WEST BANK AND GAZA UPDATE

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The Millennium Issue

AN INFORMATION TECHNOLOGY STRATEGY FOR "THE WEB ECONOMY" IN WEST BANK AND GAZA

THE STAKES

A new form of economic organisation - let's call it "the Web Economy" - is transforming the nature of global development. This has happened before with telephones and electricity, but this time the transformation is happening with astonishing speed, scope, and mobility. Already, under the pressure of competition, the Web Economy is transforming itself at an exponential rate, amounting to over US$300 billion in the United States alone.[1]

The Web Economy is based on the use of telecommunications networks, the Internet, and computers for high speed processing and exchange of information. This system is referred to collectively as Information Technology (IT). Industrialized countries account for only 15% of the world's population, but account for 88% of all Internet users. The United States and Canada provide 56% of Internet users, while Europe adds another 24%. The entire Middle East contributes a mere 0.4% of the world's population of Internet users.[2] Already in this take-off phase, it is clear that if a country does not participate in the Web Economy early, it may never participate. There is a real risk of being left behind forever. Non-participation will seriously threaten the fundamentals of any economy because the inherent mobility of the Web Economy means that economic activities can shift at will to any location.[3]

In the region, Lebanon, Jordan, Tunisia, Morocco, and Israel are in the process of designing and implementing strategies to give their economies a chance to participate in the Web Economy. West Bank and Gaza (WBG) could have a special advantage in this process since its human and financial resources are spread all over the world. The Palestinian Web Economy could be the means of pooling these resources to focus them on developing the Palestinian economy no matter where the resources are located. But, urgent action is required to take advantage of the opportunities for WBG.

[1] A recent study by the University of Texas estimated that the "Web Economy" generated more than US$300 billion in revenue and created more than 1.2 million jobs in the United States in 1998. The authors of the report stated the findings "seem to exceed all prior estimates" and that for e-commerce "the growth rate is nothing short of astounding".

[2] In Israel there are around 1 million Internet users and well over 200,000 Internet customers.

[3] In Scotland there are 37,000 new jobs in call centres, more than the total employed in the more traditional industries of oil, gas, and fishing combined, but these jobs could move anywhere offering better facilities. In other cases, the manufacture of hardware components, software, and the provision of IT services forms the basis of growth economies, especially in places where physical resources are limited and human resources are of high quality.

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KEYS TO SUCCESS

There are physical and institutional keys to success. The physical key is a high-quality telecommunications infrastructure capable of moving high volumes of data at fast speed and low cost to provide all customers with the connective links to the global Web Economy. The institutional key is a legal and regulatory framework which encourages and supports entrepreneurs to make long-term investments. New investments will generate new products, services, exports, and, thereby, employment. No investment will increase the income and development gaps between those who participate in the Web Economy and those who do not.

Sadly, WBG does not yet have these keys. Specific action is required immediately.

COMPETITION IN THE WEB WORLD

High-quality, low-cost telecommunications infrastructure results from the forces of competition, but competition itself brings about many other advantages, not the least of which is innovation - a defining characteristic of the Web Economy. Monopolies bring stagnation, and in the Web Economy, stagnation results, very quickly, in decline and finally, exclusion from the higher value Web Economy.

The Palestine Telecommunications Company (PalTel) has performed well in the construction of a modern, high-performance infrastructure with approximately 250,000 customer connections, shrinking waiting lists, and extending coverage to almost universal access. These achievements are even more impressive given the difficult circumstances in which PalTel has to operate. Private investors have managed this vital expansion and they deserve a fair return on their money.

Though PalTel's tariffs are attractive today in comparison to nearby Arab States (but not in comparison to Israel), they are far from best in class - and they need to be best in class for a global market. This is particularly the case for leased lines[4] - an essential facility for the Internet. The Web Economy demands high-quality, low-cost telecommunications infrastructure. This is found only where the major supplier faces the forces of competition. The same goes for all of the various services that make up the Web Economy.

The leaders of the Web Economy all face competition, and nowhere is it possible to find a single supplier of all services - this is beyond the reach of even Microsoft, AT&T, Nokia, France Telecom, or Bezeq. In Lebanon, three operators (two of them cellular) compete for the market. Jordan plans to issue additional cellular licenses to encourage "broad band" businesses. There is also competition in payphones, paging, and data communications. In Egypt, there is competition in international services, and there may be a third cellular license in the near future. In Israel, Bezeq faces intense competition in international services and will soon have to compete in all of its fixed services. Israeli telecommunications charges are among the most competitive in the world.

In the United Kingdom, more than 600 licensed Public Telecommunications Operators compete for business - something that has helped the United Kingdom maintain its position as a leading global financial services provider. Based on competition, language skills, and the efficiency of the IT sector, Ireland has become a major Web Economy. It is now an exporter of services where once it was better known as an exporter of people. Successes in the Web Economy can be found, among others, in India, Malaysia, and Sri Lanka. Experience everywhere shows that the forces of competition will provide more and better quality telecommunications and IT services, create more jobs, more products, more innovation, more exports, more tax contributions, and will lower costs dramatically. If it admits competition, WBG could be a player or a niche leader in the Web Economy. If it does not accept competition, the gates of the Web Economy will not open to it.

THE ESSENTIAL LEGAL AND REGULATORY FRAMEWORK

Opening to the Web Economy and making the transition from monopoly to competition will provide opportunities for additional investments in WBG. There is capital and entrepreneurial ability available, but investors will risk their money only if the "rules of the game" are transparent, certain, and fair. The rules of the Web Economy are established in sector specific regulations and general competition law. These are the institutional foundations of success. International best practice[5] is to construct a regulatory regime with the following essential elements:

- an independent regulatory authority;

[4] *For example, the "wholesale price" of major international telecommunications carriers is as low as US$2.50 per year for a transatlantic voice path. The European recently recommended an upper tariff limit of about US$350 per month for a leased 2Mbits line of up to 5 kilometers in length.*

[5] *These elements are found in the WTO Regulatory Reference Paper, which has been agreed to by more than 70 countries, including 42 developing countries.*

- transparency in making and enforcing rules (no favoritism based on "wasta");
- competitive safeguards put into a competition law;
- objective, non-discriminatory, and transparent allocation of scarce resources (e.g., frequencies, numbers, rights of way);
- public availability of licensing criteria - no secret concessions; and
- an equitable interconnection regime which is fair to all competitors and facilitates market entry.

All of the above are necessary for the development of a vibrant Web Economy and IT sector. None of the above are operative in WBG. The Palestinian Authority (PA) has the responsibility of building the economic foundations of a new state. This is the perfect time to participate in the Web Economy. However, the risks of being left behind as the Web Economy develops are real. Because there is no certain and transparent legal and regulatory framework in WBG, the development of a dynamic IT sector will be severely handicapped. Unfortunately, investors cannot put their money securely into Palestinian Web Businesses. First, there is no certainty as to the scope of the exclusive rights of PalTel. This means that there are limited opportunities for investment. Yet, it is not reasonable to expect or to burden PalTel, on its own, to develop the Palestinian Web Economy.

Even where there are opportunities for investors, the legal and regulatory framework is not adequate to ensure fair play. As long as there is no independent, trusted, regulator in WBG, there will be a suspicion of favoritism (or worse) among investors. Whatever investment may come is likely to be based on relationships not competitiveness. This type of investment will not be able to compete outside WBG and so it will not participate in the global Web Economy. It will remain dependent on its connections, not its competitiveness to protect its Palestinian market and the level of technology and ability of that market to compete externally will stagnate and decline. In these protected and high-risk conditions, investors will find more attractive locations in the region and development in WBG will be stunted at best. Consequently, there is an urgent need for regulatory reform.

AN AGENDA FOR URGENT ACTION

The World Bank recommends a three-step plan of action to establish a legal and regulatory framework that will maximize the potential for the growth of the telecommunications and IT sectors in WBG:

- a clear, pro-competitive policy statement designed to maximize the commercial participation of WBG in the Web Economy;
- establishment of a National Regulatory Authority (NRA)[6] independent of operators and the Ministry of Post and Telecommunications (on a day-to-day basis) whose function is to implement the sector policy; and
- enactment of a competition law to give the necessary powers to the NRA.

The first key issue is to define clearly and openly the exact scope and duration of a monopoly over any particular segment of the market. All over the globe, exclusive rights are being terminated. Where they exist, they are usually limited to basic voice services and the network necessary to supply this particular service. All other services and the supply of the relevant networks is then open to competition.

Exclusive rights are also limited in time. Many decision-makers have come to realize that it is impossible for a government to deliver exclusive rights in the medium term in the Web Economy because technological advances continually provide new methods of getting around monopolies and around any enforcement agency. Once this is accepted, it is preferable to manage the process of liberalization by an appropriate policy rather than allowing activities to develop in a haphazard way.

Much of the uncertainty surrounding investment in the IT and telecommunications sectors results from the controversy about the appropriateness and the interpretation of the exclusivity clause in PalTel's license. That license apparently provides for PA regulation of tariffs charged by PalTel (according to a price-cap formula) and is supposed to ensure a fair basis for the interconnection of present and future service providers to PalTel's network. While it is essential to respect in full the rights of PalTel, and to ensure that it receives fair regulatory treatment, it is perfectly possible that PalTel and the PA can reach a mutually satisfactory agreement to define clearly the scope and duration of PalTel's exclusive rights. Such negotiations should be aimed at increasing the possibilities for additional investors to participate in the sector. Once there has been a clear public clarification of the exclusive rights of PalTel, investors and entrepreneurs may be expected to pick up quickly.

A second key shortcoming is the absence of an effective and independent regulator. At a

[6] *The competition law would apply to all sectors of the economy.*

practical level, this is retarding the IT sector in many ways. For example, without a transparent licensing regime, investors are unable to consider entering the market to provide services. Also, if a numbering plan is not developed, investors cannot provide simple but profitable "free phone" or "premium" services. Perhaps, most importantly, the absence of an effective regulator means WBG cannot negotiate effectively with other regulators. In concrete terms, WBG must have an effective regulatory authority for the IT sector.

The regulator has the duty to regulate tariffs in those services where there are exclusive rights. In performing this function, the NRA must establish a tariff regime that provides a reasonable return to PalTel and encourages commercial development of Web Businesses. Otherwise, WBG will not participate in the new form of economic organisation. Where PalTel faces effective competition, there is no need for these regulatory controls.

A second regulatory function is the establishment of an equitable, cost-based and non-discriminatory interconnection regime that would encourage investors to use the digital highway of PalTel during any period of monopoly. If the tolls for this highway are set too high in relation to costs, entrepreneurs developing web-based services will invest elsewhere and Web Businesses will not take off. Alternatively, investors will find ways of bypassing the network. In both instances PalTel will lose business. If the charges are set below costs, then inefficient investment will take place which will not be sustainable.

A third regulatory function is to develop, publish, and implement licensing criteria so that investors can apply for licenses in a transparent manner. The World Bank suggests two broad categories of license. The first is a "Class" License, normally for liberalised services like Internet Service Provision or any value added service. The Class License is issued to all applicants meeting pre-determined, non-restrictive criteria. The second is an "Individual" License granted to major suppliers of fixed or mobile services to the public. The Individual License specifies the obligations and rights of the operator, which must be available to the public, so that the terms of the license can be enforced in a transparent manner. Also, the regulator must provide clear and publicly available selection criteria for the Individual License so that investors can evaluate opportunities.

Finally, there are certain key national resources, such as radio spectrum and numbering plans that must be managed and allocated for the benefit of all. In the special circumstances of WBG, such management requires engagement with outside regulators. The World Bank strongly recommends that the NRA perform these functions.

Although the PA (through the Ministry of Post and Telecommunications) has intervened on several occasions to deal with tariff issues, it has not dealt effectively so far with interconnection and licensing issues or the allocation of key national resources. It needs to play a more proactive role in dealing with all regulatory matters, in order to find ways to encourage competition and establish a level playing field for all players in the market.

The regulatory reforms described above need to be established on a solid legal foundation. This is the third component of the recommended reform agenda. A new telecommunications law would help achieve WBG 's goals of having a competitive and information-based economy. The existing law (Law No. 3 of 1996) came into effect on April 23, 1996. The Law was then "superceded" by the issuance of PalTel's License Agreement in November 1996. The new law should establish clear, effective and transparent regulations for the sector, help clarify the terms of PalTel's license, especially with respect to the scope and period of exclusivity, and find ways to encourage competition and establish a level playing field for all players in the market.

The process of competition focuses on giving customers what they want. The process has two aspects: competition among firms for customers, and cooperation between firms working together with other suppliers in order to compete. However, too little competition in the form of monopoly or too much cooperation, especially in the form of cartels, can severely disadvantage customers and the development of the IT sector. Consequently, legal protections are needed to guard against too much cooperation where there are no clear-cut benefits to customers.

In other instances, the financial might and market position of one firm may enable it to crush a smaller rival by, for example, a deadly price war. In the Web Economy, a big operator may refuse to cooperate, deny access, or impose harsh terms on a smaller competitor for some essential material or facility. Without reasonable access, the small firm will collapse, customer choice will be restricted, and innovation, investment, employment, and exports will all be strangled.

A competition law can provide the competitive safeguards required of an effective regulatory regime to prevent these types of actions and prevents the unconstrained exercise of market power. A competition law, if enforced equitably, is an important essential requirement of any modern economy, because it provides a degree of security against anti-competitive behavior. The absence of a competition law in WBG can be a serious obstacle to participation in international transactions and may be a serious obstacle to investment.

Legal and regulatory reform will provide a virtuous circle. It will encourage investment in the Web Economy. This will bring new business to PalTel whose existing network will carry Web traffic. In turn, the Palestinian Web Economy will provide new jobs, more exports, more tax revenues, and the link between Palestinian skills and resources spread throughout the globe. Equally, this reform agenda will prepare WBG for participation in the international community because it will implement the principles demanded for membership in international bodies such as the World Trade Organization, as well as those required of a modern democracy.

An agenda of ad hoc reaction and inaction will leave the Palestinians in the wilderness, outside the Web Economy, watching others pass it by.

This article was written by Mr. Gareth Locksley, a Senior Telecommunications Specialist of the World Bank.

DISTANCE LEARNING

On October 31st, 1999, 40 Palestinian teachers from the West Bank and Gaza came together at Bir Zeit University for the first time to explore the electronic frontiers of education. For five days, the World Bank Institute's World Links for Development Program (WorLD) sponsored a training seminar in the Palestinian Authority to introduce teachers, administrators, and students to the power of the Internet to teach and learn. The core objective of the World Links for Development Program is to link, via the Internet, secondary-level students and teachers around the world, to improve educational opportunities, develop youth employment skills for the 21st Century, and build global awareness and understanding. WorLD, operational since 1997, has a goal to link 3,000 schools in 35 developing countries with partner schools around the world by the year 2004.

The World Links for Development Program's first objective is to bridge the digital divide and provide Palestinian teachers and students equal access to information and knowledge. During the week of training, the Palestinian educators looked beyond their individual classrooms and schools to connect with the vast global resources available on the Internet. WorLD taught Palestinian educators techniques on how to find and use the best educational resources on the Internet--ranging from the Louvre Museum site, to the site of the United States Library of Congress, to the site of the complete works of Shakespeare. The seminar also introduced Palestinian teachers to the most effective strategies for use of this tool in a classroom setting and to engage students in an active learning environment allowing them to locate, analyze, interpret, and ultimately communicate information.

The World Links for Development Program also has a strong sense of community. Through WorLD, teachers from the West Bank and Gaza have joined a WorLD community which is now active in 18 countries around the world. Community building and cross cultural understanding lies at the heart of the World Links for Development Program. WorLD aids teachers in using the power of electronic mail to bridge their geographic boundaries and reach out to colleagues all over the world to share ideas, resources, and perspectives. During these five days in October/November, WorLD training introduced teachers to a network of other professionals around the world who are pioneering the use of the Internet in their classrooms and to the concept of collaborative project-based learning. Through the development and implementation of collaborative projects, teachers use the Internet to design projects based on their curricular objectives and implement these projects collaboratively with other teachers and students around the world. During the week, Palestinian teachers developed five collaborative projects: Tourism in Palestine, Effective Use of Technologies in the Classroom, Ozone Problems, a Microsoft Monopoly Project, and Youth Internet Clubs at Our Schools. Teachers and students will work together to address the problems and challenges surrounding these themes and collaboratively develop solutions that meet the needs of their local community - sharing these ideas with other Palestinian teachers, as well as a global audience.

In an increasingly competitive global economy there are two great equalizers -- the Internet and education. The World Links for Development Program hopes to provide Palestinian youth with the technical skills and cultural understanding to become active members in the global community. For many countries involved in WorLD, the Internet and the knowledge to effectively use this technology represent enormous opportunities to use brain power as an engine for economic growth and development. This first WorLD training seminar with these 40 pioneering teachers and students is a small and humble first step toward realizing this goal.

Bethlehem 2000 and High Tech

On December 31, 1999, perhaps in the context of a deep anxiety about theY2K Bug - a fin de siècle high-tech phenomenon - the ABC TV network covered the midnight countdown in various parts of the world: Kiribati at 8:00 a.m. (U.S. Eastern Standard Time), followed by Auckland, New Zealand; Sydney, Australia; Tokyo, Japan; Seoul, Korea; etc. Starting at about 4:30 p.m. (U.S. Eastern Standard Time), pictures of Manger Square in Bethlehem were broadcast, alternating with pictures of Athens, Greece and the Pyramids of Egypt. It may well have been the first time ever that American TV broadcast live footage, designated as originating in "PALESTINE" - the TV caption read "Bethlehem, Palestine". And, unlike the usual news from the region, the coverage was not about crisis or conflict, but about joyous celebration!

While the partying in Bethlehem was modest compared to the extravaganzas in many other cities around the world, the appearance of the Bethlehem 2000 celebration on U.S. Network TV - a great success for the organizers of Bethlehem 2000 - confirmed the heritage of Bethlehem as the town where Jesus was born 2000 years ago.

During the past four years, IFC has participated in projects which have been catalysts for high-tech investments in the West Bank and Gaza. These projects have helped to link Bethlehem with global high-tech. An example of this is the Bethlehem Inter-Continental Hotel, under construction by the Palestine Tourism Investment Company (PTIC), of which IFC is a minority shareholder. The European Investment Bank (EIB) and IFC are providing parallel loans totaling US$20 million for the hotel.

Inspired by the 100 year-old Jacir Palace, originally the residence of a wealthy Palestinian merchant, the hotel will provide the latest in high-tech facilities for guests coming to Bethlehem. Four years ago, the Jacir Palace was a run-down building, used as a secondary school for girls. Today, the palace has been renovated, as a stunningly beautiful lobby for the new hotel. The secondary school for girls also fared well: the students were moved into a modern school building in central Bethlehem, built with funds donated by PADICO, a major shareholder of PTIC. The remainder of the public areas, the gardens, and the interior will be of exceptional quality, easily meeting, if not exceeding, the requirements of the most demanding businessmen, journalists, and tourists for its operator Inter-Continental Hotels. The guest rooms, as well as meeting and business facilities, will be fully equipped for the latest in information and communications technology - an appropriate venue for high-tech joint ventures. A partial opening is scheduled for early Spring 2000, while full completion of all 250 rooms will take place by July 2000 as originally scheduled. By then, tourists and business people around the world should be able to click on to the web-site to learn more about the hotel and its venue in Bethlehem.

The second and probably more significant step for bringing high-tech industries to Palestine involves the Gaza Industrial Estate (GIE). After three years of dedicated work by the Palestine Industrial Estate Development and Management Company (PIEDCO), which spent US$10 million in equity funds, Phase I of the GIE is in operation. Visitors will be pleasantly surprised to see more than 10 ha. of industrial plots and modern factory buildings. Virtually all available space has been leased to 34 industries, with expected employment of up to 3,000 workers. In addition to US$1 million in equity and US$8 million in loans from IFC, the GIE has received generous assistance from international donor agencies, including the World Bank, USAID, and EIB. The World Bank was also instrumental in establishing PIEFZA, the agency that supervises the GIE and all future industrial estates in Palestine. USAID provided the water supply system; the water quality is so good that some of the GIE water will be bottled for commercial sale.

The long term development plan for the GIE calls for its development in three phases, ultimately providing space for up to 200 tenant companies and employing about 20,000 workers. Given the degree of political uncertainty, it was expected that Phase I would cater mainly to local small- and medium-scale industries, and Phase II to joint ventures with Israeli companies and those from nearby countries. Finally, Phase III would target joint ventures with American, European, and Far Eastern companies.

As expected, a large number of current tenants are garment manufacturers taking advantage of unlimited exports to Europe and the United States. Interestingly, there are already Israeli, Jordanian, and Egyptian joint ventures, while one of the GIE tenants is a computer software company. To promote high-tech ventures, some of the space in Phases II and III could be dedicated to office space for use as "high-tech incubators". PIEDCO and PIEFZA, in cooperation with the Peace Technology Fund (a Palestinian/Israeli/IFC equity fund), could join forces to bring high-tech companies, such as those engaged in software, web-site development, and electronic equipment assembly to the GIE.

There is no question that the new millennium will be shaped by high-tech industries and their products. The Bethlehem Inter-Continental Hotel and Gaza Industrial Estate, two major projects being constructed with IFC financing, will contribute significantly towards a high-tech future for Palestine.

This article was written by Mr. Kunio Kikuchi, a Principal Investment Officer of the International Finance Corporation.

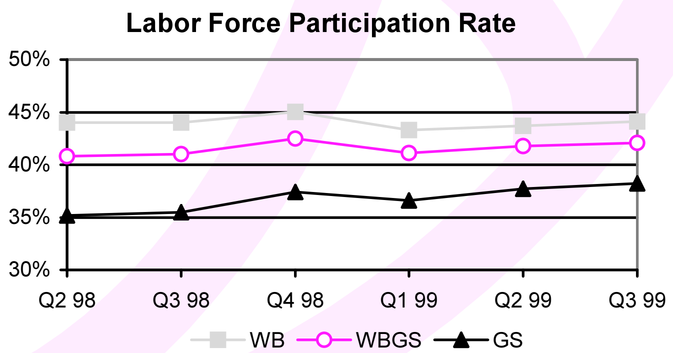
Recent Economic Developments

■ *Economic Output.* In 1998, GDP in the West Bank and Gaza Strip (WBGS) in current prices was US$4.1 billion (excluding Jerusalem) according to data recently released by the Palestinian Central Bureau of Statistics (PCBS). Including Jerusalem, GDP in 1998 was US$4.4 billion. It should be noted that PCBS im-proved the surveys underlying the 1998 national accounts data compared to earlier years, and also redefined the geographical term "Remaining West Bank and Gaza" (i.e., WBGS excluding Jerusalem) to include all of the West Bank except those parts of Jerusalem annexed by Israel in 1967. This differs from the definition used in prior years, in which "Remaining West Bank" excluded the entire Jerusalem Governorate. The result is that 1997 and 1998 data are not directly comparable without some adjustment.

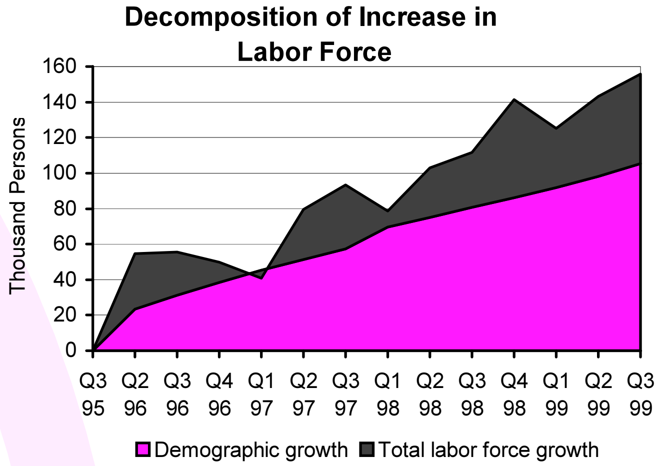
Net income from abroad, which essentially consists of wage income earned by Palestinians working in Israel, amounted to US$0.8 billion in 1998, pushing GNP to US$4.9 billion (excluding Jerusalem). In proportional terms, net income from abroad amounted to 22.3 percent of GDP in 1998 compared to 17.6 percent in 1997. The increase primarily reflects greater access to Israeli labor markets by Palestinian workers due to fewer days of border closures in 1998 compared to 1997. Total earnings from Israeli employment have also been high in 1999.

Estimates for real economic growth as measured by GDP remain around 4 percent for both 1998 and 1999, implying no gains in per capita terms. The estimated growth in GNP is somewhat higher, however, averaging 6 percent over the same period, based on the observed acceleration in job growth for Palestinians employed in Israel (see below). Accounting for inflation and population growth of 3.8 percent, Palestinian GNP per capita is estimated to have grown by an average 2 percent per year in 1998 and 1999.

■ *Labor Markets.* According to PCBS labor force survey data, the growth in the Palestinian labor force continued in the third quarter of 1999, bringing the annual increase to some 25,000 persons compared to the same period a year ago, equivalent to a 7 percent annual rate of growth. This increase in the labor force occurred despite fairly constant participation rates that hovered around 41-42 percent over the past year, implying that demographic pressures were the driving factor.

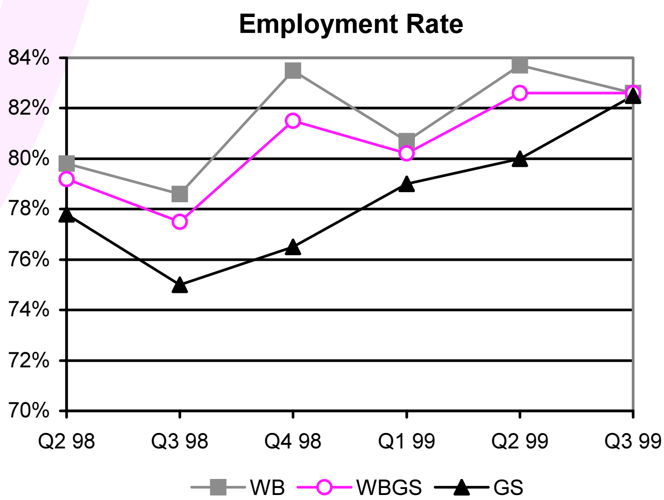


Over the last four years the Palestinian labor force has increased by approximately 150,000 persons, or 30 percent. Concurrent demographic growth (i.e., the increase in the number of persons aged 15 or above) explains a large part of this increase (up to two-thirds).

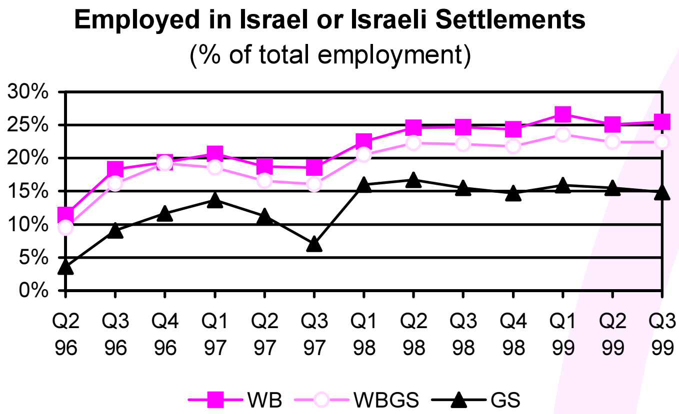


The employment situation in the Palestinian labor market registered continued strong performance in Q3 1999, adding approximately 11,800 full-time jobs, of which 3,400 were located in Israeli-controlled areas (i.e., either in Israel or in Israeli settlements). Employment growth is intrinsically linked to the improved overall economic conditions in 1998 and 1999.

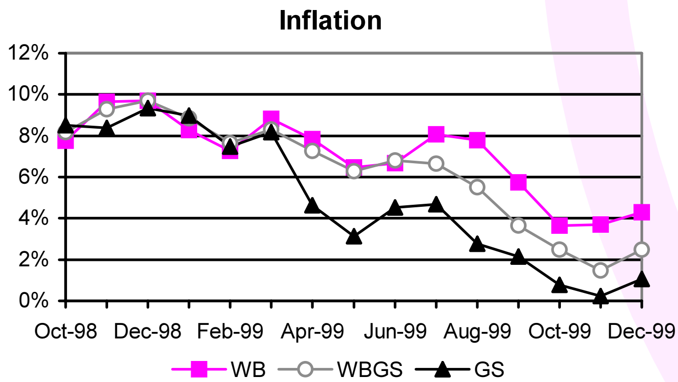
Job growth has been most significant in the Gaza Strip, where (full-time) employment rates rose for the fourth consecutive quarter, reaching 82.5 per cent in Q3 1999. As a result, employment rates in the Gaza Strip reached those prevailing in the West Bank, closing the gap for the first time since the inception of labor force surveys conducted by PCBS. In conjunction with job growth, the average Palestinian unemployment rate fell to 11.6 percent in the third quarter of 1999, the lowest in four years.



Although the share of employed Palestinians working in Israeli-controlled areas remains high at 22 percent, it is noteworthy that for Gazan workers, the share working in Israel and the settlements declined slightly in Q3 1999. Given that employment rates increased during the same period, this means that job growth in the Gaza Strip can be attributed solely to domestic job creation within the Gaza Strip. This evidence suggests a pick-up of economic activity on the domestic economy, with positive implications for overall Palestinian GDP growth.

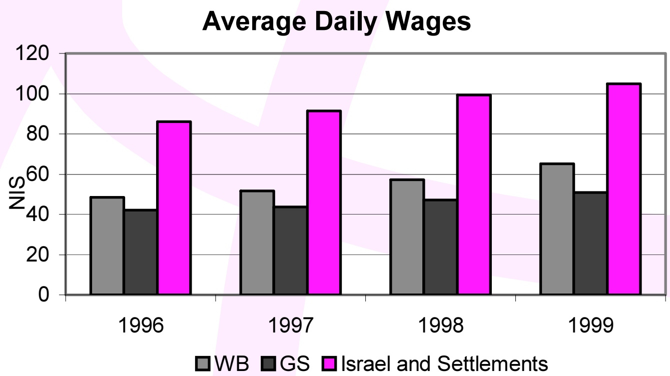


■ *Prices and Wages.* Inflation rates have fallen signi-ficantly during the second half of 1999. The average inflation rate for WBGS in November 1999 was only 1.5 percent and 2.5 percent in December, down considerably from the approximately 9.5 percent observed a year earlier. Inflation rates in WBGS closely follow rates in Israel, which have also slowed significantly. In fact, since August 1999, the average inflation in WBGS has been slightly lower than in Israel.



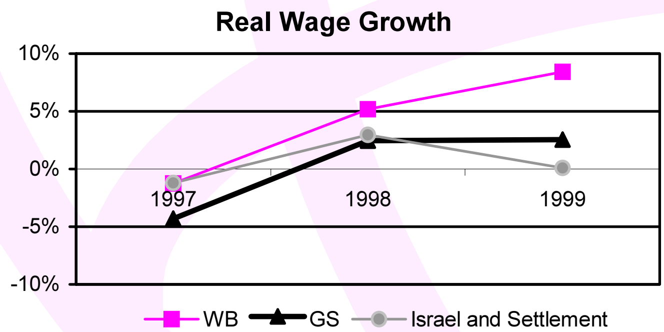
The decline in inflation rates has been more or less parallel in the West Bank and in the Gaza Strip, such that inflation in the West Bank remains 3-4 percentage points higher than in the Gaza Strip. In December 1999, for example, year-on-year inflation was 4.3 percent in the West Bank (excluding Jerusalem), compared to only 1.0 percent in the Gaza Strip. The main factor driving slower inflation is food prices - the single largest item in the consumption basket that makes up the Consumer Price Index. Prices on food items declined 1 and 2.5 percent respectively in October and November 1999, relative to the year before.

Wage inflation has picked up over the last year, especially in the West Bank, where nominal average daily wages stand at approximately 65 NIS in Q3 1999, some 14 percent higher than the average level in 1998. Average daily wages in the Gaza Strip equal 50 NIS, up 8 percent compared to 1998. The group of Palestinians working in Israel experienced relatively slower wage growth of 5-6 percent in 1999, but the average daily wage of 108 NIS is still twice as high as in the Gaza Strip. These wage developments imply that the already significant wage gap between the West Bank and Gaza Strip actually widened further in 1999.



The difference in average wage levels is likely to induce an inflow of workers from the Gaza Strip into the West Bank as labor mobility between the two regions increases. The opening of the safe passage in October 1999 could facilitate greater labor flows (primarily from the Gaza Strip to the West Bank) which should bid down the wage differential in the future.

Real wage growth (i.e., nominal wage growth minus the growth in consumer prices) in the Gaza Strip was approximately 3 percent in 1999, effectively raising the purchasing power of the average daily wage to the level prevailing in 1996. The strong wage growth observed in the West Bank means that the purchasing power of the average daily wage today is almost 15 percent higher than in 1996.

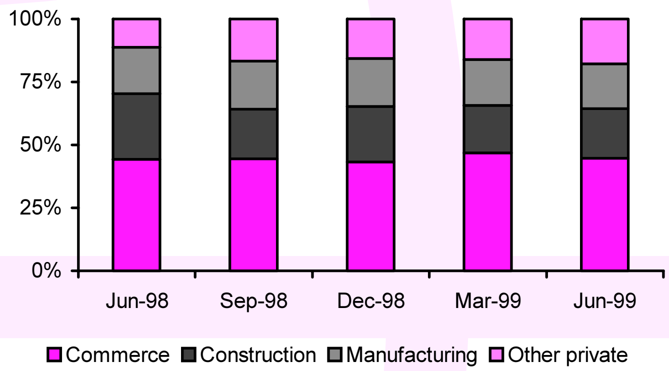


■ *Private Consumption, Investment and Savings.* There is no new data available on private consumption since the 1998 household survey. However, slower inflation and higher real wages suggest higher purchasing power, which may imply a real increase in consumption.

With respect to private investment, several indicators point to positive trends. The most recent data for building licenses show a 20 percent increase in the first half of 1999 compared to the same period in 1998 according to PCBS. Figures for issued building licenses reflect only intended investments, not actual investments, and the average time span between the license issue and building completion is fairly long, implying that the contribution to output will not be felt immediately. Residential buildings make up by far the largest share of total licensed areas, representing more that 80 percent.

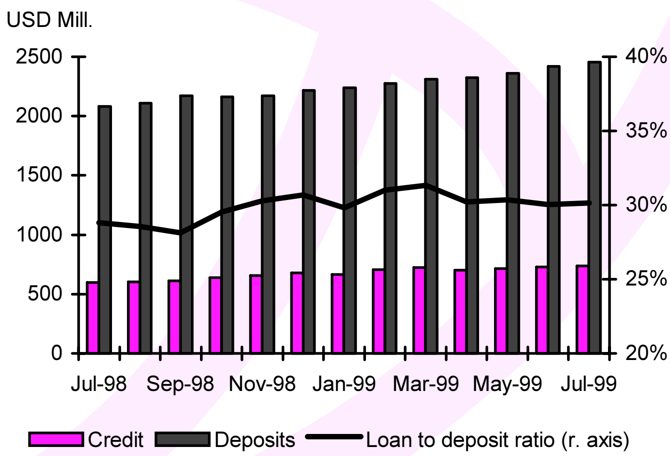
The Palestine Monetary Authority reports that commercial bank credit to private firms increased by 15 percent compared to the same period a year earlier. The distribution of bank credit across sectors has not changed much over the last year, with commerce, construction, and manufacturing respectively receiving 45, 20, and 18 percent of total credit.

Sectoral Distribution of Bank's Credit



Private sector deposits in commercial banks averaged US$2.3 billion between January and July 1999, up nearly 20 percent compared to the same period the year before. And bank credit to resident customers grew even faster during the same period, by about 25 percent, bringing total bank lending to resident customers to US$0.7 billion in July 1999.

Private Residents' Saving and Borrowing

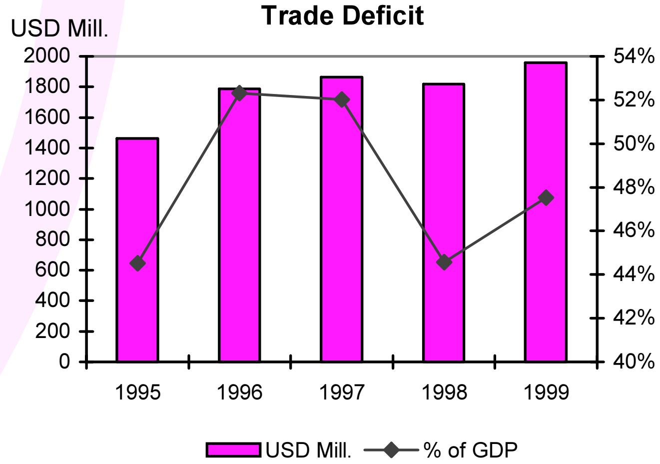


Commercial banks' loan-to-deposit ratio has been roughly stable at 30 percent throughout the first half of 1999, which is low compared to other countries in the region. This suggests scope for increasing the role of commer-cial banks to provide credit to the private sector, especially with respect to longer term credit. To date, a significant share of bank credit - approximately 50 percent - continues to be in the form of overdrafts and other short-term credit. Extending additional credit requires the necessary prudential regulations to maintain the loan portfolio quality.

■ *External Trade.* For a small economy like WBGS, adopting outward-oriented policies will be crucial to sustainable economic development in the long run. The Palestinian economy posts unsustainable trade deficits around 50 percent of GDP as a result of current trade arrangements with Israel and third-party countries, as well as continued reliance on imports from Israel. Although donors have effectively financed trade deficits until now (mostly in the form of grants), this level of support is unlikely to be available over the long run, and is already starting to diminish. Alternative sources to finance continued large deficits are limited, which underlines the importance of developing Palestinian exports.

Trade deficits with Israel and with third countries widened in 1999 according to data from the Ministry of Finance. This is surprising with respect to third countries given the observed depreciation of the New Israeli Shekel, notably against the Egyptian Pound and the Jordanian Dinar, which should have improved nominal competitiveness of the Palestinian export industry. On the other hand, domestic demand in WBGS is likely to have grown faster than domestic demand in trading partner countries, especially Israel.

Trade Deficit



■ *Fiscal Accounts.* In November 1999, the Palestinian Authority (PA) submitted on time for the first time a proposed budget law for the coming year, 2000, suggesting improved administrative capacity at the Ministry of Finance. Moreover, the budget law reflected the inclusion of a forward-looking macroeconomic framework into the budget planning process.

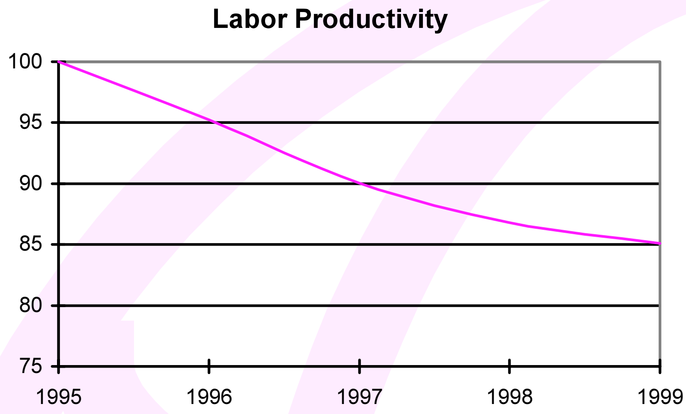
The proposed budget bill for 2000 predicts a balanced budget (including donor financing) and assumes that public expenditures and revenues as a share of GDP remain more or less unchanged from their 1999 levels around 25 per cent of GDP. However, the composition of both expenditures and revenues in the year 2000 is expected to change somewhat compared to 1999.

Palestinian Budget for Fiscal Year 2000			
	1998[1]	**1999[2]**	**2000[3]**
	---- Percent of GDP ---		
Total Recurrent Revenues	**21.7**	**24.3**	**25.1**
- Direct Taxes	2.2	2.3	2.1
- Customs and Duties	7.1	8.1	8.5
- VAT	8.4	10.6	11.5
- Other Recurrent Revenues	4.0	3.3	3.1
Donor Financing	**9.5**	**6.3**	**10.4**
Total Current Expenditures	**24.6**	**25.7**	**24.5**
- Wage Bill	14.3	15.0	14.6
- Other	9.4	10.0	9.5
Investment Expenditures	**9.8**	**6.5**	**11.0**
Overall Balance	**-3.1**	**-1.6**	**0.0**

[1]Actual figures. [2]Preliminary estimates. [3]Budget law.
Source: Ministry of Finance and World Bank calculations.

With respect to current expenditure, the PA expects to stabilize the public sector wage bill as a share of GDP at approximately 15 percent in 2000. This will be achieved by allowing only a limited increase in public employment equal to 3,400 persons. With regard to investment expenditure however, the PA expects a recovery from diminished aid disbursement levels in 1998 and 1999 (estimated) to 11 percent of GDP in 2000. Donor disbursements in 1998 and 1999 are considerably lower than 1997, e.g., estimated US$235 million in 1999 and US$330 million in 1998 compared to US$486 million in 1997). Much of the decline can be explained by the shift in donor assistance from short-term budgetary support to longer-term investment programs (trends in donor assistance will be analyzed in detail in the World Bank's Aid Effectiveness Study currently under preparation).

■ *Future Challenges for Productivity.* Despite the significant improvements observed over the last two years in employment growth and output, the Palestinian economy faces important challenges ahead, especially regarding produc-tivity. Comparing productivity across countries is methodologically difficult, but preliminary estimates of labor productivity trends in Palestine are very troubling, in view of the absolute decline observed over the last five years.



A number of factors hindering productivity improvements are inherent to the constrained nature of the Palestinian economy as a result of the political situation. These include: limited geographical labor mobility between (and within) the West Bank and Gaza Strip, the absence of direct access to external markets, the inability to adjust nominally to external shocks via exchange rate or money supply mechanisms, and a high degree of political uncertainty, all of which negatively affect investment and allocative efficiency. Although many of these constraints may be addressed during the forthcoming negotiations on permanent status arrangements between Israel and an independent Palestinian entity, there remains a considerable agenda of reform.

Measures to increase productivity will need to focus on providing incentives for Palestinians to invest productive capital, and attracting new foreign investors, which necessitates reducing the risks associated with doing business in the West Bank and Gaza Strip. This in turn requires strengthening and enforcing the legal and institutional frameworks to secure investment. It will also require greater financial intermediation in the Palestinian economy in order to encourage savings and channel them toward the most profitable and growth-generating uses. A stable macroeconomic environment will be crucial, especially vis-à-vis allocating a growing share of public resources to investment without crowding-out private savings. Finally, obstacles to compe-titiveness in the product markets (e.g., through monopolies) and in the labor market (e.g., through restrictions on worker mobility) will need to be addressed to support other efforts to raise productivity.

Bank Group Operations

I. Multi-Donor Fund Administration

■ *Holst Fund.* As of June 1999, the Holst Fund has received pledges of US$267 million (including investment income) from 26 donor countries, of which US$264 million has been paid in and US$253 million has been disbursed by the Bank to the Palestinian Authority (PA). Of the total disbursed, US$213 million was for recurrent budget support and US$40 million for employment generation projects. Since the initiation of the Employment Generation Program (EGP) in 1996, over 700 microprojects have been completed. One of the recent activities being undertaken under the EGP, in partnership with the Danish Government funded project, is the infrastructure rehabilitation of the middle areas of the Gaza Strip - Bureij, Maghazi, and Nusairat. The Holst Fund in cooperation with the Palestinian Water Authority is also assisting in drought alleviation in needy villages in the West Bank. The Holst Fund is scheduled to close on December 31, 1999.

■ *Technical Assistance Trust Fund* (TATF). As of July 1999, the TATF has received donor contributions of US$22.9 million, of which a total of US$16.5 million has been disbursed. Thirteen activities are currently under contract, worth a total contract value of US$6.1 million. The first National Conference on Training Strategies Planning aimed at initiating open dialogue between the public and the private sectors was hosted under the Project by PECDAR in June 1999. A donor workshop was conducted in July 1999 by PECDAR, where the preliminary findings of six activities were discussed: The Water Sector Strategic Planning Study; Tourism Sector Strategy & Development Project; Central Roads Administration; Municipal Financial Information Systems; Tourism Planning and Development Study; and Legal Data Inventory Documentation Project. An extension of the TATF closing date was approved for December 31, 1999.

II. Investment Projects

As of June 1999, the World Bank Group has 18 projects under implementation through the World Bank, MIGA, and IFC Programs:

World Bank Projects

■ *Emergency Rehabilitation Project* (ERP I). (US$30 million from the World Bank and US$63.5 million in co-financing by Saudi Arabia, Denmark, Switzerland, and Kuwait.) The Project (that was implemented by PECDAR) financed a total of 140 infrastructure projects, resulted in building 418 classrooms, paved 260 km of roads in cities and villages, constructed approximately 410 km of water supply pipelines, 80 km of sewer lines and storm water lines, and five water reservoirs.

■ *Second Emergency Rehabilitation Project* (ERP II). (US$20 million from the World Bank and US$3.5 million in co-financing by the Italian Government.) All available funding has been committed to 77 sub-projects in the road, water, wastewater, and school sectors (including 42 labor intensive microprojects). All sub-projects have been completed. The Project, closed on June 30, 1999, was implemented through PECDAR in coordination with the municipalities in the West Bank and Gaza. Approximately 123 km of roads and about 110 km of water and sewage pipelines have been constructed.

■ *Education and Health Rehabilitation Project* (EHRP). [US$20 million from the World Bank International Development Association (IDA), US$20 million grant from Saudi Arabia, US$2.85 million grant from Italy and US$0.40 million grant from Australia.] The Project is well advanced and is progressing satisfactorily. The IDA Fund is 100% committed and 97% disbursed; the Saudi Fund is 66% committed and 41% disbursed; the Italian Fund is 94% committed and 61% disbursed; and the Australian Fund is 98% committed and 95% disbursed. The Project is implemented through PECDAR, Ministry of Health and Ministry of Education.

Health Component: Under the IDA Fund in Gaza, construction of all planned ten clinics has been completed. Furniture for these clinics was purchased by the Ministry of Health. The work on the software programs of this component, implemented by the Ministry of Health, is progressing well. Under the Saudi Grant in the West Bank, one clinic is under construction. The construction of both extensions of Rafidia Hospital and Yatta Hospital will commence soon. The contracts for the supply of furniture and equipment for one clinic will be awarded soon. In Gaza, the construction of two clinics is complete and that of one community hospital and one clinic is progressing well. The design of the Ministry's department building is in the final stage. The supply of furniture and equipment for the completed clinic is in progress. Under the Italian Grant in Gaza, the contract for the Pilot Master Plan for Al Nasser Hospital in Khan Younis will soon be awarded. Once the Pilot Master Plan is approved by the Ministry of Health, the rehabilitation works for the existing hospital and the existing sewage system, and the construction of a corridor link between the existing and the new hospital will soon commence.

Education Component: Under the IDA Fund in Gaza, construction of all planned 11 new schools and all planned extensions of 11 existing schools has been completed. Furniture for these schools was purchased by the Ministry of Education. Under the Saudi Grant in the West Bank, construction of all planned eight schools is complete. The design for three new schools is in the final stage. The supply of furniture for the completed schools will commence soon. In Gaza, construction of three schools is complete and that of two is in progress. Furniture for the completed schools was purchased by the Ministry of Education. Under the Italian Grant in the West Bank, construction of four schools has been completed and that of two is in progress. Development of curriculums by the Curriculum Center of the Ministry of Education is progressing well. The supply of furniture for the completed schools will commence soon. Implementation of components under the recently approved Italian Grant of US$5.80 million will commence soon. Under the Australian Grant, strengthening of policy-making, planning, and research capacity within the Ministry of Education, establishment of a school mapping database, and a maintenance scheduling system for the Ministry have been completed.

■ *Municipal Infrastructure Development Project* (MIDP). (US$40 million from the World Bank, US$1.75 million from Greece, and US$4 million from Italy.) This Project aims at rehabilitating high priority municipal infrastructure networks and systems in the West Bank and Gaza (WBG), working directly with five selected municipalities in WBG; the Ministry of Local Government, the Ministry of Public Works, the Palestinian Water Authority, and PECDAR. Focus is on initiating institutional reform and capacity building at the local government level. So far, 73% of available funding has been committed to 253 sub-projects, including 170 microprojects in the WBG. A total of 237 sub-projects have been completed, including 170 microprojects. The Project has also been amended to include preparation work for Bethlehem 2000. So far approximately 176 km of roads and about 89 km of water and sewage pipelines have been constructed. Also, upgrading of two neighborhood upgrading areas in Gaza City have been completed. All other components with the Ministry of Local Government and the five selected municipalities for capacity building are currently active. A unified accounting system for 13 municipalities is in the awarding process. Three-year investment plans are under preparation for the Hebron Municipality and tender evaluation for Gaza City. Diagnostic studies for Rafah and Jenin are ongoing.

■ *Gaza Water & Sanitation Services Project* (GWSSP). (US$25 million from the World Bank, US$50 million in parallel financing from EIB/EU.) The Project consists of: (a) the provision of an international Operator [Lyonnaise des Eaux, Khatib & Alami (LEKA)] under a four-year management contract to implement a service improvement program; (b) the provision of operating investment funds for the Operator built into the management contract, essential to fund goods, equipment, works and services required for improving services and attainment of performance targets; and (c) the provision of technical assistance to strengthen the newly created Palestinian Water Authority (PWA), to support implementation and monitoring of the project, and to provide independent auditors to monitor the Operator's technical and financial performance. The implementing agency is the PWA. The main achievements after three years of implementation of the Project are: over 1,200 km of pipe have been surveyed for leaks and 16,000 illegal connections identified; over 17,000 service connections have been replaced, over 13,000 meters repaired, and a total of over 30,000 meters replaced; Unaccounted For Water (UFW) has been reduced from around 48% to 30%; reliable disinfectant (96% of water samples have positive chlorine residual); and increased revenue. The work of creating the legal entity of the Coastal Water Utility in Gaza started in January 1999 and is due to be completed by January 2000. Disbursements are approximately US$20.7 million and commitments are nearly US$23 million, representing about 92% of the total credit.

■ *Community Development Project* (CDP). Project implementation through PECDAR began two years ago and as of June 1999, over 200 infrastructure microprojects have been completed. An additional 20 projects are under implementation. The US$25 million project, in addition to reconstructing community infrastructure and creating jobs, also promotes local ownership through a community cash contribution of at least 10%. In addition to the US$10 million financed by the World Bank, the Project has been successful in attracting co-financing of nearly US$13 million. The World Bank-financed components are mostly disbursed, while projects funded through Canada and the OPEC Fund are still on-going. The Project is expected to close in December 1999. The success of the first CDP has resulted in the PA requesting a follow-up project. The new US$26 million CDP II (US$8 million from the World Bank, US$8 million from the OPEC fund, and EURO10 million from EIB) was declared effective on May 27, 1999 and the first group of microprojects have been cleared for implementation. While continuing on the success of CDP I, the new project will primarily focus on the poor and marginalized communities, including funding projects in refugee camps within West Bank and Gaza.

■ *Legal Development Project* (LDP). (US$5.5 million from the World Bank, parallel financing of US$1 million for legislative drafting from the United Kingdom.) The Project is a start to a long-term process of assisting the PA to modernize and harmonize existing legislation, to give rise to a legal framework adequate to support a modern market economy, and to encourage the growth of the private sector. The Project also supports the training of judges and court personnel in order to increase the efficiency and transparency of the judicial process. The Project is well underway. As part of the overall program of legal development in WBG, construction of two courthouses is planned--one each in the West Bank and in Gaza.

■ *Palestinian Expatriate Professional Program* (PEPP). (US$3 million from the Palestinian Authority, US$3 million from the World Bank, US$0.3 million from the Netherlands.) The PEPP supports the recruitment of expatriate Palestinians to key management and senior technical positions in PA institutions as an institution-building measure. Since beginning in late 1997, ten persons have been successfully recruited for positions at the Ministries of Economy and Trade, Finance, Health, Housing, the Palestine Monetary Authority, and the Bethlehem 2000 Committee. The Program is currently working on the recruitment of an additional 20-25 persons during 1999-2000 for key economic ministries, including the Ministries of Agriculture, Education, Finance, Higher Education, and the Government Computer Center.

■ *Palestinian NGO Project.* (US$10 million grant from the World Bank and US$4.5 million in co-financing by Saudi Arabia and Italy.) This Project began operations in early 1998 and is managed by the Project Management Organization (PMO); Welfare Association Consortium. Currently around 60 sub-projects are being implemented under the development grant scheme (cycle one and two for which US$5 million was allocated). Half of the 39 sub-projects financed under the first cycle of development grants have been successfully completed. The first cycle of Block Grants is also underway and seven Block Grants Managers (or NGOs acting as umbrella mechanisms to build the capacity of smaller NGOs responsible for service delivery) are awarding US$3.5 million in the form of grants whose amounts range between US$5,000 and US$25,000. In late November 1999, cycle three Development Grants, with a projected value of US$2.5 million, was launched. Grant awards and disbursement to NGOs will take place in April 2000. Also, the first Research Service Contract was awarded in December 1999. These grants, for which US$300,000 has been earmarked, are given to qualified institutions and individuals for research studies designed to improve information and analysis in the NGO sector. Other developments include the award of US$15,000 to the Bank's field office from the Gender and Development Thematic Group's Innovation Fund to finance a consultant who will mainstream gender in the Project. Finally, a customary Mid-Term Review of the Project will be undertaken by the Bank in January 2000 to assess the performance of the PMO to date, and decide whether its contract should be renewed for the remaining three years of the Project.

■ *MIGA: Investment Guarantee Fund.* (US$10 million from the PA through a credit from the World Bank and US$11 million from EIB and Japan.) This Fund, which is administered by MIGA, provides guarantees in the form of insurance against political risk for private investments in WBG. Under the terms of the Fund, investors who are nationals of, or companies incorporated in, a MIGA member country, or who are Palestinian residents of the WBG, are eligible to obtain guarantees provided that the investment is brought in from outside WBG. The Fund currently has the capacity to issue guarantees for up to US$5 million per project. If a project requires more insurance capacity, when requested by the project sponsor(s), MIGA will explore the possibility of obtaining reinsurance and coinsurance with public and private underwriters, including coinsurance under MIGA's Cooperative Underwriting Program. During FY99, on behalf of the Trust Fund, MIGA issued its first Contract of Guarantee (US$5 million) in the territories to Phoenix International Limited of the United Kingdom. The project involved the establishment of a cultural center for tourists and business visitors. In addition, since the inception of the Fund, nearly 20 applications have been received for almost US$400 million in investments in WBG's infrastructure, manufacturing, real estate, services, and tourism sectors.

■ *Bethlehem 2000 Project (B2000).* [US$25 million from the World Bank (IDA), US$1 million grant from Norway and US$2 million grant from Italy]. The IDA Fund is 62% committed and 37% disbursed; the Norwegian Fund is 100% committed and 68% disbursed; and the Italian Fund is 100% committed and 34% disbursed.

Infrastructure Works: Roads - Under IDA Fund -- Three of four planned major roads are under construction and are near completion. Rehabilitation of the first package of inner roads in the Bethlehem area is near completion and rehabilitation of the second package is progressing well. Under the Norwegian Grant, the rehabilitation works of the Shepherds' Fields access roads are complete. Under the Italian Grant, the rehabilitation works of the Bethlehem-Artas Road is 70% complete. Water - The water reservoir near Bethlehem University is complete, works for the rehabilitation of the first package of the water network is progressing well. Cultural Heritage - Three of four sub-projects are under construction: the rehabilitation of the cultural heritage of the old cores of Beit Jala Phase I, Beit Sahour and St. Mary's Church. The Government of Austria has indicated interest in providing a grant of US$ 0.8 million for the rehabilitation of the cultural heritage of the old core of Beit Jala Phase II. Tender documents for this phase are under preparation.

Celebration Support: Under IDA Fund - The Bethlehem 2000 organization has been consolidating, but remains weak in marketing, sponsorship, and events management staff. The private sector development staff have not yet been effective and the Management Contract (MC) has been terminated for non-performance. The sponsorship and fund raising effort has also been quite weak. The events group has been restructured -- now relying almost wholly on local staff. This group successfully launched the events program on November 28, 1999 and have been working hard on program development for the coming year. In sum, celebration efforts have gotten off to a slow start and the opportunities for major TV network exposure and sponsorship support in December 1999 have been missed. Nevertheless, a modest but creditable, dignified, and appropriate events program has been launched. On a more positive note, the construction management consultants have performed very well and have things under control even though start-up and completion of the works has been slower than planned.

The Capacity Building: Under IDA Fund - Not much work was planned here, and little has been done. This component will be accelerated in 2000.

■ *Southern Area Water and Sanitation Improvement Project* (SAWSIP). This Project with an estimated cost of approximately US$63 million was approved by the Board of Executive Directors of the World Bank in late May 1999, and was subsequently declared effective in August 1999. The Project is designed to improve water and wastewater services in the southern area of the West Bank (covering the Governorates of Bethlehem and Hebron) and prepare and implement an appropriate institutional framework for water and wastewater service provision, including the implementation of a performance-based MC. The procurement of the MC was done under International Competitive Bidding procedures. The selected international Operator (Vivendi, Khatib & Alami) started their four-year performance based MC in September 1999. The Project will also support building regulatory and institutional capacity in the Palestinian Water Authority. Proposed funding includes a US$21 million proposed credit from the World Bank to cover the MC fixed fees, the MC performance incentive fees, and an operating investment fund to cover essential operations and maintenance expenditures not covered by the collected revenues. EIB financing would provide US$36 million equivalent (EURO30 million) for capital investments. The balance of approximately US$6 million would be funded by local contributions from the Bethlehem and Hebron Governorates. Disbursement as of December 1999 are approximately US$2.04 million.

■ *Electric Sector Investment and Management Project* (ESIMP). (US$15 million from the World Bank, US$38 million from EIB, US$35 million from Italy, and US$3 million financed by beneficiaries.) The objectives of this US$91 million Project are to rehabilitate the power distribution systems in the central and southern West Bank and to address the institutional structure for longer-term sector management. The Project was approved by the Executive Directors of the World Bank on August 31, 1999, and the Trust Fund Credit Agreement (TFCA) signed at the time of the Bank/IMF annual meetings. A Project launch mission took place in October 1999, during which the Project implementation plan was updated. A technical assistance package for JDECO, the electricity distribution company serving the central West Bank, has been procured under International Competitive Bidding procedures. It is expected that the Project will be declared effective shortly.

Joint World Bank and IFC Projects

■ *Housing Project.* (US$25 million from the World Bank, up to US$19 million in equity and loans from IFC.) The largest component of this Project supports the creation and initial operations of the Palestine Mortgage and Housing Corporation (PMHC) which is designed to facilitate the flow of private capital into the housing sector in WBG. The World Bank loan was declared effective in March 1998 after which, private investors, including IFC, decided to provide equity to PMHC. PMHC will operate through two affiliates, the Liquidity Facility (LF) providing long-term funds for lending by banks and other primary mortgage lenders in WBG, and the Mortgage Insurance Fund (MIF) providing partial risk coverage for primary lenders. Canada Mortgage and Housing Corporation is the technical partner for the PMHC and has prepared the business plan as well as much of the operational documentation. Final institutional arrangements are underway and PMHC is expected to commence operations shortly. The borrower has also requested that a portion of the Bank loan be applied to the Housing Assistance Fund which has been designed to provide targeted assistance to low- and moderate-income households for the purchase of a primary residence. Restructuring of the Project to accommodate this request is presently being processed. Another component of the Project, the Institutional and Policy Development Program, addresses issues related to the functions and structure of the Ministry of Housing, in addition to its technical, administrative, and managerial capabilities.

■ *Gaza Industrial Estate* (GIE). (US$10 million from the World Bank for off-site infrastructure and public institutional development, US$9 million in equity (US$1 million) and loans (US$8 million), and up to US$7 million in syndicated loans, from IFC to the developer/operator. EIB and USAID parallel financing, and the PA long-term lease on the land, amount to a further US$65.5 million.) The GIE, on a 50 hectare site at Al-Muntar in the northeast of Gaza (adjacent to the Israeli border), is the first largely export-oriented industrial zone or "estate", established to generate sustainable employment and stimulate industrial development in Gaza. The project is expected to attract foreign and local investment, and to facilitate joint ventures between Palestinians and others. The GIE is managed and operated by Palestine Industrial Estate Development and Management Company (PIEDCO), a private sector company. Regulatory oversight as well as offsite infrastructure are provided by the Palestinian Industrial Estate and Free Zone Authority (PIEFZA). The GIE is being developed in three phases; PIEDCO is planning to launch Phase II construction shortly to double the industrial sites available for lease by the end of the year 2000. Some 34 firms have leased space at the GIE to date, filling all space made available under Phase I. Of these, 15 firms are now operating and currently employ over 600 people, with a further 200 or so occasional workers.

■ *Microenterprise Project*. (US$5 million from the World Bank; US$7.5 million from each, the IFC and the participating banks; US$3 million from the Netherlands). The Project initiates a program to finance microenterprises in WBG through the banking system in order to: (a) promote employment through private sector development; (b) achieve commercial viability and sustainability for microenterprise lending; and (c) build capacity in both the participating banks and the microenterprises by providing technical assistance. As of October 30, 1999, 453 projects for a total US$5.1 million have been approved, of which 406 projects for approximately US$4.7 million have been disbursed. The disbursed loans created over 713 new full- and part-time jobs. It is estimated that the participating banks will approve a total of US$5.5 million in microenterprise loans by the end of December 1999.

Projects Under Reparation

■ *Financial Sector Development Project* (FSDP). To be presented to the Bank's Board of Executive Directors in FY2000, this Project aims at assisting with the development of the legal, institutional, and regulatory framework for more efficient financial intermediation. The Project seeks to expand the pool of assets that can be used as collateral, thereby improving access to credit for small- and medium-size businesses. It would also support measures to modernize and expand land survey and registration, particularly in central urban areas where property values are high. Banks operating in WBG and the PA have begun to pledge formally up to US$3 million in equity in the Palestinian Banking Sector Services Company to provide electronic banking services.

■ *Institutional Development Project* (IDP). The proposed Project will be demand-driven and will provide a flexible instrument to respond to a variety of different PA ministry/agency capacity-building needs. Its underlying objective is to further the development of a transparent, efficient, and lean public sector by reducing transaction costs and creating a regulatory environment that is conducive to private sector development. The Project is on hold until such time as the discussion on the Public Expenditure Review (PER) and Comprehensive Development Framework (CDF) has been completed with the PA, at which point the final scope of the Project will be finalized in consultation with the PA. Preparation work is not expected to start until the late half of 1999 or early 2000.

■ *Solid Waste and Environmental Management Project* (SWEMP). The proposed US$17 million Project's objective is to finance interventions in solid waste collection, transfer, and disposal of waste. The Project will also assist in institutional-building within the Palestinian Environment Authority

(PENA). The Project feasibility studies for the solid waste component are nearing completion. Priority investment projects including detailed solid waste management plans have been prepared for two sites in the districts of Jenin and Hebron. The World Bank is working in partnership with the European Investment Bank, the European Union, and the Italian Cooperation in assisting the Palestinian Authority to prepare the Project. The Project is envisioned to be appraised by the end of the calendar year 1999.

Commitments and Disbursements[1]

Disbursements under World Bank Projects (in US$ million)-as of December 31-99

Project Name	Bank Allocation	Donor Cofinancing	Bank Disbursed	Donor Disbursed	Total Disbursed
EHRP	20.00	23.30	20.00	11.31	31.31
MIDP	40.00	5.41	32.94	1.19	34.13
GAZA WATER & SANITATION	25.00	0.00	21.43	0.00	21.43
MICRO -ENT.	5.00	0.00	1.62	0.00	1.62
CDP1	10.00	2.81	9.88	1.68	11.56
HOUSING	25.00	0.00	0.65	0.00	0.65
Legal	5.50	0.00	1.61	0.00	1.61
PEPP	3.00	0.32	0.31	0.25	0.56
NGO	10.00	4.60	4.33	1.88	6.21
GAZA Ind. Est.	10.00	0.00	1.22	0.00	1.22
BETH. 2000	25.00	2.91	11.22	1.32	12.54
CDP2	8.00	0.00	1.50	0.00	1.50
SAWSIP	21.00	0.00	2.04	0.00	2.04
ESMP	15.00	0.00	0.00	0.00	0.00
COMPLETED PROJECTS					
ERP 1	30.00	63.48	30.00	63.48	93.48
MIGA	10.00	0.00	10.00	0.00	10.00
ERP2	20.00	3.57	20.00	3.53	23.53
TOTAL	**282.50**	**106.39**	**168.75**	**84.63**	**253.38**
Funds Administrated by Bank					
HOLST FUND	-	262.52	-	-	255.27
TATF	-	22.77	-	-	17.97
TOTAL	-	**285.29**	-	-	**273.24**

[1] These figures do not include parallel and IFC financing

IFC Projects

IFC Portfolio

Including the joint projects above, under the Mainstream Program, eight projects worth US$75.78 million have been approved to date. Under the Extended Reach Initiative, which supports projects in the US$0.25-5 million range, IFC has met strong demand for long term loans from small, private sector enterprises since the initiative began in WBG March 1997. To date, seven projects have been approved under the Extended Reach Initiative, for US$7.42 million (total project cost worth US$29.76 million). Of this amount, US$4.92 million is committed and US$4.59 million is disbursed.

Mainstream Program Projects

■ *Arab Palestine Investment Bank.* The Arab Palestine Investment Bank (APIB) was established to provide a variety of financial and investment banking services in the West Bank and Gaza. The current shareholders of APIB include: Arab Bank, DEG, Enterprise Investment Company, and IFC. Operations and services provided by APIB are expected to parallel the development of the Palestinian financial sector.

■ *Peace Technology Fund.* The Peace Technology Fund was set up by IFC, Capital Investment Management Corporation, the Peres Center for Peace, and Evergreen Canada Israel Investments Ltd. The first closing of the project at US$60 million occurred in October 1998. Subsequent closings are expected to bring the total size of the fund to US$200 million. The objective of this fund is to provide equity capital for productive investments in the West Bank and Gaza.

■ *Palestine Tourism Investment Company Ltd.* (PTIC). The Bethlehem Inter-Continental Hotel Project is to build and operate the first international standard hotel in the West Bank. The 250-key hotel would set the standard for quality and comfort, and cater to both tourism and business clientele. The estimated total project cost is US$48 million, to be financed US$27 million by equity and US$21 million by loans. To date, IFC has disbursed US$1.35 million for about 5% of PIEDCO's shareholding, and US$4 million, or half of its A Loan commitment. EIB is committed to provide EURO12 million in a parallel loan, and has disbursed EURO6 million to date. Hotel construction is more than 90% complete and "soft opening" for about half of the rooms is expected by March 2000, with full opening expected in June 2000. Besides creating more than 200 permanent jobs, earning foreign exchange, and promoting Palestine's tourism sector, this project complements the World Bank-assisted Bethlehem 2000 Project to celebrate the start of the new Millennium.

Extended Reach Initiative Projects

■ *Nabahin Industry and Trading Company.* IFC provided financing for this tire re-treading factory to: (i) expand its production capacity in Gaza; (ii) open a new production facility in Ramallah, the West Bank; and (iii) increase its distribution capacity. Both facilities have been completed. Tires are sold under the brand name Matin/Global and include rebuilt truck and passenger vehicle tires with the durability and quality of new tires, but with costs that are 35-60% below the new cost. IFC provided a long-term loan of US$0.5 million out of total project cost of US$1.7 million. IFC's loan is fully disbursed, and the project is fully implemented.

■ *Pharmacare Ltd.* IFC financed upgrading and expanding the production capacity of Pharmacare, a 12-year old pharmaceutical company in Ramallah. The project will allow Pharmacare to improve its efficiency and quality according to Good Manufacturing Practice (GMP) standards, and ultimately to increase its sales in the local and export markets. IFC provided a long-term loan of US$0.45 million out of total project cost of US$3.2 million. IFC's loan of US$ 0.45 million is fully disbursed.

■ *Arab Concrete Products Company.* This project enables Arab Concrete Products Company to utilize fully its production capacity of ready-mix concrete, and increase its sales in the local market. Arab Concrete Products Company currently operates two ready-mix plants and ten delivery trucks in Nablus, with a combined production capacity of 110,000 m^3/year. IFC provided a long-term loan of US$0.8 million out of total project cost of US$2.6 million. The project is nearly fully implemented, and IFC has disbursed US$0.47 million of the loan.

■ *Jericho Motels Company.* IFC provided a 10.5-year US$1.17 million loan for this important tourism project in Jericho consisting of a 60-room hotel, 48 bungalows, and a health center. Developed on a 31,000 m2 piece of land, the Jericho Tourist Village includes outdoor restaurants, coffee shops, swimming pools, gift shops, as well as recreational facilities. At a total cost of US$7.3 million, the financing plan included both foreign as well as local equity investments, and long-term loans from two local banks and two international lending institutions. IFC played the leading role in estimating project cost, structuring the financing scheme, and in mobilizing the necessary funding. The project is expected to promote the West Bank's tourism sector, increase foreign exchange earnings, and create a significant number of permanent direct and indirect jobs. IFC's loan is fully disbursed, and the tourist complex is open for commercial operations.

■ *Al-Ayyam Printing Press.* This project assists the three year old *Al-Ayyam*, one of the largest private sector companies in the WBG, to upgrade its printing line, refinance its short-term debt, and perform construction improvements. In addition, the project will help the company increase its working capital to allow it to directly purchase raw materials at internationally competitive prices and to bid for high volume commercial printing jobs in the WBG and Israel. IFC provided a loan of US$1.8 million. IFC's loan is fully disbursed, and the project is nearly fully completed.

■ *Arab Palestinian Storage Company.* The project consists of establishing a cold storage facility in Gaza with a capacity to store about 5,000 tons of perishable food products. The storage method includes both freezing as well as chilling to preserve the products for long periods of time. The project also involves trading in fruits and vegetables, mainly for resale in the off-season. IFC provided a loan of US$0.2 million, which was fully disbursed in October 1999. The project is nearly fully implemented.

■ *Agency Line.* The project consists of an agency line of credit in the amount of US$5.0 million to assist the expansion and growth of productive and financially sound small- and medium-scale enterprises (SMEs) in WBG, with good business and profitability potential, by providing them with medium- and long-term loans. The agency line, to be administered by Cairo Amman Bank (CAB) is funded by US$2.5 million from IFC and US$2.5 million from CAB. In conjunction with this project, the Italian Ministry of Foreign Affairs approved Italian/IFC Technical Assistance Trust Funds to assist CAB develop its project finance unit.

IFC Technical Assistance

IFC's technical assistance efforts have aimed at further broadening and deepening the Palestinian financial sector. IFC has been working closely with the Palestinian Authority and the private sector to encourage the emergence of new instruments and players in the financial sector and capital markets through the development of framework laws and institutions.

■ *Insurance Sector.* With support from the Irish Trust Fund, IFC has worked closely with the Insurance Controller's office and the Ministries of Finance and Economy and Trade to redraft the WBG insurance law, with the purpose of establishing a system based on the European model, ensuring solvency standards in the Insurance Sector. The Insurance Sector was also involved in the work. The new draft is now finalized and was submitted to the Diwan for review.

■ *Securities Law.* With CIDA funding, IFC has worked closely with the Palestinian Authority and the private sector to draft the Palestinian Securities Law. This draft law is now finalized and has been translated into Arabic. It aims to establish an urgently needed legal and regulatory framework for capital markets, and thereby increase local and international investor confidence, and hence investment, in the Palestinian market. A number of foreign fund managers have inquired about this law, and its implementation will do much to increase investment flows into the market.

■ *Capital Markets Authority Law.* In December 1998, the Palestinian Authority decided to establish a single regulatory authority for all non-bank financial sector activities (including securities markets). The Swedish International Development Agency (SIDA) is assisting the PA to establish a single Capital Markets Authority. The IFC team working on development of the Securities Law has cooperated closely with SIDA and the Palestinian Authority in preparing a draft Capital Markets Authority Law based largely on the Securities Commission provisions included in an earlier draft of the Securities Law.

■ *Mutual Funds Law.* IFC is assisting with the elaboration of the necessary framework for the development of the mutual funds industry in WBG. The aim is to create a new vehicle for Palestinian savings (restricted today to bank deposits). This work is being supported by Swiss funding. It has already resulted in the inclusion in the Securities Law of a special mutual funds chapter setting out the basic framework for organization and regulation of these important conduits for savings and investment. Future work will involve elaboration of regulations governing eligible mutual fund investment, diversification requirements, marketing, and custody of fund securities.

■ *Mortgage Market.* IFC is playing an advisory role with the aim of eliminating inefficiencies in housing finance in the mortgage market. This effort is being financed in conjunction with CIDA, and is being coordinated with the PMHC team and the Ministry of Housing.

■ *Tax Code.* With the support from the Irish Trust Funds, IFC made recommendations for the revision of the Palestinian Tax Code. In particular, IFC's efforts focused on the methodology of taxation of the financial sector, attempting to ensure an efficient system which will encourage the development of new areas such as leasing, insurance, funds, pensions, etc. The Tax Code is now before the Palestinian Legislative Council.

■ *Competition Law.* The Ministry of Economy and Trade, with the assistance of the IFC and Irish Trust Funds, has now finalized the Palestinian Competition Law and final draft is now under review by the *Diwan*. This law establishes the principles of a free market economy and is in line with the standards of the European community.

Going Forward

IFC is working on two projects in Bethlehem (including PTIC) in the hotel and tourism sectors, which would help handle the high volume of tourism expected in the Second Millennium. IFC's efforts would complement the Bethlehem 2000 Project financed by the World Bank.

BANK GROUPS NEWS

■ **Two Economists Join the World Bank Country Office.**

-Mr. Sebastien Dessus, French, economist, Ph.D., joined the World Bank in November 1999, to work at the West Bank and Gaza Country Office. He previously worked at the OECD Development Center, where he conducted and published several studies on trade, growth, regional integration, political economy, and environment.

-Mr. Claus Astrup, Danish, economist, MA, also joined the West Bank and Gaza Office in November. He previously worked at the Ministry of Finance in Denmark, in macro-economic studies.

■ **Board Approval** (December 1999) for an IDA Credit amount of US$7.9 Million to West Bank and Gaza Health System Development Project. This Project will enhance the management and planning capacity of the Ministry of Health (MOH), as well as improve access to high-quality, affordable primary health care services, especially in rural and under-served areas.

■ **Workshop for the Second Emergency Rehabilitation Project (ERP II).**

As part of the implementation completion process of ERP II, a Stakeholder Workshop was held on November 3, 1999 at the World Bank's office in the West Bank. PECDAR senior management, mayors, community leaders from municipalities in Gaza and the West Bank attended the Workshop, as well as World Bank staff. Discussed at the Workshop were the benefits of ERP II, the lessons learned, and how all stakeholders can perform their responsibilities better and more efficiently in the future. ERP II contributed towards improving the transportation system, accessibility to primary services, opportunities for women's education, the opening of women's social clubs, improving environmental quality through reduced groundwater pollution, and finally, ERP II provided opportunities for development of local agricultural, industrial, and commercial activities. On the other hand, mayors and community leaders indicated some concerns such as: increasing pledges from the donor community; improving communication and consultation between the donor, implementing agency, and the local community; ensuring good quality and sustainable products; and improving capacity to prepare maintenance plans for the developed projects.

■ **Procurement Questions and Answers Session.**

Two sessions were held on November 7- 8, 1999 on procurement of works, goods, and consultancy under IDA Credits were held in the West Bank and Gaza (at the Islamic University and at the World Bank office). Both sessions were chaired by Mr. Frederick Kranz, Senior Procurement Advisor. The objective was to strengthen the capability of the Palestinian Authority (PA) counterpart in carrying out procurement of projects financed by the World Bank and to answer questions on procurement related to the participant's project.

■ **IFC Executive VP Visits the West Bank and Gaza.**

Mr. Peter Woicke, Executive Vice President, IFC, and Managing Director, World Bank, visited the West Bank, Gaza, and Israel from October 23-25, 1999 accompanied with Mr. Mohsen Khalil, Director, CMEDR, Mr. Salomon Asamoah, Special Assistant to the

Executive Vice President, Ms. Brigid Janssen, Chief, Media Relations, Ms. Margaret Henderson, Principal Investment Officer. During his visit, Mr. Woicke met with President Yasser Arafat and a number of Palestinian and Israeli businessmen. He also made site visits to Jacir Palace, to a number of microenterprises in Bethlehem and to the Gaza Industrial Estate.

New IFC's CAMENA Director.
On December 22, 1999 Mr. Sami Haddad was appointed to the position of Director of the Central Asia, Middle East, and North Africa Department. Mr. Haddad has wide-ranging experience at the IFC that will be useful as IFC continues to diversify and strengthen its geographic and clientele base of new investments in the CAMENA region. He has served as a Regional Representative in both West Africa and the Middle East, where he currently is based in Cairo. In addition, he has worked in Capital Market and General Manufacturing in the South and Southeast Asia Department, and as an Associate Director in Portfolio Management and Credit Review.

Donors Meetings:

Ad Hoc Liaison Committee (AHLC).
A meeting of the Ad Hoc Liaison Committee (AHLC) was hosted by the government of Japan in Tokyo on October 15, 1999. The meeting was attended by senior representatives of 12 major donor countries in addition to the PA and the government of Israel. President Arafat, the Norwegian Foreign Minister, Mr. Knut Vollebaek and the Japanese Foreign Minister, Mr. Yohei Kono addressed the meeting. During the meeting an updated version of an agreement (Tripartite Action Plan) between the PA, Israel, and the donor community was signed. The new agreement highlights the various duties and responsibilities the parties have agreed to in order to best achieve Palestinian economic development. The World Bank is to monitor the agreement.

Local Aid Coordination Committee (LACC).
Over 50 people representing the donor community, the PA, and Israel gathered at the UN Special Coordinator's Office on December 9, 1999. Issues discussed included an update on the Palestinian economic situation, report-back on the follow-up of the Tokyo AHLC meeting, a status report on the work plan on macro-economic policy and management, the budget proposal for the year 2000, and the status of donor disbursements.

Joint Liaison Committee (JLC).
On December 15, 1999, some 25 members of the JLC representing the PA ministries, the 12 major donor countries, and Israel gathered at UNSCO, Gaza. Discussions included the PA's fiscal situation, a report on the follow-up to the AHLC Tokyo meeting, and project implementation-related matters, such as, the Task Force on Project Implementation (TFPI), issues related to safe passage, the Gaza Port, and the Industrial Zones. As part of the report on the follow-up to the AHLC Tokyo meeting, the World Bank reported on the implementation and monitoring of the time-line of the Tripartite Action Plan (TAP), and with regard to project implementation-related matters, the World Bank presented its report on the TFPI which is currently being chaired by the World Bank.

Sub Sector Working Group on Public Administration.
On November 22, 1999, about 30 experts in the field of public administration (representing the various PA institutions), as well as the donor community, convened at UNSCO in Gaza. In the very well organized meeting, the World Bank introduced the concept of the Comprehensive Development Framework (CDF) and discussed the draft CDF matrix for public administration in the West Bank and Gaza. In addition, the World Bank held discussions on the idea of supporting the CDF matrix with a Public Administration Network of Knowledge (PANK), which was submitted for funding to the Danish Trust Fund in Washington, D.C. Such a Network of Knowledge would make available documents and reports in electronic format in English and Arabic on a web-site easily accessible to everyone.

Sub Sector Working Group on Water and Wastewater .
On December 13, 1999, over 25 people representing the PA and the donor community convened at the World Bank office in the West Bank in order to discuss the progress made thus far in the sector, as well as planned activities issues. During the meeting, the World Bank introduced the draft CDF matrix on Water and Wastewater as an advanced stage of its efforts, and as a tool for development.

Sub Sector Working Group on Industry.
On December 16, 1999, World Bank staff participated in the first meeting held on Industry at the UNSCO offices in Gaza with an objective to develop industrial policy of the PA, and to motivate direct contact with the donor community. Discussion focused on the developments of the private industrial sector, and donors presented their current and future

activities in the industrial sector. In this regard, the World Bank briefed participants on its experience in the Gaza Industrial Estate (GIE), as well as its future activities in the industrial sector.

New Bank Publications:

■ **Strengthening Public Sector Management West Bank and Gaza, 1999.**
The report looks into matters of public operations and expenditure of the Palestinian Authority, including local government. The objective of this is not only to give advice to the PA on public sector management, but also to suggest how the PA can build its own capacity for public sector management. The report is concentrating, in particular, on the objectives of managing planning, budgets, and expenditures. This includes the means for integrating into the budget current expenditure impact of projects proposed in the Development Plan. The report is available in Arabic and English.

■ **Entering the 21st Century - World Development Report 1999/ 2000.**
Policymakers in the next century will need to pursue development across a transformed economic, political, and social landscape. Entering the 21st Century examines the contours of the changing development landscape and charts the way forward.

The Report focuses on two of the most important forces shaping development: the integration of the world economy, and the increasing demand for self government.

By drawing on a wealth of recent research on cross-country experience, the Report proposes a rich menu of rules and policies that can serve as the ingredients of a comprehensive approach to development. The Report also includes selected World Development Indicators. The World Development Report 1999/2000 provides invaluable guidance for decision-makers in the next century. The Arabic edition will be available January 31, 2000 at a special price of US$6.00. (For more information, please contact Ms. Mary Koussa at the World Bank Library/Public Information Center).

Latest Available Publications:

■ Environment Matters - Annual Review 1999. This issue looks at the World Bank's environmental work for the past year. Its contents include: an overview article that describes the current effort to develop an Environment Strategy for the World Bank; an article on emerging trends in the World Bank's environmental portfolio; and each of the World Bank's operational regions has written an overview of the region's work, accomplishments, lessons learned, and future challenges.

■ Towards a Virtuous Circle: A Nutrition Review of the Middle East and North Africa. This is the first comprehensive overview of nutritional issues in the region, putting together the problems in an overall economic development context. The review focuses on the health implications of nutritional issues, and supplements a regional study of food subsidy programs, and the regional health, nutrition, and population sector strategy paper.

■ The World Bank Annual Report 1999. The Report contains the World Bank Highlights for the past fiscal year, the Regional and Thematic Perspectives, the Development Effectiveness, the World Bank Finances, and the Summaries of Projects Approved, and Financial Statements.

■ Precis # 185 World Bank Operations Evaluation Department: Aid Coordination and Post-Conflict Reconstruction: the West Bank and Gaza Experience (English and Arabic).

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