Report Number : ICRR0020814

1. Project Data

Operation ID	Operation Name	
P156865	WBG - DPG VII	
Country	**Practice Area(Lead)**	
West Bank and Gaza	Macro Economics & Fiscal Management	

L/C/TF Number(s)	Closing Date (Original)	Total Financing (USD)
TF-A1742	30-Jun-2016	40,000,000.00
Bank Approval Date	**Closing Date (Actual)**	
11-Feb-2016	30-Jun-2016	

	IBRD/IDA (USD)	Co-financing (USD)
Original Commitment	40,000,000.00	40,000,000.00
Revised Commitment	40,000,000.00	40,000,000.00
Actual	40,000,000.00	40,000,000.00

Prepared by	Reviewed by	ICR Review Coordinator	Group
Xiaolun Sun	Robert Mark Lacey	Malathi S. Jayawickrama	IEGEC (Unit 1)

2. Project Objectives and Policy Areas

a. Objectives

According to the Program Document (p. 17), the Program Development Objectives (PDO) of the development policy grant (DPG) were to (I) improve public revenue performance and sustainability of public expenditures; (II) improve transparency of public finances; (III) facilitate the land registration process.

The Grant Agreement did not provide a statement of objectives.

b. Were the program objectives/key associated outcome targets revised during implementation of the series?

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c. Pillars/Policy Areas

Aligned with the objectives, the DPG had three policy areas:

1 . ***Improving public revenue performance and sustainability of public expenditures***. Between 2012-14, the tax revenues of the Palestinian Authority (PA) grew from 18.4 to 21.5 percent of GDP thanks to higher imports and customs revenues. However, domestic revenue collection remained below potential despite some improvement. To reduce the recurrent fiscal deficit, the program also aims to contain expenditure growth.
2 . ***Improving transparency of public finances***. Over the years, the government had made good progress in developing modern public financial management (PFM) systems. The Previous DPGs supported some of these efforts, but there is room for further improvement.
3 . ***Facilitating the land registration process***. Bank studies had confirmed that Israeli restrictions on trade, movement and access were the binding constraints to private investment. Nevertheless, the PA undertook reforms to improve the internal business environment, and property registration was considered a significant obstacle to doing business in the Palestinian territories.

d. Comments on Program Cost, Financing, and Dates

The DPG of $40 million was approved on February 11, 2016. It became effective on May 11, 2016, and was closed as scheduled on June 30, 2016 after full disbursement.

3. Relevance of Objectives & Design

a. Relevance of Objectives

In October 2015, when DPG VII was appraised, West Bank and Gaza faced very difficult political and economic challenges, including a large projected financing gap. The DPG, along with the other donor support it leveraged, provided a life line to the budget. Meanwhile, the PA needed to address persistent fiscal pressures to reduce recurrent fiscal deficits and high financing gap. Therefore, the objectives of improving revenue performance, expenditure containment, and PFM were highly relevant to the country context.

In comparison, the relevance of facilitating land registration was less obvious under the circumstances. While it was appropriate to maintain a medium-term reform focus in a standalone DPG, it was not sufficiently explained why property registration, an area where the West Bank and Gaza achieved one of its best Doing Business (DB) rankings (just behind getting electricity), was targeted for improving the business environment among all areas that needed work.

The objectives were aligned with two of the four blocks of the Palestinian National Development Plan (NDP) 2014 to 2016 on *Good Governance and Institution Building* and *Economic Development and Employment*, as well as the two pillars of the World Bank Group's Assistance Strategy for the Fiscal Years 2015-2016: *Strengthen the institutions of a future state* and *Support private sector led growth*. They continue to be relevant to two of the three pillars of the National Policy Agenda (NPA) 2017-2022 launched in December 2016: *Effective Government* and *Sustainable Development.*

Rating
Substantial

b. Relevance of Design

The design of the DPG was straightforward. The Program Document explained in detail the rationale for the actions supported and how they would contribute to the objectives. In an extremely challenging political and economic context, the DPG kept the scope of the program modest, and supported a limited number of ongoing actions within an overall medium-term development plan that were underpinned by analytical work. However, in the area of revenue performance, the prior actions were unlikely to deliver the desired outcomes because they represented the necessary initial steps, which needed to be followed up with considerable institutional reforms to yield the expected outcomes. While the line of sight was clear, the additional actions were not spelled out and were not supported by the DPG.

At the time of appraisal, the macroeconomic situation in the West Bank and Gaza was deemed adequate to proceed with a development policy operation. Driven mainly by private consumption in the West Bank and post-war reconstruction in Gaza, real GDP growth was expected to be 3-4 percent in 2015 and beyond. Thanks to a considerable fiscal consolidation in recent years, the PA reduced its recurrent deficit (before grants) from 25 to 10 percent of GDP during 2007-14. Although this positive trend was expected to continue in the medium term, the financing need remained large and would continue to be financed mainly through aid, arrears to the pension fund, and borrowing from local banks. In 2016, strong exceptional revenues (additional transfers by the government of Israel to settle clearance revenue accounts and advance receipts of telecom license fees) led to a sharp drop of the deficit to 8.1 percent of GDP. Nevertheless, arrears continued to accumulate as donor support faced further cuts.

Rating
Modest

4. Achievement of Objectives (Efficacy)

Objective 1

Objective

Improving public revenue performance and sustainability of public expenditures

Rationale

The DPG would contribute to this objective by supporting actions on both revenues and expenditures. While there is evidence of substantial achievement in greater expenditure control through the supported measures, implementing income tax reforms has proven challenging.

Improving public revenue performance. To increase tax revenues, the PA had adopted a revenue action plan and had worked on widening the tax base by eliminating some tax breaks (supported by the previous DPG). This operation focused on better tax enforcement through (i) draft amendments to the Income Tax Law to enhance collection of predetermined tax debts through the execution court, and (ii) unification of the VAT and income tax collection departments to improve operational efficiency (prior actions). The ICR reports that although these prior actions were met, they are not yet in effect (i.e., the amendments not yet issued, the execution court reform not yet implemented, and the single collection department not yet fully functional). They could not, therefore, have contributed to the 45 percent reduction in the stock of income tax debt (exceeding the target of 15 percent). The ICR does not offer an explanation of how the debt stock was reduced, but notes the lack of commitment, insufficient political consensus, and possible vested interest in the current court arrangement for lack of follow-through after the prior actions. According to the IMF (a mission visited East Jerusalem and Ramallah in February, 2017), the improved revenue performance was due mainly to one off factors, especially discussions with the government of Israel, which resulted in the payment of past obligations by Israel to the PA. Despite this, declining donor budget support led to a financing shortfall and the further accumulation of arrears.

Improving sustainability of public expenditures. To control public spending, the PA maintained a zero net hiring policy since 2013 and approved a decision to reduce fuel and phone allowances by 25 percent for public employees. The DPG supported the reduction of non-wage expenditures, focusing on (i) ensuring that Palestinian local governments and distribution companies to pay their electricity bills to the Israeli electricity provider in a timely manner, and (ii) reducing the cost of medical referrals outside the public health system (both prior actions). The ICR reports significant advances in electricity bill collections and payments. The Palestinian Energy and Natural Resources Authority (PENRA) implemented management reforms and signed agreements with all five distribution companies (exceeding the target of two) and almost all municipalities (11 out of 128 compared to a target of one), which facilitated payments of electricity bills to the Israeli provider. This resulted in a jump in the ratio of the amounts paid to electricity provider to the amounts collected from electricity users from 65 to 90 percent in 2014-16 (exceeding the target of 80 percent). Similarly, through agreements with six Israeli hospitals (against the target of three) and mandatory use of a new health referral manual, the Ministry of Health (MOH) was able to reduce medical referral spending in Israel by 31 percent in 2015 and a further 5 percent in 2016. This contributed to a reduction of the overall cost of health referrals outside the Palestinian public health system from 1.88 to 1.48 percent of GDP in 2014-16. The MOH is pursuing similar agreements with private Palestinian hospitals.

Sustainability of expenditures also depends on improving the revenue effort (see above), and controlling public service wage expenditures. These latter are by far the largest expenditure item, and are not tackled under DPG VII.

Rating
Modest

Objective 2

Objective

Improving transparency of public finances

Rationale

A modern PFM system was already being put in place with an Integrated Financial Management Information System (IFMIS), a Government Financial Statistic budget classification, and a unified treasury system. Previous DPGs had supported increased transparency and information quality in the PA's fiscal reporting. This DPG continued such support by focusing on (i) timely publication of information on transportation tax flows between the central and local governments, and (ii) implementation of a commitment recording system in a number of line ministries (prior actions). The ICR reports that the Ministry of Finance has placed on its website, albeit with some delay, annual information on the amount of transportation tax collected, the service fees charged, deductions/intercepts for each municipality, and the amount transferred to each municipality, thus leading to enhanced transparency. Moreover, four of the five targeted ministries (i.e., transportation, interior, public works, and local government) now use the IFMIS to record pipeline commitment information, which allows for improved expenditure surveillance and control. The MOH, however, has not yet implemented the system due to unresolved data entry issues on medical referrals.

Rating
Substantial

Objective 3

Objective

Facilitating the land registration process

Rationale

The Program Document recognized that the aspects of the business environment assessed in the "Doing Business" (DB) reports were not currently the binding constraints for private investments in the West Bank and Gaza given the larger issues of political instability and security concerns. Nonetheless, removing those constraints would prepare the Palestinian economy for sustainable growth once external conditions improved. The 2016 DB ranked the West Bank and Gaza at 138 among 189 peers for the overall ease of doing business; the particularly challenging aspects included dealing with construction permits (#174), starting a business (#173), resolving insolvency (#167), protecting minority investors (#157), enforcing contracts (#122), and getting credit (#109). The DPG supported a recent action by the PA to reduce the cost of land registration by waiving land titling registration fees and charges for first time land purchasers (prior action). The ICR reports that this waiver provides the desired incentive for increasing land registration: in the pilot area, the number of issued land titles being picked up rose from 188 in October 2015 to 2,950 by the end of 2016, largely exceeding the target of 375.

Rating
Substantial

5. Outcome

The program objectives were, in general, substantially relevant to the country context and well aligned with the PA’s and the World Bank Group’s strategies, although the current priority of the third objective - improving land registration - is unclear. Program design was conservative, but modestly relevant for achieving the stated objectives because some critical links in the results chain were undefined and unsupported for improving public revenue performance. Efficacy was substantial in two of the program areas (transparency of public finances and land registration), where the expected outcomes were achieved with minor missed targets. In the third area (fiscal consolidation), important progress was made in controlling public expenditures, but enforcing tax collection has been difficult. This may undermine the sustainability of the strengthened expenditure framework.

a. **Outcome Rating**
Moderately Satisfactory

6. Rationale for Risk to Development Outcome Rating

DPG VII was designed and implemented in a high risk environment. The Program Document identified eight types of risks, of which three were considered high (political and governance, macroeconomic, and fiduciary) and one related risk substantial (sector strategies and policies). All these risks continue to be present. Nevertheless, the risk to a reversal of the outcomes achieved under this operation varies depending on the nature of the reforms. In the area of expenditure containment, the agreements reached among the relevant parties on electricity payments and medical referrals stand a reasonable chance of being sustained, despite the multiple fragilities in the external and internal environment. Similarly, the fees waived for first time land owners, which was never a significant source of revenue, are not likely to be revoked and will thus continue to provide an incentive to register land titles. On the other hand, tax administration and PFM reforms are inherently complex and require considerable political commitment to sustain an adequate momentum for results. These institutional reforms can be easily reversed in face of the political, social, and economic risks in the West Bank and Gaza. The follow-up DPG being prepared currently to support the 2017-2022 National Policy Agenda could help reduce some of the risk to the outcomes achieved.

a. Risk to Development Outcome Rating

Substantial

7. Assessment of Bank Performance

a. Quality-at-Entry

Being the seventh in a series of standalone DPGs, all of which had focused on strengthening the PA's fiscal position and improving PFM (and business environment since DPG VI), this operation has a similar design to that of its predecessors. It benefited from analytical work by the World Bank (e.g. Public Expenditure Review), the PA (e.g. analysis for a Revenue Strategy), other donors (e.g. USAID technical assistance on health referrals), and global research (e.g. worldwide experience on land). Program design reflected a concern to balance the PA's priorities, capacities, the social and security risks, and the need for deeper structural reforms.

The ICR criticized the choice of some of the prior actions as pro forma and not focusing on the critical actions to deliver the expected results. Indeed, the actions supported under this DPG to improve income tax administration were the initial steps that would require determined follow-up actions to implement complex institutional reforms to achieve the objectives. The ICR points to weak ownership and commitment, and lack of consensus, with which the Borrower disagrees (see ICR, Annex 4). The results chain in the policy area of improving public revenue performance was weak - given the timeframe of the DPG and the additional reforms required, it would be unlikely for the supported actions to yield the expected outcomes. In addition, the rationale for targeting property registration for improving the West Bank and Gaza's business environment was not adequately explained.

There was close collaboration between the World Bank and other external partners, especially the IMF and the EU. The risk assessment was candid, highlighting the considerable risks facing the operation and outlining the mitigation measures for some of these risks. The implementation arrangements, including those for M&E, followed those of the previous DPGs, with the results framework used to monitor not only progress under this operation, but also the implementation of the Multi-Donor Trust Fund support of the NDP, as well as the PA's broader reform efforts.

Quality-at-Entry Rating

Moderately Satisfactory

b. Quality of supervision

The ICR reports that the Bank supervision team prepared quarterly supervision reports (although no Implementation Status Reports were prepared, as they are not required for stand-alone development policy operations) that detailed developments, identified implementation programs, and suggested corrective actions. Supervision was facilitated by the continuous nature of the DPG series, a strong Bank presence in the field, high quality advisory and analytical work, and a range of external partners to provide joint support.

Quality of Supervision Rating

Satisfactory

Overall Bank Performance Rating

Moderately Satisfactory

8. Assessment of Borrower Performance

a. Government Performance

The ICR reports that the PA maintained a cooperative dialogue with the Bank, other development partners, and stakeholders (e.g. energy companies, health services), and operated the M&E system effectively. The PA also successfully pushed forward reforms to reduce waste and contain spending on energy and healthcare. However, the ICR notes important shortcoming in fiscal reforms, especially slow progress in implementing institutional measures to improve tax administration. It notes further that the government failed to take corrective actions when the implementation problems became evident in 2016.

Government Performance Rating

Moderately Satisfactory

b. Implementing Agency Performance

NA

Implementing Agency Performance Rating

Not Rated

Overall Borrower Performance Rating

Moderately Satisfactory

9. M&E Design, Implementation, & Utilization

a. M&E Design

Following the same arrangement as in previous DPGs, this operation's M&E design was clear and largely appropriate. The Program Document presented a plausible results chain in most policy areas. The exception was for improving public revenue performance, where the prior actions were unlikely to deliver the desired outcomes and the additional reforms would take more than the short program period to complete. The results indicators were adequate for measuring progress towards achievement of the objectives, and were measurable with time-bound baselines and targets. Data collection responsibility was shared among the relevant agencies and monitored by the Ministry of Finance (MOF).

b. M&E Implementation

M&E arrangements have been institutionalized within the government, with the same monitoring data used for this DPG, the overall program of the Multi-Donor Trust Fund supporting the NDP, and other reforms.

c. M&E Utilization

Information generated through the M&E system was used in the preparation of subsequent interventions. Through data monitoring and reporting, the M&E system also strengthened the dialogue between the MOF and the line ministries.

M&E Quality Rating

Substantial

10. Other Issues

a. Environmental and Social Effects

The DPG was not expected to have significant effects on the environment, forests and other natural resources. Nor were the measures supported expected to affect the poor and vulnerable groups negatively. Over the medium term, the reforms were expected to augment the fiscal space for poverty reducing social and development spending, and improve prospects for employment opportunities in the private sector. The ICR does not address environmental impact, and does not provide evidence on the actual impact of the DPG on poverty or gender.

b. Fiduciary Compliance

Over the years, the Bank, IMF and other donors (e.g. DfID, EU) have been assisting the government in strengthening its PFM. It has been a key policy area for the DPG series from the beginning. Despite considerable progress, however, the Program Document identified fiduciary risks as high. The internal audit function is not yet fully operational nor decentralized, and there are delays in preparing annual accounts and financial statements. Mitigation measures include continuous technical support by the Bank and other donors to improve the credibility, reliability and accountability of the PFM system. Government revenues and uses of funds are monitored through monthly analysis of the reports issued by the MOF. The ICR does not raise any particular fiduciary issue linked to this operation.

c. Unintended impacts (Positive or Negative)

NA

d. Other

NA

11. Ratings

Ratings	ICR	IEG	Reason for Disagreements/Comment
Outcome	Moderately Satisfactory	Moderately Satisfactory	---
Risk to Development Outcome	High	Substantial	Risk of reversal is uneven across outcomes achieved. In some areas such as waiving first time title registration and agreements with hospitals/electricity companies, there is a good chance that the outcomes achieved can be sustained.

Bank Performance	Moderately Satisfactory	Moderately Satisfactory	---
Borrower Performance	Moderately Satisfactory	Moderately Satisfactory	---
Quality of ICR		Modest	---

Note

When insufficient information is provided by the Bank for IEG to arrive at a clear rating, IEG will downgrade the relevant ratings as warranted beginning July 1, 2006.
The "Reason for Disagreement/Comments" column could cross-reference other sections of the ICR Review, as appropriate.

12. Lessons

The lessons offered by the ICR concern the importance of:

- Adopting long-term perspectives of reform, because successful institutional reforms require continuity of effort over a number of years.
- Tackling difficult reforms on the basis of high quality political economy and technical analysis.
- Aiming at greater fiscal consolidation and adequate financing of budgets to reduce the risk of further accumulation of arrears. Leveraging additional donor support is key to this dimension.
- Focusing prior actions on critical policy areas.
- Conducting a candid assessment of the Authorities' commitment to reform, and of the risks related to weak implementation capacity, with concrete proposals for mitigation in both areas.

While these lessons are unobjectionable, they are of a general nature, and lack practicality (for instance, ***how*** can commitment be ensured?). Concrete examples from the experience of designing and implementing the operation under review would have been useful (see Section 14 below for further discussion).

13. Assessment Recommended?

Yes

Please explain

DPG VII does not demand further assessment on its own. However, the West Bank and Gaza’s uniquely difficult context and the use of stand-alone DPGs as a de facto programmatic series, with uneven success from one operation to another, offer an opportunity to understand better how the World Bank could achieve maximum development in conflict situations.

14. Comments on Quality of ICR

The ICR provides a candid assessment of the DPG. It discusses both the achievement of the operation, and its shortcomings to draw lessons for future operations. There is, however, substantial repetition in the discussion – instead of analyzing program achievement in more depth, the text on pages 23-25 repeats verbatim the last two columns of Table 4. Pointing to a lack of government commitment and inadequate risk assessment and mitigation for the disappointing results in revenue performance, the ICR could have usefully discussed in more detail which parts of the government resisted the reforms and for what reasons. Especially since the Program Document amply demonstrated an awareness of the need for government commitment to ensure program success, it would be important to understand why such awareness did not translate into proper program design. Similarly, the ICR could offer an explanation on why the merger of the two tax departments did not proceed as quickly as expected.

As noted in Section 12 above, the lessons are general in nature and of limited practical application. For example, the seven DPGs (and the eighth in preparation) has been a *de facto* programmatic series, with each operation going a little further in supporting the medium-term agenda of strengthening the government's fiscal position and the PFM system. Does the ICR suggest that future DPGs continue this approach, or make an adjustment (if so, which?) now that the NPA has a longer-term orientation than the previous NDPs? Moreover, design seems to have paid great attention to ensuring commitment and ownership based on the lessons from earlier DPGs, but continues to fall short in this respect. What should future operations do to ensure "clear commitment from the Authorities"? Similarly, while it is indeed desirable to limit further accumulation of arrears by trying to secure adequate budgetary financing, the risks of continued inadequate financing continue to be quite significant in the case of West Bank Gaza, and is unclear what practical guidance, if any, has emerged from the operation under review that could help in addressing this issue.

a. Quality of ICR Rating

Modest