In This Issue

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Gaza Office

West Bank Office

West Bank & Gaza Country Team earns President's Award for Excellence

The year 2004 marks two milestone events in the history of the World Bank's program in the West Bank & Gaza—ten years of dedicated support to Palestinian institutional and socio-economic development, and a public recognition of these endeavors through the President's Award for Excellence.

The President's Awards for Excellence program was instituted in 1996 as a means to celebrate the outstanding service that World Bank teams provide to clients throughout the world in terms of cooperation, the quality of the support, and the facilitation of equitable, stable and sustainable growth. Since then, over 20 teams representing more than 500 staff in core teams have received official recognition for their work.

The 2004 award ceremony singled out the achievements of four teams: (1) IDA Credit Buydown; (2) China Tubercolosis Control Program; (3) China-Loess Plateau Rehabilitation Project and (4) West Bank & Gaza Country Program Team. In all, 57 nominations were received and criteria for selection focused on results, client responsiveness and cost-effectiveness.

"I think you've done a phenomenal job," World Bank President James Wolfensohn told the award winners. "I also want to recognize that none of these awards would have been possible without partnership with people in places outside our institution."

Partnership was also one of the achievements of the West Bank & Gaza program highlighted by Middle East and North Africa Vice-President, Christiaan Poortman. Coming from six years of experience with conflict-affected countries in the Balkans, Mr. Poortman praised the standards and innovative approaches to post-conflict work set by the West Bank & Gaza program ten years ago, starting early on with the first post-conflict trust fund through which the World Bank's assistance to the Palestinians is still managed today and the first post-conflict multi-donor trust fund (the Holst Fund). Over the past ten years, the team has achieved sustained performance in the face of enormous challenges and has demonstrated exemplary dedication, motivation, and technical and diplomatic skills.

Accepting the award on behalf of 104 team members, Nigel Roberts, the current Country Director, pointed out that this is the first time the award has been granted to a Country Team (as opposed to a Project Team). He thanked all those who dedicated their time and efforts to the program, in particular during the last four years of intensified challenges. He described the Team's work as a "collective act of professional devotion" and singled out a few members who prefer to work behind the scenes to provide key support to the team in terms of security, transportation, cleanliness, analytical standards and information management.

A big Thank You and Well Done are due to one and all!

Disbursements to-date

Donor contributions have started flowing through the RTF and are being disbursed at a fast pace. As of June 15th 2004, US$31 million have been received from Canada, Norway and the United Kingdom. Japan has committed US$10 million. The EC, Belgium and France have expressed strong support for the Reform Fund. The Bank's own parallel contribution (US$20 million) in support of the PA's reform program accompanying the RTF was approved on June 3rd, 2004. To date, US$45 million have been disbursed to the PA through donor and Bank funds. Other potential donors include Germany, Belgium, the Netherlands and Sweden. The Fund will terminate on December 31st, 2005.

Leveraging Budgetary Support to the Palestinian Authority - the Public Financial Management Reform Trust Fun

Background

At the *Ad Hoc* Liaison Committee meeting in Rome December 10th, 2003, donors were alerted to the PA's widening budget financing gap. In spite of generous donor support to the PA budget throughout the *Intifada* years (approximately US$1.25 billion), clear evidence of donor fatigue suggested that an alternative mechanism was required to help leverage new budgetary assistance – one that also responded to donors' concerns about reform and public financial management and accountability. Given the Bank's past experience in managing multi-donor trust funds for budget support in the West Bank & Gaza, Afghanistan and other countries, the PA requested that such an instrument be set up and administered by the World Bank in the beginning of 2004.

The Bank's Board of Directors approved the *Public Financial Management Reform Trust Fund* (RTF) on April 22nd, 2004. The main focus of this multi-donor instrument is to support improved PA financial management within a broader national reform agenda. In parallel, the PA has developed a *Public Financial Management Reform Program* (RP) as a basis for donors to channel budgetary assistance through the RTF.

RTF Structure & Governance Mechanisms

The RTF is aimed at leveraging donor budgetary support through a single channel against a number of clearly defined financial accountability benchmarks that are consistent with the RP. budget support instruments which helped push forward key PA reforms including, the creation of a single treasury account, reinforced transparency in PA public finances and auditing, full MoF responsibility for managing the PA payroll, and the adoption of a Judiciary and Basic Law.

As the fund administrator, the Bank is responsible for monitoring and certifying compliance with the benchmarks and making disbursement decisions accordingly. It is advised in these decisions by a Guidance Committee comprising the Bank, as chair, the IMF and a limited number of other key Reform Fund donors (actual or potential contributors and partners of significant posture).

In discussions earlier this year with the World Bank, the IMF and potential contributing donors, the PA has specified two sets of benchmarks consistent with the Reform Program for 2004, each covering a period of six months, and a timetable for their implementation. Further benchmarks will be developed to cover each subsequent six-month period.

Table2. West Bank and Gaza: Consolidated Banking System

	1998	1999	2000	2001	2002	2003				2004			
		Dec	Dec	Dec	Dec	Mar	Jun	Sept	Dec	Jan	Feb	Mar	April
Net foreign assets	1,669	1,972	2,313	2,329	2,568	2,678	2,813	2,880	2,795	2,787	2,812	2,775	2,803
Palestinian Monetary Authority	182	184	275	259	274	286	378	380	374	383	403	410	418
Commercial banks	1,487	1,788	2,037	2,070	2,294	2,392	2,435	2,500	2,421	2,404	2,409	2,365	2,386
Net domestic assets	568	690	1,025	890	490	454	477	436	485	491	468	515	498
Net claims on the PA	-41	-49	223	196	-40	-27	-11	-54	32	82	-18	50	20
Net claims on local government	-17	-13	-12	-6	-22	-28	-32	-29	-66	-58	-73	-53	-62
Credit to the economy	740	919	1,015	923	866	829	869	878	884	882	926	894	920
Private sector loans and overdrafts	736	913	927	865	865	805	853	862	867	864	909	894	920
Loans to the private sector	299	402	416	378	353	346	333	364	367	370	372	372	395
Overdraft	381	453	429	421	424	371	424	409	409	405	446	413	416
Other	60	63	169	124	89	111	111	105	108	107	108	108	110
Nonfinancial public sector loans and overdrafts	4	6	88	58	1	24	16	16	17	17	17		
Other items (net)	-114	-167	-200	-224	-315	-320	-348	-358	-365	-414	-367	-377	-381
Deposits with banks	2,237	2,663	3,338	3,218	3,058	3,132	3,291	3,316	3,280	3,278	3,281	3,289	3,301
Private sector Deposits	2,216	2,615	3,274	3,161	2,980	3,051	3,205	3,236	3,209	3,214	3,219	3,228	3,238
Private sector demand deposits	605	673	808	757	752	815	929	974	1,007	1,010	1,027	1,023	1,053
Private sector time and savings deposits	1,611	1,942	2,466	2,404	2,229	2,236	2,276	2,261	2,202	2,204	2,192	2,205	2,185
Nonfinancial public enterprises	21	48	64	57	78	81	86	80	70	64	61	61	63
Memorandum items													
Currency composition of deposits 1/	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0		
U.S. dollars	60.7	63.1	62.1	60.5	62.4	61.8	61.3	60.4	59.7	59.2	58.4		
Jordan dinars	24.2	22.2	20.7	22.1	22.3	21.9	22.0	22.6	23.5	23.1	23.4		
New Israeli shequels	14.3	13.6	15.3	15.4	12.8	13.4	14.2	14.6	14.3	14.2	14.6		
Other	0.8	1.1	1.9	1.9	2.5	3.0	2.5	2.4	2.5	3.5	3.6		
Currency composition of credit 1/	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0		
U.S. dollars	49.1	57.0	60.1	66.6	67.6	68.2	67.6	67.4	62.6	63.5	66.0		
Jordan dinars	25.3	21.0	16.2	14.2	14.3	14.3	13.3	14.4	13.6	12.5	12.8		
New Israeli shequels	24.2	20.5	23.0	18.7	17.4	16.7	18.3	17.5	22.9	22.8	20.4		
Other	1.4	1.5	0.8	0.5	0.7	0.8	0.8	0.8	0.8	1.2	0.8		
Credit to the private sector													
as a share of private sector deposits	33.1	34.5	30.4	28.7	28.3	26.5	26.4	26.5	27.0	26.9	28.2		
in percent of GDP	17.4	20.3	23.2	25.0	28.0	...	...	...	24.7	22.9	24.1		
Deposits to GDP ratio(in percent)	52.5	58.9	76.3	87.3	99.0	...	...	...	91.7	85.3	85.4		

Source: Palestinian Monetary Authority 1/Residents only both public nonfinancial and private sectors.

PA Employment

As of end March, the PA had hired a net 2,702 government employees (additional to the end 2003 level). This is a seasonal peak because of the Ministry of Education recruitment for additional teachers. The budget allows for a net 3,500 additional positions by December 2004. In comparison to the first quarter of 2003, the growth in government employment in first quarter of 2004 was 5.6 percent. This was comprised of a 7.8 percent increase in security employment and a 4.0 percent increase in civilian employment. Within civilian employment, social sector employment[2] increased 37 percent compared to that of the first quarter in 2003.

(see Table 1 for fiscal update)

Recent Monetary Developments

Overall, the banking sector remained strong with no perceptible negative impact of the Israeli raid on banks in West Bank and Gaza. While the seizure of US$ 8.5 million dollars from banks' vaults in the West Bank and Gaza on February 25, 2004 by the Israeli Defense Forces unsettled the Palestinian Monetary Authority (PMA), and the banking sector, there was no detectable negative impact as of end April. Deposits did not decline implying that the public confidence in the banking sector was maintained. However, the seizure of funds appears to have reduced the growth in deposits by the private sector and May and June data would be required to make a reliable assessment of the raid's impact.

Total deposits increased by only 1 percent between December 2003 and April 2004, compared with 5 percent in the same period last year. This can be attributed to the decline in time deposits and a lower growth of demand deposits. Although savings deposits grew faster than last year, their impact on total private sector deposits was minimal because they are the smallest component of private sector deposits.

Credit to the private sector grew at a slightly faster rate than the growth in total domestic deposits. After being stagnant through 2001-03, credit witnessed a 4 percent growth in the period compared with a 3 percent fall over the same period last year. This led to a 6 percent improvement in the credit/deposit ratio as against an 8 percent fall in the same period last year. Both loans and overdrafts witnessed higher growth rates of 7 percent and 2 percent respectively, consistent with the observed rebound in economic activity in 2003 and the carryover in 2004. Lending to the private sector of about US$ 850 million amounts to about one quarter of private sector deposits.

There was increased use of the banking sector by the Palestinian Authority (PA). Loans and overdrafts to the PA reached US$311 by April 2004, whereas they were $239 in December 2003. However the net credit position of the government improved by $US 8 million as PA deposits grew by 41percent compared with a 13 percent fall in the same period last year.

The currency composition of deposits remained fairly stable. There was continued dominance of the dollar with 58 percent of private sector deposits. On the credit side, the dollar gained more importance with 66 percent of credit denominated in dollars compared to 63 percent in December 2003. 15 percent of the deposits and 20 percent of credit were denominated in NIS, while the rest is worthy in Jordanian dinars.

(See Table 2 for monetary update)

Table 1. West Bank and Gaza: Central Government Fiscal Developments, 2003-04 (in millions of U.S. dollars, unless otherwise stated)

	2003		2004									
	Budget	Actual	Preliminary Actuals						Budget			
							Jan-April		Monthly	Avr.	Annual	Jan-April
	(at actual exchange rate)		Jan	Feb	March	April	Avr.	Total	Avr.	(at actual exchange rate)		
Revenue	585	747	66	73	73	66	70	278	67	70	845	282
Domestic	228	275	18	21	21	25	21	85	25	26	312	104
Net tax revenues	...	151	9	15	14	9	12	47	13	13	157	52
Tax revenues	...	165	13	15	18	19	16	64	14	14	172	57
VAT refunds	...	-14	-4	0	-4	-10	-4	-18	-1	-1	-15	-5
Non-tax revenues	...	123	10	6	6	16	9	38	12	13	155	52
Gross monthly clearance 1/	357	471	48	53	52	41	48	193	42	44	532	177
Expenditure	1,174	1,129	89	91	108	105	98	393	110	116	1,387	462
Gross wages	700	743	72	71	72	72	72	287	69	72	868	289
Civilian	...	455	46	44	45	45	45	180	69	46	550	183
Security	...	287	27	27	27	27	27	107	69	27	319	106
Non-wage expenditure	449	350	17	19	35	32	25	102	40	42	501	167
PA financed capital spending	24	36	0	1	1	2	1	4	2	2	19	6
Net lending 2/	0	178	16	5	11	2	9	34	10	10	126	42
Balance	-589	-561	-39	-23	-46	-41	-37	-149	-53	-56	-668	-223
External budget support 3/	589	229	11	26	55	6	24	97	54	57	681	227
Balance including budget support	0	-332	-28	3	9	-35	-13	-52	1	1	13	4
Total other financing	0	332	28	-3	-9	35	13	52	-1	-1	-13	-4
Gross withheld clearance revenues 4/	528	294	0	0	0	0	0	0	15	16	189	63
Net change in arrears (- = repayment) and residual	-457	-46	-75	73	-57	52	-2	-8	-15	-16	-189	-63
Net domestic bank financing	-72	85	104	-76	49	-17	15	60	-1	-1	-13	-4
Memorandum items												
Exchange rate NIS/$	4.54	4.54	4.42	4.46	4.50	4.55	4.49	4.49	4.70	4.49	4.49	4.49

2-Social sector employment is defined as the employees of the following ministries: education, health, social affairs and justice, and the High Judicial Council.

it should stimulate private sector activity and bolster confidence in the VAT system, both of which would contribute to a stronger VAT collection in the future. Hence for the full year of 2004, the expectation is for a net repayment of NIS200 million (US$46 million) on top of that projected in the budget.

Expenditures and Net Lending

Budgeted growth of expenditures is expected to surpass that of revenues during 2004. The rationale was to reverse the sharp squeeze in non-wage expenditure which occurred throughout most of 2003 and carry through the implementation of the civil service law of last year. Thus the Budget envisages a 23 percent increase above 2003's actual total outlays. The recovery in non-wage expenditure is set for a growth of 43 percent during 2004, while the wage bill will increase by 17 percent. Net lending to municipalities (primarily in order to cover their outstanding utility payments to Israeli providers) is expected to be 30 percent lower than the outturn of 2003, when a back-log of bills owed from 2002 was cleared. However, this expectation will depend on greater efforts by municipalities in utility bill collection.

The expected growth in expenditure outlays during January-April did not materialize. Expenditures were US$393 million, 15 percent lower than budgeted, due to a continued sharp squeeze (by 39 percent) in nonwage expenditure, PA financed development spending (only US$4 million) and much lower PA net lending to municipalities (totaling US$34 million) some 19 percent lower than budgeted. The wage bill was US$287 million, within 1 percent of the budget expectation. This was comprised of a slightly higher security wage bill (1 percent) and a slightly lower civilian wage bill (2 percent). However, due to the increase in the wage bill and the squeeze in other types of expenditures, the wage bill now represents 73 percent of total expenditures—much higher than the share of total wage outlays last year *(66 percent).*

The Fiscal Deficit and Financing

The projected 2004 budget gap of US$650 million—may turn out to be slightly larger due to the NIS stronger than expected position against the US dollar. The gap was planned to be covered entirely by donor budget support. Should other sources of finance materialize, such as the release of the remaining withheld clearance revenues of 2001-02, this would be spent on reducing the stock of outstanding arrears and the PA's exposure to the domestic banking system.

As of end April, the deficit was 33 percent smaller than envisaged due to a shortfall in external financing and an expenditure squeeze. Despite impressive management of the budget, lower donor budget support could not cover the smaller than expected recurrent budget deficit, leading to additional borrowing from domestic banks.

Donor support amounted to $97 million in the first four months of 2004, 57 percent lower than expected. This comprised assistance from Saudi Arabia of US$31 million, Libya of US$5 million and joint donor funds under the Emergency Services Support Program (ESSP) of US$22 million. The latter is designed to safeguard non-wage expenditure on education, health, and social welfare. Finally, the EC's US$32 million held up from last year were cleared for spending in March; in addition, the US$50 million which were disbursed by the EC in April will only be released pending the vetting of supplier's bills.

The only other source of finance to cover the recurrent deficit has been domestic bank borrowing. The MOF is still unable to fulfill its obligations on social security payments (including pensions) and thus accumulating some arrears. Nevertheless, by the end of April a net repayment of US$58 million was registered for the January-April period, reducing the stock of arrears to US$312 million (8.7 percent of GDP), while the stock of the PA's debt to banks increased to US$253 million (7.1 per cent of GDP).

Fiscal and Monetary Developments, January-April 2004

By the International Monetary Fund

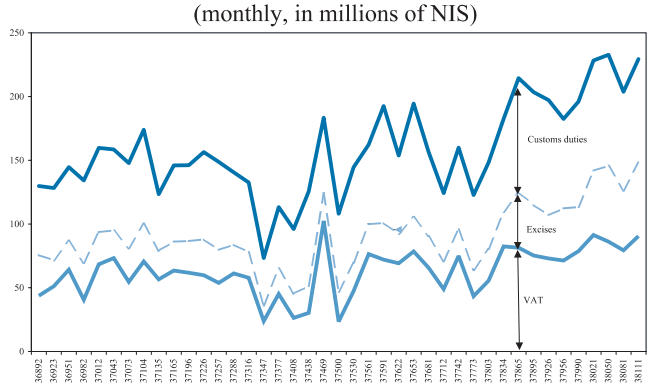
Fiscal Performance

Revenue

The rebound in budgetary revenues in 2003 is set to continue in 2004. Following the collapse of 2000-02, the 2004 Budget envisages a stronger revenue collection by 13 per cent above 2003's actual receipts in US dollar terms.[1] This is driven mainly by growth in non-tax revenues collected domestically and indirect taxes collected by Israel (clearance revenues). The former are expected to grow 26 percent above 2003's actual receipts, while the latter by 13 percent.

Gross revenue performance during January-April at US$296 million, exceeded budgeting projection by 3.1 percent. Gross domestic tax receipts were higher than budgeted by some 12 percent but this was not the case for non-tax revenue which underperformed by 27 percent, despite a transfer from the Palestine Investment Fund's profits to the budget of US$11 million in April. On the other hand, net clearance revenue was US$193 million, 9 percent higher than expected. This was driven by much stronger excise tax performance, particularly petroleum excises, following the takeover of the petroleum agency by the Ministry of Finance since last July (chart 1).

Chart 1
Structure of Clearance Revenues by type, 2001–04
(including clearance revenues not transferred)
(monthly, in millions of NIS)



Overall, this points to better than expected revenue performance.

VAT refunds surpassed the full year appropriation. Refunds are paid out from gross domestic receipts and amounted to an estimated US$18 million at end April, of which US$8 million were paid during the first quarter, resulting in a slightly weaker than expected net domestic revenue position. The (annual) budget appropriation of US$15 million was for regular refunds accrued within 2004. However, in addition to this amount, the ministry of finance (MOF) did not budget for a refund of arrears from last year. Last year refunds amounted to only US$16 million and an accumulated arrear position of about NIS240 million (US$53 million). Following the passage of the budget, the objective has been to clear as much as possible in 2004, since almost 60 percent of these arrears are due to private sector contractors implementing donor projects. Although the immediate effect of this measure has been lower net revenues,

[1] Or growth of 15.5 percent above 2003 receipts in NIS terms.

worsened somewhat, and 8.5 percent considerably over the preceding month.

Looking forward one month, more West Bank businessmen are evenly divided between those expected an improvement relative to the current situation, those foreseeing no change, and those expecting a decline. In Gaza, however, businessmen remained pessimistic on balance.

In addition, business respondents were also asked their expectations of future employment and sales over two time frames – "next month" and "next six months" – as compared to the current situation. Expected investment levels over the coming year were also surveyed. Again, five answers were possible: "much higher"; "somewhat higher"; "about the same"; "somewhat lower"; and "much lower" than current levels.

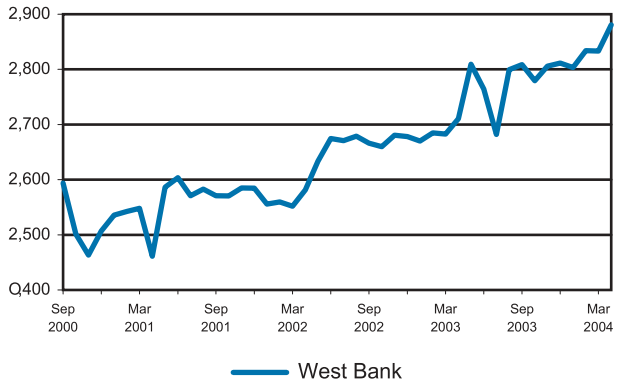
In general, both Gazan and West Bank businessmen were on balance negative over prospective improvements in specific aspects of business operations over the short-term ("next month"), turning slightly more optimistic over the medium-term ("next six months") in both prospective employment and sales levels. Regarding future investment plans, large majorities in both Gaza and the West Bank saw little change in planned investment levels over the coming year relative to their current spending *(See Table 3).*

Table 3. Expectations of Palestinian Business Owners and Managers: "Next Month" and "Next Six Months" Compared with Current Levels

	Employment		Sales		Investment
	Next Month	Next Six Months	Next Month	Next Six Months	Next Year
West Bank					
Much Higher	0.6%	0.6%	0.5%	0.6%	0.4%
Somewhat Higher	11.1%	12.9%	21.5%	12.7%	7.6%
No Change	65.9%	64.3%	50.8%	44.4%	68.8%
Somewhat Lower	13.8%	15.5%	18.7%	14.7%	12.0%
Much Lower	8.6%	6.7%	8.5%	5.1%	11.2%
Gaza Strip					
Much Higher	0.0%	1.4%	0.0%	1.7%	0.2%
Somewhat Higher	13.3%	45.1%	13.8%	45.1%	13.9%
No Change	62.9%	31.2%	57.3%	26.2%	83.8%
Somewhat Lower	22.7%	19.4%	23.1%	20.5%	0.6%
Much Lower	1.1%	2.5%	5.8%	6.5%	1.5%

Source: World Bank staff calculations based on PCBS survey data. Survey conducted May 2-15..

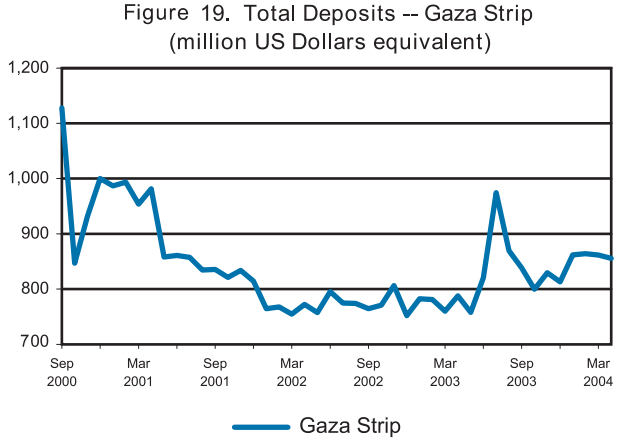
Figure 18. Total Deposits -- West Bank
(million US Dollars equivalent)



Source: Palestinian Monetary Authority (PMA).

In Gaza, deposits stood at $1.13 billion prior to the Intifada, declining to $1.0 billion at end-2000. In 2001, they fell an additional 18.5 percent to end the year at $814 million; 2002 saw additional decline in the first quarter followed by relative stability, ending the year at $752 million. 2003 witnessed a return to deposit growth, continuing into the first quarter of 2004; April 2004's level of $855 million has brought deposits back to the level of May-July 2001 *(Figure 19)*

Figure 19. Total Deposits -- Gaza Strip
(million US Dollars equivalent)



Source: Palestinian Monetary Authority (PMA).

The difference in deposit behavior between Gaza and the West Bank likely reflects the higher rates of unemployment and poverty, and hence lower savings, in Gaza as well as the fact that West Bank residents have greater family ties (and access to relatives) abroad, primarily Jordan – a source of financial transfers and support.

Business Confidence.

The World Bank, with financial support from the Government of Norway, has commissioned PCBS to conduct a series of surveys on the attitudes of both Palestinian households and Palestinian business owners and managers concerning their current economic situation and their expectations concerning short- and medium-term changes. Similar to consumer confidence, investor confidence, and business attitude surveys conduced around the world, the business survey measures current perceptions and future expectations; of particular interest are questions related to future employment levels, expected sales volumes, and future investment plans, as they reveal information concerning overall optimism/pessimism and, over time, could indicate expectations of economic recovery.

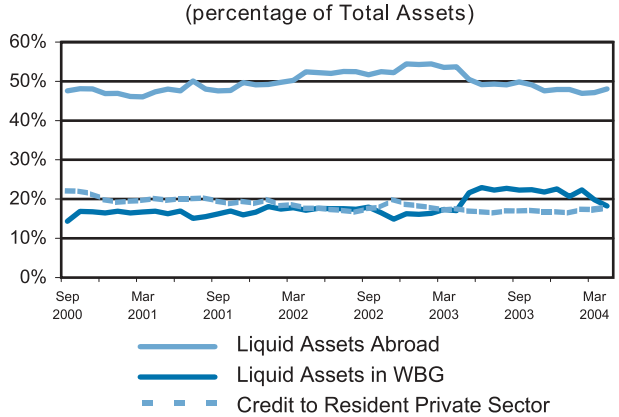
Business establishment owners/managers were asked to evaluate the current business situation – the overall business operating environment – compared to the situation one month ago and their expectations concerning the overall business climate one month in the future – would it be "much better", "somewhat better", "unchanged", "somewhat worse", or "much worse".

In the most recent survey (conducted May 2-15, 2004) business managers in both the West Bank and Gaza were, on balance, negative in their assessment of the current situation compared to one month ago – with businessmen in both areas noting deterioration relative to the previous month.

In the West Bank slightly more than one-third (37.4 percent) saw the current situation as unchanged; 24.0 percent saw somewhat of an improvement (and 0.8 percent considerable improvement); one-fourth (24.9 percent) saw somewhat of a worsening; and 12.9 percent believed the situation to be much worse than one month ago. In Gaza, only 3.9 percent witnessed an improvement (0.3 percent saying "much better"; 3.6 percent, "somewhat better"); one-half (51.6 percent) saw no change; 36.1 percent believing the situation had

The Palestinian banking sector continues to try to weather the current economic crisis by maintaining the very conservative investment positions taken over the years. Banks remain very liquid, with placements in the West Bank and Gaza and, more significantly, overseas and have continued to increase their liquidity ratios since September 2000 – by end-April 2004, 18.2 percent of the combined assets of commercial banks operating in the West Bank and Gaza were held in cash or deposits with other Banks; a further 48.1 percent of assets were held as deposits in foreign banks. These represent significant increases in asset allocation compared to September 2000 when 14.3 percent of total assets were maintained in cash and local bank deposits and a 47.6 percent were in deposits with foreign banks *(Figure 16)*.

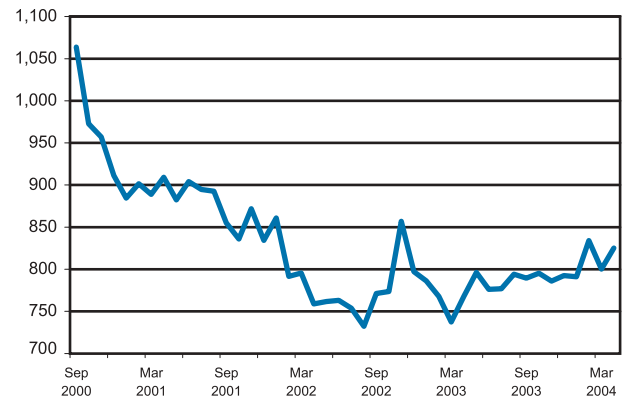
Figure 16. Composition of Bank Assets
(percentage of Total Assets)



Source: Palestinian Monetary Authority (PMA).

Along with this increase in liquid assets is the decline in Bank's lending activity. Throughout the first two years of the *Intifada*, the volume of credit extended to the private sector declined steadily, reflecting both lower demand on the part of borrowers and greater risk aversion on the part of bankers during a period of economic downturn and political uncertainty. In such a climate, the granting of new credits is scaled back and existing lending and overdraft facilities are rolled-over less automatically. Over the past twelve months some increase in lending to the resident private sector has been noted. From its low point in March 2003, when the stock of credit outstanding was US$737 million, lending has increased; at end-April 2004, amounting to US$825 million. Nevertheless this still represents a 22.4 percent decline from pre-*Intifada* September 2000, when US$1.06 billion in credit was outstanding *(Figure 17)*.

Figure 17. Credit to Private Sector
(million US Dollars equivalent)



Source: Palestinian Monetary Authority (PMA).

Expressed as a share of total bank assets, private sector credit has declined from 22.1 percent in September 2000 percent to 17.9 percent end-April 2004 (see Figure 16).

Although it is quite probable that the quality of bank's loan portfolios has suffered (non-performing loans have increased and some collateral destroyed as the result of military operations) as well, the low percentage of loans to total assets mitigates solvency concerns thus far for most banks.

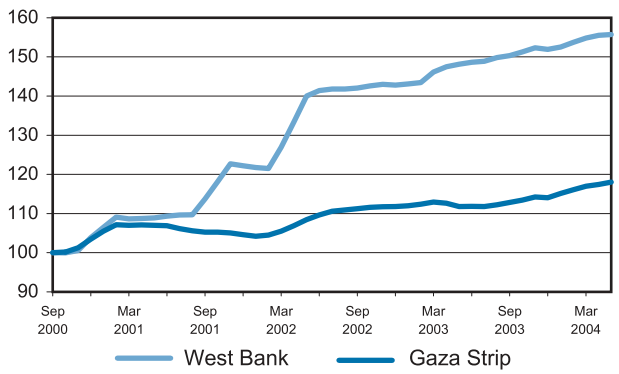
Resident private sector deposits witnessed a considerable decline in the first two months of the Intifada in both the West Bank and Gaza; however in subsequent months different patterns emerged.

In the West Bank, deposits levels recovered; from May 2001 to April 2002 their level was essentially as in September 2000. Further growth in the second quarter of 2002 was followed by another period of stability until April 2003; over the next twelve months deposits again increased, reaching $2.88 billion end-April 2004, 11.1% above September 2000 *(Figure 18)*.

on as increases in the final price of all goods faced by consumers in the market place.

Thus the tightening of closure associated with the outbreak of the *Intifada* in fall 2000 affected both Gaza and the West Bank, while Israeli military interventions in the West Bank in autumn 2001 and spring 2002 explain the difference in movement in the transportation price index in the West Bank and Gaza. In effect, these are negative shocks that raise the level of the transportation price index (seen as upward steps in *Figure 14*).

Figure 14. Transportation Price Indices, (July-September 2000 = 100)



Source: World Bank calculations based on PCBS data. Figure shows three-month moving averages, re-based to Third Quarter (July-September) 2000 = 100.

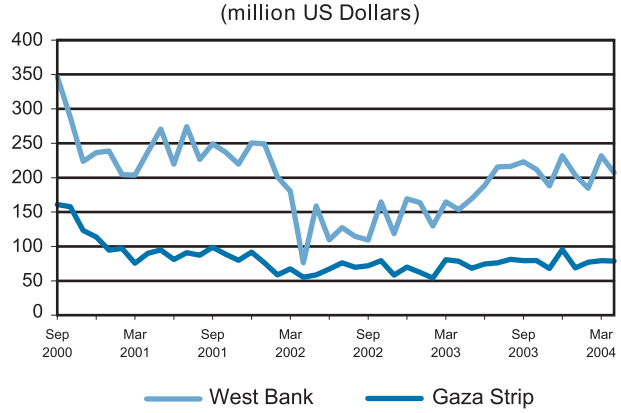
In 2003, transportation prices increased in the West Bank 7.9 percent; in Gaza, transportation costs have increased 3.1 percent. January-May 2004 has again seen increases in the transportation index – since December, it has risen 2.9 percent (7.0 percent annualized) in the West Bank, and by 3.8 percent (9.4 percent annualized) in Gaza.

Banking Sector

The decline in overall economic activity in the West Bank and Gaza since the beginning of the *Intifada* is clearly evident in the total value of checks cleared by banks operating in the West Bank and Gaza Strip, particularly in the periods of increased Israeli military operations. During the first nine months of 2000, i.e., prior to the *Intifada*, the value of checks presented for clearing averaged US$449 million (US$301 million in the West Bank, $148 million in Gaza) per month. During the twelve months of 2002, monthly values averaged less than half the pre-*Intifada* levels: US$148 million in the West Bank; $67 million in Gaza; total, US$216 million.

April 2004 saw US$207 million cleared in the West Bank and US$79 million in Gaza. Compared to the first four months of 2003, the total value of checks cleared has increased 33.9 percent (43.8 percent in the West Bank and 7.3 percent in Gaza). However, this apparently strong increase in the West Bank is deceptive, reflecting the depressed volume in the January-April 2003 period. Indeed, the average monthly value cleared in the West Bank during the first four months of 2004 ($207 million) is below the monthly average for the July-December 2003 period ($214 million). Likewise, the monthly average thus far in 2004 for Gaza ($76 million) is below the average recorded during the second half of 2003 ($80 million).

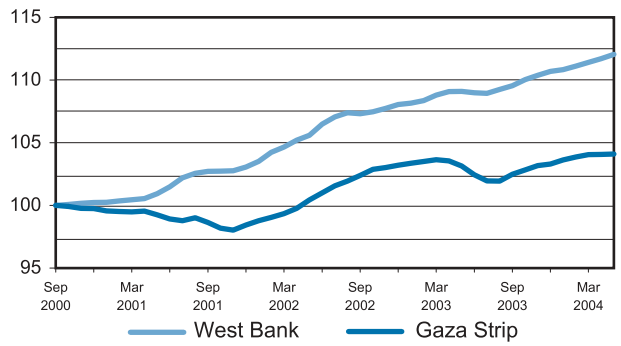
Figure 15. Total Value of Checks Cleared (million US Dollars)



Source: Palestinian Monetary Authority (PMA).

emerges. Non-food, non-transportation prices in the West Bank increased 4.1 percent in 2003, and by 1.5 percent in Gaza *(Figure 12)*.

Figure 12. Consumer Price Indices, excluding Food and Transportation (July-September 2000 = 100)



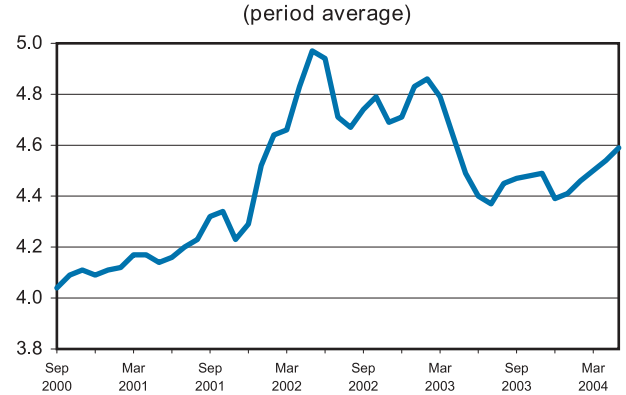
Source: World Bank calculations based on PCBS data. Figure shows three-month moving averages, re-based to Third Quarter (July-September) 2000 = 100.

(During 2002, non-food, non-transportation prices rose 4.6 percent in the West Bank and 2.6 percent in Gaza. In 2001, these prices rose 2.0 percent in the West Bank and fell 1.6 percent in Gaza.) Over the first five months of 2004, this measure of "core inflation" increased 1.2 percent in the West Bank (2.8 percent annualized) and 0.3 percent in Gaza (0.7 percent annualized).

There is also a relationship between price movements in the West Bank and Gaza and changes in the shekel-dollar exchange rate. 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 13*) and its subsequent appreciation, especially in the period February-July 2003 (downward movement in the figure) explains to a large extent the acceleration of inflation: during the 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, expressed in shekels, imported into Israel from overseas – and by extension, into the West Bank and Gaza – mechanically increased and the overall consumer price index, also measured in shekels, increased – not by the same amount, but to the extent that the CPI market basket consists of imported goods and of services priced in dollars (such as rents). With an appreciating shekel – from February 2003 through December 2003 the shekel has strengthened 9.7 percent against the dollar (11.7 percent since the shekel's weakest point in May 2002) – imports become cheaper, and inflation measured in shekels lessens (to the extent that importers actually pass on these reductions to consumers). In the five months through May 2004, the shekel has again weakened against the dollar, depreciating by 4.6 percent. Consequently, inflation tendencies might be expected to pick up during the course of this year, particularly if such depreciation continues.

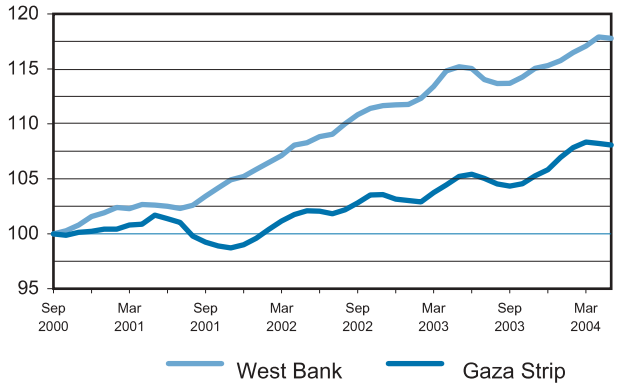
Figure 13. NI Shekel-US Dollar Exchange Rate (period average)



Source: Central Bank of Israel..

While exchange rate movements help explain basic trends in tradeable consumer goods prices (particularly in non-food prices, which are less affected by seasonality) tightened closure during the *Intifada* period also impacted consumer prices overall. This effect comes through both direct and indirect channels: changes in the transportation component of the consumer price index (which measures transportation prices that have increased directly as a result of heightened closure) and indirectly through increased costs of shipping for producers and distributors, which are in turn passed

Figure 10. Consumer Price Indices
(July-September 2000 = 100)



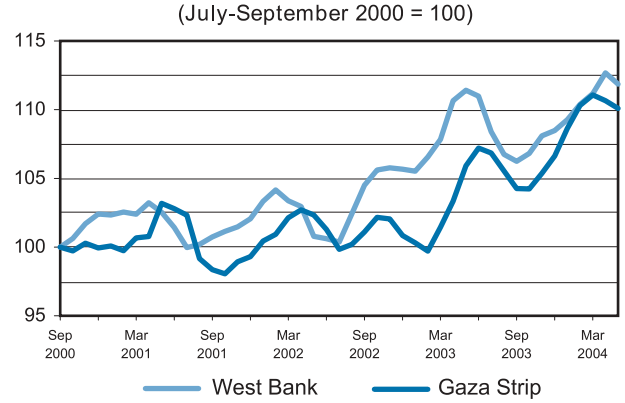
Source: World Bank calculations based on PCBS data. Figure shows three-month moving averages, re-based to Third Quarter (July-September) 2000 = 100.

Leading the increase in 2003 in the West Bank was the Transport and Communications price index, up 7.9% last year (compared to 21.7 percent in 2002) and, somewhat surprisingly, Medical Care, up 8.0 percent. (In 2002, the West Bank Medical Care index fell 1.0 percent; in the period from the beginning of the Intifada through December 2002, medical care prices rose only 0.5 percent.) For the January-May 2004 period Textiles, Clothing, and Footwear have led the increase, rising 4.0 percent since December.

Cost of medical care in Gaza represented the second largest increase in the components of the consumer price index in 2003, rising 4.9 percent (compared to a 1.2 percent fall in 2002 in the Medical Care index for Gaza.) Medical care costs continued to increase in 2004, with May's level 2.8 percent above December's index. The component with the largest increase in Gaza last year, the Education price index, rose 7.3 percent. A significant change from 2002, when education prices rose 2.1 percent. (Education in the West Bank rose 5.8 percent in 2003, a rate less than in Gaza, but above the overall West Bank Consumer Price Index increase for the year.) Since December, education costs have stabilized, declining 0.5 percent through May. Leading the overall change in prices since December was Transportation and Communications, up 3.8 percent *(see also Figure 14).*

As Figure 10 indicates, much of 2003's increase in overall consumer prices occurred during the first six months of 2003, with price declines in the third quarter offset by price increases in the fourth. The price increases during the first two quarters was driven by increases in food prices. Food prices generally exhibit strong seasonality effects, peaking during the second quarter *(see Figure 11).*

Figure 11. Food Price Indices
(July-September 2000 = 100)



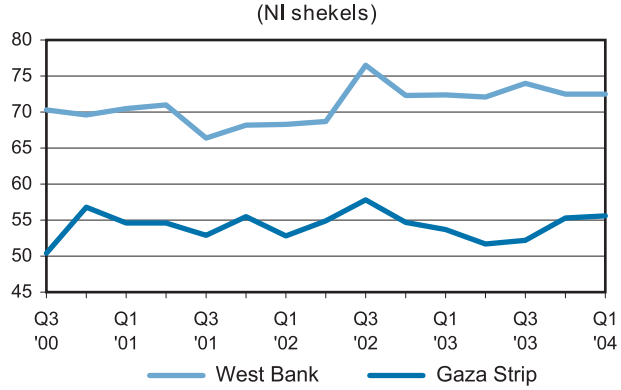
Source: World Bank calculations based on PCBS data. Figure shows three-month moving averages, re-based to Third Quarter (July-September) 2000 = 100.

As is customary, food prices then declined in the third quarter before rising modestly in the fourth quarter of the year and continued to increase during the first quarter of 2004. Over the course of 2003, the Food price index increased 4.7 percent in the West Bank and 3.5 percent in Gaza – in both areas above the increase in the overall price index.

Excluding food, the consumer price index in the West Bank has risen by 4.1 in 2003; in Gaza, the non-food CPI increased 1.8 percent last year – rates below what were witnessed in previous years. (In 2001, non-food prices rose 4.6 percent in the West Bank and fell 0.3 percent in Gaza; in 2002, non-food prices rose 8.7 percent in the West Bank and by 2.8 percent in Gaza.)

When the Transportation and Communication price index is also excluded – transportation prices being most affected by changes in the closure regime, but also by changes in world energy prices, which can be quite erratic – a clearer portrait of general price changes

Figure 9. Average Daily Wages
(NI shekels)



Source: PCBS. West Bank includes East Jerusalem.

The average daily wage in the West Bank stood at NIS 72.5 in first quarter 2004, and NIS 55.6 in Gaza; these compare with an average daily wage of NIS 127.5 received by Palestinians working in Israel and Israeli settlements.

One explanation for the stickiness of nominal wages may be the physical partitioning of the labor market – the result of travel restrictions associated with internal closure – which has resulted in increased mis-matches between supply and demand for various types of labor in the local labor market. Unemployed workers – even those willing to work for less than the prevailing wage – who cannot reach potential jobs remain jobless; at the same time, firms that face a shortage of labor are, therefore, not inclined to reduce workers' compensation.

Such behavior helps explain why the decline in labor demand witnessed during the *Intifada* has resulted primarily in higher unemployment and only to a lesser extent in lower real wages. Indeed the decline in real wages has mostly been the result of increase consumer prices and not decreased nominal wages. Even so, the decline in real wages during the *Intifada* period is much less than experienced in the 1995-96 period of external closure, when real wages declined more than 20 percent in response to a reduction in the number of Palestinians working in Israel – a reduction much smaller than that of the current *Intifada*

Monthly labor force data from the Israeli Central Bureau of Statistics showed an decrease in ("legal") Palestinian employment in Israel in March, the second monthly decrease following four months of growth. March's monthly average of 9,500 workers compares with 15,200 in January 2004 and 16,900 in January 2003 (the highest level during the *Intifada*).[2]

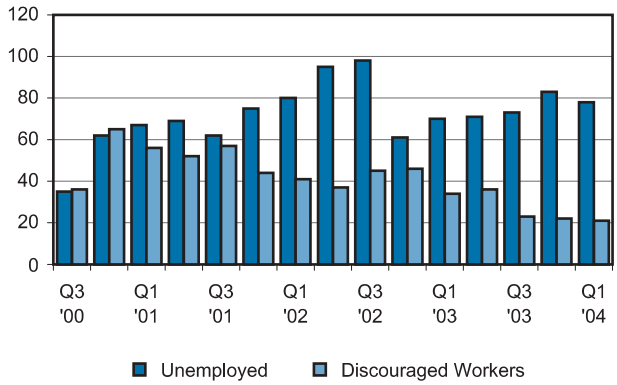
Of the 5,700 decrease recorded since January, the majority – 4,000 – were in construction, and make reflect seasonal considerations as well as security concerns. Currently 29 percent (2,800) are employed in agriculture; 55 percent (5,200) in construction; 16 percent (1,500) in other sectors. It is in these "other sectors" – primarily manufacturing and commerce – where the falloff since pre-Intifada employment levels has been greatest. According to ICBS data in September 2000 29,500 Palestinians were legally employed in Israel – 5,000 in agriculture; 15,200 in construction; and 9,300 in other sectors.

Prices

Consumer prices, measured in NI shekels, increased in both the West Bank and Gaza in the twelve month period January-December 2003, by 4.3 percent in the West Bank and 2.5 percent in Gaza. For the West Bank, this represents a reduction from 2002's inflation rate of 6.1 percent, and a slight increase over the 2.2 percent recorded last year in Gaza. During the first five months of 2004, inflation in the West Bank has slowed, to 2.9 percent (compared to the January-May 2003 level), while in Gaza it has accelerated, to 3.7 percent *(Figure 10).*

PCBS Quarterly Labor Surveys consistently report higher levels of Palestinian employment in Israel than does ICBS, the result of two factors: first, PCBS data includes Palestinians who hold Israeli identity cards (primarily East Jerusalem residents) or foreign passports as well as persons who hold Palestinian identity – presumably ICBS considers foreign passport holders as foreigners and Israeli identity card holders as Israelis; second, PCBS data includes "illegal" (non-permit holding) workers, whereas these undocumented workers are likely to be under-counted by ICBS, as ICBS reports foreigners' employment on the basis of employers reporting to the National Insurance Institute.

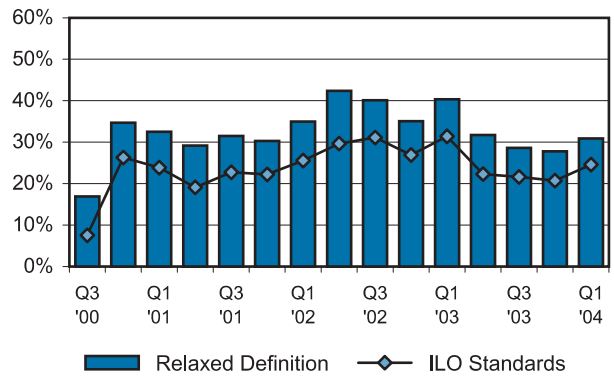
Figure 5. Gaza Strip Unemployment
(thousands of persons)



Source: PCBS.

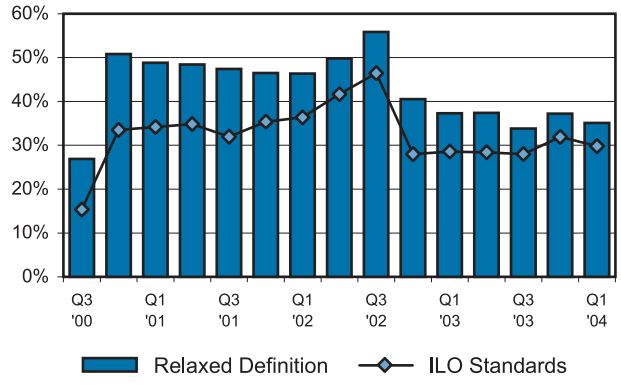
When the definition of the labor force is broadened to include "discouraged workers" – persons without jobs who, because of their pessimism regarding the prospect of actually finding work, have stopped looking – the "relaxed definition" of unemployment shows similar trends. In this case, the relaxed definition unemployment rate in the West Bank has increased from 16.9 percent (95,000 individuals) in third quarter 2000 to 30.9 percent (187,000) in first quarter 2004; in Gaza, from 26.9 percent (71,000 individuals) to 35.1 percent (99,000) over the same period (*see Figures 6 and 7*).

Figure 6. West Bank
Unemployment Rates



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

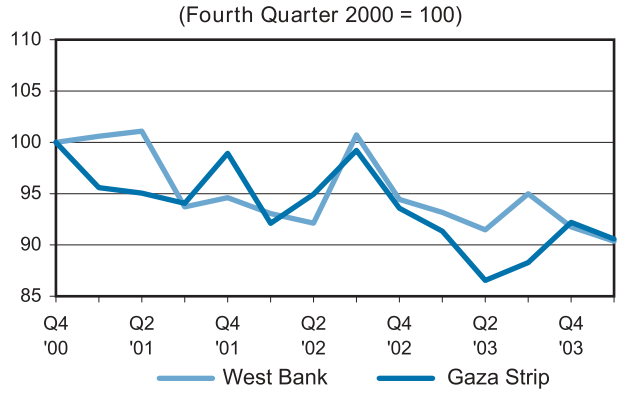
Figure 7. Gaza Strip
Unemployment Rates



Source: PCBS.

For wage earners continuing to be employed, the impact of the increase in dependency ratios during the course of the *Intifada* (and the implied obligation of working Palestinians to support greater numbers of extended family member) is exacerbated by the decline in real wages over much of the period of the *Intifada*, fairly consistently in both the West Bank and in Gaza. In the West Bank, real wages have declined 9.6 percent since fourth quarter 2000; in Gaza, they have decreased 9.4 percent *(see Figure 8)*.

Figure 8. Real Wage Indices
(Fourth Quarter 2000 = 100)



Source: PCBS average wage data; World Bank staff calculations. West Bank includes East Jerusalem. Data are deflated by consumer price indices for West Bank and Gaza, re-based to Fourth Quarter 2000 = 100.

Nominal wages have actually increased (3.2 percent in the West Bank and 10.3 percent in Gaza) over the 42 months since third quarter 2000 *(Figure 9)*.

Table 2. Number of Palestinians Employed (thousands)

	Q-3 2000	Q-4 2000	Q-1 2001	Q-2 2001	Q-3 2001	Q-4 2001	Q-1 2002	Q-2 2002	Q-3 2002	Q-4 2002	Q-1 2003	Q-2 2003	Q-3 2003	Q-4 2003	Q-1 2004
Working in West Bank	352	316	292	314	314	316	304	287	288	334	300	371	377	386	368
Working in Gaza	163	120	126	127	129	134	138	131	111	150	169	175	180	173	177
Working in Israel – from West Bank	116	40	69	72	60	66	56	30	50	49	43	50	59	54	49
Working in Israel – from Gaza Strip	30	3	3	2	3	2	2	2	2	7	6	4	8	4	6
Total Employed	662	479	490	515	506	518	501	451	452	540	518	600	624	617	602
of which, Unpaid Family Member	65	62	46	47	46	48	48	51	40	61	52	76	71	70	60

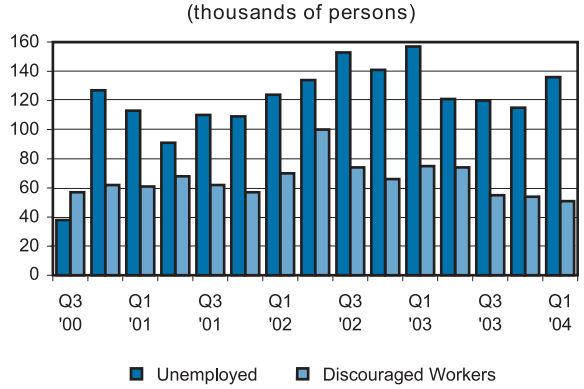
Source: PCBS. Data for West Bank includes East Jerusalem.

Despite the recent increases in employment, with population growing at approximately 4.3 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 2004 each employed person was supporting 5.7 persons. In Gaza the dependency ratio increased equally dramatically, from 5.9 to 7.5.

Growing population and labor force, 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 quarters, the 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".)

Following a decline in the unemployment rate in the West Bank in the fourth quarter of 2003 to 20.7 percent (down from its *Intifada* peak of 31.4 percent in first quarter 2003) first quarter 2004 again saw an increase, to 24.6 percent; 136,000 persons remain unemployed (*see Figure 4).*

Figure 4. West Bank Unemployment (thousands of persons)



Source: PCBS. Data for West Bank includes East Jerusalem

.

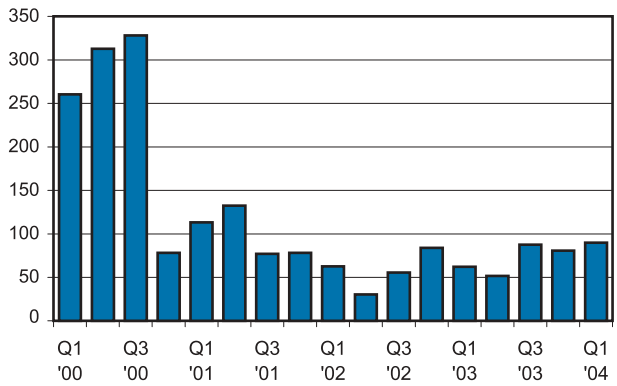
(By contrast, during the third quarter of 2000 the number of West Bank unemployed was 38,000 and the unemployment rate stood at 7.5 percent.

In Gaza, fourth quarter 2003 unemployment stood at 31.9 percent (83,000 individuals); first quarter 2004 saw some improvement, with the rate declining to 29.8 percent (78,000 persons). Prior to the *Intifada* the unemployment rate in Gaza was 15.4 percent (35,000 persons). *(Figure 5.)*

At its low point during the second quarter of 2002 the 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 roughly stable, fluctuating in accordance with the extent of closure imposed in the wake of specific terror incidents. In first quarter 2004, the number of workers stood at 55,000 (49,000 from the West Bank and 6,000 from Gaza)

Fewer jobs in Israel translates directly into a decline in workers remittances. According to the Israeli Central Bureau of Statistics, third quarter 2000 remittances totaled US$328 million; in first quarter 2004, only $90 million – a 72.6 percent decline *(Figure 3)* – was remitted.

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



Source : Israeli Central Bureau of Statistics.

This decrease has had direct consequence on the income of Palestinian households, as workers' remittances from Israel represented some 18 percent of their total disposable incomes in 1999. In turn, lower incomes inevitably affected the demand for Palestinian goods and services and hence, labor demand for Palestinian workers producing such goods and services within the West Bank and Gaza.

The 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.

By second quarter 2002 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 (see Table 2)*. At the same time, however, the number of unemployed has continued to grow, from 73,000 in the pre-*Intifada* third quarter 2000 to 214,000 currently.

In first quarter 2004 the number of West Bank Palestinians working in the West Bank was 368,000 compared to 352,000 just before the *Intifada*. At its low point in second and third quarter 2002, their number had fallen to 287,000 and 288,000 respectively. Fourth quarter 2002 saw an increase in jobs in the West Bank to 334,000, but this growth was short-lived, concentrated in agriculture (related to the olive harvest and reversed in the first quarter of 2003) and some one-off infrastructure repair generating employment in construction.

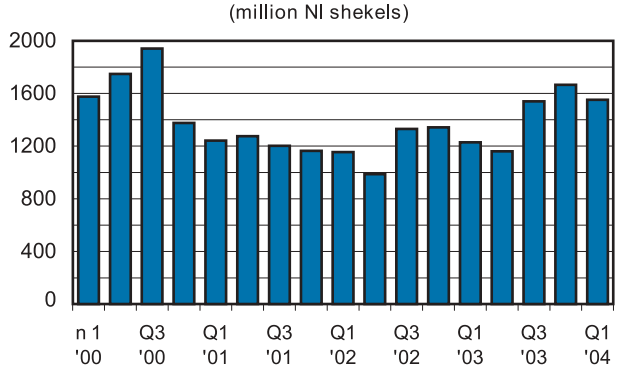
From a first quarter 2003 decline to 300,000, second quarter 2003 saw strong growth – to 371,000 – with continued expansion in the third (to 377,000) and fourth quarter (to 386,000) last year, followed by a decline (to 368,000) in the first quarter 2004. The most recent decline represents season factors in agriculture and construction, sectors responsible for the growth witnessed in the latter half of 2003.

In the Gaza Strip, 163,000 Gazans were domestically employed during third quarter 2000. By third quarter 2002, the low point during the *Intifada*, this number had fallen to 111,000 (a 32 percent decline). Four quarters of continuous job growth found 180,000 Gazans employed inside the Gaza Strip, before the decline registered during the fourth quarter of 2003 reduced the number of employed to 173,000. First quarter 2004 again witnessed domestic job growth in Gaza, to 177,000. It is likely that the increase in tension and deteriorating security environment in Gaza during spring 2004 will be reflected in the worsening employment numbers during the coming quarter.

and Israel). The Israeli Central Bureau of Statistics nevertheless estimates such flows, and we rely on their data to depict the evolution of trade since 1998. This only covers Palestinian trade with Israel, and not with the rest of the world. However, trade with Israel represents the bulk of total Palestinian trade.[1] Furthermore, a significant share of imported goods from Israel are actually originating from third countries – "indirect imports". In addition, it does not appear that these relationships are considerably impacted by exchange rate movements; neither the depreciation of the New Israeli Shekel in the first half of 2002 nor its subsequent appreciation during 2003 is thought to have significantly altered the composition of Palestinian imports in terms of trading partners. *(See Figure 13 for shekel-dollar exchange rate movements.)*

The impact of closures following the outbreak of the *Intifada* and their progressive tightening through summer 2002 were clearly reflected in the reduction of Palestinian imports from Israel. While both first and second quarter 2003 again witnessed reduction from the levels seen in the second half of 2002 (which, in turn, represented a rebound from the depressed second quarter 2002, the height of Israeli military operations in the West Bank), third and fourth quarter 2003 imports were at levels not seen since the outbreak of the *Intifada*. First quarter 2004 (NIS 1553 million; USD 349 million equivalent) declined slightly from fourth quarter 2003; compared to the third quarter of 2000, the decline in imports is 20.0 percent *(Figure 1)*.

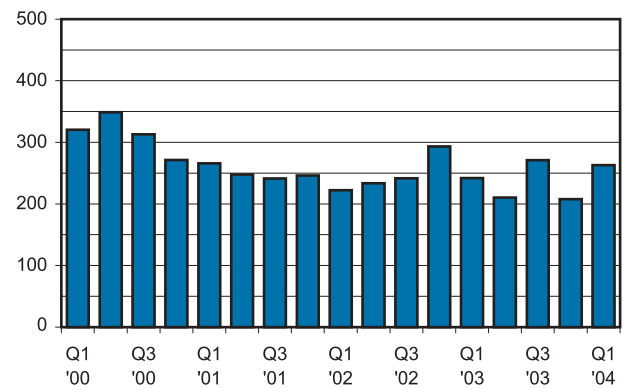
Figure 1. Merchandise Imports from Israel (million NI shekels)



Source : Israeli Central Bureau of Statistics.

Trends in merchandise exports to Israel have followed a similar pattern: decline through summer 2002; some rebound in the second half of that year; two consecutive quarters of decline in 2003, followed by an uptick in the third quarter. Unlike imports, fourth quarter 2003 saw a decline, while first quarter 2004 (NIS 263 million, US$59 million equivalent) demonstrated strength. This represents a 16.0 percent decline from third quarter 2000 *(Figure 2)*.

Figure 2. Merchandise Exports to Israel (million NI Shekels)



Source : Israeli Central Bureau of Statistics.

At least three factors explain the reduction in exports witnessed during the past three years: increased costs in transportation resulting from closure making Palestinian products less competitive; foreign purchasers switching to more reliable alternative sources of supply in the face of production and shipping interruptions; and Palestinian producers switching to service domestic markets.

Labor Markets

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.

In 2000, imports from and via Israel represented 73 percent of total imports, while exports to Israel represented 92 percent of total exports.

Recent Economic Developments

Economic Output.

Most recent economic data available (Palestinian imports from Israel for the first three months of 2004; Palestinian employment data through the first quarter of 2004 and in Israel through March; banking sector data through end-April) continue to provide evidence of a modest economic recovery throughout 2003 and extending into this year, but at a reduced rate of growth.

Underlying the economic stabilization of 2003 were diminished levels of violence, fewer curfews, and more predictable (albeit intense) closures, as well as adaptation by Palestinian businesses to the contours of a constrained West Bank economy. Looking forward, the extent to which this admittedly fragile growth path can be sustained depends greatly upon the political/security situation and the extent to which travel and transit restrictions within the West Bank and Gaza, and whether closures of Israeli labor markets to Palestinian workers are eased or tightened (as recent Government of Israel policy statements suggest).

Under a political "status quo" scenario, economic performance in the West Bank and Gaza will continue to be considerably below its previous levels, with the domestic economic unable to generate employment necessary to absorb the increasing number of new entrants to the labor force. Private investment will continue to be depressed and increased foreign investment unlikely (Table 1). Indeed, monthly surveys of Palestinian business owners and managers conducted through May 2004 revealed that, in their view, the overall business climate had deteriorated; their expectations regarding future employment, sales, and investment are at best neutral over the short-term and, on balance, only modestly optimistic over a medium-term horizon *(See "Business Confidence" and Table 3, below).*

Table 1. Macroe conomic Projections 2003-2006

	2003	2004	2005	2006
GDP (US$ million)	3,144	3,262	3,351	3,401
real growth rate	6.1%	1.6%	0.4%	-0.8%
GDP per capita (US$)	925	913	894	866
real growth rate	0.6%	1.6%	0.4%	-0.8%
GDI per capita (US$)	$1,467	$1,382	$1,299	$1,221
real growth rate	5.7%	-7.7%	-15.2%	-22.0%
Unemployment Rate	26%	28%	31%	35%
Poverty Rate	47%	50%	52%	56%

World Bank staff projections, June 2004, "Status Quo" scenario.

Foreign Trade

Trade traditionally played an important role in the small and open Palestinian economy. Throughout the past five years, imports of final goods, services, equipment and intermediate inputs represented approximately 70 percent of GDP, while exports of goods and services represented less than 20 percent of GDP.

Unfortunately trade is badly registered, as most of it takes place between the West Bank and Israel, where no custom stations exist (unlike trade between Gaza

1. Pumps and a transfer line to drain part of the lake to infiltration basins to be built at the site of the new wastewater treatment plant of which they will subsequently become a part of. However, before the plant is built, this infrastructure will pump effluent from the lake to eliminate the immediate threat of flooding from the effluent lake into local communities.

2. Technical assistance to supervise the works outlined above, and to carry out an environmental assessment, monitor the implementation of the environmental monitoring plan and to carry out detailed studies for remedial works.

Phase II will ensure that a long-term solution the treatment of wastewater is implemented in north Gaza, and will consist of the following:

Construction of the north Gaza wastewater treatment plant to secondary treatment and nitrogen removal with a design capacity of 35,000 m^3/day. Implementation of remedial works, and operation and maintenance costs for the first 2 years of operation (excluding spare parts). The estimated cost of these activities is US$29.5 million. It is anticipated that the works for this component would take up to two years to be completed.

Technical assistance to monitor and supervise the execution, as well as to monitor the implementation of the environmental monitoring plan during the construction period of item 2 above.

The project will be implemented by PWA and should take about 42 months to complete. Upon completion the infrastructure component will be handed over to the Coastal Municipal Water Utility.

Today the effluent lake provides a natural breeding ground for mosquitoes and parasites. This environment is also conducive to the transmission of water-borne diseases. A large and growing number of children are already showing signs of digestive and respiratory health problems. An assessment of the health risks posed to the neighboring communities was conducted in June 2003. The worst affected population is that of Um An Nasir, a village situated at the very edge of the treatment plant and its overflow. The village clinic identified three principal health problems: (i) over 50% of children have problems with their digestive system; (ii) the population is also suffering from skin infections and allergies caused by the high prevalence of mosquitoes leading to ulcers, itching and rashes; and (iii) respiratory diseases are also widespread caused by gases from the sewage basins and the high levels of humidity in the summer.

Health professionals are seriously concerned about the long-term effects of this hazardous environment, in particular the high level of nitrates in the groundwater, on the local population. These could lead to stunted growth, mental disorders and cancer.

Rationale for Donor Involvement.

Recognizing the immediate and serious threat to public health and the environment by increased exposure to sewage-borne disease from the effluent lake, PWA with support from several donors and humanitarian coordination agencies formulated a phased action plan to deal with the impeding threats and the longer-term needs of proper wastewater treatment and disposal.

As an immediate step, PWA is continuing to take temporary measures to prevent catastrophic over flowing of the effluent from the lake into the surrounding communities. These short-term measures therefore need to be complemented by further robust actions to eliminate the risk of flooding. Such actions are included under the two next phases of the action plan – the first, to drain the lake and thus alleviate the environmental and health threats associated with the existing wastewater treatment plant and the effluent lake; the second, to provide a long-term solution to the wastewater treatment issue in northern Gaza by increasing the capacity for processing wastewater with improved effluent quality standards. The immediate steps, as well as the two phases should be considered an integral part of the overall solution, thus allowing for higher flexibility with respect to arranging the necessary financing and implementation as they could be run in parallel.

The Bank has had considerable global experience in designing and implementing operations in response to natural disasters and emergencies arising in conflict-affected settings. For this particular project, the Bank is working in partnership with other donors whose long involvement in water treatment operations is well known and respected. These include the European Commission, SIDA, AFD and the EIB. The total project cost is estimated at US$41.3 million.

Objectives of the Bank Project

The objective of Phase I of the project is to mitigate the immediate and gathering health and environmental safety threats to the communities surrounding the effluent lake at Beit Lahia through implementing a scheme to transfer the effluent in the lake to the newly constructed infiltration basins east of Jabalya. The objective of Phase II is to provide a satisfactory long-term solution to the treatment of wastewater for the Northern Governorate in Gaza through implementing the proposed North Gaza Wastewater Treatment Plant east of Jabalya.

Project Description

Phase I will ensure that the immediate threat of flooding posed to the communities that are neighboring the Beit Lahia wastewater treatment plant is eliminated, and will finance the following:

Averting a Human Crisis – the Effluent Lake at Beit Lahia

Background

There are three wastewater treatment facilities in the Gaza Strip and all of these are designed for aerated lagoon process. The southern facility, serving part of Rafah City is essentially a collection pond with very minor treatment facilities. The poorly treated wastewater is disposed into the sea. The second plant serves Gaza City. It is about 50% overloaded but the effluent quality is still acceptable and the total effluent (about 40,000 m^3/day) is mostly disposed to the sea. The third plant is in the north (at Beit Lahia) and is heavily overloaded, poorly functioning and not equipped with any disposal facilities. This has led to the current unfavorable situation of sewage overflows into the surrounding area putting human lives at risk.

The Beit Lahia wastewater treatment plant (BLWTP) serves a population of 190,000 from the municipalities of Jabalya (including the refugee camp), Beit Lahya, Beit Hanoun and Um An Nasir. It was built in 1976 with a design load capacity of 5,000 cubic meters per day (CMD) of wastewater to secondary treatment levels. The original design, however, did not incorporate any effective effluent disposal and the treated effluent has been left to infiltrate into the sand dunes surrounding the plant. In the past this did not pose any risks since the effluent quality was good and the sandy soil was able to handle the volume of effluent through natural infiltration.

During the past few years, many communities were provided with sewerage networks, which were subsequently connected to the BLWTP. Consequently, the volume of sewage inflows to the plant, currently estimated at 12,000 CMD, has substantially exceeded the plant's capacity. The combination of increasing volume of sewage inflows and insufficient capacity to handle this inflow properly has led to poorly treated effluent overflowing from the treatment plant into the surrounding sand dunes, creating a lake of nearly 1.5 million cubic meters of foul water, which now covers over 30 hectares (300 donums) and continues to rise, threatening to overflow and flood the neighboring communities.

Without a concerted response to the persistent rise in the level of the effluent, such flooding is regarded as inevitable. Flooding has already occurred on two occasions in 1989 and 1992, when sand barriers collapsed under the pressure of the foul water. These floodings caused several fatalities, health problems and resulted in substantial damage to residential buildings in Beit Lahia.

According to the Palestinian Water Authority (PWA), tens of thousands of people would be affected if the lake were to overflow into these communities again. PWA and other local agencies have intervened to strengthen and raise the height of the sand barriers around the lake to try to prevent such flooding from happening again, but these are only band-aid solutions to a serious threat to the residents of that area.

The best form of protection of the settlements is an open process of public consultation resulting in clear plans and procedures. The PA should seize the opportunity to re-assert leadership, show sensitivity to public concerns and demonstrate technical competence. Civil society, municipal governments, and the PLC all have essential roles to play. It will also be important to disabuse the public of some of the more fanciful expectations that evacuation of the settlements may give rise to.

Next steps

The paper recommends that, without prejudice to the critical need for Palestinian security reform, the Quartet focus on a dialogue on what can be done to address closure and kick-start the Palestinian economy. A number of discrete tasks feeding into this dialogue may usefully be launched at once. These tasks include:

- An in-depth review of ways to facilitate border cargo management;
- A rapid review of the feasibility of industrial estates/export processing zones;
- A study of Palestinian export possibilities;
- A detailed review of the settlement assets and their potential uses;
- Design work on the structure, functions, staffing and support needs of a special PA agency to be charged with managing the transfer and disposal of settlement assets.

These preparatory studies should be accompanied by a joint PA-donor effort to define a time-bound, monitorable agenda of top-priority Palestinian reforms. This merits a higher level of energy by both the PA and the donors to this important topic.

If commitment by the GoI, the PA and the Quartet to creating a proper enabling environment for economic development is forthcoming, a full reconstruction assessment of the type mentioned in the May 4 Quartet Action Plan would be very useful. One way to proceed would be for the donors to support the efforts of the Ministry of Planning as part of, or as a supplement to, ongoing work on a Palestinian Medium-Term Plan. This could then lead to a donor funding conference, at which it would be important to define a "quick-hitting" program of investments.

Neither a general assessment nor a high-profile donor meeting have much added value in today's stagnant economic environment, however. Donors are already providing high levels of emergency, humanitarian and reconstruction assistance and appear disinclined to do much more without a quantum shift in Palestinian economic prospects.

the process, *e.g.* a temporary special agency created by and reporting to the Palestinian Legislative Council; determining the legal status of the lands and organizing a transparent claims procedure; agreeing on the use of the settlement areas and assets; arranging for any interim use pending disposal; and conducting a public information campaign. This preparatory period would take *at least* six months.

Muncipalities should be carefully involved in the process. Those areas which the PA does not decide to retain as 'public land' would in time come under municipal jurisdiction. In the Katif Block, in particular, this gives rise to a need for technical and fiscal support to the municipalities concerned – to ensure that settlement infrastructure (roads, electricity grids and sewage systems) is well-integrated, and that the aquifer is properly protected.

Claims on land

The special agency should receive and adjudicate property claims. Accordingly, the law establishing the agency should detail the procedures to be used, and should define the rights of former owners.

The status of settlement lands is complicated. According to the Palestinian Land Authority, about 90-95% of the land on which the settlements are built in the Gaza Strip was declared 'public land' during the Ottoman period. In the West Bank, land registration has been restricted, and the GoI has declared a considerable quantity of land privately held (but unregistered) to be 'public' – subsequently using it to create Israeli settlements. A significant number of individual land claims should be anticipated against evacuated properties in the West Bank.

Disposing of the settlement assets

There is serious concern among Palestinians, international observers and the GoI that settlement assets may find their way to those with power or connections. This would seriously damage the PA's reputation. A well-prepared and well-publicized policy based on clear economic and social goals and on rational physical plans will do much to avoid such an embarrassment.

In deciding the best use of settlement assets, the PA may wish to take five factors into account: first, private claims on the relinquished land; second, the trade-off between productive and social uses of space; third, environmental constraints; fourth, the usefulness of the infrastructure left behind for Palestinian needs; and finally, planning for the longer-term (with particular attention to environmental considerations).

Assets can usefully be broken into three categories: public infrastructure, productive assets and houses. *Public infrastructure* (roads, electricity and water installations) is in principle best handed over to the responsible PA/municipal authorities. *Productive assets* (land, industrial infrastructure and equipment) can be sold to investors using transparent auction methods, unless the land is needed for public projects or for green areas/tourism. *Houses* are a more difficult proposition.

If the houses are left standing, their disposal needs careful thought. Possibilities range as follows: giving houses away, renting houses at full economic cost, renting houses at subsidized cost, selling the houses at full or subsidized cost, to specific groups or on the open market, and "densifying" the housing blocks with low-cost units.

Allowing temporary occupation of vacated houses and land is a tempting option, but should be avoided. International experience, from the Balkans in particular, shows that temporary occupation may be impossible to reverse peacefully. Instead of this, a maximum effort should be made to dispose of the assets quickly.

Securing the settlements

Whether the settlement assets can be protected after their evacuation depends on the general security situation. If the overall security environment is positive, the integrity of the settlements is likely to be respected, and problems would hopefully be limited to isolated incidents of theft or squatting.

reluctance to invest in major new infrastructure assets as long as they perceive a risk of damage or destruction, and this continues to inhibit productive investment.

The settlements – transferring the assets

The settlements and their productive potential

A total of 21 settlements are at issue in the Disengagement Plan – 17 in Gaza and 4 in the West Bank. The 17 settlements in Gaza occupy 15-20% of the land and by December 31, 2003, contained a population of 7,254 in approximately 1,500 to 2,000 houses. Some 32 square kilometers have been allocated to agriculture, and 160,000 square meters are occupied by buildings. There is a small industrial zone inside the Katif Settlement Block – Neveh Dekalim, where 18 enterprises provide employment for 90 Israelis and 120 Palestinians.

Although situated on some of the best-watered and richest arable land in Gaza, the settlements use little of it and produce at well below the area's potential. Data on the economic output of the settlements needs further analysis. By one account, though, the 17 Gaza settlements produce c. US$33 million in gross output per annum, equivalent to only 3% of the 2003 GDP of the rest of the Gaza Strip. Most of this (US$25 million) is derived from agriculture – with only 3.3 of the 32 square kilometers of agricultural land in use. Expansion of the area under irrigation seems attractive, but the scarcity of water in Gaza and today's border management regime mean that careful planning will be needed.

The Disengagement Plan also calls for the evacuation of four small settlements in the northern West Bank. These settlements house around 550 people, and are "dormitory communities". They do not contain any agricultural or industrial enterprises, and their productive potential is negligible – particularly if the houses were to be dismantled by the GoI.

Handover and the role of the international community

The GoI believes that the PA may be unwilling or unable to secure the settlements, leading to looting and destruction, or to seizure of houses and other assets by militants. The GoI has indicated that it will not negotiate the withdrawal process with the PA, but has signaled a willingness to coordinate the process at a technical level, either directly or through a third party.

Third-party custodianship of settlement assets raises many questions. First, it is unclear that a third party has the legal authority to receive, administer and dispose of these assets. A more pressing question is how a custodian could in reality secure the assets against destruction, looting or squatting in the event of a breakdown of Palestinian authority. Third, a custodian would have to accept a significant reputational risk – even a token pass-through role would not absolve the custodian of blame for any subsequent misuse of the assets.

A more practical alternative to custodianship is for a third party to act as a "technical partner" in close support of the PA. This would be more compatible with the views of the PA, which sees itself as the rightful custodian of the relinquished assets, and would have the added benefit of strengthening, not displacing the PA. The donors, through the *Ad Hoc* Liaison Committee (AHLC), should provide the advice and assistance needed to ensure that the asset transfer process goes well and is acceptable to all parties.

Preparing for handover

The GoI should make relevant information available to the PA or the third party well in advance of the first evacuations so that their transfer and disposal may be properly planned. It should also ensure that departing settlers preserve any assets intended for handover to the Palestinians.

The PA, in its turn, needs to mobilize without delay. Adequate preparation will involve a considerable number of steps – creating a mechanism to oversee

forward with early local elections is therefore a welcome step. In this respect, missing elements of the relevant legislative framework and completion of the voter registration process are two immediate priorities. For its part, Israel will need to facilitate campaigning and voting so that a valid democratic process is feasible.

Maintaining PA fiscal stability is essential and a vigorous financial effort by donors will help contain the current fiscal stress. For its part, though, the PA must take decisive steps to contain the escalating wage bill. Critical areas are civil service reform and a comprehensive reform of the pension system. Legal, judicial and regulatory reform also needs to progress.

PA transparency has improved considerably during the last two years; nonetheless, further measures are needed to create confidence among investors, the public and donors. This relates in particular to the establishment of an independent audit function. In the interest of minimizing anti-competitive bias, the PA should also move ahead with liquidating equity holdings and privatizing most public enterprises.

Developing the infrastructure of Gaza and the West Bank

A well-functioning infrastructure is important to improve the quality of life and popular confidence in the future, and to build a stable platform for private economic activity. An added benefit is the short-term impact of public works programs on the local construction industry and on employment.

If violence in Gaza and the northern West Bank abates, donor-financed rehabilitation and development work will accelerate somewhat – as it did during the comparative calm in mid-2003. A cease-fire in Gaza would encourage donors to repair key components of the infrastructure network as well as press ahead with basic needs projects delayed by insecurity. The restoration of freer movement in the northern West Bank would encourage rehabilitation of degraded local roads as well as delayed school and health infrastructure projects.

Unless donors perceive a fundamental change in Palestinian economic prospects, though, there is unlikely to be much "additional money". The rationale for a major additional donor effort is a scenario promising true economic revival. Under such a scenario, the main constraints to public investment would be the availability of donor finance, and PA implementation capacity.

The World Bank has estimated that a "major new effort" might bring in another US$1.5 billion over the 2004-6 period (for a total of US$4.3 billion). If such a target could be achieved, only part of these funds could be made available for infrastructure. Even with a recovering economy, up to US$1 billion per year would need to be devoted to a combination of budget support, humanitarian assistance and the transition to a new public pensions system. This would leave about US$500 million each year for the rehabilitation and development of infrastructure, and for the creation of public and private capacity.

Any detailed assessment of Palestinian reconstruction and development needs will require careful prioritization in view of other needs for budgetary and humanitarian assistance. It is appropriate, therefore, that any further reconstruction planning related to the Disengagement Plan should mesh with work being done by Ministry of Planning on the PA Medium-Term Plan (2005-7).

GoI facilitation of development and humanitarian assistance

Donor frustration with operational policy of the Israeli Defense Force (IDF) is considerable and has not met with an adequate response, despite GoI assurances from the highest levels that donor activity and humanitarian aid will be fully facilitated. The destruction of donor-financed infrastructure assets is a serious issue for donors. While the scale of this is now significantly less than in 2001-2, during May 2004 appreciable damage was done to economic infrastructure in Gaza (road surfaces, electricity transformers, water mains, the environs of the Gaza Industrial Estate). Much of this had been built or repaired with donor funds. Donors have expressed

transaction costs and make it impossible to fulfill export orders on time. In recent times, over 90% of Palestinian exports have gone to or through Israel. At the same time, over 75% of imports have come from or through Israel.

Primary attention should therefore be given to regularizing cross-border trade with Israel. For *exports*, extensive use can be made of advanced electronic equipment at checkpoints, with large, truck-size scanners at border crossings such as Karni and Erez in Gaza and along the Green Line in the West Bank. In addition, simple but meaningful facilitation measures can be introduced – such as extending border operating hours and ensuring perishable cargoes are given priority.

For *imports* from certain countries, pre-shipment inspections by third parties and transport in specially sealed containers should allow some relaxation of the current requirement that all cargoes destined for Gaza and the West Bank must be inspected upon entry at Israeli ports. Bonded warehouses or logistic facilities for cargo moving to and from Gaza and the West Bank could also be introduced at Haifa and Ashdod.

International gateways for the Palestinian economy, and a link between Gaza and the West Bank, should also be developed. The export routes running through Israel (to the seaports of Ashdod and Haifa and to Ben Gurion airport) have been unreliable and costly, due to inconsistent security procedures and the need to use Israeli logistic service providers. Similar issues arise in relation to cargo moved through Jordan and Egypt. *If* a satisfactory security protocol can be established, a sea port in Gaza, provided it is accessible to West Bank businessmen and efficiently run by a private operator, is likely to be competitive – particularly if initiated as a 'Roll-On, Roll-Off' facility, which could be built in a relatively short time and for as little as US$15-20 million.

Developing Palestinian exports

Given that Israel will remain the primary Palestinian trading partner for some time to come, Palestinian economic recovery will depend on re-building commercial cooperation with Israel.

The best way to access third countries appears to lie in partnerships with Israeli companies. The business model that carries the most logic today, and which benefits both Palestinian and Israeli economies, is one in which Israeli companies secure market access for high-end products wholly or partly produced by Palestinian enterprises.

A future Palestinian state should aspire to build its own export base, but it will take time before such exports make an appreciable contribution to living standards. Palestinian products today have little independent penetration in international markets. Cost structures – both labor and other inputs – are high compared with those of Jordan and Egypt, while productivity is still poor. New business opportunities will need to be developed to maximize comparative advantage, for example in tourism, crafts, agriculture and in the apparel industry. Significant retooling and adjustment is needed, though, and donors should intensify programs aimed at building competitiveness at the firm and the industry levels.

Creating a growth-oriented economic environment

If donor funds are to be put to effective use, the PA needs to build an environment attractive to investors. Although the impact of PA efforts will remain limited unless GOI addresses the restrictions on internal movement and external trade, this is no reason to delay important reform measures both in terms of establishing better control of domestic security and improving public accountability and governance structures.

The holding of national and local elections would re-legitimize the PA and renew investor confidence in Palestinian governance. The recent PA decision to press

Table 3. Selected Macroeconomic Indicators Under "Complete Withdrawal Plus Trade Facilitation" Scenario with Different Aid Assumptions Over 2004-2006 and Impact in 2006 of Increasing Donor Support

		$2.8 billion in Total Donor Assistance Over 2004-2006 Amount of Donor Support:			$4.3 billion in Total Donor Assistance Over 2004-2006 Amount of Donor Support:			Impact in 2006 of Increasing Donor Support over period 2004-2006
		$1.0 billion	$0.9 billion	$0.9 billion	$1.3 billion	$1.5 billion	$1.5 billion	
	2003	2004	2005	2006	2004	2005	2006	
Gross Domestic Product (GDP), US$ million	3,144	3,338	3,740	4,196	3,703	4,468	4,909	+ 713
West Bank	2,172	2,322	2,620	2,959	2,575	3,130	3,463	+ 503
Gaza Strip	973	1,016	1,120	1,236	1,127	1,338	1,446	+ 210
GDP per capita, US$	925	935	998	1,068	1,037	1,192	1,250	+ 182
West Bank	1,052	1,072	1,156	1,249	1,190	1,381	1,461	+ 212
Gaza Strip	729	723	756	793	802	904	928	+ 135
Real GDP growth rate (West Bank and Gaza)	6.1%	4.1%	9.4%	9.2%	15.4%	17.9%	7.2%	
Real GDP per capita growth rate (West Bank and Gaza)	0.6%	-1.0%	4.3%	4.2%	9.8%	12.3%	2.2%	
Cumulative Real GDP per capita change since 2003		-1.0%	3.2%	7.6%	9.8%	23.3%	26.1%	+18.5 pts.
GDI per capita, US$	1,467	1,403	1,403	1,424	1,590	1,757	1,758	+ 334
West Bank	1,621	1,570	1,583	1,621	1,772	1,969	1,987	+ 365
Gaza Strip	1,227	1,147	1,126	1,124	1,310	1,433	1,411	+ 287
Real GDI growth rate (West Bank and Gaza)	11.5%	-1.4%	2.4%	3.6%	11.6%	13.3%	2.3%	
Real GDI per capita growth rate (West Bank and Gaza)	5.7%	-6.2%	-2.4%	-1.2%	6.2%	8.0%	-2.4%	
Cumulative Real GDI per capita change since 2003		-6.2%	-8.5%	-9.5%	6.2%	14.7%	11.9%	+ 21.4 pts.
Poverty Rate	47%	48%	48%	46%	42%	37%	37%	- 10 pts.
West Bank	37%	38%	38%	36%	32%	27%	27%	- 9 pts.
Gaza Strip	64%	66%	64%	64%	61%	53%	53%	- 11 pts.
Unemployment Rate	26%	27%	25%	23%	22%	16%	14%	- 9 pts.
West Bank	24%	25%	23%	21%	20%	13%	12%	- 9 pts.
Gaza Strip	29%	31%	29%	28%	26%	20%	20%	- 8 pts.

Changing today's economic reality

Summary

The key to restoring Palestinian economic vitality is for Israel to dramatically ease internal closures and restore the predictable flow of goods across borders. Easing internal closures throughout the West Bank must be accompanied by a credible Palestinian security effort. As long as Palestinian violence persists, the case for dismantling closures will always be contestable.

Even today, though, it should be possible to re-establish a regular, predictable import/ export regime without compromising Israeli security. Removing restrictions on the movement of cargo across borders is relatively simpler – technologies and administrative methods exist that permit the orderly flow of cargo *and* the maintenance of security. Introducing a new, efficient border cargo regime would make a major difference to Palestinian welfare and commercial prospects.

A maximum PA effort to fulfill its security obligations under the Road Map is needed if the donor community is to argue for a major easing of today's closure regime. An easing of closures alone, though, will not attract investors back to the Palestinian economy. A reinvigorated program of Palestinian reform, designed around measures that will create an investor-friendly business environment, is essential. There is no reason for the PA to delay implementation of such a program.

A reasonable economic future is possible

A reduction in violence, a major easing of internal closures and the revival of trade across borders could hold today's stabilization in place, depending on the number of Palestinian workers allowed into Israel. Israel should, at least, maintain the current level of Palestinian workers entering Israel for several years to come.

It is important to understand that additional donor money alone can not solve today's economic problems. Donor disbursements of c. US$1 billion per annum (or US$310 per person) are already very high. Additional aid in today's economy would help alleviate day-to-day hardship, but would have little lasting impact. As long as the web of Palestinian economic transactions remains shredded by closures, investors will stay away, and short-term gains will not be sustainable.

With a freeing-up of the constraints on economic activity and committed Palestinian reform, an additional major donor effort would make a difference – it would enable the Palestinian economy to turn the corner. An additional US$500 million per annum, on top of existing disbursements, could by 2006 spur a growth in real personal incomes of about 12% (and 20% in nominal terms), and could reduce unemployment to levels only slightly higher than prior to the *intifada*. (See Table 3)

The alternative to this is stark. At the wrong end of the spectrum of possible outcomes is a Palestinian economy with unemployment levels of over 35% by 2006, and with poverty afflicting upwards of 55%, and 70% in Gaza. With the PA weakened as it is, the time to get things right is running out.

Borders and trade

Creating an export-based economy depends above all on efficient, unimpeded access to Israeli and third-country markets. The current security-oriented border regime – and access through the West Bank or Gaza to the borders – involves unpredictable delays, and uses inefficient methods which add considerably to

4 Use of this word in the paper does not imply any judgment by the World Bank on the appropriate location of any political borders. The term is used to denote boundaries between areas of economic jurisdiction, and the movement of people and goods across them. Unless otherwise indicated, though, the location of these economic boundaries is assumed to be the security fence that surrounds the Gaza Strip, and the 1949 Armistice Line (the 'Green Line') in the West Bank.

An additional US$1.5 billion in donor assistance over three years under these conditions would increase per capita GDP, but would no more than offset otherwise declining personal incomes. The World Bank modeled the impact of disbursement increases of c. US$500 million per annum in 2004-6. This would boost real GDP per capita by 7% by 2006, but as a result of the decline in work in Israel, real per capita GDI would be unchanged from 2003. Poverty and unemployment would remain stuck at levels similar to those of today. This outcome makes it difficult to justify such extra outlays, other than on humanitarian grounds. If the Erez Industrial Estate closes, this will represent a further serious setback for the Gaza economy.

Table 2. Macroeconomic Indicators Under Various Scenarios

		"Status Quo"			"Disengagement"			"Disengagement Plus Lifting Internal Closures throughout the West Bank"		
	2003	2004	2005	2006	2004	2005	2006	2004	2005	2006
Gross Domestic Product (GDP), US$ million	3,144	3,262	3,351	3,401	3,266	3,360	3,422	3,276	3,472	3,637
West Bank	2,172	2,269	2,347	2,399	2,272	2,354	2,414	2,279	2,432	2,566
Gaza Strip	973	993	1,004	1,002	994	1,007	1,008	998	1,040	1,072
GDP per capita, US$	925	913	894	866	915	897	871	917	926	926
West Bank	1,052	1,048	1,035	1,012	1,049	1,038	1,018	1,053	1,073	1,082
Gaza Strip	729	706	678	643	707	680	647	709	702	688
Real GDP growth rate (West Bank and Gaza)	6.1%	1.6%	0.4%	-0.8%	1.8%	0.6%	-0.5%	2.2%	3.6%	2.3%
Real GDP per capita growth rate (West Bank and Gaza)	0.6%	-3.3%	-4.3%	-5.4%	-3.1%	-4.1%	-5.0%	-2.8%	-1.3%	-2.4%
Cumulative Real GDP per capita change since 2003		-3.3%	-7.4%	-12.4%	-3.1%	-7.1%	-11.7%	-2.8%	-4.0%	-6.3%
Gross Disposable Income (GDI) per capita, US$	1,467	1,382	1,299	1,221	1,383	1,301	1,227	1,386	1,331	1,282
West Bank	1,621	1,546	1,463	1,385	1,547	1,466	1,391	1,550	1,501	1,455
Gaza Strip	1,227	1,130	1,047	973	1,131	1,049	977	1,134	1,072	1,018
Real GDI growth rate (West Bank and Gaza)	11.5%	-3.0%	-3.6%	-3.6%	-2.8%	-3.4%	-3.4%	-2.6%	-1.5%	-1.4%
Real GDI per capita growth rate (West Bank and Gaza)	5.7%	-7.7%	-8.1%	-8.1%	-7.5%	-8.0%	-7.8%	-7.3%	-6.1%	-6.0%
Cumulative Real GDI per capita change since 2003		-7.7%	-15.2%	-22.0%	-7.5%	-14.9%	-21.6%	-7.3%	-13.0%	-18.2%
Poverty Rate	47%	50%	52%	56%	49%	52%	56%	49%	50%	51%
West Bank	37%	40%	43%	47%	40%	43%	47%	39%	40%	42%
Gaza Strip	64%	68%	69%	72%	66%	69%	72%	66%	66%	68%
Unemployment Rate	26%	28%	31%	35%	28%	31%	34%	28%	29%	31%
West Bank	24%	26%	29%	33%	26%	29%	32%	26%	27%	29%
Gaza Strip	29%	32%	35%	39%	32%	35%	38%	32%	33%	35%
Population (million)	3.40	3.57	3.75	3.93	3.57	3.75	3.93	3.57	3.75	3.93
o/w Gaza Strip	1.33	1.41	1.48	1.56	1.41	1.48	1.56	1.41	1.48	1.56

The performance of the security services is less commendable, with instances of lawlessness in some areas of the West Bank and Gaza (for instance, Jenin, Nablus, and Rafah). The PA's Reform Program, launched in mid-2002, lost much of its early momentum during the summer of 2003. It has registered relatively few achievements in the past year, most of them clustered in the public financial accountability sphere.

Excessive Dependence on Donor Assistance

The PA, the Palestinian economy and Palestinian personal incomes have come to depend on high levels of donor financial support. Donors have more than doubled their pre-intifada disbursement levels, providing an average of US$950 million per annum between 2001-3, and in so doing adding 30% to GDP and over 20% to Palestinians' disposable incomes.

Without donor help, living standards would be far worse; of the estimated US$713 million spent in 2002-3 on welfare instruments (food, cash support, job creation), some 97% was donor-financed. This insinuation of donor funding into the core of the economy will be hard to unravel without a general economic recovery.

Although there was little sign of "donor fatigue" through 2003 (with the exception of budget support from Arab donors), these levels of assistance cannot be counted upon indefinitely. At the last major conference on the Palestinian economy in Rome in December 2003, delegates stressed that the lack of a clear political horizon made it increasingly difficult to argue for sustained high levels of donor assistance to the West Bank and Gaza.

The economic benefits of disengagement – of itself, very limited

The Plan and closure

The GoI's Modified Disengagement Plan provides for the evacuation of settlements in Gaza and redeployment of the army along the Philadelphi Route and outside the Gaza "envelope", as well as the evacuation of four settlements in the northern West Bank. A disengagement of this type would benefit the Palestinian economy in two ways – reduced internal closures, and the transfer of settlement land and assets. But the Plan does not provide for any change in border trade regimes, with Israel retaining control of the Gaza Strip's external perimeter, its airspace and coastline.

In the short-run, little economic benefit

Table 2 shows that the differences between "status quo" and disengagement as envisaged under the current Plan are negligible; indeed, the Palestinian economy would experience similar levels of decline. A step-by-step disengagement would further reduce the aggregates due to uncertainties and potential delays during each phase of implementation.

Were disengagement accompanied by the sealing of Gaza's borders[3] to labor and trade or by terminating supplies of water and electricity to Gaza, disengagement would create worse hardship than is seen today. This could forfeit the international goodwill that Israel's initiative has created. Under such circumstances, the Plan's assertion that Israel is no longer responsible for the population of Gaza will not resonate. Nor would donors appreciate the implication that they must bear the humanitarian consequences of this style of disengagement.

2 In view of the current GoI policy inclinations, the Bank has projected, for illustrative purposes only, a decline in Palestinian employment levels in Israel. This should *not* be taken as a World Bank recommendation, however.

3 Public Opinion Pulse Poll, Jerusalem Media & Communications Center, December 2003.

point to further decline under the political 'status quo'2 scenario (See Table 1). Assuming that the closure regime remains essentially unchanged, no appreciable revival in private investment can be expected. Without new sources of capital, the trend towards informalization will continue, and new entrants to the labor market will outstrip the economy's ability to provide work. By 2006 real GDP per capita (domestic output) would drop by about 12% from 2003 levels, while real GDI per capita (overall incomes including aid transfers) would decline by 22%. Unemployment would increase to 35% by 2006 and poverty levels would reach 56%.

Table 1 – Economic Scenarios, West Bank and Gaza

	Nominal GDP per cap. US$	Nominal GDI per cap. US$	Unemployment Rate (percent)	Poverty Rate (percent)	Gaza Poverty Rate (percent)
As at end 2003	925	1,467	26	47	64
Projected Outcomes by 2006					
1. Status Quo	866	1,221	35	56	72
2. Disengagement	871	1,227	34	56	72
3. Disengagement + lifting internal closures in West Bank and opening borders	1,068	1,424	23	46	64
4. Disengagement + lifting internal closures in WB and opening borders + extra US$1.5 billion from donors over 2004-2006	1,250	1,758	14	37	53

Note: Scenarios all assume labor flows to Israel are in gradual decline. Scenarios 1, 2, and 3 assume donor contributions of US$1 billion (2004), US$900 million (2005), and US$900 million (2006) = US$2.8 billion over three years. Scenario 4 assumes donor contributions of US$1.3 billion (2004), US$1.5 billion (2005), and US$1.5 billion (2006), a total of US$4.3 billion over three years.

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Poverty and social stress

Palestinian social resilience is notable despite donor and PA predictions that Palestinian coping mechanisms would be exhausted. However, the number of families unable to cope is poised to increase quite sharply. Sixteen percent of the total population, and one quarter of all Gazans, live in deep or "absolute" poverty, and are unable to feed themselves adequately, even with food aid. The population as a whole has reduced its per capita food consumption by 30-35% since 1999, and were it not for donor assistance (food aid having increased five-fold since 2000), malnutrition would be at levels associated with much poorer countries.

A weakened Palestinian Authority

The effectiveness of the Palestinian Authority (PA) has declined over the past year. Persistent restrictions on movement and a sustained fiscal crisis have taken their toll on the PA. To its credit, the civilian apparatus still functions quite well, and PA core services – education, health, water and electricity, sewerage and solid waste – continue to be delivered on a regular basis. Inevitably, however, service standards are in decline.

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New World Bank Paper – Disengagement, the Palestinian Economy and the Settlements[1]

On June 6, 2004 the Israeli Cabinet approved a Modified Disengagement Plan for withdrawal from the Gaza Strip and from four settlements in the northern West Bank. In a recent paper on the Plan, the World Bank argues that if implemented with wisdom and foresight, disengagement could make a real difference to the Palestinian economy. Critical conditions for success include the radical easing of closure by Israel, which can be achieved without compromising Israel's security; a reinvigorated program of Palestinian reform designed around measures that will create an investor-friendly business environment, accompanied by a credible Palestinian security effort; and an additional US$1.5 billion in donor assistance over three years.

The Palestinian economy today – few prospects

Economic decline

The Palestinian recession between September 2000 and late 2002 is among the worst in modern history. Unemployment increased from 10% of the workforce to an average of 41% during 2002, and the number of the poor rose from 20% to over 50% of the population. In Gaza, unemployment exceeded 46% of the workforce, and the poverty level rose to 68%. Private investment and trade fell dramatically through 2001 and 2002.

The precipitator of this economic crisis has been 'closure' – a multi-faceted system of restrictions on the movement of goods and people designed to protect Israelis in Israel itself and in the settlements. Closures have cut through the web of Palestinian economic transactions, raising the costs of doing business and disrupting the predictability needed for orderly economic life.

Fragile stability

The Palestinian economy stabilized in 2003. This reflected diminished levels of violence, fewer curfews and more predictable (albeit intense) closures – and adaptation by Palestinian businesses to the contours of a cantonized West Bank economy. It also reflects the fiscal stimulus from Israel's resumption of revenue transfers in late 2002.

This stabilization, however, possesses little vitality. The economy continues to function at well below its previous capacity, and under today's movement restrictions cannot generate the employment needed to absorb a rapidly expanding workforce – let alone mount a sustained attack on unemployment. Sustaining this recovery will prove difficult as stabilization in 2003 resulted from factors which will either not be repeated, or may not last.

The World Bank drew up a series of macro-economic projections based on the Government of Israel's (GoI) Modified Disengagement Plan of. These projections

1 The full paper can be found at: www.worldbank.org\we

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