity Generation Company and an estimated $11 million in payments to Israeli utility suppliers out of clearance revenues (the average monthly deduction in 2005), as Israeli companies continued to provide water and electricity to WBG. With these additions, net lending in the first quarter reached $68 million—less than two-thirds the amount paid out in the last quarter of 2005.

II. DEVELOPMENTS SINCE APRIL 2006[14]

14. **Following the formation of the Hamas-led government on March 29, 2006, the resource flow to the PA all but dried up**. In addition, the PA virtually lost access to banking services, making it very difficult to make payments or receive

[8] Wages are reported by the PA and here on a commitment basis.

[9] Transfers, as presented in the attached fiscal table, include PA pension contributions, which are recorded on a commitment basis but are not paid. The amount of transfers effectively paid is therefore much smaller.

[10] Monthly transfers to the ministry of interior increased sharply in August 2005, reportedly due to the implementation of the security trainee program and, following the Law on Security Services, due to the PA obligation to pay the employer contribution for the pension plan for security services.

[11] Mainly, fuel oil expenses paid by the PA to the Gaza Electricity Generation Company, loans to the municipalities for the delivery of water services, electricity and water bills unpaid by households but owed to the Israeli companies, and price subsidies for petroleum products. Additional details are provided in "Macroeconomic Developments and Outlook in the West Bank and Gaza—Ad Hoc Liaison Committee Meeting", London, December 14, 2005 (available at IMF.org).

[12] Net lending is recorded on a cash basis.

[13] Based on information from senior officials or on estimates based on past history.

[14] The data provided since April must be viewed with caution since the ministry of finance focused more on finding resources and prioritizing spending rather than reporting on its operations. Furthermore, banks no longer provided written reports of their transactions.

assistance. Fearing possible anti-terror litigation abroad, no bank appeared willing to lend to the PA or to hold its treasury account. Hence, new budgetary support—mostly from Arab League countries— intended for the PA failed to reach it until very recently, accumulating instead in bank accounts in Egypt. Relying only on domestic tax revenues and cash carried through the Egyptian border with Gaza, the PA's fiscal policy was reduced to carefully selecting which expenditures to pay when scarce resources became available. Under these circumstances, preparing a budget for 2006 had become a meaningless exercise. The Palestinian Legislative Council (PLC) extended until September 2006 the rule for monthly executing one-twelfth of the expenditure of the 2005 budget.

15. **In April, the deficit widened as a result of depressed domestic revenue collections adding to the loss of clearance revenues and lower nontax revenue**.[15] Total domestic revenues in April were estimated at about $20 million.[16] In these circumstances, nonwage spending was further compressed by virtually eliminating social transfers and keeping operating expenditures to a minimum.[17] Overdue bills for petroleum products delivered to the PA had accumulated to such an extent that the supplier, the Israeli company DOR, threatened to interrupt the service. A fuel crisis was narrowly avoided owing to both payments out of PIF assets to cover the price difference on oil products between Israel and the West Bank and Gaza, and to the EU transferring an additional $6 million for the purchase of fuel for electricity production in April (followed by an additional $7 million in May). External budget support of $41 million, which had been secured by the caretaker cabinet, was mostly used to further reduce PA debt to banks.[18] According to data from the Palestinian Monetary Authority (PMA), gross PA debt to banks was reduced from close to $614 million at end-February to an estimated $480 million at end-May.

16. I**n this dire context, PA employees have not received their full salaries since mid-March**. This has left between one-fourth and one third of the Palestinian population without their main source of income. The PA was just able to complete before mid-July one single payment of about $300 to each employee, made in several tranches starting with the lowest paid employees. To that effect, the PA used part of its domestic revenue, as well as cash donations from abroad brought into Gaza through the border crossing with Egypt. The withholding of clearance revenue and the halting of external budget support has resulted in removing the equivalent of $85 million per month of liquidity from the Palestinian economy (about $1 billion on an annual basis), with deep and widespread consequences for the entire Palestinian economy.

17. **In July, financial support from Arab countries reached the account of the President's office, allowing another partial wage payment**. The Arab League and Kuwait managed to transfer, respectively, $91 million and about $45 million to the account of the presidency. The President's office was then able to cover some of the overdue wage bill, paying a full month's salary to PA employees earning less than NIS 1,400 (around $300) monthly, while all others received half their salary. The funds to the President's office will also be in part allocated to the Presidential guard and current expenses of the President's office.

18. **In June, the Quartet endorsed a Temporary International Mechanism (TIM) to channel aid directly to Palestinians, bypassing the Hamas-led government**. The arrangement, proposed by the European Commission (EC), is limited in scope and duration. It consists of three windows, of which the first two—envisaged to each provide some $6 million a month—are existing facilities managed by the World Bank and the EU. The World Bank facility will cover essential operating costs of the social sectors, and the EU facility will cover the cost of fuel oil for hospital generators, water pumps and water treatment plants in Gaza.[19] The third window would fund allowances for health care workers and for a needs-based social safety

[15] This figure is mostly on a commitment basis, due to the overwhelming weight of the wage bill in total expenditure.

[16] It is unclear whether or not this amount includes income tax liabilities of banks which they are offsetting against debt service obligations due to them by the PA.

[17] In April, debt service, at about $2.8 million, was 62 percent of operating expenditures, and operating expenditures of the ministry of interior increased from $1.2 million to $1.5 million between March and April 2006, equivalent to an increase from 11 percent to 34 percent of operating expenditures.

[18] Of the total support, $35 million was received from Algeria and $6 million from the EU.

[19] Following the destruction of the Gaza power plant.

net. It is currently envisaged to disburse up to $25 to $30 million monthly. The EC started paying allowances to health care workers in late July. Payments are made directly into workers' bank accounts. The payment of social allowances has yet to start because of the difficulty in identifying beneficiaries.

19. **In the current political context, key public finance reforms implemented in recent years are now critically compromised and monitoring recent fiscal developments is becoming extremely difficult**. The Single Treasury Account is not operational, due to the refusal by key domestic banks to handle the PA's accounts and to communicate formally with the Ministry of Finance. Consequently, combined with the preference by some key donors to bypass the PA, there is an increasing amount of expenditure being executed outside normal channels, including through the PIF; the account of the President; direct payments made by donors; and cash brought into WBG and not deposited in PA accounts. Furthermore, clearance revenues collected on behalf of the PA, but withheld by the GoI, and direct payments from these clearance revenues to Israeli utility suppliers are no longer reported to the PA. In addition, the intensified restrictions of passage between the West Bank and Gaza have weakened interaction between PA employees of each area and, thus, the centralization of recording between the two territories. For all these reasons, a comprehensive assessment of PA expenditures and revenues is becoming very difficult.

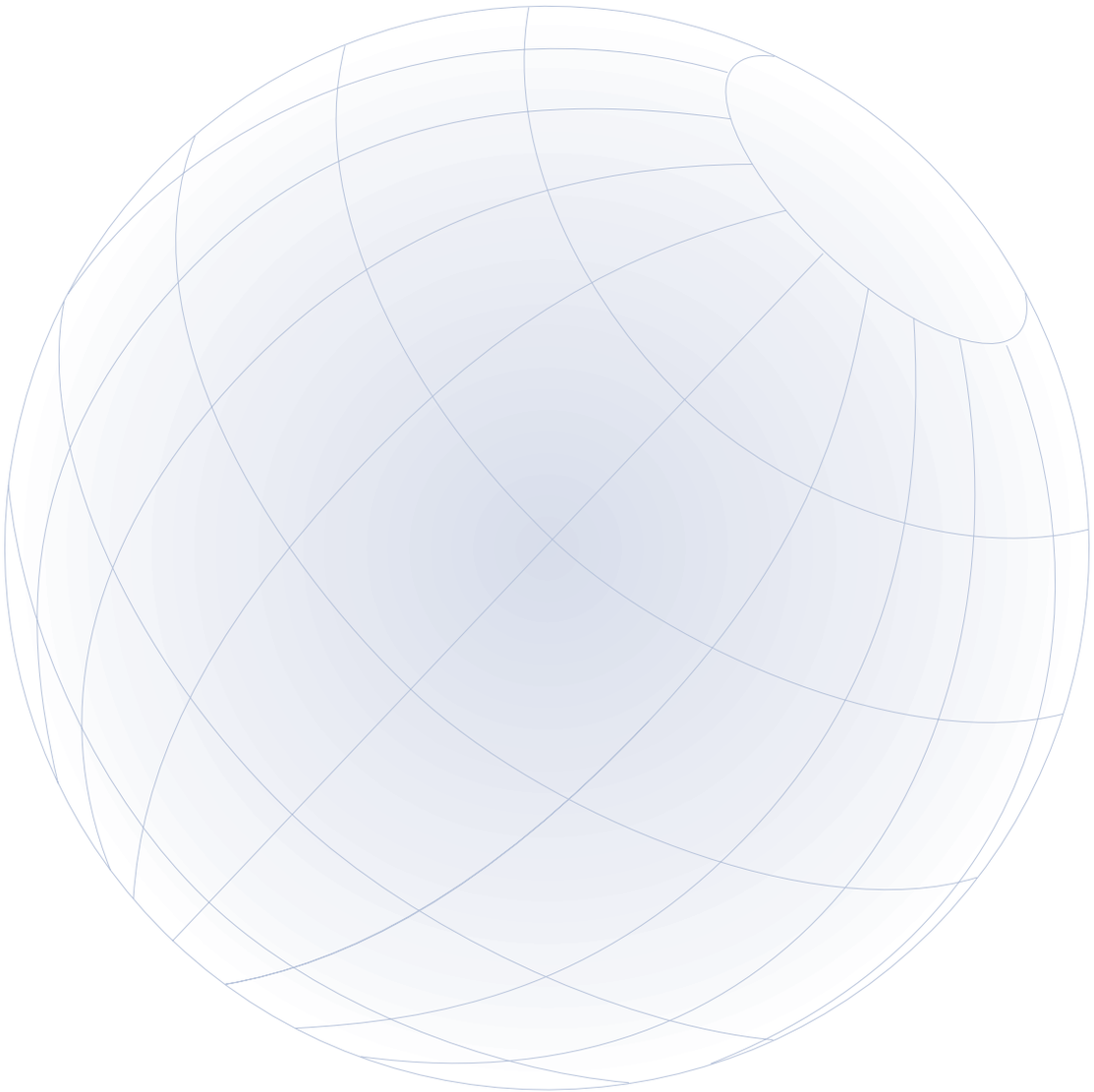


Table 1. West Bank and Gaza: Central Government Current Fiscal Operations, 2004–2005

	2004	2005					2006		
	Prel.	QI	QII	QIII	QIV	Year	QI		
							Total	Average	April
	(in million of US dollars)								
Revenue	954	254	342	291	331	1,232	236	79	20
Gross domestic	337	86	152	95	142	476	99	33	20
Tax revenues	191	53	65	67	46	231	74	25	13
Non-tax revenues	146	33	87	28	96	245	25	8	7
Gross monthly clearance 1/	617	167	190	196	203	757	137	46	0
Expenditure	1,355	320	407	445	466	1,638	371	124	116
Gross wages	870	236	235	253	278	1,001	278	93	95
Civilian	538	148	149	153	165	614	164	55	56
Security	333	88	86	100	113	387	114	38	39
Non-wage current expenditure	449	81	155	177	180	593	92	31	21
Of which Operating	193	36	72	57	53	218	21	7	5
Of which Transfers (incl pensions)	257	45	83	120	127	375	71	24	16
PA financed capital spending	36	3	17	16	8	44	1	0	0
Net lending 2/	157	59	93	85	107	344	68	23	4
VAT refunds	16	1	1	5	4	12	0	0	4
Balance	-574	-127	-160	-244	-232	-762	-203	-68	-104
External budget support 3/	353	71	174	54	51	349	154	51	41
Balance after budget support	-221	-56	14	-190	-181	-413	-49	-16	-63
Total other financing	221	56	-14	190	181	413	49	16	63
Exceptional and advances 4/	...	0	0	109	64	173	76	25	0
Gross withheld clearance revenues 5/	97	10	43	11	73	137	0	0	0
Net domestic bank financing	134	74	105	84	41	304	-21	-7	-30
Residual 6/	-9	-28	-162	-14	3	-202	-6	-2	93
	(in percent of GDP)								
Gross revenue	23.4	5.7	7.6	6.5	7.7	27.5	...	...	...
Expenditure 7/	33.2	7.1	9.1	9.9	10.4	36.6	...	...	...
wages	21.4	5.3	5.3	5.6	6.2	22.4	...	...	...
nonwages	11.0	1.8	3.5	3.9	4.0	13.2	...	...	...
Net lending and VAT refunds	4.2	1.4	2.1	2.0	2.5	8.0	...	...	...
Deficit before grants	-14.1	-2.8	-3.6	-5.4	-5.2	-17.0	...	...	...
Deficit after grants	-5.4	-1.2	0.3	-4.2	-4.0	-9.2	...	...	...
Memorandum items:									
Wages									
in percent of revenue	91.2	92.8	68.8	86.8	80.3	81.2	117.8	117.8	484.6
in percent of expenditure and net leading	57.5	62.2	47.1	47.7	48.4	50.5	63.3	63.3	79.2
Exchange rate NIS/$ (period average)	4.48	4.36	4.41	4.54	4.65	4.49	4.67	4.67	4.58
Government employment (end of period)	133,106	134,984	135,811	135,226	136,772	136,772	138,110	...	...
Of which: civilian	76,039	77,917	78,744	78,159	79,705	79,705	81,043	...	...
Of which: security	57,067	57,067	57,067	57,067	57,067	57,067	57,067	...	...

Sources: Ministry of finance, and Fund staff estimates.
1/ Includes payments deducted for dues owed to the Israeli utility companies, while the budget figure is on a net basis. For March 2006, includes an estimated US$11 million in clearance revenue which would be withheld for the payment of Israeli utilities.
2/ Transfers to electricity generation and distribution sectors as well as to the General Petroleum Corporation and to cover unpaid utility bills by households. In March 2006, includes an estimated US$11 million which would normally be financed through clearance revenues.
3/ In 2005, the budget includes US$240 million to finance social safety net and unemployment programs.
4/ Advances from the Palestine Investment Fund and the telecommunications company Paltel.
5/ Includes equalization tax transferred by the Government of Israel to the PA, earmarked for employment programs.
6/ Includes repayment of arrears, while accumulated arrears, other than on wages and pension contributions, are not recorded.
7/ Comprised of gross wages, nonwage expenditure, and PA financed capital spending (excluding donor financed).

The World Bank's Operations in West Bank and Gaza

August 2006

On-going Bank Group Operations	
Project Name & Details	**Description**
Solid Waste and Environmental Management Project (SWEMP). World Bank: US$9.5 million Approval Date: October 10, 2000. Closing Date: December 31, 2007. Task Team Leader: Andrew Mokakha	The Project is financing interventions in solid waste collection, transfer, and disposal of waste for the District of Jenin. The Project is managed by the Joint Services Council for Solid Waste Management (JSU). The Project is assisting in strengthening capacity building of the Environmental Quality Authority. The EC is financing the supply of collection vehicles and transfer stations relation set-ups.
Electric Sector Investment and Management Project (ESIMP). World Bank: US$15 million. EIB: US$38 million. Italy: US$35 million. PA: US$3 million. Approval Date: August 31, 1999. Closing Date: December 31, 2006. Task Team Leader: Somin Mukherji	The objectives of this US$91 million Project are to rehabilitate the power distribution systems in the central and southern West Bank, and to address the institutional structure for longer-term sector management.
Emergency Water Project (EWP). World Bank: US$12.5 million Approval Date: February 2004 Closing Date: June 30, 2007 Task Team Leader: Sana Al Nimer	The main objective of the project is to support investments that would help alleviate the chronic shortages of safe water supplies; reduce water costs and health risks; and conserve scarce water resources by reducing system losses. The Project includes the following components: (a) emergency water supply repair and rehabilitation in remote rural areas of the southern West Bank; (b) repair and rehabilitation necessary to maintain water and sanitation service levels in the Gaza Strip at the high levels achieved under the Gaza Water and Sanitation Project despite the deteriorating economic and security conditions; and (c) Technical Assistance and Capacity Building provided to the Palestinian Water Authority and the recently established Coastal Municipal Water Utility in the Gaza Strip and to form pilot joint services councils for smaller towns in the southern West Bank.
Social Safety Net Reform Project (SSNRP) World Bank: US$10.0 million Approval Date: July 19, 2004 Closing Date: December 31, 2008 Task Team Leader: Sima Kanaan	The objectives of the Project are to mitigate the impact of the present social and economic crisis on the most vulnerable, and to protect the human capital of poor children in the West Bank and Gaza. This objective is achieved through enhancing and modifying the existing Special Hardship Case (SHC) program of MOSA to include a component that will make eligible households' receipt of assistance conditional upon their compliance with a set of pre-determined criteria related to school attendance, attendance at scheduled health check-ups, and attendance at awareness session on pertinent social issues. The Project also aims to strengthen the institutional capacity of PA agencies involved in the implementation of the proposed project, in particular in Ministry of Social Affairs.

The Integrated Community Development Project (ICDP). World Bank: US$10 million. Approval Date: May 23, 2002. Closing Date: December 31, 2006. Task Team Leader: Husam Abu Dagga	The Project seeks to improve the quality and availability of basic social and economic services in poor and marginalized communities of West Bank and Gaza. It succeeds previous community development operations financed through the Bank under Community Development Projects I & II. The project finances the rehabilitation of roads, water supply and sanitation systems, schools, clinics, thereby preserving and extending the capital stock of villages and small municipalities. It also finances agricultural activities, including the rehabilitation of wells, roads, and terraces. Lastly, the project is piloting new Information and Communication Technology (ICT) initiatives by funding the creation of Multipurpose Tele-centers, thereby improving access to information and training for the poor and marginalized.
North Gaza Emergency Sewage Treatment Project. World Bank: US$7.5 million Approval Date: September 9, 2004 Closing Date: June 30, 2010 Task Team Leader: Sana Al Nimer.	The North Gaza Emergency Sewage Treatment project is the fourth in a series of Bank-funded water and sanitation projects since 1994. The Project is addressing the immediate and impending health, environmental and safety hazards to the communities near the poorly-treated and rapidly growing sewage lake in the Beit Lahia area of North Gaza. The project is also part of a long-term solution for the adequate treatment and disposal of wastewater in North Gaza, which entails the construction of a new wastewater treatment plant expected to be financed by various donors. Approximately 300,000 people living in North Gaza will benefit from this project.
Gaza Water and Sanitation Services Project (GWSSP II). World Bank: US$25 million Approval Date: June 7, 2005 Closing Date: January 31, 2009 Task Team Leader: Khairy Al-Jamal	This Project is a follow-up to the previous GWSSP. The development objectives of this Project are: (a) to develop a sustainable institutional structure of the water and wastewater sector in Gaza by supporting the functional establishment of a Coastal Municipalities Water Utility, as well as by enhancing and deepening the involvement of the private sector through an eight-year operating contract and strengthening the regulatory and institutional capacity of the Palestinian Water Authority; and (b) to continue improving the water and sanitation services by rehabilitation, upgrading and expansion of existing systems and facilities. Like the GWSSP, this Project is part of a larger parallel capital program to improve water and sanitation services in Gaza. The Project includes substantial investments in the establishment of a bulk water supply network connecting the various municipalities in Gaza, in the sewerage network, and in wastewater treatment plants. These investments, totaling about US$340 million for 2000-2005, will be financed by soft loans and grants from EIB, USAID, and KfW.
Tertiary Education Project World Bank: US$10 million Approval Date: April 26, 2005 Closing Date: December 31, 2009 Task Team Leader: Adriana Jaramillo	The project development objectives are: 1) to improve the regulatory environment for tertiary education management, relevance and quality assurance; 2) increase internal and external efficiency of the tertiary education system, as a first step towards seeking sustainability; and 3) to create incentives and provide the basis for improvements in efficiency, quality and relevance of tertiary education institutions in order to meet the socioeconomic needs of the Palestinian population. The project provides technical assistance on defining policies consistent with increasing the financial sustainability of the sector and improving the capacity to respond to labor market needs. It also provides incentive mechanisms to improve quality and relevance of the programs offered. On a competitive basis, Institutions will apply for quality and management grants, administered by a Fund mechanism. In addition the project will provide technical assistance to improve the management of the current student loans program managed by the MOEHE, and will set the basis for expansion of the financial resources available for funding the student aid programs. The EC is providing co-financing in the amount of € 6 million.

Land Administration Project World Bank: US$3 million Approval Date: January 26, 2005 Closing Date: December 31, 2007 Task Team Leader: Ibrahim Dajani	The objective of this project is to assess/learn the extent of commitment and readiness of the PA to reforming land administration by introducing policy, legal and institutional changes to achieve efficient procedures for the issuance of land titles and registration of property transactions, and transparent processes for the management and disposal of public land. The project is the first phase of a long-term Land Administration Program, which aims at enhancing economic growth by improving land tenure security and facilitating the development of efficient land and property markets in rural and urban areas through the development of an efficient system of land titling and registration based on clear, transparent and coherent policies and laws and supported by an appropriate institutional structure.
Avian Influenza Prevention and Control Project World Bank: US$10 million Global Fund for Avian Influenza: US$3 million Board Date: October 2006	The Bank's Board has recentrly approved an Avian Influenza (AI) Project for the Palestinian Terretories. West Bank and Gaza has been considered at high risk for AI due to the large number of migratory birds crossing the territories and the high risk of spreading the infection among domestic poultry. In April, FAO/WHO confirmed AI H5N1 presence in 8 locations in Gaza and preventive culling was concluded in the infected areas. The project aims to strengthen the public and veterinary heath sectors to respond to possible future outbreaks and will be implemented jointly with UNDP. The overall responsibility for overseeing and coordinating institutional and implementation arrangements will be vested with the National Emergency Committee for Avian Influenza Control (NCAIC) which is chaired by the Minister of Health.
Proposed Multi-Donor Trust Fund	
Name of Fund	**Description**
Emergency Services Support Program Approval Date: August 2006 Closing Date: June 30, 2008 Task Team Leader: Sima Kanaan	The development objective of the Emergency Services Support Program is to mitigate the deterioration of service delivery brought about by the inability of the Palestinian Authority to meet its non-salary recurrent costs. The ESSP will finance the non-salary expenditures of the key social ministries and based on the PA's recurrent expenditure program for these ministries. It may also later finance the non-salary recurrent costs of other PA entities. Consultations are currently ongoing with a number of donors on possible contributions. The ESSP budget would be based on the PA's annual recurrent expenditure program and will be subject to the agreement of the Ministry of Finance and the President's Office. Eligibility of expenditures would be assessed by the World Bank, taking into account the emergency nature of the project and the Bank's procurement and fiduciary requirements. Financing of expenditures in other sectors may become possible if donors are willing to provide the necessary financing. Coordination with participating donors will be maintained through a coordination committee.

West Bank and Gaza Portfolio June 30, 2006								
	Trust Fund for Gaza and the West Bank				Co-financing			
	Committed	Disbursed	Undisbursed	Disbursed	Committed	Disbursed	Undisbursed	Disbursed
CURRENT PROJECTS	US$ Million		Percent		US$ Million		Percent *	
00 Electricity Sector Management Project	15.0	14.8	0.2	99%				
01Solid Waste and Environmental Management Project	9.5	3.9	5.6	42%				
02 Integrated Community Development Project	10.0	7.9	2.1	79%				
04 Emergency Water Project	12.5	6.1	6.4	49%				
04 Social Safety Net Project	10.0	1.0	9.0	10%	10.0	0.0	10.0	0%
05 North Gaza Emergency Sewage Treatment Project	7.8	2.9	4.9	38%	10.0	0.0	10.0	0%
05 Land Adminsitration Project	3.0	0.4	2.6	14%	1.5	0.3	1.2	20%
05 Tertiary Education Project	10.0	1.0	9.0	10%	6.0	0.0	6.0	0%
05 Gaza II Emergency Water Project	20.0	4.3	15.7	22%				
Total	97.8	42.5	55.3	43%	27.5	0.3	27.2	1%
COMPLETED PROJECTS								
03 Emergency Services Support Project II	40.0	40.0	0.0	100%	38.8	40.4	-1.6	104%
97 Palestinian Expatriate Professional Program	3.0	2.3	0.7	77%	0.3	0.0	0.3	0%
02 Emergency Services Support Project	20.0	20.0	0.0	100%	37.5	37.5	0.0	100%
04 Public Financial Management Reform SAO	20.0	20.0	0.0	100%				
97 Legal Development Program	2.8	2.8	0.0	100%				
96 Municipal Infrastructure and Development Project	40.0	40.0	0.0	100%	5.4	5.4	0.0	100%
97 Microenterprise Project	2.2	2.2	0.0	100%				
95 Emergency Rehabilitation Project	30.0	30.0	0.0	100%	63.9	63.9	0.0	100%
97 MIGA Fund	10.0	10.0	0.0	100%				
96 Emergency Rehabilitation Project II	20.0	20.0	0.0	100%	3.5	3.5	0.0	100%
97 Community Development Project	10.0	10.0	0.0	100%	2.8	2.8		
01 Emergency Response Program	12.0	12.0	0.0	100%				
95 Education and Health Rehabilitation Project	20.0	20.0	0.0	100%	29.1	29.1	0.0	100%
99 Community Development Project II	8.0	8.0	0.0	100%				
97 Gaza Water and Sanitation Project	31.0	31.0	0.0	100%				
98 Palestinian NGO Project	10.0	10.0	0.0	100%	4.6	4.6	0.0	100%
99 Bethlehem 2000	25.0	24.9	0.1	100%	3.6	0.0	3.6	0%
97 Palestinian Housing Project	17.4	17.4	0.0	100%				
98 Gaza Industrial Estate	10.0	6.9	3.1	69%				
99 Southern Area Water and Sanitation Project	21.0	21.0	0.0	100%				
00 Health System Development Project	7.9	7.9	0.0	100%				
01 Education Action Project	7.0	7.0	0.0	100%				
03 Emergency Municipal Services Rehabilitation Project	20.0	20.0	0.0	100%				
00 Municipal Infrastructure and Development Project II	7.5	7.5	0.0	100%				
01 Palestinian NGO II Project	8.0	8.0	0.0	100%	11.6	9.3	2.3	80%
TOTAL (Current & Completed)	500.6	441.4	59.2	88%	228.7	196.8	31.8	86%
DONOR FUNDED TRUST FUNDS								
The Holst Fund (closed)					273.4	273.4	0.0	100%
Technical Assistance Trust Fund (closed)					22.8	23.6	0.0	104%
PEACE Facility (closed)					25.0	23.8	1.1	95%
Public Financial Management Reform Trust Fund (closed)					273.4	273.4	0.0	100%
TOTAL DONOR FUNDED TRUST FUNDS					594.6	594.2	1.1	100%
GRAND TOTAL	500.6	441.4	59.2	88%	823.2	791.1	33.0	96%

* For some cofinancing, investment income is added to the principal and disbursed, causing disbursements to go above 100%
2/ Year approved by World Bank Board of Executive Directors

Partnerships with the Palestinian Private Sector

The World Bank Investment Climate Assessment

Over the past five to six years, the private sector, like all of Palestinian society has suffered extreme hardship. The conflict, and the various movement and access restrictions currently in place, have severely depressed businesses and the livelihoods of many people.

Ultimately, the prosperity of the Palestinian people relies on a dynamic and productive private sector. Therefore, it is imperative for policy makers to understand the most important factors for the performance of a typical Palestinian firm and the decisions of an investor, and to create a climate that supports both. It is also important for business organizations and other groups supporting the private sector to have this information, as this will impact their policies and goals. Unfortunately, there is currently very little information available on state of the private sector or the investment climate.

To this end, the World Bank along with partners such as DFID, PALTRADE and MAS, is carrying out an Investment Climate Assessment (ICA) of the West Bank and Gaza. The ICA is a standard tool used by the World Bank around the world to provide a way of measuring and comparing investment climate conditions in a country. The ICA will allow policymakers to identify the features of the Palestinian investment climate, and to compare it to other countries.

The ICA will use all available information to analyze the investment climate, including a variety of studies and published documents. Most importantly, the ICA will include a detailed enterprise survey that seeks out information directly from businessmen. In the West Bank and Gaza, the survey is being conducted by the Palestinian Central Bureau of Statistics and will cover approximately 400 firms in all sectors and regions. The results will provide information on the state of the private sector and their most pressing constraints. They will also allow the investment climate in West Bank and Gaza to be benchmarked against Jordan, Egypt, Syria, Turkey, China, India and other countries where recent surveys have been conducted.

The Survey should be finished in early October and the final analysis will be available by November. The results will provide an important source of guidance for policy makers, business associations, donors and other groups working to support the private sector.

Private Sector Development and Trade Group

Mechanism for Donor, Private Sector and Government Coordination

The Private Sector Development and Trade Group (PSDT) is a subset of the Economic Strategy Group- one of four Strategy Groups established in August 2005 by the Palestinian Government and donors to enhance coordination on all initiatives towards long term economic development in the West Bank and Gaza.[1] The PSDT was established to focus on projects relating to the private sector and trade, and is chaired by the Ministry of National Economy and the World Bank. The PSDT involves a number of donors, and the active participation of the Palestinian Private Sector Coordination Council (PSSC).[2]

The role of the private sector in economic growth and employment is undeniable. In 2003, for example, 66,000 enterprises employed almost 200,000 people and provided one-third of the total jobs in the West Bank and Gaza. Recognizing its importance, the donor community has supported private sector development over the past ten years by financing physical and institutional infrastructure; and by building the capacity of several private sector institutions, associations, civil society organizations, and local government. Donors also supported guarantees for foreign and domestic investors.

Unlike other countries, the Palestinian private sector does not face many of the regulatory obstacles found in other countries. For instance, studies show that the time and number of procedures needed to register a business has dropped significantly. Also, a survey of the private sector shows that licensing requirements, taxation and inspections are not regarded as overly burdensome. However, much still needs to be done.

However, the Palestinian private sector faces challenges that are unique to the West Bank and Gaza, including the movement and trade restrictions posed by the numerous checkpoints, and border crossings and terminals. These pose considerable impediments to trade.

During a PSDT meeting on June 14th, 2006, the Private Sector Coordination Council presented a three–year strategic plan (2006–2008)- a collaboration between the Ministry of National Economy and the private sector. This plan focuses on four priorities: (1) developing a legal and regulatory environment that supports the private sector; (2) enhancing physical infrastructure (e.g., roads, power connections, etc.); (3) developing finance, leasing and mortgage mechanisms; and (4) increasing the competitiveness of key sectors.

Despite the substantial progress to date, much work remains to prioritize, implement and finance the plan. Here, donors and the private sector play a major role.[3] The private sector representatives are preparing a matrix of priority projects, and will present this in a third meeting in late summer 2006.

[1] The donor members of the PSDT include Canada, France, Germany, IMF, Islamic Development Bank, Italy, Japan, Spain, Switzerland, UNDP, U.K. U.S., World Bank and IFC.

[2] The Private Sector Coordination Council was established early 2000 and represents 9 Palestinian organizations representing the private sector. The Council coordinates between all private sector institutions and works closely with the PA to put policies forward for economic development.

[3] The PSCC Secretariat rotates every six months among the four largest associations: Paltrade, Palestinian Businessmen Association, Palestinian Federation of Industries, and Federation of Chambers of Commerce, Industry and Agriculture.

The Public Expenditure Review – "From Crisis to Fiscal Independence"

Upcoming World Bank Study

The Palestinian Authority (PA) is currently confronting a fiscal crisis that is largely unprecedented in its history. While the proximate causes are the withholding of clearance revenues by Israel, the termination of budget support from many donors, and the regulatory concerns that are preventing many banks from engaging in financial transactions with the PA in the wake of the January 2006 election, the structural roots of the crisis run deeper. By late 2005 in fact, the PA had already reached a position that was fiscally unsustainable, in which assets were being liquidated or mortgaged to meet current expenditures.

Under these circumstances, it is difficult to think about a Public Expenditure Review (PER)- an analysis the World Bank carries out in many countries- for the West Bank and Gaza in the traditional sense. Implicit within the idea of a PER is the belief that a government faces options and tradeoffs in how it uses its financial resources – that it has the flexibility to choose between competing priorities, and to structure its finances in such a way as to free up resources for use elsewhere. It assumes that a government has latitude to develop institutions and deploy human and financial resources in ways that will maximize efficiency while achieving their developmental objectives. On each of these fronts, the PA faces severe constraints, fiscal or otherwise. At first glance, beyond creating a prioritized schedule of expenditures to be paid as resources become available, it is hard to see what else can be done.

Yet the current crisis also provides an opportunity to take a longer term and more strategic view of Palestinian finances. The PER focuses on five major categories: the first is the Government's wage bill, which during 2005 was 22.4 percent of GDP and was clearly the largest, as well as the most pressing, area for reform. The other areas are transfers to municipalities; health and education expenditures; and social policy and social protection.

The World Bank's PER is expected to be completed in October, following discussions and consultations with the authorities. Public release is expected by the end of the year.

An Interview with a World Bank Managing Director

Dr. Juan Jose Daboub, the World Bank's new Managing Director was most recently El Salvador's Minister of Finance with responsibilities for the World Bank, IMF and Inter-American Bank. Juan has distinguished himself in both the public and private sectors. When El Salvador suffered two devastating earthquakes, Mr. Daboub was deeply involved in a successful recovery effort which provided 250,000 homeless families with shelter within 90 days and restored $2 billion in damaged infrastructure.

Mr. Daboub joined the Bank Group on July, 2006. Among his responsibilities as Managing Director, Mr. Daboub is responsible for the Africa, Middle East and North Africa, and East Asia and Pacific regions.

Q: Mr. Daboub, thank you for agreeing to this interview and for allowing us this opportunity to introduce you to the people of the region. To start, could you can give us an idea of your family background and how your family came to be in El Salvador

JJD: Let me say first of all that I was in born into a closely-knit Arab family both in terms of tradition and inheritance from both my mother's side and from my father's side. I was raised in the traditions of Arab families in El Salvador and educated in the US. My grandfather on my mother's side came from Palestine to El Salvador in 1887. He started from zero in El Salvador. He used to travel through the small towns and villages of the north near the border with Honduras with goods, selling small pieces of cloth, fabric which he would buy and take to the interior of the country.

My grandfather on my father's side came to El Salvador the capital city and then started a business where he could import ceramics, chairs and lamps from France into El Salvador. After about 10 to 15 years of hard work, both of my grandparents, in their own different business started to do very well. My grandfather on my mother's side started an agricultural business growing cotton. From my father's side, my grandfather was the first Salvadorian to own a motor car in the early 1900s. And even though the Arab community was then very small in El Salvador, maybe at that time, a hundred Arabic families existed, the majority of them have been extremely successful. They have passed on, I would say, their practices, beliefs and values to the next generation who in large degree have also continued their success. As of, I would say, the late 1970s, there were no Salvadorians of Arab origin in the government and in the last 10 to 15 years there have been at least 20 high level officials, ministers, presidents of states and companies of Arab origin and they have done a successful job, with transparency and honesty. So that's a little bit of my story. From my wife's side, it is basically the same, both of her grandparents are also from Palestine.

Q: Let's talk about you. Could you tell us a bit about your career and what brought you eventually to the World Bank? Was it a long journey from El Salvador to Washington?

JJD: I have spent almost an equal amount of time in academia as I have in the private sector and in the public sector of my country. When I came to the United States to study there was a war going on in my country. I was made offers to stay in the US, but I wanted to go back to my country and to engage in my family business. I decided to go back because I wanted to fight for my country. Not with weapons but fight by generating jobs, by creating opportunities and by being with my family. I was 26 years old and immediately was invited to be a member of the

board of directors of the Chamber of Commerce. I was teaching at the Masters level in a business institute and I was doing some consulting both in El Salvador as well as in Mexico and in the US and also overlooking at that time two of the companies the family owned, a cookie factory and a plastics factory.

Shortly after that I was asked if I wanted to be a member of the board of directors of one of the state electric companies and I accepted. Later, I became the president of that company and my job was to restructure the company and then privatize it, which I did. I did not then and I do not now, belong to any political party. Even so, three different presidents asked me to help and so for 12 years I worked for three different governments. In my last position, as Minister of Finance, I was a Governor at the World Bank and the IMF. Thus, I had an opportunity to learn about the Bank, to know something about the Bank from the client's perspective. When I finished my term I was invited to continue in government but I did not want to do that and went back to our family business. I was a member of the board of an international think tank that was formed by former Presidents of El Salvador and Spain as well as other well recognized international figures. It was then that I was head-hunted for the position of Managing Director of the World Bank. At first I said "No, I am not interested because this position is usually based on political criteria and not necessarily on the knowledge or expertise of the person and I did not want to be a figure head." But they told me, "Wolfowitz is different. He wants people who have made things happen. We strongly suggest that you participate in the selection process." So, I did.

There were 70 candidates as far as I know. There was then a short-list and then President Wolfowitz offered me the position of Managing Director and I accepted. That's why I am here now. Now I realize that the experience I had in my previous job both in academia as well as in government and the private sector is going to help me move this organization in the direction that President Wolfowitz thinks the Bank should go. That direction is to better meet the mission of reducing poverty and doing so by creating opportunities and doing that in a sustainable way.

Q: Can you give us a sense of where you see the World Bank being in five years time?

JJD: Well five years seem like a short period of time but also given the speed at which the world changes it could be a lot of time as well. In some of the most pressing areas like fighting poverty, conflicts or in regions like Africa we face great challenges. So, even though I would like to see in five years the problem of poverty solved, it is optimistic to think that it can happen. But in five years you can set the conditions and show by virtue of example that it is possible to do it. Also, on the subject of global public goods, actually the Bank has an extremely important role and has also developed the strength to support different governments in addressing this issue. The Bank recognizes too that our clients can go to the market and have access to alternative financing, but I think we have a great advantage within the Bank which is the specialized knowledge of our people that is available for middle income countries, which they can capitalize on and continue their process of reform. These are a few of the major areas where I see us going in the next five years.

Q: Do you see a relationship between poverty and some of the other challenges you have just identified?

JJD: Poverty in many countries is caused by lack of resources and environmental constraints but what we cannot afford is having poverty because of poor leadership and poor government, because of corruption or due to lack of opportunities. Where poverty is a consequence of natural causes, we should develop more tools to address that. In the case of poor governance we need to support better governance and fight against corruption.

Q: With that in mind what kind of world would you like the next generation to inherit?

JJD: Well, I have four children and I certainly hope that they will inherit a world where there is more justice and fairness, by the same token more freedom: In other words, a world where they can be owners of their own decisions and of their own destiny. That means more opportunities, and less intervention. That is why it is important for us to providing them with the right values, showing by example. Family is the nucleus of society. So, I certainly hope, that the work that the current generation does will create the opportunities for reaching a more fair, just, open and free world and will create a better environment for our children who, having obtained the right principles and values at home can hopefully out perform us and do much better than we have done.

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