



Four Years – Intifada, Closures and **Palestinian Economic Crisis**

An Assessment



World Bank, October 2004

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Abbreviations and Acronyms

AHLC	Ad Hoc Liaison Committee
COGAT	Coordinator of Government Activities in the Territories
EC	European Commission
EMSRP	Emergency Municipal Services Rehabilitation Project
ESSP	Emergency Services Support Program
GDP	Gross Domestic Product
GOI	Government of Israel
ICRC	International Committee of Red Cross
IDF	Israeli Defense Forces
IMF	International Monetary Fund
ISI	Israel and Israeli settlements
LACC	Local Aid Coordination Committee
MOA	Ministry of Agriculture
MOEHE	Ministry of Education and Higher Education
MOF	Ministry of Finance
MOH	Ministry of Health
MOPIC	Ministry of Planning and International Cooperation
MoSA	Ministry of Social Affairs
NGO	Non-Governmental Organization
NPS	National Poverty Survey
OCHA	United Nations Office for the Coordination of Humanitarian Affairs
PA	Palestinian Authority
PCBS	Palestinian Central Bureau of Statistics
QIIP	Quick-Impact Intervention Program
RTF	Reform Trust Fund
SHC	Special Hardship Case
SESP	Socio-Economic Stabilization Plan
UNSCO	Office of the UN Special Coordinator for Middle East Peace Process
UNRWA	UN Relief and Works Agency for Palestinian Refugees in the Near East
USAID	United States Agency for International Development
WFP	World Food Program



Preface

'Four Years—*Intifada*, Closures and Palestinian Economic Crisis: An Assessment' has been prepared as a follow-up to a report published in May 2003 ("Twenty-Seven Months—*Intifada*, Closures and Palestinian Economic Crisis: An Assessment") and a previous report published in March 2002 ('Fifteen Months—*Intifada*, Closures and Palestinian Economic Crisis). The main objective of this third Assessment is to paint a factual picture of economic and social developments in 2003 and to analyze how the three key parties (the Palestinians, Israelis and donor community) have responded. The goal is to help donors and the Palestinian Authority (PA) cope with the economic crisis in the West Bank and Gaza and to encourage and inform discussion on Palestinian economic issues among the donors, the PA and the Government of Israel (GoI).

2003 was a year of extraordinary volatility in the geo-political situation; the main political developments of the year are summarized in *Table 1*. During 2003, the trend continued by which the popular uprising (the *intifada*) with frequent mostly unarmed confrontations between Palestinians (typically young people) and the Israeli military was replaced by relatively less frequent armed incidents involving militant Palestinian factions. At the same time, opinion polls show continued widespread support in the Palestinian population for armed resistance.

The World Bank has modified its assessment of macroeconomic trends during 2001-2002, following the PCBS's release of its Economic Surveys and its revised labor market data for 2002. Notably, the World Bank has *reduced* its estimate of the decline in GDP per capita. In "*Twenty-Seven Months*" we estimated the decline in GDP between 1999 and 2002 at 33 percent. The decline is now estimated at 28 percent. As a result of the revision of our macro estimates during these two years, we have also revised our poverty estimate (See Chapter 3).

The report has been written by the World Bank, but benefited from significant inputs from the PA. Special thanks go to the ministries of Education, Health, Planning and Social Affairs, which have provided most of the information underlying the analysis; without their support, the report could not have been written. The report also draws on a number of ongoing or recently completed Bank reports, including the forthcoming Poverty Update, which the World Bank prepared in collaboration with the Palestinian Central Bureau of Statistics; the ongoing work on a Social Sector Strategy; a series of reports on the impact of the Separation Barrier; as well as the recent World Bank report on the Government of Israel's Disengagement Plan.

A draft of the report was shared with the Palestinian Authority, donors and the Government of Israel on July 9, 2004. Written comments were received from the Ministry of National Economy, UNRWA, the Netherlands Representative Office and the EC. The draft was discussed at a meeting on August 12, 2004 between World Bank Staff and Ministers of Finance, National Econ-

omy and Planning. The draft has subsequently been revised to reflect the received comments and the recommendations of the August 12 meeting. The report includes available data and documentation up to October 15, 2004.

Many people contributed to this report: Lina Abdallah, Consultant (education); Christina Abdel-Shafi, Consultant (health); Sebastien Dessus, Senior Economist (macro-economic developments and poverty); Tanja Hohe, Anthropologist (community study of six Bethlehem villages); Anne Johansen, Senior Health Specialist (Health); Sima Kanaan, Senior Institutional Development Specialist (NGOs); Catherine McSweeney, Consultant (editing); Stefano Mocci, Head, Local Aid Coordination Committee Secretariat (Israeli facilitation); Nithya Nagarajan, Economist (community study of six Bethlehem villages); Nadège Nouviale, assistant (editing and pictures); Elena Peresso, Institutional Development Specialist (donor response); Susan Razzaz, Senior Economist (poverty); Steffi Stallmeister, Education Specialist (education and social assistance); John Wetter, Senior Economist (closures and macroeconomic developments). Claus Astrup, Country Officer, led the team. Peer reviewers were Robert Beschel, Lead Public Management Specialist; Nick Krafft, Operations Director; and Colin Scott, Senior Social Development Scientist. Markus Kostner, Country Program Coordinator and Nigel Roberts, Country Director, oversaw the exercise.

TIMELINE OF EVENTS 2003/04

2003

- January 29** Israeli Likud party wins elections. On February 27th, the Likud presents a coalition government comprising, the Likud, the National Religious Party, the National Union and the centrist Shinui.
- February 14** PA Chairman Yasser Arafat agrees to appoint a Prime Minister.
- April 29** PA's first prime minister, Mahmoud Abbas, is sworn in.
- April 30** The 'Quartet' (United States, European Union, Russia and the United Nations) publicizes its Roadmap to Israeli-Palestinian Peace, a sequential path to a peace settlement to be implemented over a three-year period. The plan receives Palestinian backing; the Israeli government expresses reservations.
- May 25** Government of Israel endorses the Road Map with reservations.
- June 4** 'Aqaba' summit comprising, Israel, PA and the US raises hopes for a cessation of violence and the implementation of the Roadmap.
- June 29** Palestinian military factions agree to suspend military activities in Israel, leading to a *de facto* cease-fire (*hudna*) during the summer. Israeli army redeploys from positions in Bethlehem and inside the Gaza Strip and 334 Palestinian prisoners are released.
- August 21** The cease-fire ends after a renewal of violence.

(continued)

- September 6** PA Prime Minister Abbas resigns. Ahmed Qurei'a appointed in his stead. Internal disagreements delay the constitution of a new PA government and lead to the formation of a restricted emergency cabinet on October 5.
- October 1** The Israeli cabinet approves the second phase of construction of the Separation Barrier.
- October 12** Israeli and Palestinian politicians unveil an alternative peace plan known as the "Geneva Accord," formulating a complete final status agreement.
- November 12** New PA cabinet sworn in under PM Qurei'a.
- December 18** Sharon publicly gives voice to his plan for a unilateral separation, beginning with the withdrawal of Israeli troops from the Gaza Strip.

2004

- February 23** International Court of Justice hearing on construction of Separation Barrier.
- March 22** Hamas spiritual leader, Sheikh Ahmed Yassin, killed by the IDF. His successor, Abd-Al-Aziz Rantissi, is killed one month later.
- May 2** PM Sharon's Gaza disengagement plan rejected in Likud Party referendum.
- June 6** Israeli Cabinet approves revised Gaza disengagement plan, which provides for dismantling of settlements, subject to further Cabinet approval. Quartet presents its own "Action Plan" for withdrawal two days later.
- July 9** International Court of Justice declares major part of Separation Barrier illegal.

Summary

In 2003, the Palestinian economy stabilized after two years of sharp contraction. The World Bank estimates that per capita Gross Domestic Product increased about one percent in 2003. The stabilization occurred against a backdrop of a modest decline in violence. Moreover, there were fewer curfews (the most extreme form of closure) and the Government of Israel's transfer of previously withheld tax revenues produced a short-acting fiscal stimulus. However, neither of these stimuli was continued into 2004; the economy is stagnant once again. After almost four years of the conflict, average Palestinian incomes have declined by more than one third and one-quarter of the workforce is unemployed. Nearly one-half of all Palestinians live below the poverty line. More than 600,000 people (16 percent of the population) cannot afford even the basic necessities for subsistence. The precipitator of this economic crisis has been 'closure,' a multi-faceted system of restrictions on the movement of Palestinian people and goods, which the Government of Israel argues is essential to protect Israelis in Israel and in the settlements. Closures, including the Separation Barrier, prevent the free flow of Palestinian economic transactions; they raise the cost of doing business and disrupt the predictability needed for orderly economic life. Without major changes in the closure regime and significant progress in the Palestinian reform program to improve the climate for private investors, there is no prospect of a sustained recovery of the Palestinian economy.

The Palestinian economy recovered slightly in 2003, but is now stagnant.

Precipitated by several one-off factors, the Bank estimates that Palestinian Gross Domestic Product (GDP) grew by six percent in real terms in 2003. Positive growth in 2003 is a significant improvement, compared with the two previous years during when the economy shrank by more than 25 percent. Several factors underlie the stabilization of the Palestinian economy in 2003. Fewer curfews and reduced violence in the period, which followed the launch of the Road Map in April 2003, enabled a "catch-up" in private sector activity and household spending. The resumption of revenue transfers and a modest rebound of the Israeli economy also helped. However, the resumption of growth has delivered only marginal improvements in per capita incomes. Given the growth in population in the West Bank and Gaza, real GDP rose by around one percent in 2003. As a result, average incomes in 2003 were some 36 percent lower than their pre-*intifada* levels.

Labor market indicators for the first half of 2004 suggest that the recovery is coming to an end. Some 104,000 jobs were created for Palestinian workers in 2003, equivalent to a 21 percent

increase in employment compared with 2002. Job growth was particularly strong in Gaza, where employment increased by 32 percent in 2003. Unemployment rates fell from an average of 31.4 percent in 2002 to 25.7 percent in 2003. More recently, however, these trends reversed, particularly in Gaza. During the first half of 2004, the Palestinian economy lost more than 22,000 jobs. Gaza experienced the lion's share of this loss (20,000 people lost jobs). Employment in the West Bank held up only because of a sharp increase in part-time jobs, compared with full-time jobs, which declined by almost 17,000 in the first half of 2004. Moreover, at less than 1,000, the number of Palestinians working in Israel was the lowest ever reported by the PCBS.

The Palestinian economy remains severely depressed compared with the pre-*intifada* period. The World Bank estimates that GDP is 23 percent lower than in 1999. After accounting for population growth, real GDP per capita is some 35 percent below its pre-*intifada* level. An unemployment rate of about 25 percent in 2003 (compared with 10 percent at the eve of the *intifada*) underscores the fact that the Palestinian economy operates well below its potential. Young people are particularly hard hit by unemployment: 37 percent of young people were unemployed at the end of 2003 compared with 14 percent on the eve of the *intifada* in September 2000.

The PA's fiscal situation eased somewhat in 2003, but remained difficult. The PA's fiscal situation has been severely constrained by the *intifada*. Fiscal revenues increased in 2003 due to improved tax collection, the resumption of withheld revenue transfers and macroeconomic stabilization. Clearance revenues amounted to US\$442 million in 2003 compared with US\$150 million in 2002. The GoI also rebated a total of US\$294 million in previously-withheld clearance revenues to the PA; these revenues allowed the PA to pay off some of its arrears to suppliers which had accumulated during 2002. These revenues also boosted private sector liquidity. Revenues also got a boost from reform of the Petroleum Commission. The commission has operated under the direct control of the Ministry of Finance since July 2003. However, PA expenditures, driven in particular by an expanding public sector wage bill, exceeded limits set by the 2003 Budget. While civil service recruitment remained within limits set by the 2003 Budget, security sector employment grew by 3,443 in 2003 compared with a budget-stipulated freeze in recruitment. The total increase in the public sector payroll came to about 5,300—almost twice the level allowed for in the budget. At the same time, public sector salaries went up 15 percent in 2003 because the PLC forced through implementation of the 1998 Civil Service Law. The PA's budget was further strained by the burden of paying outstanding municipal bills to Israeli suppliers. As a result, the PA's financing gap in 2003 totaled US\$561 million (19 percent of GDP). To cover this gap, the PA squeezed non-wage expenditures, deferred payments to the public sector pension system, and borrowed from commercial banks. At US\$229 million, external budget support in 2003 was less than one-half of the amount anticipated in the 2003 Budget. In response, the PA squeezed non-wage expenditures to 78 percent of 2003's budgeted amount; the PA also increased borrowing from commercial banks (PA debt to commercial banks stood at US\$176 million at the end of the year).

Closures remain the defining characteristic of Palestinian economic life.

The economic space of the West Bank and Gaza remains highly fragmented; economic activity has significantly declined. Closures and curfews continue to disrupt business, commerce and routine social exchange; they have raised transport and production costs and severed vital economic

links between villages and urban areas. West Bank businessmen report difficulties in obtaining necessary productive inputs from suppliers, and in shipping finished goods to market. The movement of commercial goods between the West Bank and Israel declined by 50 percent during 2003 compared with the level prior to the launch of Operation ‘Defensive Shield’ in March 2002; Defensive Shield severely restricted Palestinian traders’ ability to engage in business outside the West Bank. Closures and permit cancellations reduced the number of Palestinians working in Israel and in the Israeli settlements (ISI) to 8 percent of employed Palestinians, according to the latest figures from PCBS compared with 22 percent on the eve of the *intifada*.

The frequency of curfews—the most extreme form of closure—occurred less often in 2003 than in 2002, but construction of the Separation Barrier accelerated. The intensity of curfews gradually declined from their peak during operation Defensive Shield in the spring of 2002, when more than one-third of the West Bank population was under curfew for extended periods of time. The decline continued in 2003; when the share of curfew-hours in most urban centers dropped to around 10 percent from over 40 percent in the second half of 2002. The Government of Israel continued the construction of the Separation Barrier in 2003. To date, a total of 185 kilometers of the Separation Barrier has been constructed. If constructed according to GoI plans, approximately 157,800 acres or 11.2 percent of West Bank land (excluding East Jerusalem) will lie between the Barrier and the Green Line.¹ These areas are home to some 93,000 Palestinians. The Palestinians are likely to be separated from their agricultural lands, irrigation networks and water resources, as well as from West Bank workplaces, schools and health clinics. Commercial establishments in Palestinian communities affected by the Barrier will face reductions in their customer base, as the ability of Israeli Arabs to frequent Palestinian shops is restricted.

To date, the Separation Barrier’s direct economic impact has been modest although especially agriculture has been negatively affected; closures have dwarfed its effect. In terms of unemployment, data collected by PCBS show that so far there has not been a significant divergence in unemployment rates between communities located on either side of the Barrier. Labor movements were severely constrained before construction began, limiting the additional negative impact of the barrier. However, there are signs that the percentage of workers commuting to Israel and to the Israeli settlements from those governorates in which the Barrier was built declined more rapidly than in those where the Barrier has yet to be constructed. The separation barrier has, however, led to destruction of agricultural lands, infrastructure and water resources, and appreciably reduced access to farmland in the seam-zone, which has had a particular negative effect in Jenin and Tulkarem districts that together account for more than 20 percent of Palestinian agricultural production².

Palestinian living standards have been severely compromised.

Despite economic stabilization in 2003, some 47 percent of Palestinians live below the official poverty line. Three years of economic crises have severely compromised Palestinian living standards. Job creation in 2003 made a dent in the poverty rates, but some 47 percent of Palestinians

¹ These numbers derive from projections based on the revised barrier route published by the IDF’s Seam Zone Authority. The routing of the Separation Barrier is still subject to uncertainty, partly because of pending lawsuits.

² The economic effects of the Separation Barrier are analyzed in depth in the forthcoming Separation Barrier Report.

(around 1.7 million people) still live below the official poverty line of US\$2.1 daily per person (down from 51 percent in 2002). Joint analysis by the Bank and PCBS suggests that every segment of the Palestinian population (except for the richest 10 percent) has seen deterioration in their financial situations.

Economic hardship is most acute for the 600,000 Palestinians living under the minimum level for subsistence. That 16 percent of the population, who live below the subsistence poverty line, merely survive, despite significant amounts of humanitarian assistance. Families living in subsistence poverty display characteristics of long-term poverty: they are generally large with many non-working dependents (children and elderly) and limited, if any, savings. The working poor have low levels of education (20 percent of the working poor have not even completed primary school, compared with 9 percent of other workers); the Working poor are employed in sporadic, part-time or unpaid jobs (e.g. family labor). These characteristics limit their ability to withstand the economic crisis. They hovered close to the subsistence poverty line *prior* to the *intifada*; a modest decline in average incomes was enough to push them into subsistence poverty.

The coping strategies for the poorest segment of the Palestinian population are being increasingly stretched thin. By 2003, the ability of the subsistence poor to continue coping with a prolonged economic crisis by reducing consumption, drawing down savings and selling liquid assets became increasingly strained. Consumption has been drastically reduced; there is limited opportunity for further cuts. In 2001, 94 percent of the population reported cutting consumption; in 2003, only 46 percent reported they were able to do so. Family savings are being depleted. In 2001, 70 percent of the poorest families drew down their savings, compared with 13 percent who continued to do so in 2003. Social networks provide an important safety net for poor households; 60 percent of the poor reports borrowing from individuals while 34 percent rely on borrowing from friends and relatives in 2003.

The protracted conflict is taking a heavy toll on the mental health of children and youth. Continued violence has increased levels of psychological trauma and stress among children and young people. Almost one-half (48 percent) of children report having personally experienced conflict-related violence or witnessed violence affecting an immediate family member. Around 40 percent of parents report *intifada*-related psychological problems among children (aggressive behavior, nightmares, etc.) according to a study by the University of Geneva. Schoolteachers and parents also report diminished attention spans and difficulty in concentrating among school-age children. The well being of children and youth is problematic and worrisome; so too are the future cohesiveness and development prospects of Palestinian society.

Delivery of basic social services continues, due to significant donor assistance. But law and order are disintegrating.

Despite commendable efforts, the quality and coverage of basic social services are severely under stress. To their credit, the PA, municipalities and a variety of NGOs (assisted by donors) have maintained delivery of core services—education, health, water and electricity, sewage and solid waste—on a regular basis. Inevitably, however, service standards have declined; closures and the sustained fiscal crisis have taken their toll. For example, school enrollment rates have declined four years in a row. Moreover, the capacity of the education system is seriously constrained by the PA's deteriorating financial situation, a dramatic drop in payment of student tuition fees, and a lack of

planning and management capacity. Despite these constraints, generally, the quality of basic education has been sustained at pre-*intifada* levels; the average student/teacher and student/classroom ratios have remained constant over the past five years. However, the quality of higher education is deteriorating; recruitment of teaching staff and expansion of facilities have not kept pace with expanding enrollment. The quality of municipal services has also deteriorated since the onset of the *intifada*. Closures have had a particularly negative impact on solid waste collection; there was also limited access to landfills; (the IDF has closed many municipal landfill sites). Increasing transport costs have led to a proliferation of temporary dumpsites that present environmental and health hazards. Donors doubled the level of emergency municipal support in 2003, thus playing a key role in sustaining municipal services.

The PA's legitimacy and ability to enforce law and order has gradually decayed. In recent months, there have been increasing signs of a collapse of law and order in the West Bank and Gaza, with several kidnappings, mass protests and attacks on PA offices. When Prime Minister Qurei'a submitted his resignation on July 17 (later withdrawn) he warned that the West Bank was on the verge of "unprecedented chaos." Challenges to the authority of the PA have come from officials within the PLO and from a younger generation of political activists. Many of the latter are affiliated with militant groups like the Al-Aqsa Brigade and other groups associated with Fatah. Undoubtedly, the Israeli disengagement plan has fuelled internal Palestinian tensions; various political factions have sought to position themselves for the "day after" an Israeli military withdrawal.

Donor-financed emergency assistance has played an important role in sustaining social service delivery and supporting the poor. Donors disbursed US\$883 million in 2003—a slight decline from 2002. But at US\$258 per capita, the level of donor support remains high by international standards. Despite a steep decline in budget support, donors nevertheless covered some 25 percent of the PA's recurrent expenditures in 2003. Therefore, they played a significant role in helping the PA continue basic social services. Donors also disbursed US\$264 million in emergency and humanitarian aid; US\$119 million of that was for food aid, job creation programs and cash assistance for the poorest. Without these programs, the Bank estimates an additional 250,000 persons (a 35 percent increase above the current level) would have fallen under the subsistence poverty line in 2003. Donor-financed emergency assistance has been relatively effective in targeting the poorest segments of the Palestinian society. Over 40 percent of food aid and about 55 percent of cash assistance goes to the 16 percent of Palestinians live below the subsistence poverty line. Inevitably, relatively affluent households receive some emergency assistance; however, the largest share of emergency assistance (some 70 percent) reach families living below the official poverty line.

A radical easing of internal closures and facilitation of trade is needed to restore Palestinian economic vigor.

A radical easing of *internal* closures would bring growth to the Palestinian economy, but unemployment rates would still increase. Although short-lived, the modest economic recovery that accompanied the brief easing of closure and violence in 2003, and the brightened prospects for stability, illustrates the importance of closures for the health of the Palestinian economy. The World Bank estimates that an immediate easing of internal closures could lead to real GDP growth

of 3.6 percent by 2005. Despite these economic gains, easing internal closure alone would not be enough to spur economic activity to reduce unemployment and poverty. GDP per capita would remain 40 percent below its 1999 level by end-2006; poverty levels would reach 51 percent by 2006 (68 percent in Gaza). Unemployment rates would still reach about 30 percent by 2006 (35 percent in Gaza), slightly lower than under the *status quo* scenario (34 percent and 38 percent, respectively)³.

Ending the Palestinian economic crisis depends on the ability of the private sector to trade in international markets. That means the opening of external borders. A small developing economy cannot rely on domestic demand for long-term sustainable growth. Palestinian (and Israeli) businesses need international markets to sell their products and to acquire inputs and production technologies at competitive prices. Bank projections indicate that a facilitating Palestinian external trade would raise real GDP growth to 9.2 percent by 2006 (compared with a negative 2006 growth rate under a *status quo* scenario). Exports would grow at a rate of 30 percent per annum by 2006 (significantly higher than the 3.4 percent under the *status quo* scenario); exports would spur job-creation and reduce unemployment to 23 percent by 2006, compared with 34 percent if the current *status quo* continues. As a result, the poverty level would fall from 56 percent under the *status quo* scenario (72 percent in Gaza) to 46 percent by 2006, which still, however, represents only a negligible improvement compared to the poverty level today. Bank projections indicate that were donors to provide generous additional assistance, concurrently with a radical easing of closures, a significant dent in poverty could be made: an extra US\$1.5 billion (for a total of US\$4.3 billion during 2004-2006) could reduce poverty to 37 percent by 2006.

PA reform and fiscal discipline are essential to create an investor-friendly climate.

Rejuvenating the reform program is essential to create a growth-oriented economic environment and boost PA legitimacy with Palestinians and donors. Two years after the PA reform program began momentum has stalled. In 2003, reform achievements were limited to the area of public financial accountability. There is a serious need to bring the reform program up to speed again, even if a continuation of the conflict and the absence of a negotiated final settlement would compromise the effectiveness of these reforms.

Reforms to improve public accountability, transparency and stability, all vital element for economic recovery, require particular attention. The PA should press ahead with the establishment of legal and institutional frameworks for elections and complete the long-delayed voter registration process. Moreover, further measures to improve PA transparency - including the creation of an independent audit function, the privatization of public enterprises, and observing existing laws on public procurement - are essential to create investor confidence. In addition, legal and regulatory reform to ensure the orderly conduct of commercial activity must be speeded up; in particular, there is an urgent need to improve the infrastructure of the court system and give priority to training judges and lawyers. And, though this paper does not discuss the specifics of Palestinian

³ The scenarios presented in this report are identical to those of the June 23 World Bank report “*Disengagement, the Palestinian Economy and the Settlements*”.

security, it is clear that the PA needs to establish control over law and order as a precursor to economic recovery. Finally, expanding access to credit will be needed to fuel any recovery; a major land-titling program, the expansion of leasing and adopting more creative methods for assessing credit risk would all help expand credit opportunities. There is no reason to delay these important reform measures. At the same time, it should be underscored that the economic impact of any reform will remain limited unless the GoI addresses restrictions on internal movement and external trade.

It is essential that the PA brings the wage bill under control. Unrestrained growth in the PA's wage bill in past years has severely undermined fiscal stability and sustainability. That has put the PA in a situation of unhealthy reliance on unsure donor support. The PA needs to press ahead with ongoing measures to tackle the escalating wage bill and reform the pension system. In particular, a continued increase in security sector staff is unjustified; it is essential that the PA restricts any increases in public expenditures to the social sectors. However, it should be noted that reducing the wage bill, by reducing the payroll or cutting salaries, could prove to be highly destabilizing; the PA derives its legitimacy from its ability to provide jobs in a context of economic crisis.



Closures and Curfews



ONE

The precipitator of today's economic crisis in the West Bank and Gaza has been 'closure.' Closure is a multi-faceted system of restrictions on the movement of Palestinian goods and people designed to protect Israelis in Israel proper and in the settlements.⁴ Closures fragment the Palestinian economic space, raising the cost of doing business and disrupting the predictability needed for orderly economic life. In 2003, closures and curfews continued to severely constrain the Palestinian economy. But there was a reduction in curfews and in the intensity of Israeli military operations compared with the summer and fall of 2002 when Operation Defensive Shield was at its peak.⁵ However, the first six months of 2004 saw a significant escalation in military activity, particularly in Gaza. Internal restrictions on the movement of goods and people remained in place. External closure—particularly during periods of heightened security—continued to be enforced, and construction of the Separation Barrier accelerated.

INTERNAL CLOSURE

1.1 Closure severely disrupts business, commerce and routine social exchange; it has profound effects on economic and social life.

During periods of curfew—the most extreme form of closures—the wheels of the economy come to a grinding halt. Workers cannot get to their workplaces and economic transactions cease. During “severe closure,” pedestrian and vehicular mobility on main roads is reserved for Israeli military personnel, settlers, and non-Palestinians. During periods of “partial” internal closure, Palestinians still face considerable delays and frequent harassment. Often they must resort to making detours over fields or unpaved roads. Closure stifles economic activity by raising the cost of doing business and increasing uncertainty. Closures have also greatly diminished the number of Palestinian workers who are able to gain employment in the Israeli labor market. Not surprisingly, closures have been detrimental to household incomes. Closures have a particularly devastating effect in remote areas where links between villages and urban areas have often been severed.

4. The term “closure” refers to the restrictions that Israel imposed for security reasons on the free movement of Palestinian goods and labor across borders and within the West Bank and Gaza. These restrictions take three forms: i) internal closure within the West Bank and Gaza, reinforced periodically by curfews; ii) external closure of the border between Israel and the West Bank and between Israel and Gaza; and iii) the external closing of international crossings between the West Bank and Jordan and between Gaza and Egypt.

5. The Israeli Defense Forces (IDF) launched Operation “Defensive Shield” on March 29, 2002, and Operation “Determined Path” on June 18, 2002. In popular and journalistic discourse, both operations were referred to as Operation Defensive Shield.

1.2 A dense network of fixed and ‘flying’ (mobile) military checkpoints continued to restrict the movements of Palestinian goods and people during 2003. In ‘Twenty-Seven Months,’ the Bank noted “some 140 checkpoints in the West Bank and 25 to 30 in Gaza and another 200 or so unmanned roadblocks.”⁶ In January 2004 the UN Office for the Coordination of Humanitarian Affairs (OCHA) reported the existence of 59 checkpoints within the West Bank, 10 partial checkpoints, 479 earth mounds, 75 trenches, 100 roadblocks, and 40 road gates, all for the purpose of controlling the movement of Palestinians.⁷ Within the Gaza Strip, closures have often effectively divided the territory into four areas: Gaza City, the environs of Jabalya, Khan Yunis and Rafah; these closures have severely disrupted north-south travel in the Gaza Strip.

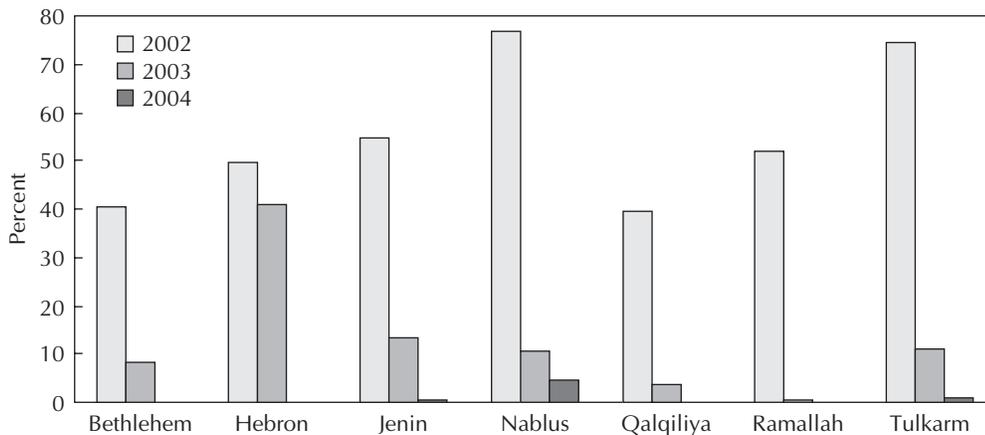
6. Twenty-Seven Months, p. 1.

7. OCHA reports that by March 2004, the total number of obstacles in the West Bank stood at 695: 57 checkpoints, 96 roadblocks, 420 earth mounds, 17 walls, 38 gages, and 67 trenches.

1.3 The incidence of curfews declined in 2003. In 2003, with the exception of Hebron, curfews occurred less often than in the past (see Figure 1.1). In mid-June 2002, Israeli military operations (‘Operation Defensive Shield’) transformed many West Bank cities, towns, and villages into restricted military zones, bringing economic activity to a standstill. Residents came under sustained (often 24-hour) curfews for days at a time. During peak periods, nearly 900,000 West Bank residents in 74 communities came under curfew; on average, during the six-and-one-half month period between June 17 and December 31 2002, 35 localities and 547,000 persons were directly affected on a daily basis. However, there were some exceptions. In general, ambulances operated during curfews and municipal workers had a limited number of permits to conduct emergency repairs. Nevertheless, commercial activities came to a halt during curfews.

1.4 The ‘back-to-back’ system for the transit of humanitarian goods became routine in 2003. In May 2002, the extension of the “back-to-back” system began. Under this system, all

FIGURE 1.1 Percentage of Hours Under Curfew, June 2002–September 2004



Note: Data for hours under curfew begin in late June 2002. The dates ranged from June 18 (Jenin) to June 25 (Hebron).
 Source: World Bank staff calculations based on Palestinian Red Crescent Society (PRCS) data.

non-humanitarian goods have to be off-loaded at eight checkpoints near major West Bank cities. Then, after inspection under the supervision of the IDF, the goods are reloaded onto local trucks. According to observations made by staff of UNSCO and the Bank, implementation of this policy was erratic. By the second half of 2003, the system had become far more routine but also erratically implemented, based on Israeli interpretations of the security situation in a particular city. According to the IDF's Coordination of Government Activities in the Territories (COGAT) Foreign Relations Branch, by year-end, between 600 and 900 trucks traveled through the back-to-back platforms in the West Bank each day.

EXTERNAL CLOSURE

1.5 On the eve of the *intifada*, 146,000 people or 22 percent of employed Palestinians worked in the Israeli labor market. The permit system, which applied to Palestinians who wanted to enter or travel through Israel, began in 1991. Until then, more than one-third of the Palestinian workforce—at that time, approximately 160,000 workers of whom roughly 120,000 were permit holders—found employment inside the Israeli labor market.⁸ On the eve of the second *intifada* in 2000, an estimated 146,000 Palestinians, which included residents of East Jerusalem,⁹ worked in Israel and Israeli settlements. They

8. Jerusalem Media and Communications Center, *Israeli Obstacles to Economic Development in the Occupied Territories*, 2nd Edition, April 1994, cited in *Palestinian Workers Exploited and Israeli Economic Oppression: The Case of Settlement Workers—Palestinian Workers in Israeli Settlements in the West Bank and Gaza Strip*, Palestinian Society for the Protection of Human Rights and the Environment (LAW), August 2000.

9. According to PCBS labor data, approximately 28,000 West Bank residents who work in Israel and Israeli settlements hold Israeli-identity cards (residents of Israeli-annexed East Jerusalem). This number, which has remained stable throughout the period, represented roughly 25 percent of the total number of West Bank Palestinians working in Israel prior to the *intifada*. Because external closures have limited access across the Green Line, that share has risen to just over one-half.

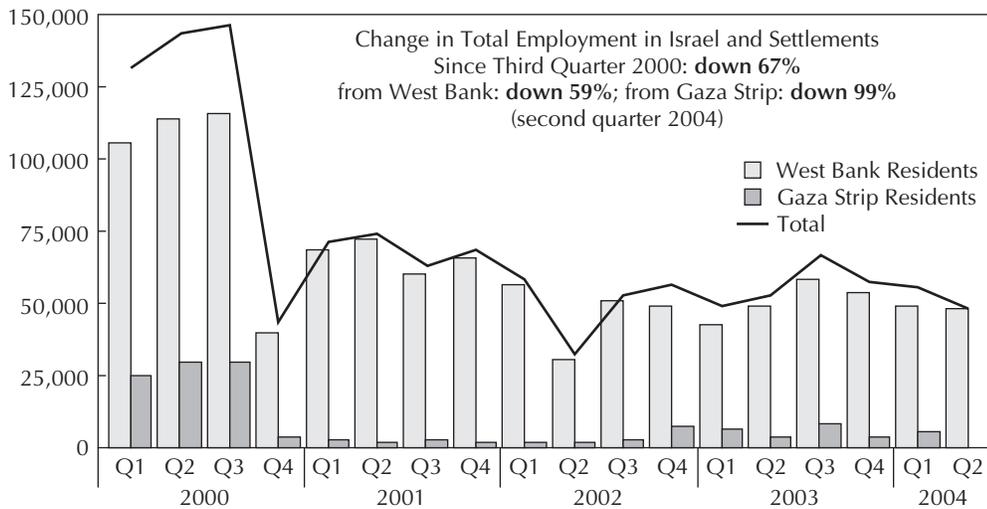
represented 22 percent of Palestinian employment (31 percent of wage employment). These people accounted for 40 percent of Palestinian wage income; in the third quarter of 2000, average daily wages were 57 percent higher than in the West Bank and 120 percent higher than in Gaza.

1.6 Closures and permit cancellations greatly reduced the number of Palestinians working in Israel and Israeli settlements. From the beginning of the second *intifada* in September 2000, the permit system tightened. Permits were frequently cancelled and border crossings sealed. As a result, employment in Israel declined; so did commercial transactions through Israel. These restrictions tightened even further during Operation Defensive Shield that began launched in March of 2002, but eased slightly in 2003.

1.7 In 2003, only nine percent of employed Palestinians (57,000 people) worked in the Israeli labor market. According to PCBS data, despite an initial contraction to about 43,000 persons in the first three months of the *intifada* (fourth quarter 2000), the number of Palestinian workers in Israel and Israeli settlements held steady throughout 2001 at about 70,000 (see Figure 1.2). In 2002, on average, the number of Palestinians was approximately 50,000; that number dropped to 33,000 in the second quarter as a result of closures during Defensive Shield). In 2003, the number of Palestinians working in Israel and Israeli settlements averaged 57,000 or 39 percent of the 1999 level. By the final quarter of 2003, only 9 percent of employed Palestinians worked in Israel and the settlements; they represented 15 percent of wage employment and yet accounted for 25 percent of Palestinian wage income.

1.8 The movement of goods between the West Bank and Gaza and Israel as well as with the rest of the world continued to be restricted. The movement of goods between the West Bank and Gaza and Israel and with the rest of the world remained heavily restricted during

FIGURE 1.2 Employment in Israel and the Settlements, 2000–2004Q2



Source: PCBS and World Bank staff calculations.

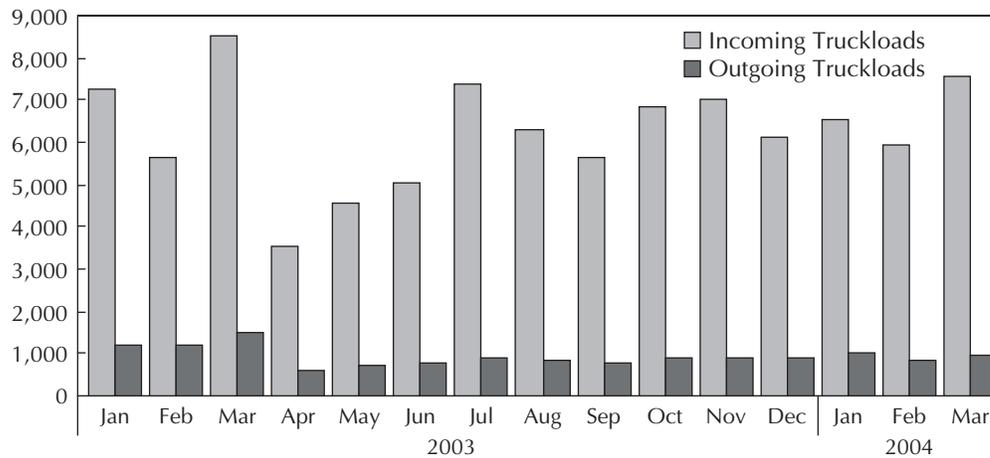
2003, with frequent delays at Karni passage in Gaza and at bridge crossings across the Jordan River. In comparison with the period prior to Operations “Defensive Shield” and “Determined Path,”¹⁰ commercial truck movements between the West Bank and Israel reportedly fell by as much as 50 percent. However, after prior consultation with Israeli authorities, trucks bearing humanitarian cargo or raw materials for donor projects and trucks driven by international drivers or residents of East Jerusalem, have easier passage. A limited number of permits exempting trucks from back-to-back controls have been granted to Israeli trucks bearing goods such as milk and medicine as well as Israeli trucks carrying quarry products from Bethlehem into Israel. Nevertheless, at times of heightened security, these exemptions do not apply. Based on available data from Gaza Strip crossings, on average, 6,159 truckloads entered Gaza each month and 934 exited (*Figure 1.3*).

10. Inconsistencies in the limited data available prevent quantitative comparisons with pre-*intifada* levels.

The separation barrier will likely further tighten closure by restricting access from the West Bank to Israel and from the “Seam Zone” to the West Bank.¹¹ In the summer of 2002, the Government of Israel (GoI) began the construction of a “separation barrier,” a complex series of walls, barriers, trenches, and fences within the western border of the occupied West Bank. The GoI justified the barrier as a direct response to Palestinian suicide attacks from across the Green Line, necessary to prevent infiltration by Palestinian militants. During 2003, the GoI completed the first phase of the separation barrier. The barrier spans some 185 kilometers in the northern West Bank and in sections around Bethlehem and Jerusalem (See Box 1.1).¹²

11. The Seam Zone refers to the areas of the West Bank caught between the separation barrier and the Green Line

12. Motivated by concerns that Palestinian livelihoods and the viability of local economies could be harmed by the construction of a separation barrier and that the barrier might negatively impact the delivery of humanitarian aid and damage assistance projects, the international donor community through the Local Aid Coordination Committee (LACC) commissioned a study and series of

FIGURE 1.3 Monthly Truckload Crossings, Gaza Strip, 2003

Source: UNSCO, based on PA Ministry of Finance, Ministry of National Economy, PNA National Security Service – Northern Command Area, and General Petroleum Corporation data. Incoming trucks enter Gaza from Soha, Rafah, Nahal Oz, and Karni crossings; outgoing trucks exit only through Karni.

BOX 1.1 The Separation Barrier

The first phase (“Stage A”) of construction of the Separation Barrier, which began in June 2002, involved extensive land requisition and clearing of land along a 126-kilometer route. This route went through the northwestern governorates of Jenin, Tulkarm, Qalqiliya, and Salfit; the route includes 21 km in areas of Bethlehem and Jerusalem. This stage was complete in July 2003.

In January 2003, construction began on a 45 km stretch running east along the northern edge of Jenin governorate (“Stage B”) and, other sections of the “Jerusalem Envelope.” This work continues. The Gol intends that the Separation Barrier or a series of “buffer zones” should extend along the entire western face of the West Bank. If completed according to current plans, the separation barrier will have a length of 622 kilometers.

(continued)

follow-up reports of the possible socio-economic impact of the barrier on affected Palestinian communities. The first report, “The Impact of Israel’s Separation Barrier on Affected West Bank Communities,” was carried out at the request and under the direction of a Steering Group composed of members of the donors’ Humanitarian and Emergency Policy Group (the European Union Presidency (HEPG chair), the European Commission, the Government of Norway, the US Government, UNSCO,

and the World Bank), plus the International Monetary Fund; released on May 4, 2003, it is available at the following web address: www.reliefweb.int. Follow-up reports on Jenin (July 31), the “Jerusalem Envelope” (September 30), and the operation of the access regime in Stage A sections of the barrier (November 30) has subsequently been produced. The Bank is currently preparing another update that will be published later in the 2004.

BOX 1.1 The Separation Barrier (*Continued*)

The second stage alignment in northern Jenin more closely adhered to the Green Line. Although built within the West Bank, less agricultural land was affected than in areas near Tulkarm and Qalqiliya during the first stage. This situation does not minimize the economic loss to individual landowners who have had their lands requisitioned for the Barrier's alignment.

The trajectory of the "Jerusalem Envelope" has magnified the negative impact of lost agricultural land seen in Stage A with the economic loss of external employment, commercial markets, and clientele seen in Stage B. West Bank identity card (ID) holders living on both sides of the barrier find their ability to access employment in East Jerusalem seriously limited. Jerusalem ID holders face difficulty in reaching jobs and services outside the city in West Bank neighborhoods (e.g. Ramallah to the north, and Bethlehem to the south). Commercial establishments in Palestinian communities outside Jerusalem face further reductions in their customer base (for example, a loss of clientele from Jerusalem in the markets and repair shops of Abu Dis has occurred as a result of the barrier obstructing access from Ras al 'Amud). In Bethlehem, the tightened closure affected by the barrier inhibits recovery of the tourism industry, formerly a mainstay of the local economy. Access to specialized medical services and educational facilities located west of the barrier in East Jerusalem has become problematic for Palestinians residing outside the barrier; similarly, Jerusalem students attending school or university outside the city face further difficulties in reaching their places of learning.

In many Palestinian families in the Jerusalem area, some members have Jerusalem residency permits and others have West Bank IDs. As movement restrictions have increased as a result of the barrier, hard decisions have had to be made—either to maintain separate residences or to live on the east side of the barrier, exposing Jerusalem ID holders to the risk of no longer satisfying Israel's requirement that Jerusalem is the ID holder's place of residence. These choices could lead to a forfeit of the right to work in Jerusalem, to educational and health facilities, to insurance, and to social welfare benefits—or to relocate to the western side of the barrier to maximize employment prospects. However, for a West Bank ID holder, such relocation without a Jerusalem residency permit is a violation of Israeli law.



Economic Developments



TWO

The Palestinian economy, which continues to function at far below capacity and under continued movement restrictions, is unable to generate the employment needed to absorb a rapidly expanding workforce. Poverty afflicts almost half of the Palestinian population. The economy stabilized in 2003, reflecting diminished levels of violence, fewer curfews and more predictable (albeit intense) closures. The quality of most new jobs created in 2003 was poor; investment and trade remained depressed. Moreover, sustaining 2003's modest recovery will prove difficult. Stabilization in 2003 resulted from factors which will either not be repeated (the return of tax revenues withheld in 2001 and 2002), or may not last. Violence has escalated again in Gaza. Resistance to the completion of the separation barrier could intensify, leading to further declines in the flow of labor to Israel. Labor market data for the first half of 2004 seems to confirm that the modest recovery is coming to an end; the level of employment is again declining.

MACROECONOMIC TRENDS IN 2003

2.1 Palestinian per capita incomes fell by almost 40 percent during the first two years of the *intifada* while poverty rates and unemployment soared. “Twenty-Seven Months—*Intifada*, Closures and Palestinian Economic Crisis” described the Palestinian economy after two years of steep decline in all economic indicators. In both 2001 and 2002, Palestinian average incomes fell at double-digit rates; by the end of 2002, real per capita GDP had fallen to 37 percent compared to its pre-*intifada* level. Unemployment stood at around 31 percent of the workforce (up from 12 percent in September 2000); levels of investment and trade were all significantly lower than pre-*intifada* levels, and social indicators, such as poverty rates, health status, and educational outcomes, had deteriorated. Closures were the main precipitating factor in this decline. Total disintegration of the Palestinian economy was averted due to the social resilience of Palestinian society and sustained donor support.

2.2 The economy showed signs of stabilizing towards the end of 2002. “Twenty-Seven Months” noted signs of economic stabilization towards the end of 2002. In particular, the 19 percent employment growth registered in the fourth quarter of 2002 was much higher than expected. This growth was partly explained by the effect of seasonal demand, particularly in agriculture, and the short-term impact of labor-intensive donor interventions to repair damaged infrastructure during this period.

2.3 “Twenty-Seven Months” presented several possible economic outcomes for 2003.

These outcomes illustrated the strong interdependence between politics and economics in the West Bank and Gaza. A ‘*status quo*’ scenario of political stagnation and continued heavy closures would lead to a contraction in GDP per capita of 2 to 3 percent in 2003, an increase in unemployment to 34 percent by 2004 and a rise in poverty to 60 percent of the population. In contrast, the “Twenty-Seven Months” scenario of political progress, which led to an *easing of internal closures*, immediately boosted economic activity; GDP increased by around 15 percent in 2003. Needless to say, relaxing external closures would have boosted growth even further, by 21 percent.

2.4 The Palestinian economy in 2003 performed somewhat better than predicted by the ‘*status quo*’ scenario in “Twenty-Seven Months,” but far worse than the “easing of internal closure” scenario. The Bank estimates that real GDP would increase by 6 percent in 2003 compared with a rise of just 2 percent projected under the *status quo* scenario. However, with population growth at around 5 percent, 2003’s GDP increase translated into per capita income growth of only 1 percent.

2.5 The stabilization of the Palestinian economy in 2003 reflected the interplay of one-off several factors. First and foremost, curfews were fewer in 2003 compared to 2002 (see chapter 1); the level of violence was less. Curfews, which oblige people to stay at home, severely impact the economy. They prevent workers from reaching their workplace, impede transactions, raise the cost of doing business and disrupt the predictability needed for orderly economic life. The decline in curfews in 2003 helped the economy to rebound. Second, the transfer of previously-withheld clearance revenue (See Table 2.2) provided a fiscal stimulus to the domestic economy. This revenue allowed the PA to repay some of its arrears to the private sector. Finally, the Israeli economy emerged from two years of recession (Box 2.1). The Pales-

tinian economy is highly dependent on the Israeli economy. Israel is by far its largest trading partner (some 75 percent of Palestinian imports transit through or originate in Israel; the Israeli market accounts for 90 percent of Palestinian exports). Also, despite the decline in the number of Palestinians working in Israel, remittances from Palestinian workers in Israel still account for some 25 percent of total Palestinian wage income (See Chapter 1).

2.6 Palestinian per capita income remains some 35 percent lower in real terms than its pre-*intifada* level. The contraction of economic activity during 2000 to 2002 brought real GDP per capita to a level 37 percent below that in 1999.¹³ Despite the modest recovery in 2003, on average, per capita incomes remain 35 percent below their pre-*intifada* level (Figure 2.1). In comparison, the financial crises in Argentina (1998 to 2002) and Indonesia (1997) entailed a cumulative decline in GDP per capita in the range of 15 to 25 percent.

2.7 The Palestinian economy continues to function well below its potential. Despite positive growth in 2003, the Palestinian output gap—the difference between the actual level of output and the potential level—remains significant. An unemployment rate of about 25 percent in 2003 (see Table 2.1) reflects the fact that demand for Palestinian goods is insufficient for the economy to function at full capacity. Foreign trade also remains subdued: Palestinian exports decreased by 4 percent in 2003; they contributed only 14 percent to GDP as compared with 20 percent in 1999. Damage to infrastructure¹⁴ and depressed investment levels associated with the *intifada* have significantly lowered the productive capacity of the Palestinian economy.

13. In “Twenty-seven Months” the decline was estimated at 41 percent. However, for this report, the Bank revised its estimates of Palestinian macro-economic developments during 2000 to 2002, see Box 2.2.

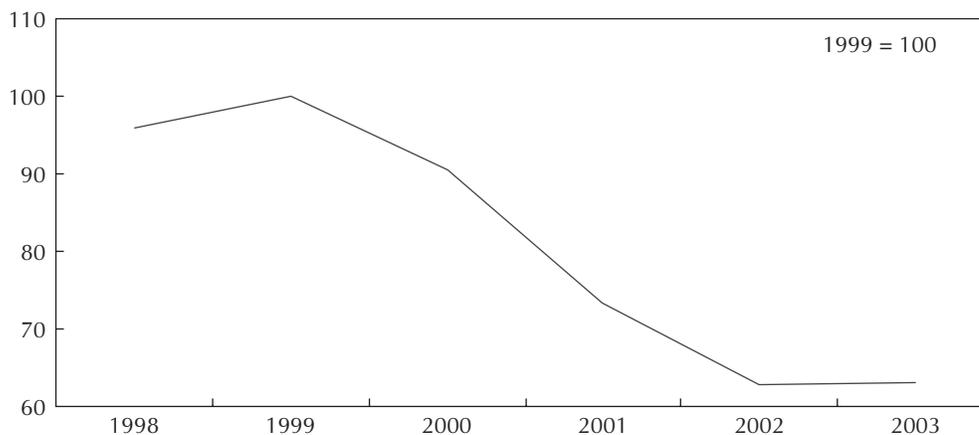
14. Up until the end of 2002, total damage was estimated upwards of US1 billion. Unfortunately, at the time of this writing, an updated damage assessment was not available.

BOX 2.1 Economic Developments in Israel in 2003

In 2003, the Israeli economy registered positive growth for the first time since 2000. At 1.2 percent, however, Israeli GDP growth remained low. The Bank of Israel attributes the slight recovery in activity to global economic growth in 2003 and a rise in private consumption against a background of relative calm in terms of security. In addition, economic policy in the second half of 2003 restored fiscal credibility and enabled the gradual easing of monetary restraints; both of these supported the upswing in economic activity. Israeli inflation declined sharply in 2003 from 5.6 to 0.7 percent, mainly as a result of exchange rate appreciation; the NIS appreciated by 4.4 percent *vis-à-vis* the US dollar. Economic growth in 2003, however, fell short of Israeli population growth. Hence, real GDP per capita declined in Israel for the third year in a row. Household disposable income was further eroded by an increase in taxes and cuts in social transfers. Moreover, the unemployment rate in Israel stood at 10.7 percent in 2003 compared with 10.3 percent in 2002.

2.8 The ability of the Palestinian economy to sustain even this modest recovery in the future is highly questionable. Several of the factors that spurred growth in 2003 will either not be repeated or they may not last. The reduction in violence and curfews in 2003 contributed to growth. However, this growth may be temporary if violence escalates and movement restrictions are not eased

in 2004. (See Chapter 6). Likewise, the return of tax revenues in 2003, which were withheld in 2001 and 2002, provided a one-off boost to growth that will not be sustained. In addition, the PA's fiscal position remains precarious; its ability to maintain the delivery of basic services and serve as a cushion to support domestic demand continues to be in jeopardy.

FIGURE 2.1 GDP per Capita, 1998–2003

Note: Level of GDP per capita is indexed so 1999=100.
Source: PCBS and World Bank Staff estimates.

BOX 2.2 Availability of Economic Data and World Bank Projections

The absence of up-to-date information on Palestinian macroeconomic aggregates has always hampered rigorous monitoring of economic activity in the West Bank and Gaza. As a result, the Bank as well as other agencies analyzing economic trends in the West Bank and Gaza has been forced to infer macroeconomic trends indirectly from a variety of sources, such as PCBS's labor force surveys, household consumption and industry surveys. As new information becomes available, the Bank revises its economic estimates. The Bank's estimates are based on simulations of a detailed macroeconomic model for the West Bank and Gaza (See "Fifteen Months," page 83).

In 2002, the Palestinian Bureau of Statistics (PCBS) for the first time published national accounts data in both real and nominal terms for the *pre-intifada* period (1994–2000). Over the period as a whole, the data showed higher growth than previous Bank estimates had indicated. At the same time, the data confirmed trends from previous estimates, showing slow growth in the Palestinian economy during 1995 and 1996, years marked by frequent external closures. The new PCBS data indicate that the period from 1997 to the outbreak of the *intifada* was characterized by solid growth; this growth is consistent with subdued levels of violence and closures and the boost to domestic demand created by the expansion of the public sector. Nevertheless, specific aspects of the new data are hard to reconcile with other indicators of economic activity also published by PCBS. In late 2003, PCBS put forth a set of economic surveys and preliminary National Accounts data for 2001–2002. The National Accounts are still undergoing revision, partly as a result of intensive dialogue between PCBS, the Bank and the IMF.

In response to the publication of this data, and the release of revised labor force surveys for the year 2002, the Bank has changed its estimates for economic activity in 2001 and 2002. Specifically, we have *reduced* our estimate of the decline in economic activity for the period 1999 to 2002. In "Twenty-Seven Months," the decline in real GDP between 1999 and 2002 was estimated at 33 percent. The decline is now estimated at 28 percent. As a result of the revision of our macro estimates for these two years, we have also revised our poverty estimate (See chapter 3).

LABOR MARKET DEVELOPMENTS

2.9 There was a significant rebound in employment in 2003;¹⁵ however, during the first half of 2004, job growth has stalled again. In total, some 104,000 jobs were created for Palestinian workers in 2003, equivalent to a 21 percent increase in employment compared

with 2002 (Table 2.1).¹⁶ Job creation was particularly significant in Gaza, where employment increased by 43,000, a gain of 32 percent compared with 2002. Employment growth was also strong in the West Bank; 55,000 jobs were created there, an increase of 18 percent over 2002. As a result, for the first time during the

15. There are reasons, however, to caution against overplaying the interpretation of the reported increase in employment. In particular, employment levels in the second and third quarters 2002 may *underestimate* employment levels due to the difficulties of data collection during this period.

16. Of these, 7,000 jobs were created in the Israeli settlements and Israel (ISI). This corresponds to a 14 percent increase compared with 2002. Increased employment in ISI also indirectly contributed to the rebound in domestic activity, because of its effect on Palestinian incomes, demand and private sector activity.

TABLE 2.1 Selected Labor Market Indicators, 1999–2004Q2 (in thousands)

	1999	2000	2001	2002	2003	2004Q1	2004Q2
Working-age population	1,613	1,676	1,763	1,856	1,962	2,033	2,060
Participation rate (%)	41.6	41.5	38.6	38.1	40.4	40.1	40.4
Labor force	671	695	681	707	793	815	831
Unemployment	80	101	174	222	204	214	237
Unemployment rate (%)	11.9	14.5	25.5	31.4	25.7	26.3	28.6
Employment (total)	592	596	507	486	590	601	593
Full-time employment	556	561	480	456	540	458	531
Part-time employment	37	35	27	31	50	53	62
Employment status (Total)	592	596	507	486	590	601	593
Employer	33	27	24	18	21	24	26
Self-employed	112	117	121	130	164	162	160
Unpaid family member	47	58	47	50	67	59	65
Wage employee	401	393	315	288	338	356	343
Place of work (total)	592	596	507	486	590	601	593
West Bank	314	334	311	304	359	368	389
Gaza Strip	143	145	126	131	174	177	156
Israel and settlements	134	116	69	50	57	55	48

Source: PCBS Labor Force Surveys, various issues

intifada, total employment in 2003 was back to its 1999 level, the last full year before the *intifada* began. Job creation was relatively higher among women (22,000, a rise of 28 percent) than among men (82,000, up 20 percent).

2.10 Palestinian employment fell during the first six months of 2004, indicating the modest recovery of 2003 may be coming to a close. By the second quarter of 2004, employment in the West Bank and Gaza was 23,000 fewer than at the end of 2003, reversing the trend of strong job growth in 2003. The decline was particularly sharp in Gaza in the wake of sustained military incursions. A virtual block on Palestinian workers to enter Israel compounded the situation (See Box 2.3).

2.11 The quality of most new jobs created in 2003 was poor. More than half of the new jobs created in 2003 were classified as self-employed or unpaid family labor in commerce and agriculture; they were low-skilled, low-wage jobs with limited potential. The number of unpaid

family members grew by 17,000 jobs in 2003, up 35 percent compared with 2002). Donor-financed employment generation programs played a role in promoting labor-intensive activities, mainly in construction and agriculture; however, the aggregate impact was probably relatively small. The World Bank estimates that donor-financed job-creation programs directly added some 3,000 to 5,000 jobs to the Palestinian labor market in 2003.¹⁷ The number of “self employed”—typically individuals engaged in small business and other services increased by some 34,000, up 26 percent in 2003. Of the 104,000 Palestinian jobs created in 2003, 18,000 were part time, equivalent to an increase in part-time jobs of 62 percent compared with 2002.

17. Total donor disbursements for job creation activities amounted to US\$28.6 million. Assuming that job creation programs paid an average daily wage of US\$10; that the labor content of the programs equaled one-third and that the total number of workdays in the year was 250, this amount would have contributed 3,800 jobs. It should be noted that the total impact of job creation is higher due to spill-over effects from the purchase of raw materials and inputs.

BOX 2.3 Has Job Growth Stalled?

During the first six months of 2004, employment declined by 2,400 persons in the West Bank. However, this number masks a much larger decline of 16,700 full-time jobs; the latter occurred almost exclusively in construction, where more than 16,000 jobs were lost. The loss of these jobs counter-balanced an increase in part-time jobs of 14,300. Interestingly, the number of ‘discouraged workers’ among West Bank residents has been falling consistently from its high point during the second quarter of 2002; it is now below pre-*intifada* levels.

Gaza employment declined by some 20,000 during the first six months of 2004 to 156,000 in the 2004Q2. That decline led to a steep increase in the unemployment rate (ILO definition) to 39.7 percent. The number of unemployed in Gaza is now almost three times the pre-*intifada* third quarter 2000 level, when 35,000 were unemployed. During the first half of 2004, jobs were lost in all sectors, except services. Agriculture and construction experienced the largest declines, of some 8,000 each.

The number of Palestinians working in Israel and Israeli settlements continued to fall. According to PCBS data, in the three years and nine months since the third quarter of 2000, the number of Palestinians employed in Israel and Israeli settlements has fallen by 97,000. By the second quarter of 2004, employment in Israel and settlements stood at 48,000—almost all of them West Bank residents (including the residents of East Jerusalem who have Israeli-identity cards). In the second quarter of 2004, PCBS reported the lowest number of Gazans working in Israel ever: less than 1,000 as both the Erez industrial estate and the Erez crossing into Israel was closed for much of the quarter.

2.12 The public sector continues to be an important source of Palestinian employment.

In 2003, public sector employment (PA and municipalities) accounted for an estimated 26 percent of total employment in the West Bank and Gaza.¹⁸ This is a slightly lower share than in 2002 (31 percent); growth in public employment was lower than that in private employment in 2003. Public sector wages represented about 34 percent of total wages paid in the West Bank and Gaza in 2003. These figures underscore the importance of the public sector in cushioning household incomes from the decline in the Palestinian economy.

2.13 Improved employment prospects pulled many Palestinians back into the labor force

18. If the approximately 12,000 employees of UNRWA are added, that share reaches 28 percent.

in 2003. The labor force expanded by 85,000 persons in 2003, an increase of 12 percent against the 2002 level and well above the 5 percent natural growth rate of the working-age population. In 2003, the labor force participation rate (the share of working age people who are either employed or looking for employment) increased significantly to 40.4 percent compared with 38.2 percent in 2002. However, the 2003 rate was still lower than that for 1999. The increase in labor force participation was particularly strong among women, although the female labor force participation rate is quite low (Box 2.4).

2.14 The unemployment rate declined from an average of 31.4 percent in 2002 to 25.7 percent in 2003, but in 2004Q2, the rate reached 28.6 percent. The unemployment rate in Gaza (29 percent) continues to be higher than in the

BOX 2.4 What Brought Palestinians Back Into the Labor Market in 2003?

The inflow of workers to the labor market in 2003 was a reversal of trends in 2002. In 2002, many workers withdrew from the labor market in the face of limited job opportunities. In 2003, the number of “discouraged workers”—i.e. workers who stay outside the labor market citing bleak employment prospects—reached its lowest point during the *intifada*; that number was 92,000 or 7.9 percent (See Table below).

In addition, the share of people citing “home duties,” which generally reflects the number of women prioritizing household tasks as a reason for staying outside the labor force, declined from 52.0 percent in 2002 to 50.8 percent in 2003. The decline in women reporting “home duties” as a reason for not participating in the labor market added some 28,000 women to the labor force, equivalent to a 30 percent increase.

The female labor force participation rate in 2003 almost recovered to its pre-*intifada* level; the rate for men still was somewhat lower. In 2003, almost a third of all potential members of the labor forces did not participate because they were engaged in studies. The share has been rising since 1999, reflecting growth in the number of persons of student age and increasing enrollment in higher education (Chapter 4).

	1999	2000	2001	2002	2003
Population aged 15+ years (1,000)	1,613	1,676	1,763	1,856	1,962
Labor force (1,000)	672	695	681	707	792
Participation rate (%)	41.6	41.5	38.6	38.1	40.4
Outside labor force (1,000)	942	980	1,082	1,149	1,170
Old or illness (%)	9.9	9.5	9.0	8.5	9.8
Home duties (%)	55.3	53.7	53.4	52.0	50.8
Student (%)	25.8	26.8	27.0	29.0	31.5
Discouraged (%)	9.0	10.0	10.6	10.4	7.9
Males					
Aged 15+ years (1,000)	809	841	886	934	989
Labor force (1,000)	572	589	590	612	668
Participation rate (%)	41.6	41.5	38.6	38.1	40.4
Outside labor force (1,000)	237	252	295	322	321
Old or illness (%)	20.0	19	17	16	21
Home duties (%)	2.0	2	1	1	1
Student (%)	50.0	48	48	50	54
Discouraged (%)	28.0	32	34	32	24
Female					
Aged 15+ years (1,000)	804	835	877	922	974
Labor force (1,000)	100	106	91	96	124
Participation rate (%)	41.6	41.5	38.6	38.1	40.4
Outside labor force (1,000)	705	729	787	827	849
Old or illness (%)	7.0	6	6	6	6
Home duties (%)	73.0	72	73	72	70
Student (%)	18.0	19	19	21	23
Discouraged (%)	3.0	3	2	2	2

Source: PCBS

West Bank (24 percent), but the gap between the two narrowed in 2003. Due to the rapid increase in the size of the labor force in 2003 (85,000), the number of unemployed declined much less (19,000) than the 104,000 jobs created suggests.

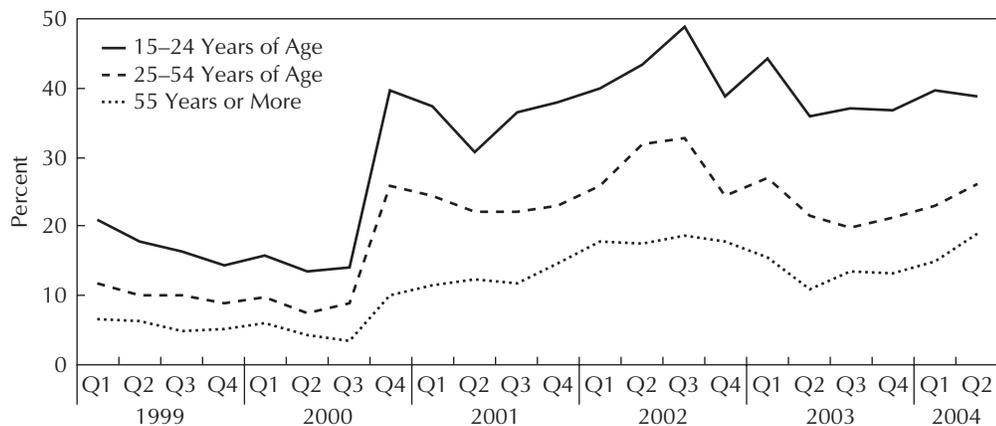
2.15 Unemployment particularly affects the young and those with few skills. Youth unemployment, a long-term problem in the Palestinian economy, has been exacerbated during the *intifada*. At the onset of the *intifada* in September 2000, the unemployment rate among 15 to 24 year-olds was around 14 percent compared with an average of 10 percent for the entire population. Youth unemployment peaked at nearly 50 percent in the third quarter of 2002. It has since declined but remains high. At the end of 2003, some 37 percent of young people seeking work did not find a job; the number has increased slightly since then (Figure 2.2). Such high rates of unemployment among young people create fertile ground for discontent.

2.16 Despite the recent increase in the number of low-skilled jobs, people with low levels of education are disproportionately affected by unemployment. Before the *intifada*, un-

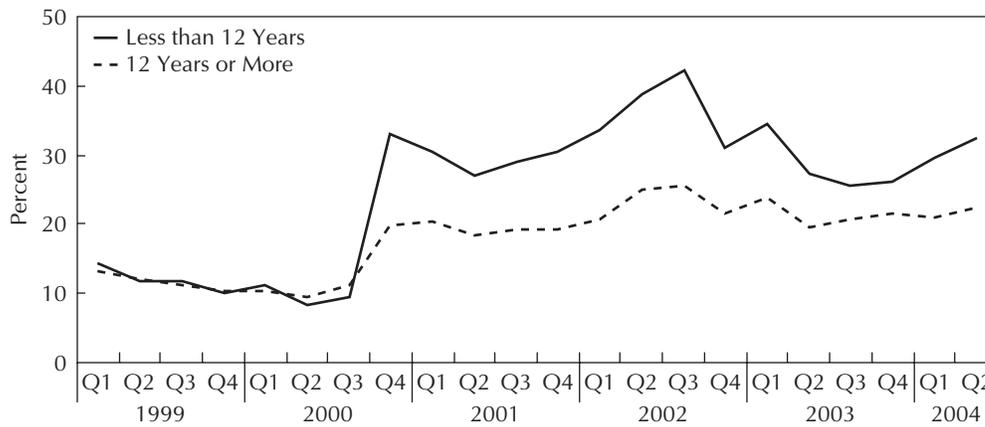
employment rates did not differ significantly between low-skilled and high-skilled labor in the West Bank and Gaza (Figure 2.3). At the eve of the *intifada*, the unemployment rate among workers with less than 12 years of education was lower than among workers with 12 years or more of education. That changed dramatically with the onset of the *intifada*. In the fourth quarter of 2000, the unemployment rate for workers with less than 12 years of education more than tripled, jumping to 33 percent, while the rate among workers with 12 years or more education almost doubled to 20 percent. The main reason was the immediate loss of job opportunities for Palestinian workers in Israel, which had mostly benefited unskilled workers. Since its peak in the third quarter of 2002, unemployment among workers with less than 12 years of education declined from 42 percent to 26 percent by the end of 2003, before climbing again to 33 percent during the first half of 2004.

2.17 Palestinian real wages have declined. Average wage growth (1.7 percent in 2003) did not keep pace with consumer price inflation (4.4 percent). As a result, real wages declined by 2.6 percent. This decline may be attributed

FIGURE 2.2 Unemployment Rates by Age Group, 1999–2004Q2



Source: PCBS and World Bank Staff calculations

FIGURE 2.3 Unemployment Rate by Educational Level, 1999–2004Q2

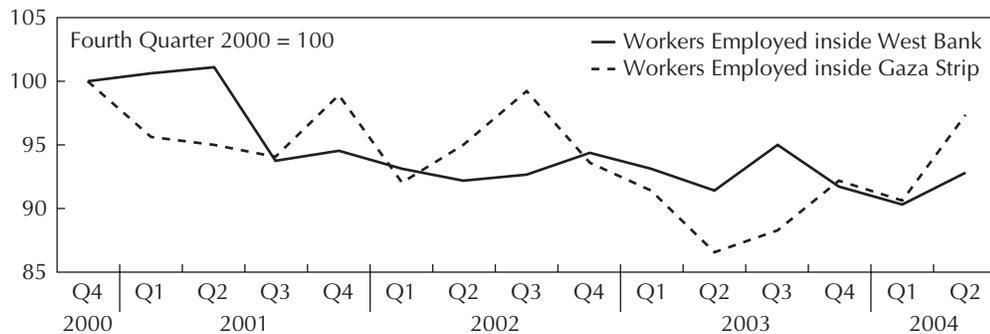
Source: PCBS and World Bank Staff calculations.

to two factors. First, the share of low-paid jobs, particularly among the underemployed, unpaid workers, workers in Gaza and women, increased relative to total employment. This increase constitutes a trend in the past few years; unemployment grew more rapidly among low-skilled/low paid workers than among high-skilled/high paid workers. Secondly, as the easing of closures in 2003 facilitated mobility of labor, a partial desegmentation of the labor market exerted a downward pressure on domestic wages, reversing a trend of the past three years. From 2001 to 2002, real wages grew in tandem with unemployment. This growth broke the usual negative relationship between real wages and unemployment, as exemplified during 1995 through 2000. This was attributed to greater segmentation of labor markets as closures and curfews reduced the capacity to match supply and demand. Unable to reach their workplace, workers remained unemployed; restrictions on movement prevented them from seeking employment elsewhere. Simultaneously, firms faced a shortage of labor; they were not inclined to reduce workers' compensation. Hence, the trend in 2003 resembled the two prior years. During 2001 to 2002, most of the adjustment

in the labor market entailed a reduction in the number of jobs rather than declining wages. The modest economic recovery in 2003 showed up in a greater number of jobs rather than higher wages. In total, real wages have declined some 7 percent in the West Bank and Gaza during the four years of the *intifada*. (Figure 2.4)

2.18 The separation barrier has so far had only a modest impact on labor market developments. In the fourth quarter of 2003, PCBS carried out a special labor force survey in areas adjacent to the separation barrier. The survey found little evidence that villages on the western side of the barrier fared worse in terms of unemployment than neighboring villages on the eastern side. Labor force participation was slightly lower in villages west of the barrier—40.3 percent compared with 44.5 percent east of the barrier. The difference reflects a greater share of discouraged workers west of the barrier. However, the unemployment rate was actually *lower* in villages west of the barrier (15.1 percent compared with 20 percent east of the barrier). The survey did find, however, that the share of workers employed in Israel and the settlements was significantly lower in villages on the eastern side of the barrier (9.5 percent) than on the

FIGURE 2.4 Real Wage Indices, 2000Q4–2004Q2



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, rebased to Third Quarter 2000 = 100.

western side (21.1 percent).¹⁹ Governorates where the barrier is in place have seen a faster decline in the number of Palestinians employed

19. Unfortunately, PCBS's labor force data do not distinguish between work in Israel proper and in the settlements; the barrier would not significantly affect the latter.

in Israel than governorates without it. (See Box 2.5) These findings may indicate that the barrier is indeed restricting access to the Israeli labor market. The modest recorded impact of the separation barrier is explained, above all, by the fact that movement of labor was severely constrained *before* construction of the barrier

BOX 2.5 Impact of the Separation Barrier on Employment in Israel

The objective of the separation barrier is to control movement of people and goods between the areas of the West Bank to east of the barrier and Israel "proper." Following the decline of Palestinian employment in Israel and the settlements since the *intifada* began, particularly during the second and third quarter of 2002 (the period of Operations "Defensive Shield" and "Determined Path"), the expectation was employment would remain depressed in governorates affected by the barrier and employment would recover in areas unaffected by the barrier. Following this logic, the decline in Palestinian employment in Israel compared with pre-*intifada* levels should have been relatively greater in Qalqiliya, Tulkarm, and Jenin (governorates affected by the barrier) compared with other governorates during the fourth quarter of 2002 and the first half of 2003 while the barrier was constructed. Employment in Israel among residents of Jenin (and to a lesser extent in Tubas and Nablus) declined further in the second half of 2003 and the first quarter of 2004 as the barrier was extended along the northern West Bank. There should be less of a fall-off in Ramallah, Salfit, Jerusalem, and Bethlehem despite the segments of the barrier built there; significant construction did not begin until the spring of 2004. Jericho and Hebron would also be expected to have a limited barrier-related decline.

(continued)

BOX 2.5 Impact of the Separation Barrier on Employment in Israel (Continued)

An analysis of PCBS's labor force surveys offers some support for the hypothesis that employment in Israel and settlements among residents in governorates affected by the barrier declined faster than in other governorates. Excluding the Jerusalem governorate (a special case because a relatively large proportion of residents in the Jerusalem governorate holds Jerusalem IDs; they do not need a permit to enter Israel), the number of workers from the whole of the West Bank working in Israel and settlements declined an average of 67.6 percent compared with the pre-*intifada* level. This comparison is of the last two quarters of 2003 and the first quarter of 2004 with the pre-*intifada*'s first three quarters of 2000; see the table below).

The greatest decline in employment in Israel occurred in the northern part of the West Bank, in Jenin (82.2 percent) and in Nablus (82.6 percent); Nablus workers generally would have traveled west through Tulkarm or Qalqiliya or north through Jenin to reach jobs in Israel). Other governorates affected by the barrier also experienced particularly sharp declines in employment in Israel: Tulkarm (76.5 percent), Qalqiliya (66.3 percent). During the period when barrier construction was most intense around Qalqiliya (the fourth quarter of 2002 through the second quarter of 2003), the decline was 73.8 percent; recent improvements to access suggest that regulated access through the barrier for workers in Israel from Qalqiliya is critical. As expected, central and southern West Bank governorates experienced lesser rates of decline; Jericho was the least affected (7.9 percent). Although the data do not distinguish between employment in Israel and in Israeli settlements in the West Bank, it is likely that Jericho residents working in Israel and the settlements were generally employed in settlements in the Jordan Valley).

Change in employment in Israel and Israeli settlements by home governorate of worker	Percent Change Compared to Q3-2000			
	Average Q4-2000 Q1-2002	Average Q2-2002 Q3-2002	Average Q4-2002 Q2-2003	Average Q3-2003 Q1-2004
West Bank, excluding Jerusalem Gov.	-61.2	-82.1	-72.4	-67.6
Jenin	-77.9	-93.5	-86.3	-82.2
Tubas	-62.5	-91.9	-64.0	-64.4
Tulkarm	-56.7	-74.8	-80.0	-76.5
Nablus	-84.7	-87.1	-75.9	-82.6
Qalqiliya	-67.6	-70.1	-73.8	-66.3
Salfit	-67.1	-75.5	-73.3	-55.6
Ramallah	-74.4	-75.2	-73.6	-56.5
Jerichó	-33.1	61.7	-16.3	-7.9
Jerusalem	-1.3	-9.8	-16.2	-5.5
Bethlehem	-29.4	-86.8	-56.5	-64.3
Hebron	-51.6	-88.3	-70.7	-61.7

Source: PCBS and World Bank Staff calculations.

Note: Declines are measured against the average level of employment in the period Q1–Q3 2000.

began, limiting the *additional* negative impact of the barrier.²⁰

PUBLIC FINANCES

2.19 The PA's fiscal situation has been severely undermined during the *intifada*. Due to the decline in economic activity, fiscal revenues have declined. At the same time, expenditures have increased, especially wage expenditures. Israel's withholding of clearance revenue owed to the PA transformed a budget surplus of US\$62 million in 1999 (and a rough balance for the first nine months of 2000) into deficits (before external financing) of US\$847 million in 2001 and US\$693 million in 2002. During

20. The broader economic effects of the Separation Barrier, including the impact on agricultural production, trade and investments, are analyzed in "Impact of Israel's Separation Barrier on West Bank Communities: Economic Impacts and Legal Developments," the World Bank forthcoming.

these two years, donors provided US\$979 million in budget support. Nonetheless, the residual deficit reached over US\$550 million in 2003, financed primarily by borrowing from commercial banks and growing arrears to the private sector and to the public sector's pension fund.

2.20 Due to the resumption of revenue transfers and improved tax collection, fiscal revenues increased in 2003 compared with 2002, but they remain low. In December of 2002, the Government of Israel resumed the regular transfer of clearance revenues, which had been frozen during most of 2001 and 2002. Consequently, clearance revenues amounted to US\$472 million in 2003 compared with US\$150 million in 2002. In addition, the GoI transferred most of the clearance revenues that had previously been withheld. A total of US\$294 million was eventually transferred to the PA in 2003 (See Table 2.2).

TABLE 2.2 Palestinian Authority Fiscal Developments, 1999–2003 (US\$ million)

	1999	2000	2001	2002	2003	2004 Budget	Per Month	Actual Jan–May
Revenues ^a	942	938	273	291	762	847	71	74
Domestic	362	352	273	219	291	312	26	25
Clearance revenue, gross ^b	580	587	0	72	472	535	45	49
Expenditures ^c	937	1212	1120	984	1140	1428	119	100
Wages	519	622	680	609	743	871	73	72
Non-wage ^d	418	577	418	352	361	503	44	27
PA financed capital expenditures	0	13	22	23	36	18	3	1
Budget balance	5	-274	-847	-693	-378	-526	-48	-26
Lending to municipalities ^e and VAT refund	0	0	0	0	189	126	9	13
Financing gap	5	-274	-847	-693	-567	-652	-57	-39
Financing	-5	274	847	693	567	652	57	39
External budget support		54	532	447	219	652	54	24
Gross transfer of withheld clearance revenue				82	294	189	16	0
Arrears (– equals repayment)	10	66	232	54	-46	-189	-16	5
Net domestic Bank financing	-15	154	83	111	95	2	3	15
Memo item: Exchange rate	4.14	4.08	4.21	4.74	4.54	4.47		4.51

Sources: Ministry of Finance; IMF and World Bank staff estimates.

Notes: a. Excluding external financing. b. Includes payments deducted by Government of Israel for dues owed by municipalities to the Israeli water company Mekorot. c. Including recurrent expenditures, PA-financed capital expenditures, and PA net lending to municipalities; excluding donor-financed investment projects. d. Includes operating expenditures and transfers (including pensions). By May 2004, year-to-date operating expenditures amounted to US\$59 million and transfers to US\$71 million. e. Payments deducted by Government of Israel from clearance revenue.

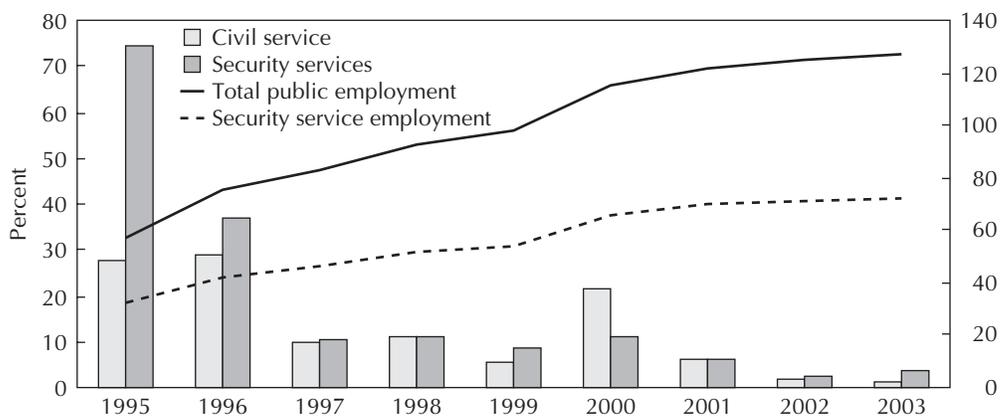
2.21 Domestic tax collections exceeded budgetary estimates. In 2003, the PA collected US\$291 million in taxes, up from US\$231 million in 2002. The 2003 tax collections were 20 percent more than projected by the Ministry of Finance budget for that year. In 2003, monthly revenues reached 70 percent of pre-crisis levels. The expansion of the tax revenue was due to the modest economic improvement in 2003 and to improvements in tax administration and collection. In addition, the takeover of the Petroleum Corporation, coupled with a change in management and pricing policy, resulted in higher sales of petroleum products and sharp increases in excise revenues.

2.22 PA expenditures also increased significantly, particularly the wage bill. Total PA expenditures in 2003 amounted to US\$1,140 million, a 9 percent increase over 2002. An expanding wage bill, which reached US\$743 million in 2003, drove the increase in PA expenditures. At US\$743 million, the 2003 wage bill exceeded the budgeted level by US\$43 million, a 6 percent overrun, and surpassed the 2002 level by some US\$130 million. Consequently, wages represented 68 percent of the PA's current expenditures in 2003, compared with 56 percent before the *intifada*.

2.23 Public employment continued to increase. By the end of 2003, around 128,000 workers were on the public payroll (Figure 2.5). This was about 2,500 more than envisaged in the 2003 Budget. In 2003, civil service employment increased by 1,838 (60 percent of which was in the social sector); this figure was within the 2003 Budget limit of 2,772. However, security sector employment increased in 2003 by 3,443, even though the 2003 Budget stipulated a freeze. During the *intifada*, growth in the PA payroll declined substantially relative to pre-*intifada* growth rates. From 1995 to 2000 the number of PA employees more than doubled, equivalent to an annual growth rate of 12.3 percent. Since 2000, PA employment has grown at an annual rate of 2.6 percent. While growth in the civil service is justified by the underlying demographic surge in demand for public services (the increase in the number of school-age children is one example), there is absolutely no justification for any further increase in security service staff.

2.24 Public salaries received a boost in 2003. Salaries for security personnel and civil servants was increased an average of 15 percent

FIGURE 2.5 Annual Growth in Public Employment, 1995–2003



Source: Ministry of Finance, IMF and World Bank staff calculations.

in 2003 as a consequence of the partial implementation of the 1998 Civil Service Law, which the PLC pushed through during 2003.²¹ Although implementation of the Civil Service Law entailed classifying public sector employees according to pre-defined job categories it was not accompanied by any improvements in public sector management to improve the efficiency of public sector employees, and hence public services, commensurable with the salary increase.

2.25 The PA's budget was further strained by the need to pay bills on behalf of municipalities. In addition to its normal budgeted expenditures, in 2003 the PA was required to repay municipal bills owed to Israeli suppliers of electricity and water. The payments averaged almost US\$15 million per month or some US\$150 million for the entire year. Israel deducted these payments from the gross transfer of tax revenues withheld in 2001 to 2002 as well as from monthly clearance revenues for water bills. Municipalities have agreed to reimburse the PA for these expenses at some future date. Technically, these funds are an asset held by the PA. However, the expenses associated with them represented a significant drain on the PA's finances and liquidity for 2003. The financing of municipal bills to Israeli suppliers brought the PA's shortfall in 2003 to US\$567 million or 19 percent of GDP.

2.26 Budget support halved in 2003. The PA's overall fiscal situation remained tight in 2003 because of a significant shortfall in external budget support. At US\$219 million²² (down

21. 'Fiscal and Budgetary Developments in 2003 and January 2004,' IMF in *West Bank and Gaza Update* March 2004, World Bank.

22. Note that this figure is US\$44 million lower than the budget support figure reported in Chapter 5. The reason for this discrepancy is that although the EC transferred US\$65 million in 2003 for budget support to the Palestinian Authority, most of the funds remained blocked well into 2004 pending the PA's fulfillment of conditions for their release, and consequently were not available to the PA to cover budgetary expenditures incurred in 2003.

from US\$540 million in 2001) (Chapter 5) it amounted to less than half the level anticipated in the 2003 Budget. The low level of budget support stemmed mainly from shortfalls in contributions from Arab League donors; the six-month extension of Arab league budget support granted in March 2003 expired in September without formal renewal. New procedures attached to the EU's assistance also delayed release of funds from the financing facility; the PA had agreed to these procedures in June 2003.

2.27 As in previous years, non-wage (operating) expenditures were squeezed significantly. Restricting non-wage expenditures to their absolute minimum was used extensively in 2003; on average, monthly non-wage expenditures were US\$8 million below budget.²³ Actual spending on non-wage expenditures for 2003 was US\$361 million or 80 percent of the budgeted amount. The cut in non-wage expenditure was particularly acute during the first quarter of 2003 in anticipation of a shortfall in financing. After April, the shortfall began to ease to ensure a smooth functioning of public administration and services. Recognizing that there is a limit to which non-wage current expenditures may be delayed before critical service delivery is impaired, the World Bank's Emergency Services Support Project was designed to safeguard spending on education, health, and social welfare (chapter 5).

2.28 In addition to squeezing non-wage expenditures, the PA incurred debt to private suppliers, deferred social security payments (including pensions), and borrowed

23. Non-wage expenditures comprise both operating expenditures and transfers, the latter includes among other item assistance under Ministry of Social Affairs Special Hardship Case program, and pension payments for retired civil servants. The PA has made significantly smaller cutbacks in transfer payments than in non-wage operating expenditures.

from commercial banks. While the repayment of most of the stock of withheld clearance revenues²⁴ helped to temporarily reduce arrears to the private sector, these arrears began to accumulate once again. By the end of 2003, the total stock of arrears reached US\$384 million (equivalent to 12 percent of GDP), down from \$456 million in 2002. The stock of the PA's debt to banks totaled another US\$176 million by the end of December 2003 and by the end of March 2004 had increased further to US\$263 million.

PA 2004 BUDGET

2.29 Preparation of the 2004 Budget built on the procedures established in 2003. The 2003 Budget was the first serious attempt to observe the procedures set out in the Organic Budget Law. It was the first budget to be formally presented to the PLC and published. The 2003 budget exercise benefited from a constructive dialogue on the level of proposed allocations between the MOF and spending ministries. This encouraging trend continued in the preparation of the 2004 Budget and with the PLC's approval of the Budget in January 2004. The 2004 Budget document was prepared on the basis of macroeconomic analysis, which estimated real GDP growth in 2004 at 3.5 percent.²⁵ Over the past couple of years, the PA has increased the transparency of the budget preparation process. In 2004, this process was further enhanced by a comparison of actual budget performance in 2002 and 2003 with the budget formally passed by the PLC. The Budget indi-

cates proposed financing of the expected budget deficit, including borrowing from the banking system. It also includes comprehensive data on authorized civil service employment and it sets a legal limit on the growth of civil service employment.

2.30 The 2004 Budget envisages further improvements in revenues. Domestic revenues are expected to reach US\$312 million in 2004, an increase of 7.2 percent compared with 2003 receipts. If this level of revenues was reached, it would bring the share of domestic tax revenues to GDP back to its pre-*intifada* level. However, domestic revenues are still some 21 percent lower than in 1999. Clearance revenues are projected at US\$45 million per month for a total of US\$535 million for the year, equivalent to an improvement of 13.3 percent compared with 2003. Total revenue in 2004 is, therefore, projected at US\$847 million (US\$71 million per month) (Table 2.3).

2.31 Nevertheless, the Budget projects a sizable deficit in 2004, underlining the PA's precarious financial position. PA's current expenditures in 2004 are projected to amount to US\$1,392 million. Wages are expected to make up 63 percent (US\$871 million) of current expenditures. PA-financed capital expenditures are projected at US\$18 million; the PA's net lending to municipalities (primarily to cover their outstanding utility payments to Israeli providers), US\$126 million. Total PA expenditures in 2004 are thus estimated at US\$1,428 million or US\$127 million per month. The Budget foresees a financing gap of US\$671 million, or approximately 19 percent of GDP. The PA Budget assumes that donor-financed budget support will cover the gap, probably an unrealistic assumption considering that budget support in 2003 amounted to one-third of this figure. It is expected that the Bank-administered Reform Trust Fund (See Chapter 5) will assist in securing funds at a higher level than in 2003.

24. The total of the stock of clearance transfers withheld by Israel between December 2000 and November 2002 amounted to over US\$560 million; all but US\$180 million have been repaid. The remaining sums have been "attached" by Israeli courts to various pending civil cases against the Palestinian Authority.

25. This is approximately in line with the Bank's *status quo* scenario (see Chapter 6).

TABLE 2.3 Selected Macroeconomic Estimates, 1999 to 2003

	1999	2000	2001	2002	2003
Real growth (percent):					
Gross domestic product	8.4	-5.0	-14.8	-10.1	6.1
Private consumption	9.8	-5.6	-12.5	-14.2	3.4
Public consumption	9.3	8.9	-4.3	0.7	0.1
Investment	35.9	-30.5	-41.2	5.0	5.4
Exports	1.2	-7.9	-15.5	-11.8	-4.0
Imports	22.5	-16.4	-20.0	-6.6	-3.0
Real GDP, cumulated decline since 1999		-5.6	-19.6	-27.7	-23.3
Real GDP per capita, cumulated decline since 1999		-9.5	-26.4	-37.3	-36.6
Net factor income, NIS	3,121	2,733	1,611	1,579	1,894
Net current transfers, NIS ^a	1,547	2,349	3,896	5,250	6,479
Population (million)	2.83	2.95	3.09	3.26	3.42
Exchange rate (NIS:US\$)	4.14	4.08	4.21	4.74	4.55
GNI per capita, US\$	1,739	1,620	1,201	971	1,041
Consumer price inflation (percent)	5.5	2.7	1.2	5.7	4.4

Source: World Bank Staff calculations and PCBS.

Notes: a. includes (negative and positive) transfers of withheld clearance revenues.

2.32 During the first five months of 2004, the PA faced difficulties in meeting budgeted non-wage expenditures. To meet salary payments, the PA once more squeezed non-wage expenditures during January-March 2004 by a monthly average of US\$22 million, well below the US\$40 million projected in the Budget. In the event of continued financing shortfalls, the planned non-wage expenditure of US\$503 million budgeted for 2004 is unlikely to be achieved.

PRIVATE CONSUMPTION AND INVESTMENT

2.33 Stabilization of the Palestinian economy allowed real private consumption to recover in 2003. The immediate response of most households to the reduction in incomes during the *intifada* has been to reduce consumption and savings (Chapter 3). Between 1999 and 2002, private consumption declined almost 30 percent in real terms. The rise in employment increased the income of many households. The

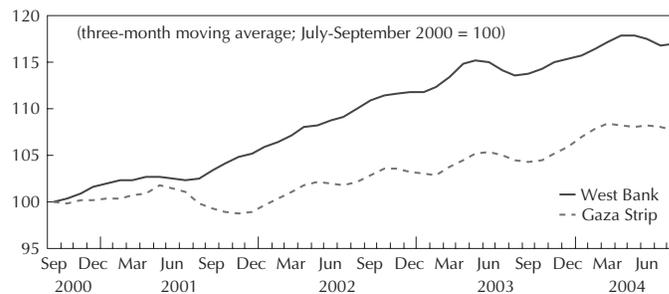
World Bank estimates that consumer spending increased by 8 percent in 2003. After accounting for the concurrent increase in consumer prices (See box 2.6), real private consumption in 2003 (table 2.4) grew by 3.4 percent. Factoring in population growth, on a per capita basis, private consumption stayed roughly constant between 2002 and 2003.

2.34 Private investment recovered somewhat in 2003, but the climate for business investment remains dismal. Levels of private investment fell dramatically during the *intifada* as the contraction of private savings shrank the pool of funds available for investments. In addition, the deteriorating business environment reduced the likelihood of a positive return on investment, making the business community (both domestic and foreign) unwilling to engage in new investments. In 2003, the World Bank estimates that real gross private investment increased by 5 percent. However the moderate pick-up in investment is not sufficient to bring the Palestinian capital stock—

BOX 2.6 Consumer Prices and Exchange Rate Trends

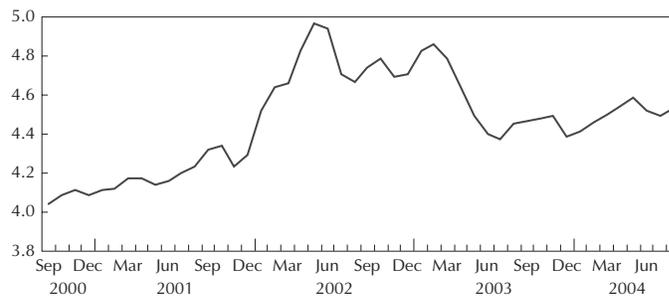
During the twelve-month period of January through December 2003, consumer prices increased by 4.3 percent in the West Bank and 2.5 percent in Gaza. For the West Bank, this percentage represents a fall from the 2002 inflation rate of 6.1 percent and a slight increase over the 2.2 percent recorded last year in Gaza (Figure 2.6). Consumer prices have generally increased at a faster pace in the West Bank than in Gaza during the *intifada*. By August 2004, consumer prices in the West Bank had increased 17.9 percent since the pre-*intifada* third quarter (July–September 2000 period). The increase in Gaza, 7.32 percent, was less than half of the increase in the West Bank. The difference in inflation trends is partly explained by the larger increase in transportation costs in the West Bank than in Gaza (Chapter 1). In addition, consumer prices in the West Bank are probably more sensitive to exchange rate changes due to a higher import-to-consumption share in the West Bank. Even if the NIS recovered somewhat in 2003, it has depreciated by 12.2 percent since the beginning of the *intifada* (September 2000–August 2004; figure 2.7). As a result, the price of imports went up during this period.

FIGURE 2.6 Consumer Price Indices, September 2000–May 2004



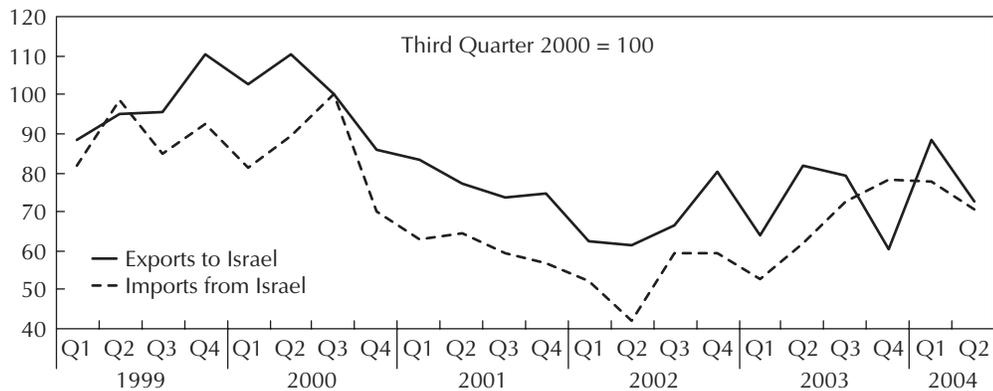
Source: World Bank calculations based on PCBS data.

FIGURE 2.7 NIS/US\$ Exchange Rate, September 2000–May 2004



Source: Bank of Israel.

FIGURE 2.8 Import and Export Indices, 1999–2004Q2



Note: Current prices; merchandise trade only.
Source: Israeli Central Bureau of Statistics.

a key determinant of the long-term productive capacity of the Palestinian economy—back to its pre-*intifada* level. The capital stock has been eroded by inadequate maintenance of equipment and infrastructure and by conflict-related damages. In fact, the Bank estimates that investment in 2003 was not even sufficient to make up for the wear and tear on the existing stock of capital. Donor-financed physical investments amounted to some US\$165 million in 2003.

EXTERNAL TRADE

2.35 Palestinian exports lost significant market share during the *intifada* and continued to decline in 2003. At the onset of the *intifada*, Palestinian exports contracted sharply. Transaction costs increased greatly, and as a result, many Palestinian exports were not competitive. Foreign purchasers gradually switched to more reliable alternative sources of supply in the face of production and shipping interrup-

tions. The consequence is Palestinian producers increasingly serve domestic markets. Exports continued to decline in 2003 (-4 percent in nominal and real terms) and remained some 30 percent below their pre-*intifada* level by the second quarter of 2004²⁶ (Figure 2.8).

2.36 Imports have also contracted to roughly one-third of their pre-*intifada* level. The declining purchasing power of Palestinian households, reduced demand for imported equipment by Palestinian businesses and lower export revenue and remittances has all pushed imports down. At the end of 2003, the level of imports was some 30 percent lower than at the eve of the *intifada*, despite stabilization in 2003. 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.

26. It should be emphasized that estimating trade data in the West Bank and Gaza is subject to particular uncertainties, especially trade between the West Bank and Israel where no custom stations exist. Moreover, the data from the Israeli Central Bureau of Statistics only covers Palestinian trade with

Israel, not the rest of the world. However, trade with Israel represents the bulk of total Palestinian trade. Furthermore, a significant share of imported goods from Israel actually originates from third countries, so-called indirect imports.





“Twenty-Seven Months” noted the role of Palestinian social resilience in absorbing the shock of the economic crisis. However, the number of families unable to cope is poised to increase. Sixteen percent of the total population and one-quarter of all Gazans live in deep or ‘subsistence poverty.’ They are unable to adequately feed themselves, even with food aid. The population as a whole has reduced its per capita food consumption by one-third since 1999. One-third now depends on cash from friends and relatives, compared to almost none in 2001. The latest University of Geneva Perceptions Survey shows that one-third of Palestinians have exhausted all financial means, and another one-quarter expects this to occur “soon.” The effect of living in an environment of curfews, movement restrictions and urban decay is reflected in high levels of stress and, as frequently shown in credible opinion polls, widespread support for violence against Israelis. Such damage to the social fabric cannot be offset by providing humanitarian relief, important as this has been.

Impact on Households and Communities

POVERTY

3.1 Four years of economic crisis have severely compromised Palestinian living standards. An indicator of trends in living standards is the dependency ratio, i.e. the number of people supported by each worker. In 1999, each Palestinian worker supported 5 people, including him or herself. In the second quarter of 2002, the dependency ratio peaked at 7.2 as employment plummeted. As job growth picked up in 2003 (Chapter 2) the dependency ratio fell to 6.2 (figure 3.1). Nevertheless, in 2003 the salary of each worker supported more than one additional household member compared with 1999. Moreover average real wages declined some 7 percent in the same period, further straining household finances.²⁷

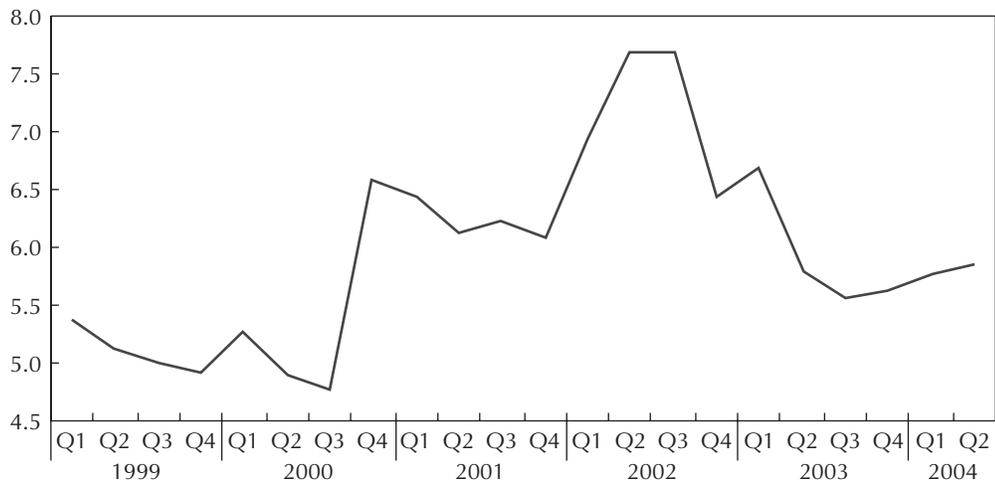
3.2 Various studies, using a range of methodologies, have pointed to a sharp increase in poverty rates compared with pre-intifada levels. The Palestinian Central Bureau of Statistics published a series of “Impact” surveys between 2001 and 2003, which reported the proportion of households below the poverty line range between 61 and 72 percent.²⁸ According to the PCBS’s quarterly labor force surveys, the percentage of employees with a monthly wage below the poverty line was between 59 and 61 percent in 2003.²⁹ According to the National Poverty Survey that PCBS conducted in December 2003, 40 percent of the population had a per

27. The average salary is calculated for all Palestinian workers, including those working in Israel.

28. Source: PCBS, Impact of the Israeli Measures on the Economic Conditions of Palestinian Households, various issues.

29. Quarterly Labor Force Surveys, Palestinian Central Bureau of Statistics, and various issues.

FIGURE 3.1 Quarterly Economic Dependency Ratio, 2000–2003



Note: The quarterly dependency ratio is calculated as the mid-year population divided by the quarterly employment level.
 Source: PCBS and World Bank staff calculations.

capita consumption below the official poverty line. The University of Geneva, based on their most recent *Palestinian Perception Surveys*,³⁰ estimated the proportion of poor Palestinians at 58 percent in July 2003. Finally, using a poverty line of US\$2.1 per day, the World Bank’s “Twenty-Seven Months” report estimated that poverty in 2002 afflicted 59 percent of the population.³¹

3.3 Job creation made a dent in poverty rates in 2003, but some 47 percent of Palestinians (1.8 million people) still live in poverty, according to Bank estimates. This is almost 15 percent lower than the Bank’s estimate for poverty in 2002 in “Twenty-Seven Months.” There are

two reasons for the downward revision. First, as explained in chapter 2, the Bank has revised its estimates of the economic developments in 2001 and 2002. Consequently, the Bank now estimates that poverty in 2002 afflicted 51 percent of the population (a reduction of 8 percent compared to the estimate in “Twenty-Seven Months”). Secondly, the modest economic recovery in 2003 enabled Palestinian households to increase consumption by 3.4 percent.³² This increase in consumption reduced poverty rates by 5 percent. The Bank’s estimate is consistent with the results of the *2003 National Poverty Survey* that the PCBS carried out in December 2003. However, it should be emphasized that poverty estimates tend to be sensitive to the methodology used (see Box 3.1).

3.4 Few families have managed to escape the negative impact of the welfare crisis. A comparative analysis of the PCBS’s *National Poverty Survey* carried out in December 2003

30. *Palestinian Public Perceptions*, Report VI October 2003, Palestine Research Unit, IUED Geneva.

31. In addition to poverty estimates, other studies quantify other poverty-related concepts. Using focus groups and interviews, the FAO estimates that 40 percent of the Palestinian population did not have food security as of March 2003. Food security refers to “physical, social and economic access to sufficient, safe, and nutritious food.” See FAO and WFP (2003). There were no significant differences between the West Bank and Gaza Strip.

32. In real terms, see Chapter 2.

BOX 3.1 Why Do Estimates of Poverty Differ So Much?

There has been a proliferation and wide range of poverty estimates in the West Bank and Gaza during the *intifada*. This box summarizes some of the main reasons why poverty estimates may differ.

Measure of welfare. Most studies use either consumption or income as the measure of welfare. There is a consensus that *consumption* is preferable to income. The reason is consumption can normally be measured more precisely and generally fluctuates less than income. The World Bank (and the PCBS in the National Poverty Survey) use consumption as a welfare measure.

Unit of analysis. Some studies estimate the share of *households* in poverty while others focus on the share of the *population* below the poverty line. Estimates based on households in poverty are generally lower than population-based estimates because poor households tend to be larger than non-poor. The World Bank generally uses population-based poverty measures.

Survey methodology. Preferably, poverty surveys should be national in scope. PCBS, which uses the 1997 Census as its sampling frame, is best positioned to ensure its surveys are representative. In addition, poverty surveys should preferably be carried out over a 12-month period to minimize seasonal differences. The 1998^a Palestinian Expenditure and Consumption Survey (PECS) met both these criteria. In contrast, the National Poverty Survey (NPS) conducted by PCBS in December 2003 covered only one month (December). According to the 1996–98 PECS, in December, consumption is generally some 10 percent higher than the average for the full year. For this reason, the NPS is expected to *underestimate* actual poverty. On the other hand, the NPS was based on a simple questionnaire that included a limited number (38) of consumption items. In contrast, PECS included more than 700 items. International experience shows that simple questionnaires tend to underreport consumption and hence overestimate poverty.

Types of poverty lines. The simplest poverty line is based on a minimum daily consumption (or income) needs per capita. However, a simple poverty line does not take into account the lower consumption needs of children compared with adults, nor household economies of scale. The official Palestinian poverty line takes these factors into account; it is based on the estimated minimum needs of a “benchmark family” comprising 2 adults and 4 children.

The level of the poverty line. Clearly, the higher the poverty line, the higher the poverty rate will be. The *official poverty line* for West Bank and Gaza, developed by the National Poverty Commission in 1998, corresponded in December 2003 to NIS1,800 per month for the benchmark family. Using a NIS/US\$-exchange rate of 4.4; this translates into a poverty line of US\$2.3 per day per member of the benchmark family. A narrower definition of poverty focuses on ‘subsistence poverty.’ Subsistence poverty is the cost of satisfying the minimum caloric intake, plus an allowance for basic non-food items, such as clothes and shelter. The Bank estimates the *subsistence poverty line* for the West Bank and Gaza at NIS205 per capita per month, which translates into US\$1.6 per capita per day.^b

(continued)

BOX 3.1 Why Do Estimates of Poverty Differ So Much? (Continued)

Estimates of poverty in the absence of surveys. Poverty surveys are expensive, time-consuming, and not always available. (Prior to the NPS, the most recent published poverty survey conducted by PCBS was the 1998 PECS). To estimate poverty in the interim years, the World Bank applied its macro-economic estimates of per capita consumption to the 1998 distribution of per capita consumption in PECS.^c The World Bank assumed that only average consumption changed over time while distribution remained unchanged.^d

Notes: a. *Palestine Poverty Report*, 1998, Palestinian National Authority. b. See the World Bank/PCBS *Poverty Update* (forthcoming). c. The World Bank/PCBS *Poverty Update* (forthcoming) discusses the sensitivity of the poverty rate to the choice of poverty line and the estimated change in per capita consumption. d. This is, of course, rarely the case: if economic growth only benefits the richest segments of the population, there may not be any impact on poverty at all. Alternatively, if a recession is accompanied by distribution policies in favor of the poor, poverty might actually decline even if the economy is shrinking.

and the *Palestinian Expenditure and Consumption Survey* of 1998 (the last household consumption survey carried out before the *intifada*) suggests that every segment of the Palestinian population experienced deterioration in their financial situation, except for the richest 10 percent.³³ In 2003, the share of total (food)³⁴ consumption by the bottom 90 percent of the Palestinian population was 62 percent, down from 76 percent in 1998. In other words, the richest 10 percent accounted for 38 percent of total consumption in 2003 compared with 24 percent in 1998 (Table 3.1). This clearly suggests that only the wealthiest in the Palestinian society have been able to weather the impact of the *intifada*. That may be because they derive most of their income from sources external to the conflict (for example, income from abroad). There are some indications that the poorer segments of the Palestinian population have suffered more than the more affluent segments, but the difference is not large. If we restrict attention to the poorest quarter of the

population, the poorest 50 percent of this quarter accounts for 36 percent of the group's total consumption in 2003, slightly below the 1998 share of 40 percent. This can be attributed to the fact that while poorer families' ability to cope with a prolonged crisis, such as the *intifada*, is more limited than affluent families, poorer families also benefited from emergency assistance to a greater degree than richer households (Chapter 5).

SUBSISTENCE POVERTY

3.5 More than 600,000 Palestinians live in subsistence poverty.³⁵ In other words, 16 percent of the population cannot even afford (or can barely afford) the basics of survival, despite significant amounts of humanitarian assistance. It should be noted that the proportion of *households* living in subsistence poverty is somewhat lower (12 percent). On average, the subsistence poor have larger households than the non-poor.

3.6 Families living in subsistence poverty are generally large; they have many non-working

33. Care needs to be taken when the two surveys are compared though, see box 3.1.

34. Food consumption is used in this calculation; food consumption can be measured more accurately than non-food items.

35. As of the end of 2003, the Palestinian population in WBG was estimated at 3.74 million by the PCBS.

TABLE 3.1 Distribution of Total Food Consumption, 1998 and 2003

... Among Entire Population		
	Poorest 90%	Richest 10%
1998	75	25
2003	62	38
... Among Poorest 25% of Population		
	Poorest 50%	Richest 50%
1998	40	60
2003	36	64

Source: World Bank Staff Calculations, based on NPS and Palestinian Expenditure and consumption Survey, 1998.

dependents, and low levels of education. Most live in Gaza. Poverty rates are particularly high among individuals living in households with many children and elderly members relative to the number of working-aged adults. The reason is children and the elderly are less likely to earn an income than adults of working age³⁶ (Table 3.2). One-quarter of individuals living in households whose working-aged adults have not finished elementary school are poor. In contrast, only 4 percent of individuals in households whose working aged adults have completed secondary school are poor. This may be attributed to the fact that workers with higher levels of education earn higher wages. It may also be the case that poverty leads to lower levels of education; children in poor families are forced to start working at a younger age.

36. An individual at least 16 years but no more than 64 years old is considered to be of working age. Interestingly, poverty rates are low among individuals living in households with no members of working age, generally comprised of elderly individuals who can afford to live independently. Clearly, it is not household characteristics, which determine poverty status, but rather the poverty status. The relative wealth of some elderly individuals determines their household characteristic, namely their ability to maintain their own household rather than needing to move in with relatives.

Poverty rates differ significantly from one place to another. Individuals living in the Gaza Strip are more likely to be poor (23 percent) than individuals living in the West Bank; individuals living in the middle West Bank are the least likely to be poor (6 percent). Workers in Gaza earn less compared with workers in the West Bank, possibly as a result of lower levels of productive investment and infrastructure in Gaza. It is also possible that the higher poverty rates in the Gaza Strip are overestimated because of the lower price levels found in the Gaza Strip relative to the West Bank.³⁷

3.7 Refugees are not significantly worse off than the rest of the population. The data in table 3.2 suggest that individuals living in refugee camps³⁸ are more likely to be poor than

37. As previously discussed, it is likely that the difference in poverty estimates between Gaza and the West Bank may have been overstated. That would be the case if the aggregated price level is lower in Gaza than in the West Bank; a single national poverty line tends to overstate the poverty rate for Gaza relative to the West Bank.

38. Please note: not all refugees live in refugee camps. As of June 2003, UNRWA in West Bank and Gaza officially registered a total of 1.56 million Palestinians as refugees; 660,000 of them lived in camps (Source: UNRWA, www.unrwa.org).

TABLE 3.2 Likelihood of Living in Subsistence Poverty

	Not Poor	Poor	Total
Total population	84	16	100
Household size			
Eight or more members	76	24	100
Less than eight members	93	7	100
Average education of the household's working age adults			
Less than elementary	75	25	100
At least elementary but less than secondary	82	18	100
Secondary or more	96	4	100
Place of residence			
Gaza Strip	77	23	100
Northern West Bank	84	16	100
Southern West Bank	85	15	100
Middle West Bank	94	6	100
Location type			
Refugee camp	81	19	100
Rural	85	15	100
Urban	84	16	100
Refugee status			
Refugee	83	17	100
Non-refugee	85	15	100
Sex of household head			
Male	83	17	100
Female	93	7	100
Economic dependency ratio			
More than 5 dependents per employed household member	83	17	100
Less than 5 dependents per employed household member	96	4	100
Unemployment			
One or more unemployed household members	71	29	100
No unemployed household members	89	11	100

Source: PCBS and World Bank calculations based on the National Poverty Survey, 2003.

Note: Male-headed households are defined by the presence of at least one working-age male in the household. Female households are households with no working-age male present.

individuals living in locations categorized as urban or rural. However, closer inspection of the data reveals that it is not living in a refugee camp *per se* that increases the risk of poverty. Rather, residents of refugee camps tend to have larger families, higher dependency ratios, lower levels of education and are more likely to be living in Gaza—all factors that increase the probability of poverty. On the other hand, refugees tend to have better access to humanitarian assistance. Individuals living in female-headed households are less likely to be poor (7 percent) than are those in male-headed

households (17 percent). This may be because a large share of female-headed households is in fact a single-member household of elderly women. These women receive a minimum acceptable standard of living because of formal and informal social safety nets.

3.8 Employment reduces the family's risk of subsistence poverty. The employment of one or several household members reduces the family's risk of subsistence poverty. Conversely, individuals living in households with many non-working dependents (and few workers)

are more likely to be poor. The effect of employment on household poverty levels is quite strong; poverty rates of families with more than five dependents per worker are four times higher than families with lower dependency ratios (17 percent vs. 4 percent). Likewise, individuals living in households with one or more unemployed members are more than twice as likely (29 percent) to be poor as other households (11 percent).

3.9 The working poor tends to have low levels of education and part-time, sporadic or unpaid family employment. A characteristic of the labor market participation of Palestinians living in subsistence poverty is that many (48 percent) work only sporadically. Moreover, many (35 percent) work fewer than 15 hours per week. A large share work as unpaid family workers (7 percent compared with 3 percent among other workers) (Table 3.3). Crucially,

the working poor have low levels of education: 20 percent have not even completed primary school, compared with 9 percent for other workers; and only 21 percent have completed secondary education compared with 44 percent of other workers. For the working poor, creating jobs will not relieve their poverty. Poverty reduction requires increasing their productivity and earnings, which can only be achieved in the longer term.

THE NUTRITION AND HEALTH STATUS OF THE PALESTINIAN POPULATION

3.10 A large share of the Palestinian population is at risk for not getting adequate amounts of food. Between February and July 2003, the FAO undertook a “Food Security Assessment” in the West Bank and Gaza. The Assessment concluded “food is generally available in West

TABLE 3.3 Labor Status Characteristics of the Working Subsistence Poor Compared with Other Workers

	Not Poor	Poor
<i>Frequency of work</i>		
Regular	67	50
Seasonal	3	2
Sporadic	30	48
Total	100	100
<i>Hours of work</i>		
Less than 15 hours/week	30	35
15 or more hours per week	70	65
Total	100	100
<i>Work status</i>		
Employer	8	3
Self-employed	14	15
Unpaid family worker	4	7
Employee	74	75
Total	100	100
<i>Educational status</i>		
Less than elementary	9	20
At least elementary but not secondary	47	59
Secondary or more	44	21
Total	100	100

Source: PCBs and World Bank calculations based on the National Poverty Survey, 2003

Bank and Gaza but access [to food] is limited due to physical (curfews, closures) and economic reasons (high unemployment, depletion of resources, exhaustion of coping strategies and strained social support networks). Consequently, “food insecurity is a reality for some and a (near) constant threat for a large and growing number of people.”³⁹ FAO estimates that about 40 percent of the West Bank and Gaza population was food insecure⁴⁰ at the time of the assessment and an additional 30 percent was under threat of becoming food insecure in the near future.

3.11 Many families have been forced to cut back on food consumption since the onset of the *intifada*. FAO’s Food Security Assessment reports that more than 90 percent of the population reduced food consumption during the *intifada*.⁴¹ The World Bank estimates that per capita food consumption declined some 25 percent in real terms compared to 1999.⁴² The situation stabilized in 2003 as a consequence of a modest increase in per capita incomes (See Chapter 2).

3.12 Malnutrition rates in Gaza declined from their high levels in 2002 and remained

low in the West Bank. In the summer of 2003, Al Quds and the Johns Hopkins Universities (AQ/JHU) updated their 2002 nutrition assessment;⁴³ their goal was to estimate the prevalence of acute and chronic malnutrition among pre-school children and to assess the quality of food consumption.⁴⁴ The new AQ/JHU study indicates a decline in *acute* malnutrition in Gaza from 13.3 percent in 2002 to 3.9 percent in 2003 and a smaller, but still significant, decline in *chronic* malnutrition from 17.5 percent in 2002 to 12.7 percent in 2003 (Table 3.4).⁴⁵ In the West Bank, there was no significant change between 2002 and 2003. Acute malnutrition affected 3.1 percent of pre-school children in 2003, down from 4.3 percent in 2002; chronic malnutrition was 9.2 percent, up from 7.9 percent in 2002.

3.13 The quality of children’s diet declined markedly between 2002 and 2003. The AQ/JHU survey points to a worrying deterioration in the quality of children’s diets. The quality of food consumption is measured by the number of calories and by the presence of essential micronutrients in the diet.⁴⁶ The energy intake for 4 to 5 year-old children declined by 12.3 per-

39. *Food Security Assessment, West Bank and Gaza*. Food and Agriculture Organization of the United States in collaboration with World Food Program, 2003., p.28.

40. A family is said to be “food insecure” if the family “[does] not at all times have physical, social and economic access to sufficient, safe and nutritious food which meets their dietary needs for an active and healthy life.” *Food Security Assessment*, op cit., p 29.

41. According to a study by the World Food Program (*Coping strategies of World Food beneficiaries in the OPT—a Pre-test Study*, February 2004), only 2 percent of beneficiaries of WFP food aid never had to reduce the *quality* of food consumed. This is broadly consistent with figures from Al Quds/ Johns Hopkins University, which showed that 55 percent of all households in the West Bank and an astonishing 99 percent of all households in Gaza “generally decreased the amount of food consumed.” *Nutrition and Quantitative Food Assessment*, preliminary results, presented to the Humanitarian Emergency Support Group, April 2004.

42. The estimated decline in food consumption is lower than the estimated decline in total consumption, due to the relatively lower income-elasticity of food consumption. That is, since food is a necessity, families generally reduce food consumption less than consumption of other goods when their income declines.

43. Malnutrition studies were the source of some controversy in 2003. The AQ/JHU study found somewhat higher rates of malnutrition than a similar study carried out for the same period by PCBS. An independent review of the two studies concluded that both surveys were methodologically sound, but the PCBS survey was preferable due to its comparability with previous PCBS surveys and its larger sample size. *Analysis of nutrition surveys on the West Bank and Gaza* (unpublished), JY. Hwang, A. Armstrong and E. Frongillo, Cornell University, October 2003. Since the PCBS did not update its survey in 2003 (and AQ/JHU expanded their sample in 2003 compared to 2002), it was thought most appropriate to compare these two.

44. The AQ/JHU study also attempted to assess the targeting efficiency of food aid.

45. Although not strictly comparable, these results are mirrored in a study conducted by Accion Contra el Hambre in March 2003.

46. The deterioration in the quality of the diet is also documented in the Geneva Perceptions’ Surveys. In 2003, 39 percent of respondents reported that they had reduced consumption of dairy products and 57 percent had reduced consumption of meat. *Palestinian Public Perceptions*, Report VI October 2003, Palestine Research Unit, IUED Geneva.

TABLE 3.4 Malnutrition in the West Bank and Gaza, Percent of 6–59 Month-Old Children

	2002	2003
West Bank		
Acute malnutrition	4.3	3.1
Chronic malnutrition	7.9	9.2
Gaza		
Acute malnutrition	13.3	3.9
Chronic malnutrition	17.5	12.7

Source: AQ/JHU, preliminary results, presented to the Humanitarian Emergency Support Group, April 2004.

Note: These figures report global rates of acute and chronic malnutrition. Thus, according to generally-accepted standards, the table shows the share of the sample for which the malnutrition indicator (defined as weight divided by height in the case of acute malnutrition, height divided by age in the case of chronic malnutrition) is less than 2 standard deviations from the mean.

cent between 2002 and 2003, while for 1 to 3 year-old children the decline over the same period was smaller (5 percent). The data suggest that older children take in *less* energy than younger children, even though older children have greater energy needs. Children's intake of essential micronutrients, such as iron, declined some 10 percent from 2002 to 2003; the intake of micronutrients did not increase with age. A possible explanation might be that families unable to provide adequate amounts of quality food to all offspring make their younger children a priority. Sub-par calorie levels and consumption of micronutrients can have severe implications for children's learning abilities and cognitive skills. The potential long-term effects of a poor diet suggest that a broad-based effort to improve access to fortified food items is warranted. There should also be an effort to increase families' awareness of the importance of a varied and nutritious diet, particularly for children.

3.14 The extremely tense environment is taking its toll on the psychological well being of children and youth. Continued violence has increased levels of psychological trauma and stress, particularly among children and young people. Almost one-half (48 percent) of all children report personal experience of conflict-related violence or have witnessed

violence affecting a member of their immediate family.⁴⁷ Rates of *intifada*-related psychological problems among children are high. According to the University of Geneva Palestinian Public Perceptions report, 30 to 50 percent of parents report aggressive behavior⁴⁸ in their children. Evidence indicates that children living in areas of intense military activity suffer extremely high rates of post-traumatic stress disorders (PTSDs). A recent Gaza study of 121 children (aged 6–16 years) found that 87.5 percent suffered from severe (54 percent) to moderate (33.5 percent) levels of PTSDs, with girls more vulnerable than boys.⁴⁹ Another indicator of the severe conflict-related stress on Palestinians (MOH, 2004) is that between 2000 and 2004 there was a 38 percent increase⁵⁰ in the number of mental health patients receiving treatment at community mental health centers. is

47. C. Arafat: *A Psychosocial Assessment of Palestinian Children*, 2003.

48. *Palestinian Public Perceptions*, Report VI October 2003, Palestine Research Unit, IUED Geneva. Forty-six percent of parents report aggressive behavior, 38 percent report poor school results, 39 percent nightmares and 27 percent report bedwetting among their children.

49. S. Qouta, R. L. Punamaki and E. El-Sarraj: "Prevalence and Determinants of PTSD among Palestinian Children Exposed to Military Violence," *European Children and Adolescent Psychiatry*, 2003.

50. Ministry of Health: Statement to the 60th World Health Assembly, 2004.

HOUSEHOLD COPING STRATEGIES

3.15 The subsistence poor attempts to cope with the crisis using a variety of means, but many coping strategies are gradually being exhausted. “Twenty-Seven Months” noted that “[Palestinian adaptive strategies] on balance have worked well, but they are not sustainable *ad infinitum*, and signs of exhaustion are apparent.” Comparison of coping strategies used during the early *intifada* period with more recent data indicates that these strategies are being stretched. In the early months of the *intifada*, almost all of the poorest families (94 percent) reduced consumption, including food consumption, according to data from PCBS (table 3.5). By 2003, this number had declined to 46 percent, an indication that at that time consumption had been reduced as far as possible.⁵¹

3.16 Family savings appear to be largely depleted. In 2001, 70 percent of the poorest Palestinian families were reportedly drawing down their savings. In 2003, only 13 percent continued to do so, an indication that the stock of available savings accumulated in pre-*intifada* times was by then running out. Likewise, nearly a third of the poorest families sold all or part of their jewelry during 2001 compared with 17 percent who continued to do so in 2003.⁵²

3.17 The tight-knit Palestinian social structure continues to be critical in enabling poor families to cope with the crisis. The *intifada*

51. In theory, it may be that the decreased use of these coping strategies reflects an improvement in families’ economic situation and thus reduced need for these strategies. This seems unlikely, however, given that average incomes in 2003 continued to be lower and poverty rates continued to be higher than they were prior to the crisis.

52. Data collected by FAO suggest that jewelry is the first asset that households disposed of. FAO’s Food Security Assessment reports that 75 percent of the population in West Bank sold jewelry at some point during the *intifada*, compared with about 40 percent who said that they would resort to selling land.

has increased the relevance of social networks as a safeguard for coping with economic crisis, particularly for the subsistence poor. While 24 percent of the non-poor relied on savings in 2003 compared with 13 percent of the poor, 60 percent of the poor borrowed from individuals (compared with 39 percent of the non-poor). Meanwhile, 34 percent of the poor relied on friends and relatives (compared with 19 percent for the non-poor) (Table 3.6). The extended family has become a strong and important mechanism for sharing money, food and generating income. The Participatory Poverty Assessment points to the importance of borrowing money from in-laws;⁵³ other fieldwork emphasized the importance of having relatives overseas⁵⁴ and other informal channels as potential sources of income.⁵⁵

IMPACT OF CLOSURES ON COMMUNITIES—AN EXAMPLE FROM SIX VILLAGES NEAR BETHLEHEM

3.18 The *intifada* has had a profound impact at the community and village levels. Closures have severely disrupted economic life within communities. They have also severed economic ties, ties that are vital to sustain the economies

53. UNDP Participatory Poverty Assessment, Bethlehem Governorate Report, Part 4.

54. For example, in the village of Jayyus, which has lost significant portions of income and land as a result of the Separation Barrier, family members overseas send money to the head of the family. The head of the family then distributes the money to the most needy. Field interview with head of the Jayyus Charity Palestine, April 2004.

55. In the case of Anin village in the Jenin governorate, one wealthy person has lent money to nearly every family in the village. Such a situation has an inherent conflict, however, particularly if it is difficult for indebted families to pay back their debt. (Field interview with head of village council, Rabah Yassin, April 2004). Another example of social solidarity in helping families to cope with the economic crisis is the pooling of funds for the purpose of rotating credit. For example, a group of women in Wadi Fuqeen village near Bethlehem contributes to a common pot of money every month. The women take turns to receive the entire amount collected that month. (Nagarajan and Hohe 2003).

TABLE 3.5 Evolution of Coping Strategies of the Poor, 2001 and 2003 (percent)

	Friends/ Relatives	Borrow from Individuals	Savings	Selling Jewelry	Reducing Expenditures	Work in Agriculture
Use in 2001						
Yes	NA	52	70	29	94	14
No	NA	48	27	70	7	80
NA	NA	0	3	1	0	6
Use in 2003						
Yes	34	60	13	17	46	13
No	66	40	68	70	54	49
NA	0	0	19	14	0	38

Note: The table compares the coping strategies of the poorest 16% of the population in 2001 with those of the poorest 16% of the population in 2003. Source: PCBS and World Bank Staff calculations.

TABLE 3.6 Coping Strategies in 2003 (Percent of Poor Compared to Non-poor)

	Friends/ Relatives	Borrow from Individuals	Savings	Selling Jewelry	Reducing Expenditures	Work in Agriculture
Use among poor						
Yes	34	60	13	17	46	13
No	66	40	68	70	54	49
NA	0	0	19	14	0	38
Use among non-poor						
Yes	19	39	24	12	32	10
No	79	60	62	81	67	59
NA	2	1	14	7	0	31

Source: PCBS and World Bank Staff calculations.

of many districts, ties between communities, which link villages to major urban centers. Economic activity has shrunk to the local village level; agricultural production has shifted from commercial to subsistence production. This section considers the experiences of six villages to illustrate other West Bank villages.⁵⁶

56. To improve understanding of the impact the *intifada* has had at the community level, the World Bank is undertaking a "community studies" research program of six villages in the Bethlehem area. This research, part of the Community Study Program, forms the basis of the material in this section. The study derives from survey-based information gathering, supplemented with semi-structured qualitative interviews with village residents.

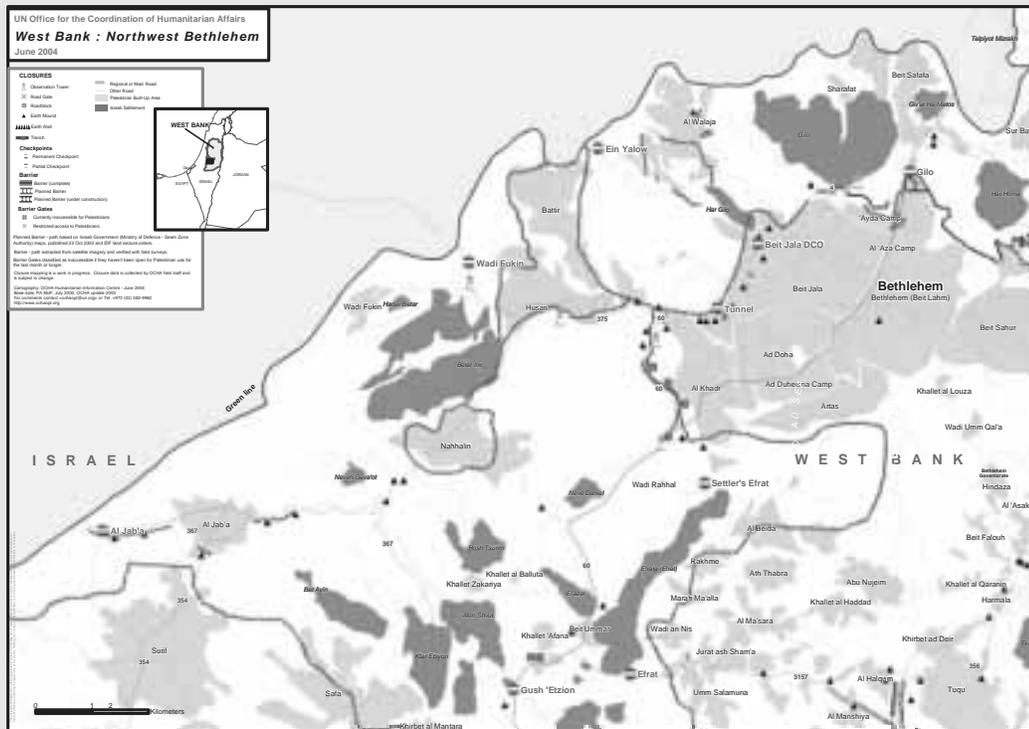
3.19 Closures block vehicle traffic and are slowly strangling economic life. Prior to the *intifada*, a single major bypass connected the six villages to the urban centers of Bethlehem and Jerusalem (see map). Closures and violence associated with the *intifada* have made access along this bypass insecure and sporadic. Physical barricades frequently block access to the road; Palestinians are only allowed to travel on foot. Communities sought alternative routes, such as a secondary road to Bethlehem and Jerusalem that cuts through the village of Husan. However, mounds of earth and barricades of sand, placed at the end of this road, prevented

BOX 3.2 A Topography of the Six Villages

Size. The six villages included in the study (Husan, Battir, Wadi Fukin, Nahhalin, Al Walaja, and Al Jab'a) are situated along the Green Line west of Bethlehem. The population of the six communities totals 19,300 people. Al Ja'ba is the smallest community with a population of 865 (87 households), Nahhalin the largest with a population of 6,164 (747 households).

Geography. Village lands span the valleys of West Bethlehem, but they have subsequently been hemmed in by confiscation of land and expansion of settlements. Following the Oslo Accords, the built-up portion of these six villages fell under Area B as defined in the Oslo agreement (areas under Israeli control); much of the surrounding agricultural lands were designated Area C (under PA control).

Economy. Historically, these villages served as an agricultural heartland for the Bethlehem area. Like many other Palestinian villages, over the past three decades the economy shifted from agriculture to dependence on labor in Israel. The tourism industry in Bethlehem also became an important source of employment. Agriculture continues to play an important role in the local economy; 34% of households hold land averaging 5.4 dunums for self-consumption and commercial purposes (1 dunum = 1,000 m²). The main winter crops are cauliflower, beans, and spinach; summer crops include eggplants and pumpkins. Other crops grown include mint, parsley, cucumber, and radishes.



the passage of vehicular traffic. Villagers wishing to go to Bethlehem must pass the mounds of earth and barricades, walk 800 meters, then cross a busy highway and climb over another mound of earth, until they reach the Al Khadr checkpoint. Once they have crossed this checkpoint, they can enter Bethlehem.

3.20 Roadblocks severely restrict movement into and out of the six villages. The village of Nahhalin used to have one eastern road leading to Hebron city. That road is now completely blocked by mounds of earth. Villagers built an alternative track to bypass the roadblock and reach Hebron, but that too has been sealed. In addition, the main access road leading from Nahhalin through Husan to Bethlehem is sealed at various times; over the past six months, the road has been blocked four times for periods of two to three weeks and on one occasion for two months. Villagers wishing to sidestep the roadblocks must travel on foot and climb over mounds of earth. The only route out of the village, along a dirt track to the village of Al Jab'a, requires a detour to reach Bethlehem.

3.21 Faced with closure, village economies are increasingly turning inward. Disruptions of economic ties among the six villages, which had linked them with the urban centers of the West Bank and Israel, have shrunk economic activity to the village level. One indication of that is the share of workers employed within their own village has doubled from the pre-*intifada* level of 10.6 percent to 23 percent (Table 3.7). Another indicator is the proliferation of small-scale village businesses (grocery shops, bakeries, butchers, mechanic shops, etc.). Due to the lack of working capital and depressed demand, these businesses operate on a small scale; on average, they employ two persons and generate NIS 1,500 per month.⁵⁷ The trend in localization of economic activity also shows up in

the shift to purchase goods locally, especially foodstuffs. Prior to the *intifada*, nearly 60 percent of respondents purchased food from Bethlehem; this figure dropped to 27.8 percent at the time of the survey and compared with 70 percent who purchased within their own villages. For other consumption items, such as furniture or household appliances, Bethlehem continues to be the primary location of purchase.

3.22 The level of workers employed in Israel and the settlements has contracted since the *intifada* began. The proximity of the six villages to the Green Line and to Jerusalem made Israel an important source of employment prior to the *intifada*. On the eve of the *intifada*, 56 percent of village workers were employed in Israel or the settlements; the percentage ranged from 48 percent in Battir to 75 percent in Husan. By the autumn of 2003, the share of workers in Israel and the settlements had declined to 42 percent.⁵⁸ In fact, the actual decline in Palestinian employment in Israel is even larger. The average *number of days* worked by Palestinians in Israel has declined from 22 to 14—a drop of 35 percent. Work in Israel is based on clandestine travel.

3.23 Employment in the settlements has expanded; this expansion partially compensates for the decline in work in Israel proper. During the *intifada*, employment in the settlements has become relatively more important to the villages than employment in Israel proper. At the time of the survey, the share of employment in the settlements as a proportion of total employment in Israel and the settlements was reported at 40 percent; this percentage is double what it was prior to the *intifada*. The proximity of villages to the settlements is an important reason why employment in settle-

57. Source: World Bank staff calculations are based on survey data for the six villages.

58. According to the survey, total employment in the six villages combined declined approximately 30 percent during the *intifada*.

TABLE 3.7 Location of Work, Share of Total Employed (percent)

	Pre-intifada	Current
Own village	10.6	23.0
Israel	44.0	25.0
Settlement	12.0	16.8
Bethlehem	13.5	15.3
Other	19.9	19.9
Total	100.0	100.0

Source: World Bank staff calculations based on survey responses.

ments has expanded. In addition, the criteria to obtain permits for work in the settlements are more lenient than those for working in Israel.⁵⁹

3.24 The quarry industry, one of the main export-oriented businesses in the area, has been severely hit by closures. Systematic data on the impact that the *intifada* has had on quarries, stone-cutting factories and stone traders are scarce. However, interviews with local traders suggest that closures have had a profound impact on these businesses.⁶⁰ The main impediment is green-plated (Palestinian) vehicles which are restricted in their movements. This situation has forced traders to rely on transport vehicles with Israeli license plates; transportation costs have nearly doubled.⁶¹ Furthermore, traders report that Palestinian suppliers have limited legal recourse in this matter; the number of Israeli contractors defaulting on payments has increased as a result. The Israeli

construction sector contracted slightly between 2002 and 2003,⁶² which contributed to a decline in quarry activity. But the effect is likely to be marginal.

3.25 Agriculture for commercial purposes has come to a virtual halt. Closures have seriously undermined commercial agriculture. Villagers report that many households have stopped holding land for commercial purposes; they plant for subsistence only. The main impediment to commercial agriculture is that farmers lack access to markets in the major urban centers of Bethlehem and Jerusalem. Demand for agricultural produce in the area has fallen significantly as local tourism, restaurant, and hotel industries stagnate. Production is undermined because farmers cannot obtain essential fertilizers.⁶³ Moreover, farmers report difficulties in tending their crops because of the curfews.

59. For example, Palestinian workers do not have to be married to work in settlements and there are no restrictions on the hours of work. In addition, those over 18 years of age are allowed to work in the settlements. The age criterion for work in Israel is 28 years of age.

60. The number of employees at the stone-cutting factory in Nahalin, for example, is nearly one-half of what it used to be.

61. Traders report that transporting a truckload of cut stones from the factory to a destination in Israel now costs NIS3,500 to 4,000; it used to cost NIS1,500 to 2000.

62. Traditionally, middlemen/traders from the six villages were used extensively in dealings between quarries and smaller Israeli contractors; the latter could not necessarily make advance payments to the quarries for their stones. The traders used their social relations with quarry owners to purchase the stones. These relations helped enforce the contracts in the absence of "collateral" or upfront payments. Traders would sell the cut stones to the smaller contractors and they were responsible for collecting payments.

63. According to a military order, shipments of products from the West Bank to Israel require a special permit, enforced at checkpoints. The permit is different from the "normal" permits required for passage of persons and vehicles and is very difficult to obtain.



Service Delivery

FOUR

The ministries of Health, Education and Social Affairs constitute the core of PA's service delivery system. Together they account for 31 percent of the PA's budgeted spending in 2004 and employ some 50,000 people; the ministry of Education makes up the lion's share of this figure. Continued provision of these services is key to the longer-term development prospects of the Palestinian economy. This economy, which lacks strong natural resources can ill afford the erosion of its stock in human capital. Provision of health, education and other social services is also important for the PA's "street credibility." During 2003, the PA maintained the delivery of core social services. However, persistent restrictions on movement and a sustained fiscal crisis have taken their toll; inevitably, standards of service are on the decline. Municipalities, UN organizations (notably UNRWA) and many non-governmental organizations remained key players in the delivery of essential services. The Palestinians depend heavily on donor support for the provision of basic social services. Without donor support, the Palestinian population would be without the current level of basic social services.

PA HEALTH SERVICES

4.1 Closures have imposed significant additional burdens upon the health system. Closures and direct destruction of health infrastructure have impeded the supply of health services. Although some improvements in access were noted in 2003,⁶⁴ closures continued to hamper Palestinians' access to healthcare.⁶⁵ Due to their proximity to local communities, primary health care centers have assumed the added burden of providing health services. Between 2000 and 2002, the Ministry of Health (MoH) reported an increase of 36 percent in visits to primary care centers. At the same time, violence has led to the destruction of clinics, hospitals and ambulances and to the injury and death of health care personnel.⁶⁶

4.2 Demand for health care has increased significantly as a consequence of conflict-related violence. The increase in demand for health services exceeds the level expected from demographic trends, suggesting a significant direct impact of the *intifada*. The demand for blood transfusion services increased by 178 percent between 2000 and 2003; in 2003, hospital emergency wards treated 749,318 injuries, an

64. For example, *Health Sector Bi-Weekly Report*, Issue 16, August 2003, notes a decline in the number of households in need of emergency services and unable to access them. Likewise, *HealthInforum*, 2004, reports improvements in access to ante-natal and post-natal care as well as accessibility to diabetes care.

65. For example, the PRCS reports that in 2003 it was prevented from or delayed in reaching health facilities in 1,294 instances. The Separation Barrier has particularly limited health care access for the people in the West Bank who live in its vicinity, cf. chapter 1. Source: data from Ministry of Health.

66. Eight primary health clinics, 29 hospitals and 38 ambulances were at least partially destroyed in 2003; 4,242 health workers and ambulance drivers were injured while on duty; 25 were killed.

increase of 52.6 percent over 2000. Major surgical admissions increased by 31 percent and general hospital admissions increased 20 percent.⁶⁷ The UNWRA has echoed MoH's accounts of increased demand for health services; the former reports a 40 percent increase in outpatient consultations and a 27 percent increase in admissions between 2000 and 2002.⁶⁸

4.3 The finances of the MoH remained precarious in 2003, but donor support covered 87 percent of budgeted non-salary operating costs. The 2003 budget allocation for the MoH's non-salary operating costs amounted to US\$52.8 million, equivalent to a 10 percent increase over the 2002 level.⁶⁹ The MoH had to rely on donor assistance to finance its non-salary budget. While the PA covered US\$10.2 million of the budget in 2002, the Ministry of Finance made no funds available to fund the MOH in 2003.⁷⁰ An increase in donor assistance from US\$31.2 million in 2002 to US\$45.9 million in 2003 helped meet the shortage. Nevertheless, the MOH had a financing gap of US\$6.9 million in 2003 (Table 4.1).

4.4 Reduced financial resources are taking their toll on the quality of healthcare. The Ministry of Health has been unable to sustain

its regular program of monitoring and testing drinking water. As a result, the rates of infectious diseases due to contaminated drinking water have increased. Analysis of a sample of households in 50 villages in the Nablus governorate indicated an alarming increase in bacteriological contamination (fecal coliforms) of piped water. The measured contamination rate was 59 percent, up from a baseline of 20 percent. That means the quality of piped water is nearly as low as tanker-water. Tanker-water has a contamination rate of 65 percent, up from 62 percent at the baseline.⁷¹ The increased contamination is partly due to dramatically lower rates of chlorination, which declined by 55 percent in Gaza and 62 percent in the West Bank. The environmental impact of reduced solid waste collection also plays a role.

4.5 The residual financing gap led to sharp cut backs in referrals for specialized treatment. Tetanus vaccinations of expectant mothers have fallen by 30 percent since the onset of the *intifada*. Documented consequences include a recent 42 percent increase in bacterial meningitis from 9.5 to 13.5 per 100,000 as well as a 30 percent increase in the reported incidence of viral meningitis (from 22.1 per 100,000 to 28.8 per 100,000).

PA EDUCATION SERVICES

4.6 Enrollment rates in basic school have declined during the *intifada*.⁷² The impact of

67. Source: data from Ministry of Health.

68. Data from the MoH, World Health Organization, Al-Quds University, 2003. UNRWA notes that the increase in outpatient consultation, which is cheaper than hospitalization, might also be explained in part by deteriorating household economics.

69. MoH salary expenditures were US\$114 million in 2003. Salaries were paid in full.

70. The Ministry of Finance's ability to sustain funding for MoH has been compromised by a steep decline in health insurance revenues during the *intifada*. Early in the *intifada* PA Chairman Arafat issued a decree, which absolved all *intifada* victims from paying health insurance, including those unemployed because of the Israeli closures. As a result, between 2000 and 2002, the number of households covered by the Government Health Insurance (GHI) scheme increased by 207,434, while revenues from premiums declined from US\$ 29.5 million to US\$ 22 million or 26 percent. More than half of persons eligible for health insurance no longer pay for it, according to *Palestinian Public Perceptions on Living Conditions*, Report VI, Geneva, October 2003.

71. The deterioration of water quality has already affected the health status of the Palestinian population, particularly children. Gastrointestinal infections in children under five have increased by 42 percent. There has been a 42 percent increase in diarrhea and a 40 to 60 percent rise in the prevalence of amoeba and *giardia*. Another concern is that the Palestinians are not sufficiently aware of the poor quality of their drinking water; 83 percent of respondents to the study reported that their water was safe.

72. The Ministry of Education and Higher Education (MOEHE) defines "basic education" as grades 1 to 10 and "secondary education" as grades 11–12. That same terminology applies here. The *tawjihi* exam occurs at the end of secondary school.

TABLE 4.1 Ministry of Health: Non-Salary Operating Budget, 2000–2003 (US\$ million)

	2001	2002	2003
Budget allocation	51.2	47.8	52.8
Funds received from MOF	16.1	10.3	0.00
Funds received from other sources	16.1	31.2	45.9
Financing gap	19.0	6.3	6.9
Percent financing gap	37%	13%	13%

Source: MoH, 2004.

TABLE 4.2 Ministry of Health Non-Salary Operating Budget 2003 (US\$ million)

Budget Component	Budget	Donor Assistance	Deficit
Drugs, medical disposables, lab materials	26.0	26.9	–0.9
Local tertiary-care contracts (referrals for specialized treatment)	12.7	3.8	8.9
Nutrition services (including hospital food)	2.3	2.8	–0.5
Operating expenditures	12.0	12.4	–0.4
Total	53.0	45.9	7.1

Source: Data provided by Ministry of Health.

the current crisis has eroded achievements of the Palestinian education system (net enrollment rates in the West Bank and Gaza basic education—1st to 10th grades—were among the highest in the region). From a peak rate of 92.2 percent on the eve of the *intifada*, the net enrollment rate⁷³ has declined every year. This enrollment rate is 88.4 percent for 2003–2004. However, the number of children enrolled in basic education has continued to climb due to growth in the number of school-age children (Figure 4.1). The decline in basic school enrollment rates has not as yet⁷⁴ affected enrollment rates at the secondary level; the latter has con-

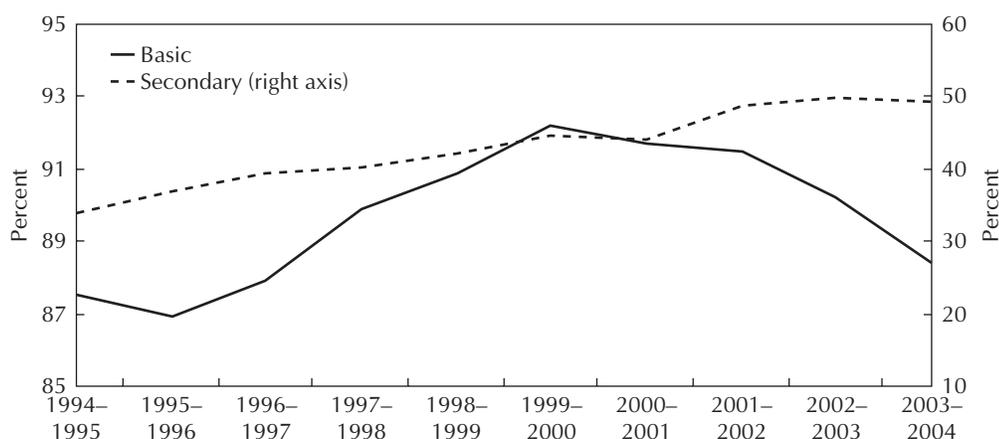
tinued to increase. After dipping during the first year of the *intifada*, enrollment rates for secondary education have steadily increased to exceed 50 percent in the 2003/04 school years. This is almost 20 percentage points higher than 10 years ago.

4.7 The number of school days lost due to violence and curfews declined significantly during 2003. On average 0.4% of school days were lost due to violence and curfews during the 2003/2004 academic years, down from 3.3% in 2002/2003. The impact of violence and closures on schooldays varied by location (See Table 4.3). Rafah in Gaza saw a sharp increase in the proportion of schooldays lost: 3.2% in 2003 to 2004, up from 1.8% in 2002. One study of Palestinian children concludes “the omnipresence of violence in children’s surroundings and the resulting feeling of danger

73. The net enrollment rate is defined as the official age group for a given level of education expressed as a percentage of the corresponding population.

74. Some years will elapse before a decline in basic enrollment shows up at the secondary level.

FIGURE 4.1 Net Enrollment Rate



Source: PCBS

BOX 4.1 Basic Statistics of the Palestinian School System

The Palestinian school system caters to more than 1 million students, almost a third of the entire Palestinian population.^a The PA is the main provider of basic education; about 589,000 students receive basic education and 100,000 students are at the secondary level. During the 2002 to 2003 school year, UNRWA provided primary education to some 248,000 students. Private schools accounted for 55,000 students. The number of children in PA schools increased by 15 percent during the *intifada*; the rise reflected population growth, increased demand for teachers, new schools and classrooms.^b The growth in UNRWA's enrollment has been slightly lower, but still considerable. Private schools have witnessed a decline in enrollment, probably an indication of the economic hardship that Palestinian families have experienced during the past 3 to 4 years.

School Enrollment by Provider, 1999–2003 (1,000 students)

School year	Basic School			Secondary School
	PA	UNRWA	Private	PA
1999/2000	514	223	56	73
2000/2001	539	232	59	76
2001/2002	565	242	57	84
2002/2003	589	248	55	92

Source: PCBS data is not broken down into primary and secondary education. UNRWA provides basic education from grades 1 through 9 and nothing beyond that.

Notes: a. This number excludes 62,000 children in kindergarten, mostly run by NGO's. b. The Ministry of Education and Higher Education (MoEHE) estimates in its five-year plan that the primary school-age population will increase by 30 percent between 2001 and 2006. There is a reason why MoEHE's projected increase is somewhat higher than recent history suggests; MoEHE's five-year plan included a gradual increase in enrollment rates; in fact, the rates declined.

TABLE 4.3 School days missed during the 2002/03 and 2003/04 school years (percent of total), by governorate

	2002–2003	2003–2004
Nablus	6.6	0.5
Qabatyah	0.4	0.1
Jenin	4.4	1.5
Jerusalem (suburbs)	0.3	0.1
Bethlehem	3.9	0.3
S. Hebron	0.7	0.1
Salfit	0.2	0.1
Ramallah	0.9	0.3
Qalqilia	2.8	0.4
Tulkarem	4.6	N/A
Hebron	5.9	0.1
Jericho	0.1	0.1
North Gaza	1.8	0.1
Gaza	0.6	0.1
Khan Younis	0.8	0.1
Rafah	1.8	3.2
Total	3.3	0.4

Source: Data provided by the Ministry of Education and Higher Education.

leads to increased aggressiveness and hyperactivity and a decrease in attention spans and concentration capacity.⁷⁵

4.8 The Ministry of Education has taken several administrative steps to mitigate the impact of closures. To overcome the effect of movement restrictions on teachers' access to schools, the MoEHE has relocated 15,000 of the 27,000-strong teacher corps to reduce the distance between teachers' residence and their place of work.⁷⁶ While this measure has reduced teacher absenteeism, it also forces a considerable number of teachers to instruct outside their area of specialization. This change is likely to

75. Cairo Arafat, *A Psychosocial Assessment of Palestinian Children*, July 2003. The MoEHE has recognized the school's increased importance as a social forum and source of support for Palestinian children. Therefore, the Ministry has developed so-called classroom-based interventions (CBIs). CBI's focus on creating an emotionally safe place, team work, self-expression, and self-esteem; the goal is to offer students positive coping mechanisms to deal with trauma.

76. In addition to teachers, MOEHE employs 17,000 administrative and support personnel in the school system.

undermine the quality of teaching, especially in the more specialized higher grades. The MoEHE has also decentralized authority for decisions concerning teacher deployment and school construction/rehabilitation to the district and school levels; the goal is to bring about a faster and more flexible response to the ever-changing situation.

4.9 Donor budget support enabled the MOEHE to cover its budgeted expenses in 2003. As was the case for other service-delivery ministries, the MoEHE suffered severe cutbacks in allocations from the Ministry of Finance for non-salary operating costs. Of US\$14.2 million budgeted for non-salary operating costs for 2003, the MoEHE received only US\$2.7 million. The shortfall was fully covered by donors, who provided a total of US\$12.3 million in budgetary support for the MoEHE in 2003⁷⁷ (See table 4.4).

77. Of this amount, a total of US\$7.6 million came through the Emergency Services Support Project.

TABLE 4.4 MoEHE Non-Salary Operating Budget, 2001–2004 (US\$ million)

	2001	2002	2003
Budget allocation	14.6	17.2	14.2
Funds received from MOF	3.0	3.5	2.7
Funds received from other sources	6.4	11.1	12.3
Financing gap	5.2	2.7	–0.8

Source: MoEHE Salaries, the largest budget item in MoEHE's budget, amounted to US\$209.1 million in 2003; it was fully paid.

4.10 Schools faced a considerable financing gap due to a continued shortfall in revenues from school fees. Parents are charged an annual fee of NIS50 (US\$11) for each child enrolled in a PA school for basic education and NIS70 (US\$16) per student enrolled in secondary education. According to current procedures, the revenue from tuition fees goes directly to the schools to cover a variety of operating costs. During the *intifada*, more and more families have chosen not to pay the fee. In the school year 2002/03, an estimated 80 percent of school fees were not paid (See Table 4.5). While this state of affairs is a reflection of economic hardship, the MoEHE's decision to continue to grant access to children of non-paying families may have played a role in the decline in fee-paying.⁷⁸ Fee income represents a significant source of potential income for schools. If fees were paid for all enrolled students,⁷⁹ total revenue would amount to around US\$6.5 million, approximately 45 percent of the MoEHE's budgeted non-salary operating costs for 2003. Only US\$1.2 million in school fees were paid in 2003.

78. While this decision was certainly well intentioned and arguably justified under the circumstances, the lack of consequences for not paying fees creates obvious moral hazard problems. In 2003, the steep increase in the share of non-payers, when the broader economic situation improved might be a manifestation of this problem.

79. Some students, namely children whose families are enrolled in the Ministry of Social Affairs Special Hardship Program, do not have an obligation to pay school fees.

4.11 Generally, the quality of education has been sustained throughout the *intifada*. Despite the shortfall in school fees, the Palestinian educational system has managed to sustain its performance at the pre-*intifada* level, based on several quality indicators. First, teacher hiring has kept pace with an increase in the student population. This has allowed the average student/teacher ratio to stay constant over the past five years—except for secondary schools in Gaza, where the ratio has increased somewhat. (Table 4.6). Likewise, the pace of construction of new classrooms has kept up with the increasing number of students.⁸⁰ Both the student/teacher and the student/classroom ratio are considerably higher in Gaza than in the West Bank.

4.12 The *intifada* has exacerbated underlying structural deficiencies in the Palestinian higher education system.⁸¹ Demand for higher education, especially for university education, has increased over the past decade. From 1995/96 to 2002/03 the number of students tripled

80. In 2003, the MoEHE constructed a total of 1,476 classrooms. Not counting classrooms destroyed in violence, an estimated 1,100 to 1,200 new class rooms are necessary to accommodate the increasing numbers of students. By exceeding this number, the MoEHE is trying to fulfill its five-year plan to gradually decrease class size.

81. The higher education system in the West Bank and Gaza is composed of 16 universities and 25 two-year colleges. The colleges are, however, comparatively small. Total college enrollment in 2002/03 was some 6,000, compared with 100,000 enrolled students in the university system.

TABLE 4.5 Revenue from School Fees, 1999–2003

	1999/2000	2000/01	2001/02	2002/03
Expected revenue (US\$ millions)	5.7	6.0	6.3	6.5
Share of students not paying fee (%)	25	40	55	80
Actual revenue (US\$ millions)	4.7	4.0	3.0	1.2
Gap (US\$ millions)	1.1	2.0	3.3	5.3

Source: MoEHE and World Bank Staff estimates.

Note: Only PA basic schools.

TABLE 4.6 Indicators for School Quality, 1999–2004

	1999/00	2000/01	2001/02	2002/03	2003/04
Student/Teacher ratio					
Basic Education					
Gaza	32	32	30	30	33
West Bank	28	26	26	28	25
Secondary					
Gaza	28	26	29	29	33
West Bank	21	21	23	18	20
Student/class room ratio					
Basic Education					
Gaza	43	43	43	42	42
West Bank	34	34	34	34	33
Secondary					
Gaza	39	39	39	40	40
West Bank	27	28	28	28	27

Source: MoEHE

from about 33,000 to 100,000⁸², translating into a gross enrollment rate of 23 percent in 2003. Most universities have exhausted their expansion capacity and are not in a position to meet the demand from an increasing number of secondary school graduates. (Figure 4.2)

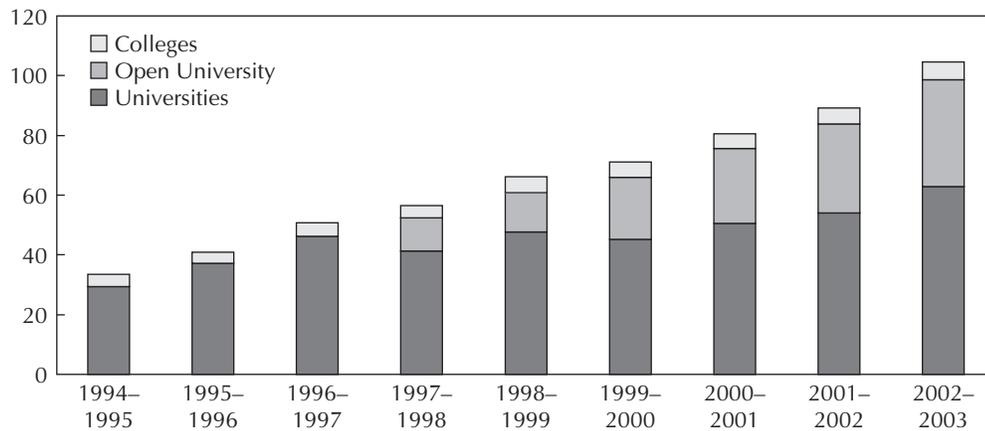
4.13 While the quality of primary education has been maintained, the quality of higher education is deteriorating. Recruitment of

teaching staff and expansion of university facilities has not kept pace with higher education's expanding enrollment. The recent *Assessment of Higher Education Needs in the West Bank and Gaza*⁸³ points to a steep decline in proxy indicators of quality. The share of full-time to total faculty dropped from 82 percent in 1996/97 to 64 percent in 2000/01; the ratio of students to full-time faculty has increased from 26 to 41 in the same period. Universities have tried to

82. It should be noted, that much of the increase in enrollment is due to the rapid expansion of the Al-Quds Open University, which focuses on distance learning.

83. *An Assessment of Higher Education Needs in the West Bank and Gaza*, USAID/AED, September 2003.

FIGURE 4.2 Higher Education Enrollment, 1994 to 2003 (1,000 people)



Source: MoEHE and PCBS

compensate for the decline in full-time faculty by hiring temporary and part-time staff. Nevertheless, the student-teacher ratio increased from 22 to 26 (Table 4.8). Assessments of the higher education system⁸⁴ emphasize the decreasing relevance and academic quality of university programs.

4.14 The finances of the higher education system are extremely precarious. Three factors precipitated the current financial crisis in the higher education system. First, the deterioration of the PA's overall fiscal situation has led to cutbacks in budget allocations for higher education. The PA's support of higher education institutions amounted to US\$15.8 million for 2003–2004 (Table 4.7). This support is some 50 more than in 1996, but the expansion in enrollment far exceeds that. Second, tuition fee income for higher education institutions has diminished as a consequence of the protracted economic crisis. In 2003, higher education institutions collected a total of US\$63.4 million in tuition fees, equivalent to 60 percent of

their recurrent budget (down from 68 percent in 1999).⁸⁵ Finally, poor planning and management capacity in the higher education system has played a role in the current financial crisis.⁸⁶

PA SOCIAL ASSISTANCE

4.15 The number of recipients of MoSA assistance, which has marginally increased since 1999, has fallen far short of the rising number of Palestinians living below the poverty line. The principal assistance program provided by the PA's Ministry of Social Affairs (MoSA) is the *Special Hardship Case* (SHC) program. This program extends to around 39,000 beneficiary

84. An example is the *Higher Education Financing Strategy*, op cit.

85. The introduction of the Palestinian Student Loan Fund (PSLF) Fund in 2001 by the MoEHE and other student aid programs has, to some extent, eased the financial constraints students face. In 2002/03, 43 percent of the student body received funding from the PSLF, up from 10 percent in 2000/01. The PSLF, financed by contributions from Arab League States, disbursed some US\$10 million in 2002/03. Source: data provided by MOEHE.

86. The Palestinian Higher Education Financing Strategy (MOEHE/World Bank, August 2002) states that "uncontrolled growth and unplanned expansion and ineffective governance" characterize the higher education system.

TABLE 4.7 Indices of Quality of Education at Universities in West Bank & Gaza, 1996–2002

	Percent Full Time Faculty	Student/Teacher Ratio	Student/Full Time Teacher
1996/97	82	22	26
1997/98	78	24	30
1998/99	64	22	34
1999/2000	65	23	35
2000/01	67	25	38
2001/02	64	26	41

Source: An Assessment of Higher Education Needs in the West Bank and Gaza, USAID/AED, September 2003.

Note: data do not include colleges.

TABLE 4.8 Financial Situation of Palestinian Higher Education, 2003/2004

Higher Education Budgets	US\$ millions	
Salaries (A)	80.7	<i>Total number of students enrolled in Palestinian universities: 114,806</i>
Recurrent expenditures (B)	25.7	
Recurrent budget (C) = (A) + (B)	106.3	
Fees (D)	63.4	<i>Average fees per academic year: US\$553</i>
Scholarships	5.6	
Student loans fund	10.4	
Budget deficit (E) = (D) – (C)	42.9	<i>Fees/expenses: 59.7%</i>
PA contribution (F)	15.8	
Donors contributions to budget support for HE (G)	7.4	<i>Salaries/expenses: 75.9%</i>
Financial gap (F) + (G) – (E)	19.7	

Source: MoEHE, MoF.

cases⁸⁷ or about 135,000 individuals⁸⁸ (See Table 4.9). The SHC program was allocated US\$13.3 million in 2002; that amount increased to US\$15.3 million in 2003.

4.16 Limited financial resources have constrained MoSA's ability to respond to the economic crisis.

87. 'Cases' include nuclear families and individuals, roughly 38 percent of all cases.

88. Beneficiaries receive either (a) full support, which includes cash assistance, food aid and the provision of family health insurance (80 percent of beneficiaries), (b) food assistance and health insurance (about 5 percent of beneficiaries) or (c) free health insurance (about 15 percent of beneficiary cases). On average, each individual receives approximately US\$10 monthly.

economic crisis. Since the onset of the *intifada*, the increase in the number of recipients of MoSA's assistance has been marginal, despite the economic crisis and the increased poverty of the Palestinian population (See Chapter 3). This can be attributed to two factors. First, while demand for assistance has increased, MoSA (like other social service ministries) has found itself in an increasingly precarious financial situation. Assistance to beneficiaries has at times been sporadic since the onset of the *intifada*. By the beginning of 2002, MoSA had accumulated six months of arrears, which it began paying off in early 2003. By October 2003, MoSA had resumed regular payments, however.

TABLE 4.9 Ministry of Social Affairs—Special Hardship Case Program and Emergency Cases, 1999–2003

	1999	2000	2001	2002	2003
Number of cases (SHC)					
West Bank	14,766	12,753	16,599	17,328	18,799
Gaza	17,813	17,949	18,116	18,732	19,986
Total	32,579	30,702	34,715	36,060	38,785
Number of applicants					
West Bank	2,708	2,399	2,872	2,285	4,651
Gaza	3,083	2,531	2,763	2,978	4,033
Total	5,791	4,930	5,635	5,263	8,684
Number of accepted applications ^a					
West Bank	1,643	1,583	2,143	1,408	2,751
Gaza	2,172	1,648	1,594	1,690	2,429
Total	3,815	3,231	3,737	3,098	5,180
Number of emergency cases					
West Bank	28,556	30,492	162,359	319,652	297,063
Gaza	8,450	98,900	104,989	191,842	183,379
Total	37,006	129,392	267,348	511,494	480,442

Source: MoSA

Note: a. A beneficiary who, for example, received assistance twice, was counted twice. Therefore, the number of emergency cases reflects the total number of incidences of assistance.

4.17 The restrictive targeting method used by MoSA to identify potential recipients of SHC assistance has led to the exclusion of the ‘new poor.’ The second factor behind the low increase in the number of recipients of MoSA concerns SHC eligibility criteria; the latter excludes households headed by healthy males, despite the fact that their income may fall below the subsistence poverty line. The number of so-called emergency cases under MoSA has increased substantially. This last program aims at assisting the new poor through *ad hoc*, usually one-off, food assistance.⁸⁹

89. Families benefiting from the Emergency Program do not have to go through a formal application process. Social workers determine the need for food assistance. The WFP and other agencies provide food to the Ministry.

90. The World Bank report on the program (*West Bank & Gaza: The Current Socio-Economic Crisis and the Ministry of Social Affairs*, World Bank, December 2002) found that it was effectively managed and that leakage was limited.

4.18 MoSA is reforming its targeting methods to ensure the poorest households—including the ‘new poor’—receive SHC assistance.⁹⁰ It is expected that the number of beneficiaries will increase by 50 percent to about 180,000.⁹¹ Measures to improve targeting include a proxy-means test for household income.⁹² Cash transfers will be contingent on household investment in the health and education of children.⁹³

However, due to its categorical targeting, this program is not an instrument to assist the newly poor.

91. The increase of beneficiaries will be financed by a World Bank grant (Social Safety Net Reform Project).

92. Proxy-means tests use a relatively small number of household characteristics to calculate a score that indicates the level of income and consumption.

93. To maintain eligibility, households must comply with the following conditions: (i) children aged 0 to 5 years attend a health and nutrition program with quarterly visits to health clinics; (ii) children enrolled in basic, secondary, or vocational school, maintain a class attendance rate of at least 85 percent and they do not repeat a grade more than once; and (iii) parents/adult household members attend

MUNICIPAL SERVICES

4.19 The quality of municipal services has deteriorated during the course of the *intifada*. Nevertheless, in general, water and electricity has been sustained. Water and electricity are the most important services provided by municipalities because of their impact on the quality of life and their share of municipal budgets. The Palestinian population continued to have access to water and electricity throughout the *intifada* chiefly because of the high priority municipalities and donors associate with these utilities. Damage to water and electrical networks have generally been fixed without delay, occasionally in coordination with the IDF. It must be emphasized however, that damage repair more often than not happens at the expense of necessary upgrades and longer-term improvements in infrastructure.⁹⁴ In addition to water and electricity, solid waste collection is the main service that municipalities provide on their own. Other services include maintenance of local roads and administration.

4.20 Closures have had a particularly negative impact on solid waste collection. The effectiveness of solid waste collection has been severely compromised during the *intifada*. Several municipalities reported that access to landfills has been denied. In some instances, the IDF closed landfills. Almost everywhere transportation distances have risen. As a result, the wear and tear on garbage trucks and other equipment have sharply increased. One outcome is a proliferation of temporary dump sites which pose a hazard to the environment.

4.21 Municipal revenues recovered in 2003 compared with 2002, particularly in Gaza. Revenues in Gaza increased some 20 percent, reaching pre-*intifada* levels (See Table 4.10).

four family and health training/counseling sessions per year. See also, World Bank Press Release, No.2004/392/MNA, June 3rd, 2004.

94. This is one of the findings of the UNRWA/OCHA Rafah Needs Assessment.

Revenue growth was more modest in the West Bank, where revenues remained about 15 percent lower than the pre-*intifada* level.

4.22 Municipal expenditures also rose in 2003, though less than revenues. In Gaza, municipal expenditures increased almost 9 percent in 2003 compared with 2002. At 1.4 percent, the increase in the West Bank was comparatively small.⁹⁵

4.23 The PA effectively bailed out municipalities in 2003 by paying municipal bills owed to Israeli suppliers (Chapter 2). The Israeli Ministry of Finance deducted a sum of approximately US\$150 million from the clearance revenues due to the PA in 2003, an amount that approximately equals total expenditures reported by the municipalities. The PA had no choice in the decision of the GoI to deduct municipal dues from clearance revenue. However, bailing out municipalities does little to encourage prudent spending by municipalities. The fact that municipalities have incentives to collect utility dues but not to pay what they owe to Israeli suppliers creates a clear moral hazard.

95. Municipal budget numbers need to be taken with suitable caveats, however, for two reasons. First and most important, *budget numbers are on a cash basis, rather than on an accrual basis*. Cash implies that the recorded revenues reflect individual Palestinians' willingness (or ability) to pay their dues to the municipality. It is not possible to infer that, for example, an increase in municipal revenue from water distribution (which rose some 20 percent between 2002 and 2003) reflects a 20 percent increase in households' water consumption, and thus an increase in "water services." Rather, the general improvement in the economy in 2003, may have prompted more households to pay their water bills. Since water and electricity make up a significant share of the "services" provided by municipalities, the interpretation of data on municipal finances is a serious problem. Second, as a rule, *municipal budget data do not include information on donor assistance*. The main reason is that many donors do not channel their funding through municipalities, even though municipalities are the ultimate beneficiaries. Instead donors choose to pay contractors and suppliers directly. The difficulty of interpreting municipal budget data is also reflected in expenditures, particularly significant municipal spending on water, wastewater and electricity. In Gaza, these items made up some 20 percent of all spending in 2003; they represented one-third of all spending in West Bank municipalities. The West Bank's share was higher because West Bank municipalities are responsible for power distribution. However, given that Israeli suppliers provide most water and electricity distributed by municipalities, municipal "spending" is determined by the portion of these dues municipalities choose to honor.

BOX 4.2 Impact on Solid Waste Collection

In the northern part of Gaza (Jabalya, Beit Lahia and Beit Hanoun), the IDF has closed municipal solid waste landfills. Temporarily, these municipalities are using the landfill at Juhr Al Deik (south of Gaza city), which is at some distance from the municipalities and requires travel along unlevelled sandy roads. Almost all municipalities report that access to landfills is restricted to long roundabout routes on sub-par roads. Roads leading to the landfill site are intermittently closed by the IDF. As a result, the municipality must arbitrarily dump solid waste in open areas or near roads. The consequences are an increase in health hazards, accelerating deterioration of garbage trucks, and a reduction in the number of daily trips that garbage trucks can make. For example, Jabalya, Beit Lahia and Beit Hanoun report that garbage trucks can make only one daily trip, compared with two or three trips before the intifada. Some municipalities in the West Bank (e.g. Al Bireh and Tulkarm) report that they have stopped night shifts due to security concerns. Summary indicators suggest that the above factors have doubled the disposal cost of 1 ton of solid waste, from about US\$14 to about US\$28.

In a number of places, such as Qalqilya, municipalities have built new landfills. However, these new landfills generally do not meet engineering specifications. For example, many lack appropriate lining and others are constructed near water wells. Municipalities also report that they are obliged to pile solid waste in temporary sites inside towns. These temporary sites impose health hazards and negative environmental effects on local residents, especially when the solid waste is burned to reduce odors. Burning garbage in the streets is an increasingly frequent practice. In the West Bank, municipalities report that solid waste containers have been damaged as a result of conflict-related violence.

TABLE 4.10 Annual Change in Municipal Expenditures and Revenues, 2001–2003 (percent)

	2001	2002	2003
<i>Expenditures:</i>			
Gaza	-25.7	4.6	8.9
West Bank	-12.5	5.3	1.4
Total	-16.5	7.0	2.7
<i>Revenues:</i>			
Gaza	-19.5	5.1	20.3
West Bank	-9.1	-8.7	2.3
Total	-10.9	-6.5	5.5

Source: World Bank Staff calculation based on survey of 16 municipalities in Gaza and 36 in the West Bank. 2000 base-year figures are annualized based on the last two quarters. Current price change.

BOX 4.3 The Emergency Municipal Services Rehabilitation Project (EMSRP)

The World Bank, the Government of Belgium, and the EC finance the EMSRP. As of March 2004, the EMSRP reported the following achievements, among others:

- Reduction in electricity shortfalls (up to 40% in Jericho, 9% in Tulkarm)
- Increased number (676) of electricity lanterns and 258 electricity poles
- Reduction in water shortfalls (up to 18 percent in Tulkarm)
- Rehabilitation of 361 existing water connections and the installation of 1,965 new connections
- Rehabilitation of some 51 km of municipal roads and 13 km of newly-constructed roads
- Rehabilitation of 1,252 existing sewage connections and the establishment of 83 new connections
- Solid waste collection increased by 1,984 tons; 1,647 additional garbage collectors were employed

EMSRP has also supplied various kinds of office equipment to 26 municipalities and financed training for almost 200 municipal staff. EMSRP's job creation component has created almost 170,000 working days of employment.

Source: Monthly Report on The Emergency Municipal Services Rehabilitation Project (World Bank component), various issues.

4.24 In 2003, donors doubled assistance for emergency municipal support. According to data collected by the MoP, donors disbursed some US\$54 million for emergency municipal service support in 2003. This support was more than double the level of support in 2002, and represents around 25 percent of total revenues in the municipal sector. In 2003, the major donors in the municipal sector were the European Commission and the World Bank. Donor emergency interventions in the municipal sector focused partly on damage repair and rehabilitation of physical infrastructure (roads, sewage networks, electrical grids and water connections), sustaining solid waste collection and disposal, operation of water and electricity pumping stations and generators and some job-creation activities.

4.25 Preliminary indicators suggest that donor interventions have had a tangible impact on municipal service delivery. For example, data from the *Emergency Municipal*

Services Rehabilitation Project (EMSRP) suggests that donor interventions have played an important role in sustaining water and electricity services, rehabilitating roads and increasing the collection of solid waste (See Box 4.3).

UNRWA SERVICES

4.26 UNRWA provides nearly one-third of basic education services in addition to health, relief and social services, the vast majority of these services are to the almost 1.6 million registered refugees⁹⁶ in the West Bank and Gaza. UNRWA is the second-largest service

96. 922,000 registered refugees reside in Gaza while 665,000 reside in the West Bank. Registered refugees make up about two-thirds of the population in Gaza. Slightly more than one-half of registered refugees in Gaza live in refugee camps. The share of the total population of registered refugees in the West Bank is about 30 percent. Only 27 percent of the registered refugees in the West Bank live in camps. UNRWA employs about 12,200 staff in WB&G, almost exclusively Palestinians.

TABLE 4.11 UNRWA Special Hardship Program: Number of Beneficiaries^a

Number of Beneficiaries (SHP)	1999	2000	2001	2002	2003
West Bank	29,375	29,372	33,160	34,914	37,664
Percent of registered refugees	5.1	5.0	5.4	5.5	5.7
Gaza	70,628	72,521	76,744	80,032	86,663
Percent of registered refugees	8.7	8.7	8.9	9.0	9.4

Source: UNRWA.

Note: a. These figures reflect the actual number of beneficiaries.

provider in the West Bank and Gaza after the PA. Under its regular operations, about 250,000 primary-school pupils were enrolled in UNRWA's 272 schools in 2003; this figure is equivalent to 30 percent of all primary-school pupils in the West Bank and Gaza. In addition, UNRWA runs 51 primary health clinics that catered to more the five million patient visits in 2003. UNRWA also provided social assistance to some 125,000 beneficiaries of its Special Hardship Case program. This program has seen an increase in the total number of beneficiaries (Table 4.11).

4.27 UNRWA's budget for its regular operations in the West Bank and Gaza for 2003 amounted to US\$154 million.⁹⁷ UNRWA is primarily financed through bilateral contributions from UN member states. It also receives contributions from UN agencies, NGOs and private citizens. The EC and US were the largest contributors in 2003, together they provided 51 percent of UNRWA's financing in 2003. UNRWA's financing has been strained in recent years. UNRWA reported a US\$20 million shortfall in funding for 2003 compared to budgeted expenditures.

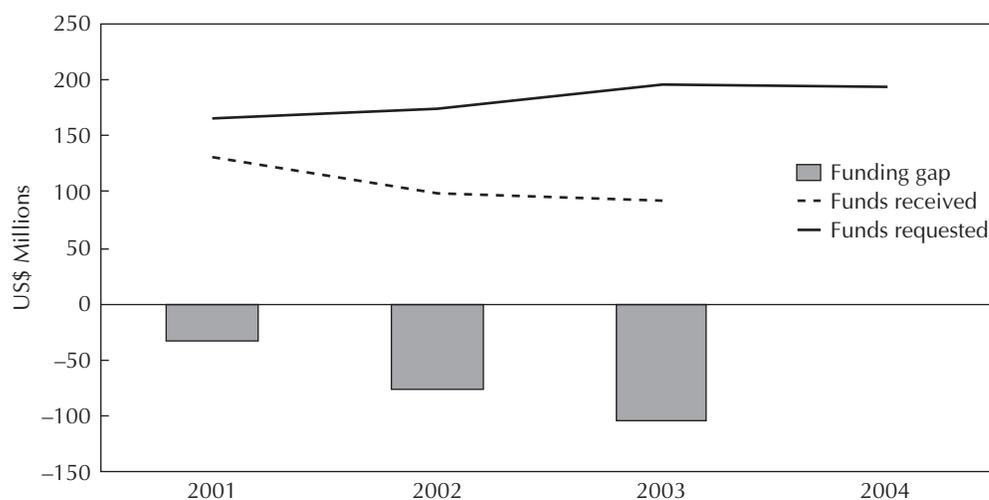
4.28 UNRWA has significantly expanded its activities in response to the *intifada*. UNRWA

97. This is equivalent to 49 percent of UNRWA's total, regional operating budget of some US\$314 million. In addition, UNRWA's 2003 budget included US\$40 million for its headquarters in Amman and Gaza City.

has launched a total of eight emergency appeals, including the 'flash appeal' in October 2000. The 2001 appeal requested a total of US\$165 million, increasing to US\$174 million in 2002 and US\$197 million in 2003. The appeals propose financing a range of interventions, particularly food and other social assistance, employment generation, shelter repair and reconstruction to meet the emergency needs of registered refugees. Of total disbursements of US\$197 million under the 2003 appeals, 44 percent was for food aid and other social assistance, 28 percent for employment generation and 18 percent for shelter repair and reconstruction.

4.29 It has proved increasingly difficult for UNRWA to mobilize donor funds to cover funding needs for its emergency appeals. The gap between funding requested by UNRWA for its emergency appeals and the funding received has steadily increased during the *intifada* (figure 4.3). Donors provided US\$132 million for the 2001 appeals. That amount declined by US\$35 million in 2002 to US\$97 million, despite a request by UNRWA in June 2002 for additional emergency funding in the wake of IDF's "Operation Defensive Shield" in April 2002. In 2003, funding for UNRWA's emergency appeals was subject to a further, albeit modest, decline of US\$5 million.

4.30 Faced with a funding shortfall of more than 50 percent for its 2003 appeal, UNRWA was forced to curtail significant parts of its

FIGURE 4.3 Financing of UNRWA's Emergency Appeals, 2001 to 2004.

Note: Data for 2001 includes the first emergency appeal made in November 2000. Data for 2002 includes the supplementary appeal of June 2002.

emergency assistance programs. The UNRWA strategy has been to continue to assist as many beneficiaries as possible, despite scarce resources. This strategy has entailed significant cutbacks in the assistance each family receives. For example, in Gaza the frequency of food aid declined from every 6 weeks to every 10 weeks. The basket of food distributed covers about 40 percent of nutritional needs, a reduction of one-third compared with 2002.

4.31 The budget for the newly-released 2004 emergency appeal amounts to US\$194 million about the same as 2003. Goals of the appeal includes food supplements for 232,000 families, which is equivalent to roughly two-thirds of registered refugees; the creation of around 2.3 million job days through employment generation programs; construction of about 1,200 housing units, predominantly in Gaza, where destruction of private housing has been most prevalent; and the provision of psycho-social support to children.

PALESTINIAN NGOS

4.32 NGOs continued to play an important role in providing social services in 2003. This was especially the case for marginalized segments of society that do not benefit from the PA's main social service delivery programs. NGO services concentrated on primary health care, physical and psychological rehabilitation, early childhood development/education, agricultural extension services and community/youth services.⁹⁸ In an effort to assess the impact

98. A study undertaken by the Palestine Economic Policy Research Institute in 2000 provided a complete map of NGOs working throughout the West Bank and Gaza. The study contained disaggregated data on their geographic locations, the communities they serve (rural, urban and refugees), their strategic mandates and sectoral focus/programs, their sources of financing, their staffing composition, and their capacity building needs. According to the study, there were a total of 926 active Palestinian NGOs, of which 76% were based in the West Bank and 23.4% in the Gaza Strip. The greatest number of NGOs was concentrated in urban areas (60.2%), followed by rural areas (29.3%); the balance was in the camps (10.6%). The largest percentage of NGOs surveyed provided youth and sports' services (youth clubs); the second largest provided childhood services; the third welfare; the fourth cultural/

of the *intifada* during 2003 on the work of Palestinian NGOs, the World Bank conducted a mini-survey of 23 Palestinian NGOs in April 2004. Information was gathered by questionnaire and subsequent interviews with selected Palestinian and international NGOs. While not representative, the survey encompassed large and small NGOs; “national” and local-based NGOs; NGOs operating in Gaza and the West Bank; and NGOs providing the full range of services typically provided by NGOs. Seven of the surveyed NGOs accounted for 89 percent of the total annual budget of US\$ 45.2 million for all 23 NGOs surveyed. This is in line with the general characteristic of the Palestinian NGO sector, namely that a small number of the larger NGOs are well resourced. However, the majority of NGOs are small; they provide limited services to a small number of people in the communities where they are based. Unless stated otherwise, the findings reported below originate from this survey.

4.33 Since the onset of the *intifada*, NGOs have refocused their programs on emergency assistance. Based on the NGOs surveyed, by 2003 NGOs had adjusted to the emergency situation and were dealing with it in a high degree of normalcy. One-quarter of NGOs surveyed allocated more than one-half of their budgets to emergency programs; within the same sample, one-half indicated that they had to reallocate resources away from development programs in favor of emergency response. The impact of the *intifada* on the service delivery profile and funding levels of NGOs varies across the sector. Large NGOs responsible for providing primary health care and other basic services were particularly stretched; they sustained their regular programs

scientific services. Other sectors covered by NGOs include rehabilitation of the handicapped, health services, rural development, education and human rights. On the other hand, 32% of financing went to the health sector, 16.6% to childhood development, 13% to welfare and charity programs, and 6% to educational services.

while providing additional emergency services.⁹⁹ International NGOs, like CARE, OXFAM and the Welfare Association, have shifted their resources towards emergency services. However, most of this adjustment had taken place during the early years of the *intifada*.

4.34 Many NGOs have had to expand the size and coverage of their service delivery programs to meet additional demands arising from the *intifada*. In addition, one-half of the NGOs surveyed indicated that they had to introduce new services to respond to emerging needs. About 40 percent of survey respondents confirmed that they should be able to sustain their services. Another 40 percent indicated that they might be forced to limit some of their services, due to a lack of financing. This state of affairs reveals yet another phenomenon about NGOs in West Bank and Gaza—their almost total reliance on external resources, which makes them financially vulnerable.

4.35 Closures have forced NGOs to decentralize. By the third year of the *intifada*, decentralization of service delivery emerged as a new *modus operandi* for many Palestinian NGOs. Even “national” NGOs that typically had regional offices covering all of the West Bank and Gaza found a clear advantage in delegating authority and independence to district offices and field staff. One-third of survey respondents indicated that they had to relocate or to open new offices to deliver community services. Coupled with an increase in the cost of transportation, this shift raised operating costs for Palestinian NGOs. More than 80 percent of NGOs surveyed indicated that their operating costs had increased. Interestingly, based

99. For example, between 2002 and 2004, the Palestine Medical Relief Society experienced a 45% drop in funding. As a result, 15 mobile clinics, which serviced up to 300,000 persons, lost financial support. The decline in the organization’s funding also brought about suspensions/curtailments of other critical programs, such as the women’s health program, equipment loan centers and the Community Based Rehabilitation Centers.

on interviews conducted with some of the NGOs surveyed, this “forced” decentralization has had a positive impact in bringing NGOs closer to their communities. Moreover, the additional training necessary to strengthen regional and district offices offered an opportunity for capacity building.

4.36 The amount of financing available to NGOs remained roughly constant in 2003, compared with 2002. Consistent, aggregate data on NGO financing is not readily available. With suitable caveats, the World Bank estimates that financing for Palestinian NGOs amounted to US\$150 million in 2003.¹⁰⁰ NGOs continued to receive the bulk of their funding from international NGOs, multilateral organizations and bilateral donors. Other sources of funding include service fees and private contributions.

4.37 NGOs that traditionally have relied on service fees and have provided non-emergency assistance appear to be squeezed financially. One-half of the NGOs surveyed confirmed that their level of financing had dropped significantly. One-half of those showed a drop of up to 30 percent while the remaining one-half showed a drop of up to 60 percent. Only 20 percent of the NGOs surveyed attributed their reduced financing to a drop in external funding.

4.38 The NGO sector has to rise to the challenge of other exogenous factors. Two issues in particular preoccupied the NGO dialogue in 2003/2004. First, a legal case was made against the “LAW” NGO for misuse of funds. Second, USAID imposed conditions relatives to funding of terrorist activities. It is likely that these two issues will have a long term and far-reaching impact on Palestinian NGOs. Despite the drawbacks of a more intrusive approach by donors (which often undermines the NGOs’ capacity to further their development consistent with local needs), these issues have forced NGOs to improve their governance structures and practices and to demonstrate greater accountability vis-à-vis their financial backers. This scrutiny, coupled with challenges that NGOs were facing as a result of the emergency, forced the “reform” agenda to the forefront. References to PA reform echoed in calls for similar reforms in the NGO sector. By early 2004, NGOs and donors alike launched a number of initiatives/studies to assess their own work. Reservations may be in order if policies come about that undermine the ability of NGOs to play the critical role they do in offering much needed services. Nevertheless, these recent challenges offer Palestinian NGOs an opportunity to enhance their performance.

100. The MOP 2003 database indicates a total of US\$ 91 million as disbursed by bilateral/multilateral donors to NGOs. This figure, however, excludes financing from Arab countries that provide significant contributions to the NGO sector. During 2003, the total amount disbursed by only 7 International NGOs who completed the Bank’s survey amounted to US\$ 75 million.





FIVE

Donor assistance has played a critical role in enabling Palestinian society to withstand the economic shocks of the last four years. Without donor help, living standards would be far worse. Donors have more than doubled their pre-*intifada* disbursement levels, providing an average of US\$950 million per annum between 2001 to 2003. In doing so, they added 30 percent to GDP and over 20 percent to Palestinians' disposable incomes. In 2003, donors disbursed US\$883 million, of which US\$119 million was spent on core welfare instruments (food, cash support, job creation). Although there was little sign of "donor fatigue" through 2003, these levels of assistance cannot be counted upon indefinitely. At the Ad Hoc Liaison Committee meeting 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 Response of Donors

THE FRAMEWORK FOR DONOR RESPONSE—PA PLANNING INSTRUMENTS

5.1 The PA improved its strategic planning and aid coordination capacity in 2003.¹⁰¹ On April 30th, the creation of a stand-alone Ministry of Planning (MoP) gave impetus to PA efforts to regain the leadership of its development agenda. One of its first outputs was the *Quick-Impact Intervention Program* (QIIP),¹⁰² the primary objective was to refocus donor assistance on the immediate emergency financing needs of the PA until the end of the year. Donors were requested to provide new funding or to reallocate undisbursed funds to bridge a financing gap of approximately US\$420 million. The instrument met with a moderate response from donors in terms of disbursements, partly because of a worsening political situation on the ground and partly because of the QIIP's mid-cycle timing for most of the donors, which complicated the reprogramming of funds.¹⁰³ Nonetheless, it was nonetheless a worthwhile exercise and laid the basis for the MoP's *Socio-Economic Stabilization Plan* (SESP) at the end of the year, which donors are using.

101. For more information on the previous setup, see Lister & Le More, *Aid Management and Co-ordination During the Intifada—Report to the LACC Co-Chairs*; Mokoro Ltd., Oxford, England, 2003.

102. *Quick-Impact Intervention Programme, July-December 2003*, presented to the LACC meeting, Ramallah, July 28th, 2003. Breakdown of request: budget support (US\$220 million), humanitarian and social assistance (US\$72 million), infrastructure repair (US\$75 million), private sector (US\$51 million).

103. *Monitoring Report of the Quick-Impact Intervention Programme July-December 2003*, presented to the LACC Meeting, Dahiat Al-Bareed, October 23, 2003.

5.2 Improved cooperation between the Ministries of Finance and Planning enabled the PA to address donors with one voice when appealing for new assistance at the end of 2003. The Ministries worked together on the preparation of the PA 2004 budget, presented for the first time in a consolidated form. The budget was supplemented by the SESP, which aims to orient donor support toward longer-term development priorities and to reposition the Palestinian economy toward recovery. The SESP format will be used in future planning documents, commencing with the *Medium-term Development Plan*, which will cover 2005–2007. In the long run, this systematic and sequential approach toward aid management will help deepen the PA’s engagement with the donor community and improve its own inter-ministerial coordination. It will also develop a solid framework for planning and monitoring international assistance to the Palestinians.

DONOR ASSISTANCE IN 2003

5.3 Donor assistance to the Palestinians fell slightly in 2003, but at US\$883 million remains very high by international standards. Between 1994 and 2000, annual donor disbursements averaged around US\$500 million (or US\$150 per capita).¹⁰⁴ At the onset of the *intifada*, this figure doubled to around US\$1 billion per annum in 2001 and 2002 (US\$308 on a per capita basis). In 2003, total disbursements fell slightly to US\$883 million, down 14 percent from the 2002 level of US\$1,026 million (Table 5.1). However, at US\$258 per capita in 2003, donor disbursement in the West Bank

104. Unless otherwise specified, disbursement figures do not include contributions to UNRWA’s regular budget. Conversely, support of UNRWA’s Emergency Appeals has been considered under emergency and humanitarian assistance calculations. In 2004, the MoP published a compilation of donor aid flows, which is the major source of World Bank calculations. See Ministry of Planning, *Donors’ Assistance in the Occupied Palestinian Territory for Year 2003*, June 2004. Disbursement figures for budget support have been adjusted to reflect those used by the Ministry of Finance. See, www.mof.gov.ps.

and Gaza remains the highest sustained rate of per capita disbursements to an aid recipient in the world since the Second World War.¹⁰⁵

5.4 The modest fall in 2003 disbursements was mainly due to a decline in budget support of 43 percent; donors reallocated resources to development assistance.¹⁰⁶ Donors increased their spending on development assistance from 20 percent of total disbursements in 2002 to 40 percent in 2003 (See Table 5.3). In contrast, budget support fell from 45 percent of total disbursements in 2002 to 30 percent in 2003. Excluding budget support, the level of donor disbursement decreased by about US\$33 million between 2002 and 2003 to reach a total of US\$619 million.

5.5 Donor commitments of assistance to the West Bank and Gaza remained steady from 2002 to 2003, but the disbursement rate slowed in 2003. Donor commitments declined slightly (by 8 percent) from their 2002 level to US\$1,404 million in 2003 (compared to US\$1,527 million in 2002) as donors showed little sign of fatigue. Disbursements declined somewhat faster—15 percent from US\$1,026 million in 2002 to US\$883 million in 2003—than commitments. Thus, the disbursement rate (i.e. the ratio of funds disbursed to funds committed) declined from 67 percent in 2002 to 63 percent in 2003. An increase in the share of regular (development) support, which

105. In comparison, the net global Official Development Aid (ODA) disbursement average currently stands at US\$13 per capita. OECD *Aid At A Glance 2003*, www.oecd.org, in 2003, ODA worldwide was US\$68.5 billion, the highest level ever reached in nominal and real terms.

106. Unless otherwise specified, 2002 figures on donor financial flows are from the Bank’s *Twenty-Seven Months* assessment. With the exception of budget support data, caution should be made when comparing the MoP data for 2003 with the World Bank figures for 2002. While both parties worked closely throughout 2004 to reduce the margin of error, past World Bank data may need to be reexamined. In 2001, when the Bank first undertook data collection to fill in the void left by the MoPIC, the following caveat was expressed in “*Fifteen Months*,” data collected for *Fifteen Months* was “*compiled from a combination of the MoPIC quarterly matrix, surveys conducted by UNSCO and the World Bank and staff estimates though its integrity is questionable and needs revisiting.*”

TABLE 5.1 Donor Commitments and Disbursements, 1998–2003, (US\$ million)

	1998	1999	2000	2001	2002	2003
Commitments:						
Regular (development) support	667	692	852	473	261	326
Emergency and budgetary support	0	0	121	755	1,266	1,078
Total commitments	667	692	973	1,228	1,527	1,404
Total disbursements:	419	482	549	929	1026	883

Source: Ministry of Planning and World Bank staff calculations

Note: Excludes support to UNRWA's regular budget.

typically disburses at a slower rate than emergency and budgetary support, probably pushed the disbursement rate down. Lower disbursement rates may also be explained by procedural delays associated with increased donor pressure for PA accountability and reform outputs.

5.6 The three largest donors provided 60 percent of disbursements in 2003, down 16 percent relative to 2002. As in 2002, the 10 largest donors accounted for 90 percent of total disbursements in 2003, excluding support to the UNRWA regular budget. USAID and the European Commission were the largest donors in 2003, disbursing US\$224 million and US\$187 million, respectively. The fall in Arab League support for the PA budget is reflected in a drop in total Arab League contributions from 31 percent of total disbursements in 2002 to 14 percent in 2003 (US\$124 million). Of this, Saudi Arabia and the United Arab Emirates account for 79 percent of Arab support in 2003, contributing US\$77 million and US\$21 million, respectively. Both Spain and the United Kingdom more than doubled their allocations to the West Bank and Gaza in 2003 compared with their 2002 contributions¹⁰⁷ (Table 5.2).

5.7 The three major donors also ranked highest for contributions to the PA budget, human-

107. The United Kingdom was one of the few donors to commit new money mid-cycle in response to the QIIP financing request during the second half of 2003.

itarian aid and development assistance. Saudi Arabia was the single largest provider of budgetary support in 2003, contributing 35 percent of total budget support in 2003 (US\$77 million), followed by the European Commission (EC) with US\$65 million.¹⁰⁸ (See Table 5.4) The largest contribution to humanitarian assistance was provided by the EC, which accounted for 43 percent of total humanitarian assistance (US\$130 million)¹⁰⁹ and was the single largest contributor to the UNRWA regular budget with an allocation of US\$63 million. USAID took the lead in development spending, contributing 40 percent of development disbursements in 2003 (US\$130 million), of which US\$57 million was invested in infrastructure, including water and waste water projects.

BREAKDOWN BY TYPE OF ASSISTANCE

5.8 Donors reallocated resources away from budget support and emergency assistance in 2003. Donor spending on budget support fell

108. This figure comprises EC *actual disbursements* to the PA general budget in 2003 and ESSP funds spent by PA line ministries.

109. EC data supplied to the Ministry of Planning (MoP) does not allow for a further breakdown of humanitarian assistance and provides unclear information on ECHO interventions. The ECHO annual report for 2003 indicates funding of US\$46 million of which an unspecified amount was channeled to UNRWA field offices in Lebanon, Syria and Jordan. See. "Protecting the humanitarian space"—www.europa.eu.int.

TABLE 5.2 Top 10 Donors, 2002 and 2003 Compared (US\$ millions)

Donor	2002 Disbursements	Donor	2003 Disbursements
League of Arab States	316	USAID	224
European Commission	217	European Commission	187
USAID	194	League of Arab States	124
Norway	44	Norway	53
World Bank	37	World Bank	50
Italy	32	United Kingdom	43
Germany	21	Italy	40
Denmark	18	Sweden	32
Sweden	16	Germany	27
Canada	14	Spain	17
Other	117	Other	94
Total	1026	Total	891
Share of top 3 donors (%)	71	Share of top 3 donors	55

Source: MoP data, World Bank staff calculations.

TABLE 5.3 Breakdown of Donor Disbursements in 2003 (exc. UNRWA regular budget)

	2001	%	2002	%	2003	%
Total disbursements (per capita)	929 (300)	100	1026 (315)	100	891 (248)	100
Budget support	540	58	464	45	264	30
Emergency/welfare	214	23	365	36	264	30
Development aid	175	19	197	19	355	40
Total without budget support	389		562		619	

Source: World Bank for 2001 and 2001, MoP data and staff calculations for 2003.

Note: The figure for budget support in 2003 figure is US\$44 million higher than the budget support figure reported in Chapter 2. The reason for this discrepancy is that although the EC transferred US\$65 million in 2003 for budget support to the Palestinian Authority, most of the funds remained blocked well into 2004 pending the PA's fulfillment of conditions for their release, and consequently were not available to the PA to cover budgetary expenditures incurred in 2003.

by 44 percent from US\$464 million in 2002 to US\$264 million in 2003. An equal amount (US\$264 million) was disbursed for humanitarian and emergency assistance, representing a drop of 28 percent compared with 2002 (Table 5.3).

5.9 Budget support declined significantly in 2003, due to a fall in contributions from Arab League States and the EC (Table 5.4). Arab League budgetary assistance declined from US\$340 million in 2002 to US\$124 million a year later. EC budget support was also lower

in 2003, following a shift from direct monthly salary contributions to a new financial facility worth US\$92 million; this new facility was designed to help the PA repay arrears to the private and social sectors. Payments were contingent on the accomplishment of certain reform benchmarks.¹¹⁰ A first US\$46 million

110. It is worth mentioning that the European Commission budgetary support facilities were initially designed to offset a failure by the Government of Israel, since the start of the current *Intifada*, to transfer clearance revenues to the PA. These transfers were resumed in the beginning of 2003.

TABLE 5.4 Budget Support in 2002 and 2003 (US million)

	2002	2003
Saudi Arabia	132.0	77.0
United Arab Emirates	26.0	21.4
Algeria	10.0	9.4
Kuwait	37.5	7.5
Other	134.5	9.0
Sub-total, Arab League States	340.0	124.3
European Commission	94.0	65.0
Other	11.2	31.7
ESSP	19.2	42.4
Total	464.4	263.5

Source: Ministry of Finance, IMF, World Bank staff calculations.

tranche was transferred to the Ministry of Finance (MoF) in June 2003. Only US\$6.5 million was actually released throughout the rest of that year, pending full EC clearance of arrears invoices received from the MoF.¹¹¹ Actual EC contributions to the PA general budget in 2003 totaled US\$26 million.¹¹² Separate assistance was provided through the Emergency Services Support Project (ESSP).

5.10 Disbursements through the Emergency Services Support Project (ESSP) proceeded satisfactorily throughout 2003. The Ministries of Health, Social Affairs and Education & Higher Education were thereby able to cover many of their running costs (See Chapter 3). In 2003, these ministries spent US\$42 million of ESSP funds. During the same period, donors disbursed US\$68.3 million in new contributions to the trust fund administered by the World Bank (*Table 5.5*).¹¹³

111. More funds were released in April 2004 and the second US\$46 million *tranche* was transferred to the MoF special account during the same month. By this time, the PA had fulfilled one of the conditions for releasing the second *tranche*, namely the cessation of cash transfers to PA security staff.

112. This figure also includes a carry-over in the beginning of 2003 of direct budget support under the EC's forerunner instrument.

113. Note there is a 2% administrative fee on donor contributions to the ESSP trust fund. Relying on MoF data, the overall ESSP disbursement figure used in this Assessment

5.11 In contrast, spending on development assistance increased by 80 percent in 2003, totaling US\$355 million (compared with US\$197 million in 2002). The implementation of capital-intensive projects remains seriously hampered by movement restrictions in the West Bank and Gaza. However, the fleeting political optimism, which accompanied the endorsement of the Road Map along with a temporary lull in violence and closures in the summer of 2003, created a more feasible operating environment for development and reconstruction projects. Infrastructure was the most funded sector (water and waste water: US\$74.5 million; other infrastructure: US\$38 million). In addition, donors disbursed approximately US\$180 million in almost equal shares for health, education, and technical assistance/institution building activities and "unspecified" other development projects. The private sector and agriculture attracted modest support

constitutes the amount *actually spent* by line ministries and not the amounts disbursed by donors into the World Bank trust fund. Table 5.5 provides indications of amounts *actually received* by the World Bank during calendar year 2003. In some cases, additional monies were forthcoming in 2004, either in the form of second *tranches* or money from new donors who had indicated in 2003 their intention to contribute. The MoP reports an overall total of US\$72.9 million on the basis of data provided by donors themselves, including contributions that actually materialized in 2004.

TABLE 5.5 New Contributions to Bank-Administered ESSP Trust Fund in 2003^a

Donor	Amount in US\$ Million Equivalent	Received in ESSP Trust Fund	Disbursement to Ministry Special Account/s—Progress as of May 2004
Italy	5.3 (ESSP I)	October 2003	48%
World Bank/IDA	25.0 (ESSP II)	January 2003	80% ^c
EC	24.6 (ESSP II)	May 2003	93%
UK/DFID	3.5 (ESSP II)	September 2003	100%
Finland	2.3 (ESSP II)	December 2003	32%
Sweden	6.0 (ESSP II)	December 2003	31%
Switzerland	1.6 (ESSP II)	December 2003 ^b	31%
Total	68.3	—	ESSP I 95% disbursed ESSP II 79% disbursed

Source: World Bank data

Notes: a. The table does not consider outstanding installments paid in 2003 from donors who had signed grant agreements with the World Bank in 2002. b. Only the first *tranche* of US\$1.5 million was received in 2003. The second *tranche* was paid in March 2004, bringing the total Swiss contribution to US\$3.1 million. The 31% disbursement rate refers to both *tranches* combined. c. In November 2003, the Bank's Board of Directors approved a US\$15 million supplemental grant to ESSP II. The 88% disbursement rate refers to the IDA grant and the supplement.

(US\$22.5 million and US\$5 million, respectively. Finally, NGO support represented 13% of overall development assistance.

5.12 Donor spending on humanitarian and welfare assistance fell by 28 percent in 2003.

At US\$264 million, total humanitarian assistance was still higher than in 2001 (US\$214 million). (See Table 5.3) According to MoP data, NGOs received 6 percent of overall emergency support. Gazans, in particular, experienced a decline in humanitarian assistance from UN agencies and other international bodies as well as Islamic charities.¹¹⁴ Among the core welfare instruments (food assistance, employment generation and cash assistance), food aid dropped by 20 percent; however, the other two

114. According to Bocco et al., *Palestinian Public Perceptions Report, No. VII* (forthcoming in 2004), 66% of the beneficiaries of Islamic organizations are from the Gaza Strip, mainly refugee populations. On August 24, 2003, the PA public prosecutor froze the accounts of nine Islamic charities. These charities had supported primary healthcare clinics servicing over 15,000 residents; they had provided financial assistance to over 1,000 children and distributed food parcels and clothes to more than 20,000 families in Ramadan 2002. See *OCHA Humanitarian Update*, November 1–15, 2003. (www.reliefweb.int/hic-opt).

instruments experienced an even more significant decline (Table 5.6).

5.13 The decline in humanitarian spending is partly a reflection of a dip in violence and military operations in the West Bank. In contrast, Gaza experienced frequent incursions in 2003, particularly in Beit Hanoun and Rafah. In the spring of 2004, the destruction of houses and fields took place in southern Gaza. In 2002, it was the West Bank that bore the brunt of military incursions and extended curfews during Operations Defensive Shield (April) and Determined Path (June). Attempts to improve targeting may also explain the decline in emergency assistance. For example, WFP pointed to better welfare conditions for some of its beneficiaries, its caseload declined from 530,000 in July 2003 (up from 500,000 in 2002) to a projected 480,000 by the end of 2004.¹¹⁵ In addition, some donors expressed reluctance to continue because their perception was it was Israel's obligation to ensure the delivery of basic ser-

115. WFP EMOP 10190.0 2002, WFP EMOP 10190.1 2003 and WFP staff estimates.

TABLE 5.6 Donor Support to Core Welfare Instruments, 2002 to 2003, (US\$ million)

	Food Assistance	Employment Generation	Cash Assistance
2002	75	95	30
2003	60	39	20
of which UNRWA emergency appeals	34	16	12

Source: World Bank staff calculations, UNRWA, MoP data.

vices to the Palestinians. For example, the International Committee of the Red Cross (ICRC), one of the major providers of relief aid to the Palestinians during the second *intifada*, began to phase out its US\$40 million emergency program in December 2003. The ICRC expressed the view that humanitarian assistance alone could not offer “a viable solution” to a long-term crisis.¹¹⁶

THE EFFECTIVENESS OF EMERGENCY ASSISTANCE

5.14 At the request of donors, “Twenty-Seven Months” made a comparative evaluation of the four types of emergency assistance provided by donors in the West Bank and Gaza: (i) budget support¹¹⁷; (ii) food aid; (iii) cash assistance; and (iv) job creation. The evaluation considered the relative merits of each instrument from the perspective of macro-economic and poverty alleviation objectives; the evaluation also weighed the benefits or costs relevant to each instrument. The evaluation concluded “the enormous expenditure on budget support has been justifiable on political/institutional grounds, as well as from a macro-economic and a welfare perspective.” Further it concluded,

116. ICRC Press Release, November 20, 2003.

117. “Twenty-Seven Months” recognized that budget support has different objectives from the other three instruments. Budget support has both clear political and service-related objectives, in addition to a welfare objective. Moreover, there are obvious differences in implementation. The three “traditional” emergency programs rely on carefully-designed targeting and delivery mechanisms; budget support does not.

“food aid is necessary and somewhat underfunded.” As noted in the evaluation, the major residual concern associated with food aid in West Bank and Gaza was the economic impact of *imported* food. In this respect, the WFP’s decision to introduce a scheme to procure local olive oil is commendable (Box 5.1).¹¹⁸

5.15 The purpose of this section is to analyze in more detail the direct impact of emergency assistance on the alleviation of poverty.¹¹⁹ The evaluation focused on (i) whether emergency assistance benefits the families that need it most, and (ii) the amount of emergency assistance received by beneficiary families. This raises two important questions about methodology. The first is: *what is emergency assistance?* The second is: *who are the needy?* Regarding the definition of emergency assistance, this section focuses on food aid and cash aid. Budget support was initially excluded from the analysis because the nature of this kind of assistance is different.¹²⁰ Also initially excluded from the analysis was job creation (the least important of the four instruments in terms of disbursements). Beneficiaries of job creation programs are often unaware that the job they are offered is part of a job-creation scheme; consequently, the survey-based data on this type of assistance is sparse.

118. UNRWA in 2003 launched a similar project.

119. This section draws heavily on the World Bank’s forthcoming *Poverty Update*.

120. Excluded is also the so-called Martyr’s compensation. However, the definition of emergency assistance includes a number of—quantitatively much more peripheral—types of emergency assistance, including health insurance, clothing, etc.

BOX 5.1 WFP Locally-Purchased Olive Oil program

On April 7th, 2003, WFP signed a Letter of Understanding with the PA Ministry of Agriculture (MoA) formalizing collaboration on the purchase of 272 metric tons of olive oil from 16,000 poor farmers. Most of the farmers targeted by this program relied on profits from sales of their oil as a means of subsistence during the year. The previous agricultural season, a good one, resulted in a high yield of olives. However, due to ongoing closures and curfews, West Bank farmers faced difficulties marketing their olive oil, therefore jeopardizing their livelihoods. Olive oil purchased through this program goes to WFP beneficiaries who have limited access to this commodity due to its high cost or to limited market availability in their locality.

Farmers received the equivalent of US\$500 for a given quantity of 170 kg (at the market rate of US\$3 per kg). Under WFP supervision, the MoA selected them on the basis of the following eligibility criteria: (i) Living under the poverty line, defined as less than 2\$ per day; (ii) no less than five dependent children; (iii) ownership of less than 8 *dunums* (2 acres); (iv) inability to market olive oil due to closure and/or road inaccessibility (v) not already recipients of WFP food aid or other assistance related to the purchase of olive oil.

The value of this project lies in its *multiplier effect*. By sustaining the livelihoods of local olive oil producers, the project is providing a staple food item to destitute households in Gaza and the West Bank. The total number of olive-producing farmers far exceeds the total beneficiaries of this project. By increasing support to at least 3,500 farmers, a more significant impact could be achieved.

The project was funded with a cash contribution by the European Commission (243 metric tons or US\$698,000), ECHO (22 metric tons or US\$63,000) and Norway (7 metric tons or US\$20,000).

Source: WFP

OVERALL IMPACT OF EMERGENCY ASSISTANCE

5.16 **In the absence of emergency assistance, the number of Palestinians living in subsistence poverty¹²¹ would increase by 35 percent, up from 600,000 to 822,000 people.** As previously noted, 16 percent of the population lived in subsistence poverty. In the absence of emergency assistance, this figure jumps to 22 percent. For the purpose of evaluating the effectiveness of emergency assistance, the Bank defines this

22 percent of the population as “needy;” a needy individual is one who would live in subsistence poverty in the absence of emergency assistance.¹²²

5.17 **The definition of ‘needy’ depends on the poverty line in question, the selection of which is somewhat arbitrary.** Nevertheless, this definition has a significant impact on the design of emergency programs and the subsequent evaluation of their effectiveness. For the purposes of this report, the Bank has defined

121. As described in Chapter 3, the *National Poverty Commission developed the official poverty line for the West Bank and Gaza* in 1998.

122. In December 2003, it corresponded to NIS1,800 per month for the benchmark family. Using a NIS/US\$-exchange rate of 4.4; this translates into a poverty line of US\$2.3 per day per member of the benchmark family.

the ‘needy’ as those individuals who would live in subsistence poverty in the absence of emergency assistance. Alternatively, ‘needy’ could be defined as those who would be below the *official* poverty line (rather than the *subsistence* line) in the absence of emergency assistance.¹²³ However, given limited donor resources, such a definition would not be operationally relevant due to the magnitude of the problem that emergency assistance seeks to solve. Using the official poverty line, the World Bank estimates that it would cost US\$400 million annually to lift all the ‘needy’ out of poverty, provided the poor could be identified with complete accuracy (perfect targeting) with no administrative costs. Adding typical targeting errors and administrative costs would double that figure. Given limited resources, donors are concerned that available resources target the poorest, and therefore a relatively narrow definition of the needy was used in this chapter.

5.18 Subsistence poverty could be eliminated using current levels of emergency assistance, if such assistance were perfectly targeted at zero administrative costs. On average, each individual living in subsistence poverty would need an additional 35 cents per day (almost US\$130 per year) to lift them out of subsistence poverty; that 35 cents per day is in addition to the assistance already received by these individuals. Providing this amount to the 607,000 people currently living in subsistence poverty would cost almost US\$80 million. However, this calculation ignores that on average each person living in subsistence poverty already receives emergency assistance. It also unrealistically assumes perfect targeting and no administrative costs.

123. Technically, a needy family is identified by (i) first subtracting the value of the emergency assistance received from family consumption (under the assumption that, on the margin, emergency assistance is consumed, not saved) and subsequently (ii) checking whether the “adjusted” per capita consumption is lower than the poverty line for abject poverty.

5.19 In practice, however, it is not possible to target emergency assistance with complete accuracy: 55 percent of those who receive emergency assistance are not needy (Table 5.7). Effective targeting requires minimizing two types of possible errors. The first type of error—leakage—is defined as the number of non-needy individuals who receive emergency assistance divided by the total number of individuals who receive emergency assistance.¹²⁴ The second type of error is under-coverage of the needy. Under-coverage is the proportion of needy individuals who do *not* receive emergency assistance.¹²⁵

5.20 The problem of the non-needy who receive emergency assistance is mitigated by the fact that many of the ‘non-needy’ are below the official poverty line. A leakage rate of 55 percent appears high. However, this is partly a result of our restrictive definition of poverty, based on the subsistence (rather than the official) poverty level. Approximately one-third of the ‘non-needy’ currently receiving emergency assistance have monthly consumption levels below 300 NIS/per person (around the level of the official poverty line) before they received emergency assistance. This leakage rate drops to 33 percent if the leakage rate is defined as the proportion of recipients whose pre-assistance consumption level is below the *official* (rather than subsistence) poverty line percent.¹²⁶ The *value* of assistance going to the ‘non-needy’ as a percentage of total assistance is less than the *number* of non-needy receiving assistance as a percentage of total recipients.

124. Leakage is sometimes referred to as an “error of inclusion.”

125. Under-coverage is sometimes referred to as an “error of exclusion.”

126. Strictly speaking, the poverty line of 300 NIS per person corresponds to the official poverty line only if the individuals live in a household of two adults and four children. For this reason, the leakage rate reported in the text might differ slightly from the one calculated using the official poverty line, after accounting for economies of scale and the fact children consume less than adults.

TABLE 5.7 Targeting Efficiency of Emergency Assistance: Share of Recipients Who Is Not Needy (using subsistence poverty line), 2003

	Not Needy	Needy	Total
Do not receive emergency assistance	89	10	100
Receive emergency assistance	<i>Leakage rate: 55</i>	45	100

Source: PCBS and World Bank Staff calculations

TABLE 5.8 Beneficiaries of Emergency Assistance According to Level of Per Capita Consumption, 2003

Monthly Per Capita Consumption Before Emergency Assistance	Share Receiving Emergency Assistance (percent)	Share that Does Not Receive Emergency Assistance (percent)
Less than 205 NIS ("Needy")	45	10
205–299 NIS ("Non-needy, but below official poverty line")	22	19
300–399 NIS ("Non-needy above official poverty line")	12	15
400–499 NIS ("Non-needy above official poverty line")	7	13
500 NIS and above ("Non-needy above official poverty line")	14	43
Total	100	100

Source: PCBS and World Bank Staff calculations.

The reason is, on a per capita basis, the non-needy receives less assistance than the needy.¹²⁷

5.21 Thirty-two percent of the needy do not receive emergency assistance. Consequently, a total of 68 percent of the needy receives some form of emergency assistance (Table 5.9). Measuring the *value* of emergency assistance, targeting is even more accurate: the total emergency assistance received by the needy amounts to 73 percent of the resources required to bring them up to the subsistence poverty line. The unmet financial need for assistance amounts thus to 27 percent of total financial needs.

127. The Bank estimates that the needy currently receive 248,027 NIS/month in emergency assistance. The 'non-needy' receive 197,707 NIS/month. See the forthcoming Poverty Update.

WAYS TO IMPROVE TARGETING EFFICIENCY OF EMERGENCY ASSISTANCE

5.22 There is no easy way to reduce leakage of emergency assistance to the non-needy. Statistical analysis by the World Bank and PCBS¹²⁸ shows that there is no systematic relationship between the probability of receiving emergency assistance and the observable characteristics of non-needy households (age, education, place of residence, etc). Therefore, improvements in targeting to reduce leakage will have to be addressed by assistance programs that allow for gathering additional information (e.g. by local organizations with better information or through self-targeting mechanisms).

128. See the *Poverty Update*, op cit.

TABLE 5.9 Targeting Efficiency of Emergency Assistance—the Share of the Needy and the Not Needy that Receive Assistance, 2003

	Not Needy	Needy
Do not receive emergency assistance (percent)	77	<i>Under-coverage rate 32</i>
Receive emergency assistance (percent)	23	68
Total	100	100

Source: PCBS and World Bank Staff calculations.

5.23 However, there is room to increase the share of the needy that receives emergency assistance. As previously noted, 32 percent of needy individuals do not receive any emergency assistance. To improve targeting of emergency assistance, it is useful to identify the characteristics of this excluded third.

5.24 Individuals living in rural areas are less likely to receive emergency assistance. Nearly

half of the rural needy receives no emergency assistance of any kind. In contrast, thanks mainly to UNRWA's effective targeting and distribution system, 17 percent of needy residents of refugee camps do not receive emergency assistance. (Table 5.10) The higher rates of exclusion for the rural needy are a common phenomenon in many developing countries due to the administrative costs of distributing assistance. In rural areas where the population

TABLE 5.10 Probability of Receiving Emergency Assistance According to Selected Household Characteristics, 2003

	No Emergency Assistance Received	Emergency Assistance Received	Total
Place of residence:			
Northern West Bank	38	62	100
Middle West Bank	54	46	100
Southern West Bank	38	62	100
Gaza Strip	25	75	100
Type of locality			
Urban	32	68	100
Rural	45	55	100
Refugee Camp	17	83	100
Sex of head of household:			
Female-headed household ^a	14	86	100
Male-headed household	33	67	100
Refugee status:			
Refugee ^b	25	75	100
Non-refugee	42	58	100
Household labor market affiliation:			
No working members	20	80	100
At least one working member	42	58	100

Source: PCBS and World Bank Staff calculations.

Notes: a. We consider a female-headed household to be one with no adult male present. b. A refugee household is one which contains at least one registered or non-registered refugee.

is dispersed, it can be significantly more expensive to deliver goods and services than in more densely-populated refugee camps or urban areas. In the Palestinian context of highly restricted movement for people and goods, the needy from rural areas are particularly disadvantaged by their inability to reach densely-populated urban centers.

5.25 Individuals living in wealthier regions are less likely to receive emergency assistance. Needy individuals who live in the middle the West Bank are more likely to be excluded from assistance than those living in other parts of West Bank and Gaza: approximately one-half of the needy in the middle West Bank received no emergency assistance. As with the rural needy, the administrative costs of distributing assistance to the middle West Bank were higher than for their needy neighbors in other parts of the West Bank. Although the population of the middle West Bank is relatively densely settled, which reduces the cost of distributing assistance, needy households are dispersed among non-needy households. Hence, the needy are more difficult to identify; targeting costs are higher as a result. In the absence of accurate individual targeting criteria, providers of assistance often prefer to distribute assistance to regions where the incidence of poverty is high to minimize leakages; in doing so, they recognize the trade off is a higher rate of under-coverage.

5.26 Needy non-refugees and needy individuals living in male-headed households or households with working members are less likely to receive emergency assistance. Only 14 percent of the needy living in female-headed households does not receive aid, compared with a third of the needy living in male-headed households.¹²⁹ This situation may reflect the tendency of aid agencies to use the absence of men of working age as a proxy for poverty. Given that individu-

129. We consider a household to be female headed if there is no male adult of workingage present.

als in female-headed-households are *less* likely to be poor than those in male-headed households, this proxy is an inaccurate indicator of poverty.¹³⁰ Needy refugees are more likely to receive aid than needy non-refugees. One-quarter of needy refugees are excluded from assistance, compared with 42 percent of needy non-refugees. As with female-headed households, it appears that refugee status is used as a proxy for poverty. Needy individuals living in households with no working members are more likely to get emergency assistance than members of other needy households. Only 20 percent of needy individuals in households with no working members do not receive emergency assistance, compared with 42 percent of needy individuals in households with at least one working member. The conclusion is that a large number of the working poor are not receiving the emergency assistance they need.

TARGETING EFFICIENCY OF INDIVIDUAL TYPES OF EMERGENCY ASSISTANCE

5.27 A range of targeting quality was observed across types of emergency assistance. Only cash and food assistance reach a large segment of the needy. As is typical in other countries, programs such as medical care cover only a small proportion of those in need.¹³¹ By international standards, cash assistance appears to

130. As previously noted, 3 percent of female-headed households are poor, compared with 13 percent of male-headed households. These numbers may be misleading because they reflect consumption levels including aid received. It is more relevant to focus on the needy by comparing consumption levels prior to the receipt of aid. Although the difference between male and female-headed households is smaller when looking at need than instead of poverty, we still find that female-headed households have significantly lower rates of need (14 percent) than male-headed-households (20 percent). These results confirm those obtained on pre-*intifada* (PECS) data. See World Bank (2001b), which suggested that the probability of being poor did not depend on the gender of the head of household.

131. See World Bank, Poverty Reduction Strategy Sourcebook. Available online at <http://www.worldbank.org/poverty/strategies/sourcons.htm>.

TABLE 5.11 Targeting Efficiency of Various Emergency Instruments, 2003

	Leakage	Leakage by Value	Under-coverage	Under-coverage by Value ^a
Food	58	56	66	87
Medical care	61	35	98	98
Clothing	38	37	95	99
Cash	45	41	54	46
Health insurance	37	44	88	98
Other	35	33	99	100
Total	55	45	32	27

Source: PCBS and World Bank Staff calculations.

Note: a. To understand the significance of under-coverage by value, consider the following. Total aid received by the needy covers 73% of the resources needed to bring them up to the subsistence poverty line. The under-coverage by value in this case is the 27% remaining.

be relatively well targeted in the West Bank and Gaza. International experience shows that cash assistance programs tend to reach 5 to 25 percent of the population, with 35 to 55 percent of benefits going to the poorest 20 percent of the population. In the case of the West Bank and Gaza, cash assistance reaches 19 percent of the population, with 55 to 60 percent of benefits going to the poorest 16 percent of the population.¹³²

5.28 Based on narrow poverty alleviation objectives, the argument for budget support is weak. As mentioned in the introduction, the main argument for budget support was never its direct contribution to the alleviation of poverty. Households headed by government employees are not likely to live in subsistence poverty; government employees are generally in the upper half of income distribution. Calculations by the World Bank show that three-quarters of households headed by government employees have a level of per capita consumption above the median; only one-quarter are below the median. Of the bottom 10 percent of the population, just 7 percent live in households headed by a gov-

ernment employee (equivalent to 0.7 percent of the total population) (Figure 5.1).

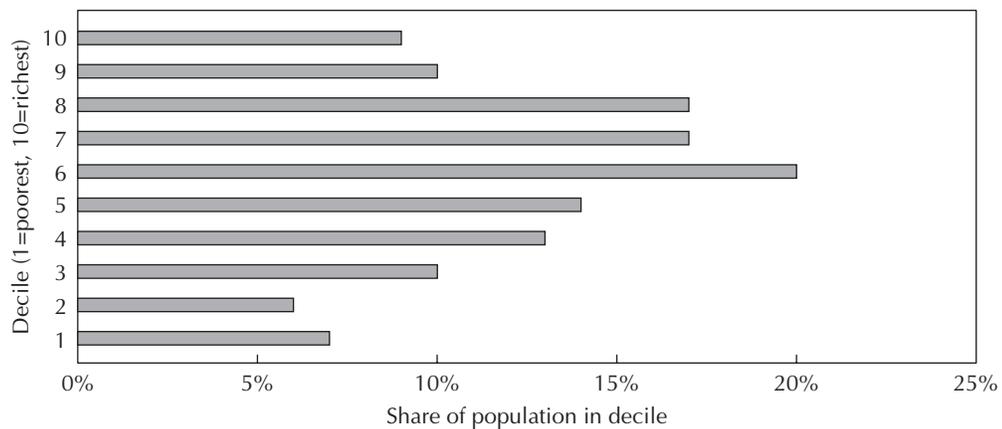
GOVERNMENT OF ISRAEL'S FACILITATION OF DONOR ACTIVITY

5.29 During 2003, the donor and aid community in WB&G experienced a steady deterioration of its operating environment. While the overall intensity of military interventions by the Israeli Defense Forces (IDF) in the Palestinian Territories decreased, a series of closures and security-related measures implemented by the Israeli security forces continued to negatively affect donor operations.

5.30 Despite specific agreements negotiated by the Task Force on Project Implementation (TFPI)¹³³ with the GoI, privileges granted to international organizations to ensure the free movement of staff and goods were regularly suspended for security reasons. As a result, movement of national staff to Israel and between the West Bank and the Gaza Strip was severely disrupted. That disruption in turn impacted

132. Fifty-five percent of cash assistance beneficiaries are needy and 59% of the value of cash assistance goes to needy individuals.

133. The TFPI, which consists of four donor Chairs, the EC, UNSCO, the US and the World Bank, is mandated by the donor community to negotiate with the GoI about the parameters under which it can operate in the West Bank and Gaza.

FIGURE 5.1 Governments Employees' Place in the Income Distribution, 2003

Note: The figure show the position in the distribution of per capita consumption of households headed by a PA employee.
Source: PCBS and World Bank Staff calculations.

the provision of humanitarian aid and the efficient implementation of emergency and developmental projects.

5.31 IDF restrictions negatively affected internal movement within the West Bank and the Gaza Strip. In October 2002, the donor community and the GoI agreed that national staff would be allowed free movement within Areas A, B and C on the basis of organizational identity documents. The Office of the Coordinator for Government Activities in the Territories (COGAT) actively tried to enforce the agreement with the IDF operatives in the field; however, the staff of donor organizations consistently reported incidents of delays and/or the lack of access throughout the West Bank.¹³⁴ On various occasions, following security alerts or attacks by Palestinian militants; these security alerts resulted in frequent disruption of movement of both international and national staff. In spite of repeated TFPI

134. The Access and Closure Information System (ACIS), set up and maintained by UN OCHA to monitor access by international organizations, collected and recorded an average of more than 100 incidents of delays and denied access per month.

requests to COGAT to explore the possibility of coordinating the movement of staff through alternative routes, that was not forthcoming. As a result, staff members were blocked in certain areas of the Gaza Strip for days at a time.

5.32 Various areas in the West Bank and Gaza Strip were declared “closed military zones” by the IDF for prolonged periods; they were off-limits to national and international staff. These restrictions were particularly severe in the Gaza Strip; areas such as “Al-Mawasi” have been cut off from regular humanitarian aid for more than a year. At the time of this writing, WFP, UNRWA and other humanitarian aid agencies are still being prevented from accessing the area with trucks. Humanitarian assistance is being channeled into Al Mawasi through back-to-back loading platforms but only after prior coordination with the IDF and thorough security checks. These restrictions have resulted in delays and a significant increase in costs for humanitarian agencies.

5.33 Movement of aid-related commodities and equipment has been severely affected by IDF-imposed restrictions. Only trucks with diplomatic license plates, driven by interna-

BOX 5.2 Increased Costs for Humanitarian Assistance

Karni crossing, the only crossing for humanitarian goods into the Gaza Strip, closed on 14 September 2003 for security reasons and remained closed until 2 October 2003. As a result, the Sufa crossing was the only alternative crossing point for WFP. Because Sufa is not an official border crossing for goods, WFP was forced to rent its own crane for lifting containers from Israeli trucks onto Palestinian trucks.

From 14 September to 2 October, WFP was able to bring only 20 containers into the Gaza Strip, despite the fact humanitarian foodstuffs continued to arrive at the Ashdod port. This situation forced WFP to rent additional storage space. Moreover, the IDF did not allow empty containers to return through the Sufa crossing. As a result, WFP incurred extra costs of NIS 1,000 per container per day.

Once Karni reopened, the Israeli authorities continued to refuse the return of empty containers. Only after intervention by the TFPI was this decision overturned. On 13 October 2003, the last empty containers went back to Ashdod.

This situation resulted in the following additional costs to WFP:

Demurrage cost for empty containers not returned	US\$10,832
Extended storage at the Ashdod port	US\$11,000
Rent of crane for Sufa crossing	US\$2,000
Return of empty containers using empty trucks both ways	US\$2,100
Double trips of containers due to empty promises by IDF	US\$2,500

tional or Jerusalemite drivers, continue to have free access to and from the West Bank to Israel. All other trucks, transporting either project or humanitarian goods, can access Palestinian areas under closure only after advance coordination with COGAT. Delays and denial of access continue to be reported by international organizations on a daily basis. The transport of humanitarian and developmental goods into the Gaza Strip is particularly difficult. The only access point for goods into the Strip is through the Karni crossing point, which has been repeatedly shut down by the IDF for security reasons. The closure of Karni has been enforced at times for up to three weeks; these closures severely affected the delivery of humanitarian aid.¹³⁵

135. In March 2004, UNRWA was forced to suspend food distribution in the Gaza Strip following the protracted closure of Karni Crossing. The IDF had refused to allow entrance of UNRWA containers into the Gaza Strip through alternative crossing points.

5.34 In May 2003, following a suicide bombing in Tel Aviv by two British nationals, access conditions deteriorated even more. After an initial full closure of the Gaza Strip for more than three weeks, the Israeli Security Forces imposed a series of new restrictions on movement of international staff members. According to these new regulations, international staff members could access the Gaza Strip only after obtaining a “security clearance” from the Israeli General Security Services (GSS); the request had to take place at least five business days prior to actual travel to the Gaza Strip. The donor community protested these new restrictions and asked the GoI to reconsider their enforcement, particularly in light of serious concerns regarding the ability of COGAT and the GSS to deal with the increased workload associated with the pre-clearance process. Nonetheless, the IDF implemented these regulations; at one point, these regulations caused a serious backlog of

donor community officials waiting to obtain authorization to enter the Gaza Strip. The regulations continue to have serious implications for the donors' ability to plan and to implement projects in the Gaza Strip and to meet necessary supervisory and monitoring responsibilities.

5.35 Throughout 2004, new restrictions were imposed which further complicated the delivery capacity of the international aid community. Following a series of attacks by Palestinian militants at the Erez Industrial Zone and the Erez VIP crossing in March and April 2004, the IDF informed donor community representatives that vehicle transit for non-diplomats would be allowed only after prior coordination with COGAT representatives in the Gaza Strip. The donor community requested and obtained a revision of these orders. However, vehicular transit is still being suspended occasionally in conjunction with security alerts issued by the GSS. These suspensions have forced non-diplomatic donor representatives to walk through the crossing on foot, thereby increasing the potential threat to their physical safety.

DONOR REACTIONS

5.36 The steadily increasing number of obstacles placed in the path of humanitarian, emergency and development aid efforts has resulted in mounting dissatisfaction amid the international community. The previously-mentioned measures taken by the GoI on security grounds have increased the difficulty and cost of providing social, economic and humanitarian support to the Palestinian civilian population. Such measures are perceived as compromising the work of international organizations; they have negative and often indiscriminate effects on the living conditions of the civilian population. The operational environment has deteriorated to a point where many donors consider unmanageable and unacceptable.

5.37 Throughout 2003, the GoI gave assurances at the highest levels that donor activity and humanitarian aid would be easier. However, these assurances contrasted dramatically with the facts on the ground. Donors and aid agencies had to adapt their operations, often at great expense, to accommodate Israeli security measures. UNRWA, by far the largest operational agency, reported that initial estimates of the losses and additional costs incurred as a result of Israeli restrictions (curfews, restrictions or prohibitions on access in terms of lost staff hours, replacement staff costs, extra fuel, etc.) totaled approximately \$25 million for the period of October 1st 2000 through November 1st 2003. On occasion, the donor community felt that these Israeli security measures were implemented without due consideration for the working requirements of international humanitarian and development organizations or for the security of these agencies.

5.38 The donor community repeatedly sought to engage GoI in a discussion of its closure policy. The intent was to establish a more workable balance between security-related measures on the one hand and the operating requirements of the international community and basic humanitarian needs on the other. Unfortunately, the GoI has generally declined to engage in such a discussion, although there has been some change in attitude on the part of GoI in the Disengagement context. Nevertheless, the climate of unpredictability and the absence of understanding between the GoI and its security services have had a dramatic effect on the efficiency, effectiveness, cost and, in some cases, the safety of the work of donors and aid agencies.

5.39 At the end of 2003, attempts by the GoI to improve the situation met with a positive donor response, but unfortunately they did not take place. In November 2003, the Israeli Minister of Foreign Affairs Shalom called for a meeting with donor representatives. The Minister reassured the international community of

the importance that the GoI attaches to continued donor assistance to the Palestinians; he also acknowledged donors' frustrations and pledged to convene a senior inter-agency committee to address impediments to donor operations. Furthermore, he announced that the GoI wished to pursue a "positive agenda"¹³⁶ with the Palestinians and urged donors not to diminish their support to the Palestinian people. Minister Shalom also attended the AHLC meeting in Rome on December 10, 2003 and again repeated the GoI's intention to re-engage with

the Palestinians on a positive agenda. Following the AHLC, the US convened a trilateral meeting in Jerusalem in December 2003 to facilitate additional dialogue on the "positive agenda" first outlined by Minister Shalom. The US suggested that this trilateral forum could appropriately address three types of concerns: short-term economic issues (principally closure-related); medium-term economic cooperation between the Israelis and Palestinians; and impediments to delivery of aid. This opportunity, although promising, was pursued no further.

136. The positive agenda was not clearly defined. But from the Minister's speech, it appeared to encompass specific relaxations of the closure regime as well as medium-term economic cooperation, particularly the creation of up to seven industrial estates offering employment to Palestinians, thereby substituting domestic employment for employment in Israel.



Going Forward



What has precipitated the economic crisis in the West Bank and Gaza is the system of internal and external closures. If the *status quo* continues, Bank projections point to further decline. No appreciable revival in private investment can be expected; the trend toward informalization will continue, and new entrants to the labor market will outstrip the economy's ability to provide employment. Unemployment would increase to about 35% by 2006, leaving real GDP per capita 45% lower in 2006 than in 1999. And poverty levels would climb to about 55% overall and more than 70% in Gaza. Any sustained Palestinian economic recovery will require a dismantling or radical easing of closures. If that was to happen, Bank projections suggest that Palestinian GDP could increase almost 20 percent in two years and the unemployment rate could be reduced to 23 percent.

THE ECONOMIC OUTLOOK FOR 2004–06

6.1 To better understand the range of possible outcomes over the period 2004 to 2006, the Bank has developed three illustrative economic scenarios. The three scenarios are, in many respects, similar to the scenarios presented in “Twenty-Seven Months,” although there are also some significant differences (Box 6.1)

The three scenarios may be summarized as follows:

1. **Status Quo:** this scenario assumes a continuation of current levels of violence and the intensity of internal and external closure remains unchanged.
2. **A radical easing of internal closures:** this scenario contemplates a progressive easing of internal closures (beginning in mid-2004), and consequently an economic recovery based on the internal Palestinian market.
3. **A radical easing of internal closures plus trade facilitation:** the third scenario envisages a partial easing of external closures (for goods at a minimum) and the facilitation of Palestinian trade with the rest of the world.

There are a number of *assumptions* common to each of these scenarios.

6.2 Firstly, it is assumed that current Palestinian employment levels in Israel will decline from 2004 onwards.¹³⁷ This assumption recognizes that Israeli public opinion is unlikely

¹³⁷ The number of Palestinian workers in Israel is assumed to reach 33,000 in 2004, 25,000 in 2005 and 15,000 in 2006.

BOX 6.1 *Why do the Projections Differ from Twenty-Seven Months?*

In *Twenty-Seven Months*, the “Easing of Internal Closure plus Trade Facilitation” scenario projected real GDP gains of 21.2 percent in 2003 and 11.9 percent in 2004. These percentages are considerably higher than projections under the same scenario in this report. Several factors explain the difference. First, significant new information on the economy’s performance in 2002 has become available that was not at the time *Twenty-Seven Months* was written. Using available data, the Bank initially overestimated the decline in GDP in 2002. Hence, the Bank overestimated, in percentage terms, the rebound that would occur if internal and external closure relaxed. Second, with the passage of another year, productive capacity has further declined because of the inefficiency of sub-optimal production runs, inadequate maintenance of capital stock, and scant new investment. Third, another year of closures has meant another year of Palestinian exclusion from international markets (the longer this absence continues, the more difficult it becomes to reenter international markets). Fourth, the reality of the Separation Barrier means that external access from the West Bank will, at least for a time, become more time-consuming and expensive than without the Barrier. Its construction will also give rise to tensions and disruption. As for personal incomes, the scenario in *Twenty-Seven Months* assumed higher levels of Palestinian employment in Israel than we do now.

to accept the presence of large numbers of Palestinian workers in Israel, that many of the jobs once open to Palestinians have gone to other immigrants. It also acknowledges the likely impact of the Separation Barrier and Gaza Disengagement on labor flows into Israel.

6.3 Secondly, it is assumed that the level of donor assistance will remain roughly the same as the past three years. We assume a constant level of donor disbursements equivalent to US\$ 1bn in 2004 and US\$900 million annually in 2005 to 2006. A significant breakthrough on the political front, as exemplified in the third scenario, may make an increase in donor assistance likely and warranted.¹³⁸ However, for the purpose of this analysis, varying the level of donor assistance among the scenarios would reduce their comparability.

138. In “*Disengagement, The Palestinian Economy and the Settlements*,” World Bank June 2004, scenarios that illustrate the impact of additional aid in a politically-conducive environment.

6.4 Thirdly, it is assumed that the PA maintains roughly the same expenditures (in real terms) during 2004 to 2006 as in 2003. In contrast, PA tax revenues parallel GDP in the different scenarios.

6.5 Finally, scenarios (2) and (3) assume the implementation of the GoI’s Gaza Disengagement Plan. The Disengagement Plan would restore internal mobility in Gaza—particularly through the opening of the north-south Erez-Rafah main road—and ease movement in part of the West Bank. The Plan would also return 55–75 square kilometers of land in Gaza where the settlements are now. However, the Disengagement Plan will have limited impact on the Palestinian economy because it proposes only a limited easing of closures. What is critically lacking is that the Plan does not envisage any change in external closures.¹³⁹

139. For a detailed account of the economic benefits of the Disengagement Plan, see *Disengagement, The Palestinian Economy and the Settlements*, op cit.

TABLE 6.1 Macroeconomic Scenarios, 2003–2006

	Status Quo				Easing Internal Closures			Facilitating Trade		
	2003	2004	2005	2006	2004	2005	2006	2004	2005	2006
Real GDP growth (%)	6.1	1.6	0.4	-0.8	2.2	3.6	2.3	4.1	9.4	9.2
—since 1999 (%)	-23.3	-22.0	-21.6	-22.3	-21.6	-18.8	-16.9	-20.1	-12.6	-4.5
Real GDP per capita growth (%)	0.6	-3.3	-4.3	-5.4	-2.8	-1.3	-2.4	-1.0	4.3	4.2
—since 1999 per capita (%)	-36.6	-38.5	-41.1	-44.2	-38.2	-38.9	-40.3	-37.1	-34.3	-31.5
Real Private Consumption growth (%)	3.4	1.2	-0.1	-0.3	1.5	2.0	1.8	2.8	5.9	6.7
Real Public Consumption growth (%)	0.1	4.3	1.3	-0.3	4.4	1.7	-0.4	4.4	1.6	-0.5
Real Investment growth (%)	5.4	-7.7	-9.2	-14.5	-7.5	-5.1	-9.2	-5.1	3.2	2.5
Real export growth (%)	-0.4	-0.2	3.6	3.4	-2.1	14.3	12.5	4.9	33.3	30.0
Real import growth (%)	-3.1	-2.4	-2.9	-3.7	-2.6	-0.9	-1.7	-1.2	3.2	3.8
Poverty rate (%)	47	50	52	56	49	50	51	48	48	46
Poverty West Bank (%)	37	40	43	47	39	40	42	38	38	36
Poverty Gaza (%)	64	68	69	72	66	66	68	66	64	64
Unemployment rate (%)	25.6	28	31	35	28	29	31	27	25	23
Unemployment West Bank (%)	23.8	27	30	33	26	27	29	25	23	21
Unemployment Gaza (%)	29.2	32	35	39	32	33	35	31	29	28
Net Factor Income (NIS)	1,894	1,974	1,558	1,115	1,974	1,558	1,115	1,974	1,558	1,115
Net Current Transfers (NIS)	6,479	5,644	5,344	5,244	5,644	5,344	5,244	5,644	5,344	5,244
Population (million)	3.42	3.59	3.76	3.94	3.59	3.76	3.94	3.59	3.76	3.94
Exchange rate (NIS:US\$)	4.55	4.55	4.55	4.55	4.55	4.55	4.55	4.55	4.55	4.55
GNI per capita (US\$)	1,041	1,030	982	926	1,034	1,014	986	1,051	1,085	1,128
Consumer price inflation (%)	4.4	3.0	3.0	3.0	3.0	3.0	3.0	3.0	3.0	3.0
PA Fiscal accounts:										
Expenditures (NIS million)		4,959	5,158	5,261	4,959	5,158	5,261	4,959	5,158	5,261
Revenue (NIS million)		2,745	2,808	2,844	2,758	2,908	3,037	2,806	3,121	3,482

Source: World Bank Staff calculations.

THE STATUS QUO SCENARIO

6.6 A continuation of the current ‘status quo’ in the West Bank and Gaza would further impoverish the population. Under current levels of closures and violence, the Palestinian business environment is not conducive to investment; no appreciable revival in private investment can be expected. Investment would fall by 34 percent between 2004 and 2006. By 2006, economic growth would be negative at -0.8 percent population growth would have

surpassed it. Incomes would therefore decline once more; real per capita incomes would be 44 percent lower than in 1999. Poverty would reach 56 percent of the overall population by 2006, and 72 percent in Gaza. Without new sources of capital, the economy will not provide enough work to keep pace with new entrants to the labor market. Unemployment would increase to about 34 percent by 2006 and 38 percent in Gaza; therefore, the trend to informalization of the Palestinian economy is expected to continue.

THE EASING OF INTERNAL CLOSURES SCENARIO

6.7 A lifting of internal closures would bring growth to the Palestinian economy, but unemployment rates would still increase. In this scenario we assume that transaction costs decline because of a gradual lifting of internal closures. By 2006, internal conditions would return to those which prevailed on the ground in September 2000. This would result in a GDP growth rate of 2.3 percent in 2006 (compared with a projected negative growth rate of -0.8 percent by 2006 under the *status quo* scenario). However, lifting internal closures would not spur enough economic activity to create jobs faster than the growth in population. By 2006, unemployment rates in the West Bank and Gaza would still stand at about 30 percent (35 percent in Gaza), slightly lower than under the *status quo* scenario (35 percent and 39 percent, respectively). By the end of 2006, per capita income would remain at 40 percent below the 1999 level, and poverty levels would reach 51 percent of the population (68 percent in Gaza). Exports would make a modest rebound; exports would increase 12 to 14 percent per annum in 2005 and 2006 (compared with 3.4 percent under the *status quo* scenario).

THE TRADE FACILITATION SCENARIO

6.8 A radical easing of internal closures, combined with a revival of trade across borders could foster growth in GDP per capita. Under this scenario, we assume that transaction costs for goods drop. Investment growth rates would be positive by 2005, in response to an improved business outlook; they would reach 2.5 percent in 2006 (compared with a negative rate of -14.5 percent under the *status quo* scenario). Exports would grow at a rate of 30 percent per annum by 2006, compared with

a 2006 level of 3.4 percent under the *status quo* scenario. Export growth would spur job-creation, pushing unemployment down to 23 percent by 2006 (27 percent in Gaza). As a result, the poverty level would fall to 46 percent by 2006 (compared with a projected level of 56 percent under the *status quo* scenario). Real GDP would grow by 9.2 percent in 2006, against a negative growth rate of -0.8 percent under the *status quo* scenario. However, by the end of 2006, per capita real GDP would remain 31.5 percent below its 1999 level.

GOING FORWARD: PRIORITIES FOR THE PA

6.9 Priority areas for the PA are observing fiscal discipline, rejuvenating reforms, and reasserting strategic leadership in setting development objectives. The PA will have to reassert itself in a number of areas in the coming period if it is to shore up its legitimacy and position itself to make the most of potential improvements. Priority areas for the PA may be summarized under three headings: (i) observing fiscal discipline; (ii) rejuvenating the reform program; and (iii) consolidating the PA's strategic leadership role vis-à-vis donors. In addition, the PA will need to prepare for the likely Israeli withdrawal from Gaza (the implications of Israel's disengagement plan are reviewed in recent and forthcoming Bank reports¹⁴⁰ and will not be addressed here).

1. Observing Fiscal Discipline

6.10 It is essential that the PA exerts strict fiscal discipline and restricts any increases in public expenditure to the social sectors. PA expenditures have risen significantly during

140. "Disengagement, the Palestinian Economy and the Settlements," the World Bank, June 15, 2004.

BOX 6.2 Developing Palestinian Trade

Palestinian economic recovery will depend on rebuilding commercial cooperation with Israeli and third-country markets. In recent times, more than 90+ percent of Palestinian exports have gone to Israel, with a significant portion re-exported. Israel is expected to remain the Palestinians' primary trading partner for some time to come. Strengthening this relationship, while opening new markets, will require action in three areas:^a

First, a number of practical steps can be taken to enhance Israeli security while improving cross-border cargo management and reducing transaction costs. These include using advanced electronic inspection equipment at checkpoints, extending border-operating hours, giving perishable cargoes priority, and setting up bonded warehouses and/or logistic facilities for cargo moving to and from Gaza and the West Bank. These steps should be accompanied by management practices that lead to minimization of closure and the delivery of a high and predictable level of service to legitimate trade. An example of the latter is using service standard targets for cross-border cargo management and "one-time" assessments and inspections with appropriate sealing technology.

Second, independent international gateways would allow Gaza and the West Bank to have unimpeded access to third-country markets. The export routes running through Israel have been unreliable and costly, principally because of costly and unpredictable security procedures and the need to use Israeli middlemen and forwarders. If a satisfactory security protocol may be established, a seaport in Gaza, initially roll-on, roll-off, is likely to be competitive, particularly if it is accessible to West Bank enterprises and efficiently run by a private operator.

Third, the competitiveness of Palestinian exporters needs to be restored and developed. Improving cross-border management should reinvigorate ties with Israel and have a significant and immediate impact on exports. To deepen the productive base and widen the markets, attention needs to focus on developing new trading relationships, addressing policy and institutional impediments to exports, and creating a business environment conducive to exports and investments. Potential sources of competitive advantage include stone and marble, tourism and related activities, high-value agricultural produce, high-value apparel, ceramics and jewelry for niche markets. To do so, significant market development, retooling and support measures are necessary at the sector and firm levels.

Note: a. These are reviewed in the recent Bank report, "Disengagement, the Palestinian Economy and the Settlements," the World Bank, June 15, 2004.

the *intifada*, driven by increases in recruitment and wages.¹⁴¹ The 2004 PA Budget shows a US\$650 million budget deficit before external financing. Of that, donors are likely to cover about US\$380 million. With no recourse to

medium-term debt, the PA has been obliged, as in the past, to cut operating costs¹⁴² and incur debt to private suppliers.¹⁴³ However it seems likely that the PA will be able to manage

141. Average monthly salaries in 1999 were US\$44 million per month; in 2000 they were US\$52 million per month, and in January–March 2004 they averaged almost US\$72 million per month (Ministry of Finance and IMF data).

142. These averaged \$23 million monthly in January–March or 43% less than the budgeted amount of \$40 million

143. Arrears to commercial banks totaled US\$253 million or 7% of GDP, at end-April 2004, while arrears on pensions and to commercial suppliers totaled US\$317 million (9% of GDP—IMF figures).

without having to lay off public sector staff or cut salaries. Either of these cutbacks could be highly destabilizing; the PA derives much of its legitimacy from its ability to provide jobs. Moreover, PA salaries serve as welfare payments; they inject critical demand into the economy.

6.11 The large and expanding wage bill needs to come under control. The PA's excessive wage bill seriously undermines fiscal sustainability; it has led to a heavy reliance on donor support that, although it has been forthcoming to date, is uncertain. In response, the PA is taking steps to tackle the escalating wage bill and reform the pension system. In June 2003, the Council of Ministers approved a Wage Bill Containment Plan, which—if implemented—could lead to zero real growth. Nevertheless, once the labor market recovers, a major program of public sector retrenchment will be essential. A related issue is the non-viability of the PA's current pension systems. Without comprehensive reform, the system will go bankrupt within two years. A National Pension Committee has recently completed a draft of a unified pension law to introduce reforms for providing pensions to all public sector employees in WBG.¹⁴⁴ However, significant financial resources (at least US\$500 million over a two to three year period) would be necessary to finance the cost of making a transition to the new system.¹⁴⁵

144. This will include both a defined benefit and a defined contribution (in the form of individual pension accounts) component, which are financially sustainable. It will also establish a new, independent pension agency to manage the system. The governance structure of the new agency will help ensure that the pension assets are safeguarded and managed and invested prudently.

145. There are two types of transitional costs: (i) clearing existing arrears to the pension system, which have accumulated as a result of the PA's inability to make its statutory contributions during long periods of the *intifada*, and (ii) financing pension payments to employees enrolled in the defined contribution system.

2. Rejuvenating the reform program

6.12 Two years after the PA reform program began,¹⁴⁶ momentum has stalled. The PA's Reform Program, launched in mid-2002, lost much of its early momentum during the internal struggles that marked the Abu Mazen government. Despite significant internal¹⁴⁷ and external pressure¹⁴⁸ for reform, the PA has registered relatively few achievements in the past year, most of them in the public financial accountability sphere.¹⁴⁹ The Task Force for Palestinian Reform and the elaborate structure of Reform Support Groups established in 2002 to support and monitor the PA reform program under the aegis of the Quartet, also appears to have stagnated.

6.13 Reform is essential to create a growth-oriented economic environment and to boost PA legitimacy with Palestinians and donors. Five priority areas for PA reform may be identified¹⁵⁰:

- **Security.** As long as Palestinian violence persists, the case for dismantling closures will be contested and investors will continue to be

146. The reform program was launched with the publication of the PA's 100 Days Reform Plan on June 23, 2002, see "27 Months" pp. 40–42.

147. According to public opinion polls, 88 percent of Palestinians support calls for "fundamental political reform in the PA." *Palestinian Centre for Policy and Survey Research*, Opinion Poll no. 11, March 14–17, 2004. Average over all polls no. 3–11.

148. Most prominently by U.S. President George W. Bush in his address of June 24, 2002.

149. It should be noted that the incentives behind internal and external calls for PA reform differ. External parties often make a link between institutional reform and a final peace settlement in Israel, which is not necessarily perceived as a priority among pro-reform Palestinians. Indeed, internal calls for reform are often the translation of perceptions of the public service as an unwieldy patronage system and the PA as a weak political entity that has been unable to manage the ongoing conflict, to withstand Israeli military interventions and international pressure. See *The Meanings of Palestinian Reform*, ICG Middle East Briefing, Amman/Washington, November 12th, 2002.

150. See "Disengagement, the Palestinian Economy and the Settlements," the World Bank, June 15, 2004.

deterred. This report is not the place to discuss the specifics of Palestinian security, but it is clear that the PA needs to establish control of domestic security as a precursor to economic recovery.

- **Elections.** Elections are essential to legitimize the PA and to create investor confidence that the Palestinian Government may be held accountable. Both local and national elections are years overdue.¹⁵¹ The recent PA decision to press forward with local elections is a welcome step. It is encouraging that voter registration began on September 4, 2004. However, the establishment of two electoral commissions without a clear division of labor is a source of concern.
- **PA transparency.** PA transparency has improved considerably during the last two years. However additional measures are needed to create confidence among investors, the public and donors. Under the tenure of the current Finance Minister, Salam Fayyad, the PA's financial management system has improved significantly. The World Bank recently released a *Country Financial Accountability Assessment (CFAA)* for the West Bank and Gaza, which documents these improvements and identifies priorities for further improvements. Areas of immediate priority include the creation of an independent audit function,¹⁵² the privatization of public enterprises, and public procurement.¹⁵³
- **Legal, judicial and regulatory reforms.** Legal, judicial and regulatory reforms have slowed. Many laws important to the orderly conduct of commercial activity have been pending for a considerable time; they need revisions

151. The last PA elections were in 1996.

152. New draft legislation paves the way for root-and-branch reform of the General Control Institute, but this will take 2 to 3 years to bring results; until then, the PA should contract with international auditors to fill the gap.

153. A recent World Bank Country Procurement Assessment has recommended establishing an independent Oversight Procurement Authority and drafting a revised and unified procurement law.

or enacted into law.¹⁵⁴ The shortcomings of the Palestinian courts system are widely acknowledged and there is an urgent need to improve the infrastructure of the court system and give priority to training judges and lawyers. The lack of progress in this vital sector may be attributed to unresolved competition between the Supreme Judicial Council and the Ministry of Justice concerning court administration and judicial training. The Office of the President has recently established an *ad hoc* committee to clarify roles, but no progress has occurred to date.

- **Access to credit.** More liberal access to credit will be needed to fuel any recovery. Bank lending is constrained by collateral requirements that rely excessively on land titles; they are scarce commodities in the West Bank and Gaza. Less than half the land in the Gaza Strip and about 30% of the land in the West Bank is registered. Apart from a major land-titling program, allowing a wider range of assets as collateral, expanding leasing and adopting more creative methods for assessing credit risk would all help expand credit opportunities. The Palestinian Monetary Authority should avoid trying to increase commercial bank lending by fiat.¹⁵⁵ Instead, this Authority should allow banks greater freedom in offering new services.¹⁵⁶

3. Consolidating PA strategic leadership vis-à-vis donors

6.14 The PA has strengthened its dialogue with donors over the past year on priorities for

154. Including the Capital Markets Law, the Securities Law, the Companies Law, the Industry Law, the Law of Leases, the Competition Law and the recently adopted Social Security Law.

155. The PMA sets punitive reserve requirements if commercial banks do not meet certain lending targets.

156. Pre-shipment financing of exports and post-shipment guarantees against commercial and political risk could be introduced.

donor intervention. Both “Fifteen Months” and “Twenty-Seven Months” highlighted “a loss of momentum in PA/donor coordination mechanisms; since September 2000, these mechanisms have included the demise of any effective system for tracking donor commitments and disbursements.” The 2003 Mokoro Report confirmed this demise and identified “a need for a more effective PA-donor working relationship at sector level.”¹⁵⁷

6.15 The Socio-Economic Stabilization Plan (SESP) provides a coherent PA strategy identifying priorities for donor investment. The SESP was adopted by the PA Cabinet of Ministers and presented to the AHLC in December 2003. Its objective is to supplement the PA 2004 Budget with an investment plan orienting donor support. This plan is to address immediate priorities (budgetary, emergency and humanitarian assistance) and also long-term development objectives. The overarching goal is to reposition the Palestinian economy for recovery. It identifies capacity-building, rehabilitation and development projects that may be implemented in the current operating environment. The document is an important tool for deepening interaction with donors and the UN system, especially on the programming of assistance, an area in which the PA is now demonstrating leadership. Preparation of the SESP entailed a consultative process, which consisted of dialogue both between the MoP and donors, and between the MoP and the rest of the PA. There was also an effort to coordinate the SESP with the UN system’s Consolidated Appeals Process (Box 6.3). Consultations with Palestinian civil society, however, were virtually non-existent.

6.16 The SESP suggested a financing envelope of US\$1,198 million for 2004.¹⁵⁸ The

157. Lister & LeMore, *op cit*.

158. In disbursement terms, disbursements have generally reached about 70 percent of commitments in the West Bank and Gaza.

SESP identified budget support as the first priority¹⁵⁹ for donor financing in 2004, for which it requested US\$650 million.¹⁶⁰ Emergency assistance needs were estimated at US\$230 million, most of them (US\$164 million) were for humanitarian assistance (food aid, cash assistance and employment generation projects). The remainder was for damage repair (US\$26 million) and private sector emergency support (US\$40 million¹⁶¹). The SESP emphasized that responding to emergency needs should not lead to the abandonment of the longer-term development agenda. Consequently, the SESP appealed for a total of US\$318 million to be allocated to “regular” development projects. Of that, US\$39 million was for capacity building and the remaining US\$278 million for investment in public infrastructure.

GOING FORWARD: PRIORITIES FOR DONORS

6.17 The SESP appears to have had some impact on the prioritization of donor interventions in the West Bank and Gaza in 2004. In the absence of a comprehensive PA program for donor assistance, “Twenty-Seven Months” outlined a program of 10 areas for donor financing of emergency assistance 2003. For 2004, the SESP has rendered such prescriptions unnecessary. While it is possible to argue for adjustments on the margin, the fundamental logic of the SESP remains valid: budget support is critical to sustain the PA’s ability to deliver ser-

159. “Supporting the budget of the PNA is by far the most important SESP component.” *Socio-Economic Stabilization Plan, 2004–2005* p. 15.

160. The SESP was based on three economic scenarios for 2004 to 2005 (political status quo, progress, deterioration), each with suggested donor assistance for three types of assistance. Budgetary support ranges between US\$621–705 million, while humanitarian assistance remains above US\$200 million in all three scenarios.

161. Of the US\$40 million requested for private sector support, US\$5 million would be allocated for capacity building and research.

BOX 6.3 The UN Consolidated Appeal

The UN Consolidated Appeals Process (CAP) is a UN instrument to coordinate mobilization of resources between UN and affiliated humanitarian agencies. The CAP also promotes strategic planning, co-ordinated program implementation and joint monitoring and evaluation. Six months after publication, a mid-year review occurs to track the financial response to the appeal and to make adjustments in targets on the basis of evolving conditions on the ground.

Last autumn, the UN identified US\$300 million worth of humanitarian financing needs for the West Bank and Gaza for 2004.^a This followed a previous effort to sustain a unified donor response through UN agencies. The *UN Humanitarian Plan of Action for 2003* identified US\$290 million in humanitarian funding needs for 2003, 40 percent of that had been financed by the end of November 2003. The funding gap remains a key concern for agencies, given the large portion of Palestinians (1.4 million or 40 percent) who depend on assistance (mostly food) to supplement their incomes. The shortfall in humanitarian funding has continued during 2004. By the end of May 2004, US\$75 million (26.4 percent) of the funds requested in the latest CAP had been pledged or received.^b UN agencies predict that the humanitarian crisis in 2004 will be higher than anticipated last December, due to an increasing number of communities affected by the construction of the Separation Barrier and by large-scale military incursions carried out by the IDF in southern Gaza this spring.

In their mid-year review of the CAP, UN agencies noted that coordination with the different line ministries and the MoP took place under the umbrella of the SESP.^c These consultations should respond to changes in humanitarian needs without making additional claims on limited donor resources.

Notes: a. *UN Consolidated Appeals Process for the Occupied Palestinian Territory 2004*. b. *UN Consolidated Appeals Process for the Occupied Palestinian Territory 2004—Mid-Year Review* c. *Ibid.*

vices and is an important stabilizing factor in the Palestinian economy. Emergency assistance should be targeted to the most needy in Palestinian society.¹⁶² Assistance for public infrastructure development should be considered integral to the needs of the Palestinian society “both now and beyond the immediacy of the current phase of conflict.”¹⁶³ With regard to the underlying macroeconomic environment, the *status quo* scenario seems the most appropriate description of developments in the Palestinian economy in 2004.

162. Among the specific objectives of the SESP was “to help meet the particular requirements of underserved populations in the Occupied Palestinian Territories.”

163. *Op cit.* p 16.

6.18 Budget support for the PA may reach US\$380 million in 2004.¹⁶⁴ Based on current indications from donors, the Reform Trust Fund (Box 6.4) is likely to disburse some US\$140 million in 2004. The ESSP program is expected to disburse around US\$60 million. In addition, the EC is expected to disburse some US\$80 million in budget support committed in 2003. Finally, assuming that bilateral donor support amounts to US\$100 million, against at its 2003 level of US\$140 million, total budget support can be expected to reach some US\$380

164. This number excludes budget support for the municipalities. In 2004, this support was expected to reach some 30 million people, mainly in the form of assistance to repair of municipal infrastructure.

BOX 6.4 The Reform Trust Fund

At the *Ad Hoc Liaison Committee* meeting in Rome on December 10th, 2003, donors were alerted to the widening budget financing gap. In spite of generous donor support to the PA budget during the *Intifada* years, evidence of donor fatigue suggested that an alternative mechanism was required to help leverage new budgetary assistance. This alternative also responded to donor concerns regarding PA reform, 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 the World Bank set up and administers this instrument in the beginning of 2004.

The Bank's Board of Directors approved the *Public Financial Management Reform Trust Fund* 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 as a basis for donors to channel budgetary assistance through the Reform Trust Fund.

The Fund plans to leverage donor budgetary support through a single channel against several clearly-defined financial accountability benchmarks that are consistent with the Financial Management Reform Program. As the fund administrator, the Bank is responsible for monitoring and certifying compliance with the benchmarks and making disbursement decisions accordingly. The Fund is advised in these decisions with a Guidance Committee consisting of the Bank, as chair, the IMF and a limited number of other key Reform Fund donors (actual or potential contributors).

The Fund builds on the experience of the European Commission's previous reform-oriented budget support instruments. These instruments helped push forward key PA reforms, including the creation of a single treasury account; they also reinforced transparency in the PA's public finances and auditing, full MoF responsibility for managing the PA payroll, and the adoption of a Judiciary and Basic Law.

Other channels for budgetary assistance are still available, including the Emergency Services Support Project, which has helped channel support for non-salary recurrent expenditures of selected PA ministries. The added value of the Reform Trust Fund vis-à-vis direct bilateral assistance is the benchmark system. In essence, every contribution to the Fund, regardless of its size, can help leverage improved public financial management by the PA.

The Fund will terminate on December 31st, 2005. As of September 1, 2004, US\$122 million has been committed from Australia, Canada, the EC, Japan, Korea, Norway, the United Kingdom, Belgium, France and Italy have expressed strong support for the Reform Fund. The Bank's own parallel contribution (US\$20 million) was approved on June 3rd, 2004. To date, US\$107 million (US\$87 million from donors and US\$20 million from the World Bank) has been disbursed to the PA through the mechanism of the RTF.

million in 2004 (Table 6.2). This is a significant improvement over 2003, but still short of what is necessary to close the gap in the PA's 2004 budget. Unfortunately, the large PA wage bill does not leave the PA with many options for meeting the budget shortfall.

6.19 The SESP request for emergency assistance will likely be met. The analysis of emergency assistance in Chapter 3 argued that donor-financed emergency assistance was effective in alleviating hardship for the subsistence poor. In addition, though a considerable

TABLE 6.2 Likely Disbursements in 2004 Compared with SESP Components

SESP Component:	Request	Likely Disbursement
Budget support	650	380
Emergency assistance:	231	230 ^a
Food aid, cash assistance and job creation ^b	189	122
Other, including damage repair	42	108
Development assistance:	318	370 ^c
Grand total	1,199	980

Source: Ministry of Planning "Donor's Assistance in the Occupied Palestinian Territory for the year 2003" and World Bank Staff calculations.

Notes: a. assumes that 75 percent of undisbursed 2003-commitments is disbursed in 2004. b. include emergency municipal support. c. assumes that 25 percent of undisbursed 2003-commitments is disbursed in 2004.

number of beneficiaries fall outside the definition of subsistence poor, many of them nevertheless live below the official poverty line. Chapter 3 also argued that there is no easy way to reduce the leakage of assistance to non-needy households. Although an increase in donor resources for emergency assistance would allow a larger number of needy households to benefit, it would also lead to an increase in the number of non-needy receiving assistance. On balance, therefore, the current level of emergency assistance generally appears appropriate.

6.20 Commitments to date suggest that the shift in donor assistance to support for infrastructure development will be sustained in 2004. According to the Ministry of Planning, some US\$355 million has been committed for infrastructure development to date in 2004. There are considerable needs for infrastructure improvement in the West Bank and Gaza. The World Bank's recent *Infrastructure Assessment*¹⁶⁵ identifies priorities for both institutional and physical infrastructure development in four main areas: water, electricity, transport and telecommunications. Depending on the overall political climate, the *Infrastructure Assessment* suggests that donor assistance of US\$300–540

million for these sectors over the next three years is appropriate.

6.21 The Medium-Term Development Plan (MTDP) under preparation could provide important policy guidance for the coming period. The Ministry of Planning is taking the lead on the Medium-Term Development Plan (MTDP); the anticipated completion date is the end of October 2004 so that it can accompany the 2005 Budget. Compared with the SESP, it is more comprehensive and also shows a conscious effort on the part of the PA to solicit the views of the private sector, unions and NGOs. The MTDP is an ambitious effort. If concluded successfully, it will be a critical building block for the recovery of the Palestinian economy. To achieve this goal, three elements warrant consideration.

- The prioritization of projects according to a set of transparent criteria is key. The selection process could build on the experiences of the SESP; it could focus on sectoral and spatial needs in relation to implementation and absorption capacities, instead of donor preferences as reflected in actual SESP sector coverage to date.
- Although the MTDP is built around the prospect of recovery (two scenarios address: delayed progress and rapid progress; they aim at a resource mobilization of US\$1 billion

165. West Bank and Gaza Infrastructure Assessment, June 2004.

and US\$1.5 billion per annum, respectively); a balance needs to be maintained between the shorter-term objective of stabilization and the longer-term objective of poverty reduction. Sustainable job creation would be a critical link between the two and could be a focus of the plan.

- The international community has been participating in the preparation of the MTDP in various ways: technical assistance, background papers, inputs through several sector working groups (for instance, health, education, and agriculture), and the link to the Consolidated Appeals Process (CAP) of the UN system. Such contributions are necessary for the successful implementation of the Plan, but they are not sufficient. Donors and UN agencies also need to adhere to the sectoral and spatial priorities identified in the Plan and direct their financial assistance accordingly.

ACTIONS RECOMMENDED TO THE GOVERNMENT OF ISRAEL

6.22 The key to restoring Palestinian economic vitality is for Israel to remove internal closures and restore the predictable flow of goods across borders. During the past three years, the excessive cost of doing business in the West Bank and Gaza and the unpredictability of the closure system have plunged the Palestinian economy into recession. People increasingly rely on low-wage, low-productivity petty commerce to make a living. Traders are losing touch with markets—particularly export markets—and private investors stay away. In the short run, a significant easing of internal closures would give a measurable boost to the Palestinian economy. However, longer-term growth prospects are intrinsically linked to improved access to export markets, in Israel and elsewhere.¹⁶⁶

¹⁶⁶ “Palestinian economic recovery depends on a radical easing of internal closures throughout the West Bank [and Gaza], the opening of Palestinian external borders to commodity trade, and sustaining a reasonable flow of Palestinian labor into Israel.” Disengagement, *The Palestinian Economy and the Settlements*, the World Bank, June 15, 2004.

6.23 The Government of Israel needs to do more to facilitate donor work in Israel. There is considerable donor frustration with the contrast between repeated Israeli assurances to donors at the highest levels that donor activity and humanitarian aid will be facilitated, and the operating environment donors face on the ground. The IDF continues to damage or destroy donor-financed infrastructure. The impediments to donor activities, coupled with the lack of a clear political horizon—make it increasingly difficult for donors to justify high levels of donor assistance to the West Bank and Gaza. Such sentiments were expressed very clearly at the Ad Hoc Liaison Committee meeting in Rome in December 2003.

6.24 Disengagement from Gaza and the northern West Bank should not entail an abrupt cut in the flow of labor to Israel. The export response to the easing of movement restrictions, the establishment of border states, and an improved business environment will not be a panacea for the high level of unemployment and rapidly growing work force, at least for the foreseeable future. The easing of movement restrictions will have a positive impact on the level of domestic productive activity and employment, as will the flow through the expanding export sector. Construction and related activities may be major beneficiaries of donor-supported public works’ programs focused on priority infrastructures.

6.25 Finally, the closure of the Erez Industrial Estate would represent a serious setback to the economy of Gaza. Until recently, 200 businesses, about half of them Palestinian owned, employed about 5,000 Palestinians. Between them, they would have supported at least 3% of the Gaza population. Since mid-January, Erez has been closed most of the time; it came under attack by Palestinian militants from within Gaza. On June 8, the Israeli Minister of Industry and Trade announced that Israeli

factories would be evacuated from Erez, leaving its future in doubt. The Disengagement Plan proposes that Erez be “transferred to an agreed-upon Palestinian or international body.” All means should be explored to keep Erez Industrial Estate in operation, including the presence

of Israeli investors and access to Israeli markets, and to ensure that the modalities are in place for the orderly transfer of responsibility to the relevant Palestinian authority. There are serious environmental clean-up issues, which also need addressing.

