



Public financial management reforms in fragile states: the case of West Bank and Gaza

Philipp Krause



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October 2012

Acknowledgements

The team would like to thank Mark Ahern and Khalida Al-Qutob, as well as several other colleagues at the World Bank office in Jerusalem, who hosted the ODI team during their field visit. They shared both indispensable guidance and logistical help. Rasha Tourjman provided interpretation and research assistance. Nithya Nagarajan shared an unpublished study on reform leadership in West Bank and Gaza.

The team would also like to express its gratitude to Prime Minister Salam Fayyad and the Palestinian National Authority for the hospitality and support extended during the ODI team's visit to Ramallah in August 2010. All interviewees (for a full list see Annex 6) were very generous with their time and insights, in spite of other pressing obligations and the fact that part of the visit took place during Ramadan.

Kind regards to Mark Ahern, Pierre Messali, Verena Fritz and Ana Paula Fialho Lopes for their comments on earlier drafts of this report.

Please note that this report covers events only until the summer of 2010. Responsibility for the opinions expressed and any errors of fact or judgement remains with the author.

Overseas Development Institute
203 Blackfriars Road, London, SE1 8NJ

Tel: +44 (0)20 7922 0300
Fax: +44 (0)20 7922 0399
www.odi.org.uk

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Abbreviations

CSO	Civil Society Organisation
DAC	Development Assistance Committee
EC	European Commission
FCAS	Fragile and Conflict-affected States
GDP	Gross Domestic Product
GNI	Gross National Income
IEG	Independent Evaluation Group
IFI	International Financial Institution
IFMIS	Integrated Financial Management Information System
IMF	International Monetary Fund
MDTF	Multi-donor Trust Fund
MoEHE	Ministry of Education and Higher Education
MoF	Ministry of Finance
MoP	Ministry of Planning
NGO	Non-governmental Organisation
ODA	Official Development Assistance
OECD	Organisation for Economic Co-operation and Development
OPM	Oxford Policy Management
PEFA	Public Expenditure and Financial Accountability
PER	Public Expenditure Review
PFM	Public Financial Management
PIF	Palestinian Investment Fund
PLC	Palestinian Legislative Council
PA	Palestinian National Authority
PRDP	Palestinian Reform and Development Plan
SAACB	State Audit and Administrative Control Bureau
TA	Technical Assistance
TIM	Temporary International Mechanism
TSA	Treasury Single Account
UK	United Kingdom
UN	United Nations
UNRWA	UN Relief and Works Agency
US	United States
VAT	Value-added Tax
WBG	West Bank and Gaza

Executive summary

Reform context and political economy

The West Bank and Gaza (WBG) have had a turbulent political history over the past two decades. At the outset of the 1990s, the territories were administered by Israel. The PFM reform trajectory can be divided into four phases, which also coincide with and were largely driven by the major high and low tides of political change in WBG.

In 2002 WBG found itself with a fragmented, personalised and informally organised public sector in general, and PFM system in particular. Its inability to deliver either an internationally credible proto-state or a stable operation of public finances (and consequent service delivery) had become apparent to most domestic and international stakeholders. There was a long-drawn build-up of domestic pressure over the PA's perceived corruption and inability to deliver, as well as a concurrent international pressure over its non-credibility as a source of stable and reliable government and governance for WBG. These pressures were brought to a head by the crisis that resulted from the Second Intifada. These factors created the political space for a technical, reformist minister of finance with an IMF background to take office.

Between 2002 and the end of 2005, there was a first wave of reforms. The finance minister was supported by the international community and at least tolerated by the most important domestic veto players. Up until late 2005, determined reforms to budget execution began to change the way the public sector operated. These reforms did not, however, prove sufficient to sway a disenchanted electorate, which voted Hamas into power in January 2006. Hamas won a strong majority in the Palestinian Legislative Council (PLC) and gained the right to form the next government.

From early 2006 until mid-2007, the Hamas-led government and the subsequent separation of Gaza and the West Bank dominated the agenda. Many reforms that had been implemented during the preceding years quickly fell apart, or, more often, became dormant. The treasury single account fell out of use, because ordinary revenues from external donors and clearances had stopped and normal budgetary operations ceased as a result of the cash shortage. The knowledge about these systems did not disappear, however, and many control functions remained intact, where applicable. For instance, the financial controllers in line ministries continued to check invoices. Since most officials remained in place during this period, the status quo ante was restored within about six months after the end of the Hamas period.

Since 2007, there has been a renewed effort to implement reforms and a gradual improvement of governance in many areas. From a reform perspective the three years 2007-2010 have been a period of stability, where the focus of attention has gradually moved from how best to respond to a multi-dimensional emergency to how best to ensure sustainable stability and more gradual improvements. Since 2008, reforms have been broadened and deepened to the point where all the basic elements of a soundly operating PFM system seem to be in place on the budget-execution side, with substantial progress in other areas. Reviews have found substantial improvements to the credibility of the budget, comprehensiveness and transparency, predictability and control, as well as accounting, recording and reporting. Improvements to policy-based budgeting and external scrutiny were rather more modest (Ahern, 2010). Over the entire period 2006-2010, no significant deterioration could be found, although of course some areas saw quite significant, but temporary, setbacks for certain periods of time.

WBG is not a sovereign state and the operations of the PA are very vulnerable to disruptions of its revenues, the two largest sources of which (clearance revenues and external aid) can be disrupted by means almost completely beyond the PA's control. The engagement of external actors is enormously important for the operation of politics and government in WBG. The donor community is heavily engaged in supporting the PA. In 2006, the PA received about 40% of its revenues from external sources. Due to WBG's particular political status, aid modalities are

fairly complex. Support from the World Bank is given in the form of grants, via a trust-fund arrangement. Other donors use a variety of mechanisms, from project aid to budget support.

Design and implementation of PFM reforms

Progress was made in fits and starts. The broader political environment determined the degree to which reforms could advance and, notably, in 2006-7 caused much progress to be reversed, if only temporarily. The government deliberately emphasised reforms that would strengthen credibility and control of budget execution. These reforms were for the most part constrained by political conditions, not by capacity or financial constraints. Where resources or capacity were lacking, the government possessed enough central-management capability to direct external assistance towards areas of priority. As a consequence of this strategy, not all fields of PFM that were considered crucial by international experts were given a similar degree of attention, which occasionally caused friction between donors and the government. On the whole, however, the international community supported the broad reform agenda of the government in 2003-2005, and since 2007.

The types of PFM reforms and their sequence are notably different from what has been observed in many low-income countries. There was a marked and deliberate emphasis on budget execution, to the exclusion, at least at first, of efforts to strengthen budget preparation. At least during the second phase of reforms, efforts were not limited to the concentrated entities at the core executive, but also extended to spending ministries. The reforms could draw on a fairly broad and deep cadre (by the standards of a small and fragile state) of competent officials, who enjoyed a modestly meritocratic career path within the ministry of finance and associated agencies after 2002. The reforms also benefitted from a core capacity within the core executive to set priorities and steer a complex reform process according to the domestic political priorities of the day, even if the capacity to implement all aspects of these reforms clearly depended on support from donors and external technical experts. This reform-management capacity is very often lacking in low-income countries and is perhaps the clearest expression that WBG is not a typical fragile state.

Reform outcomes and sustainability

It seems clear that serious reforms began in 2002 from a relatively low starting point in most areas of PFM. The fiscal crisis at the time, combined with the underdeveloped systems and procedures across all phases of the budget cycle created a sense of urgent emergency amongst donors and the government. By 2010, many substantial reforms were carried out successfully, and these reforms profoundly changed the practice, as well as the formal setting, of public financial management. It is much more difficult, unfortunately, to properly assess the success of these reforms in a comparative and reliable way. Expert reviews carried out over the last two years emphasise strongly that reforms have proceeded in many fields, although obviously many challenges still remain.

Over the entire reform period, only one PEFA assessment has been carried out (in 2006), which only partially captures even the first wave of reforms. Since it took place at a time of acute political and fiscal crisis, it is very hard to extrapolate, or reconstruct, how scores might have looked before or after this one snapshot view. At the time, the PFM system did not score very well, with only 4 'B' scores, and 12 'D's (out of a total of 28 indicators in the PEFA framework).

Since then, qualitative reviews have found substantial improvements to the (1) credibility of the budget, (2) comprehensiveness and transparency, (3) predictability and control, as well as (4) accounting, recording and reporting. Improvements to (5) policy-based budgeting and (6) external scrutiny were rather more modest (Ahern, 2010). Over the entire period 2006-2010, no significant deterioration could be found, although of course some areas saw quite significant, but temporary setbacks for certain periods of time. Without being able to quantify it, the PFM-reform record can be called broad and substantial.

The sustainability of the current state of PFM remains an open question. Many core elements of the current system, such as the TSA, have now been practiced throughout multiple budget cycles and are therefore probably accepted as standard practice amongst staff. Yet the Hamas period has shown that in WBG there is a real risk that a political reversal brings about a situation where, whether by intentional design of the government or not, progress on PFM reforms is threatened and reversed. Whilst in the past these periods have been massively disruptive to the operations of the PA, they also turned out to be reversible. However, over the last decade, many of the achievements have been associated closely with the person of the current Prime Minister, who is also a former IMF staff member. The next time a change in the highest offices of the executive takes place, a lot will depend on the precise circumstances of the changing political balance to determine if the support for PFM reforms holds firm.

Links to wider public sector and governance issues

There is a direct connection between PFM reform and state-building in WBG, and the key political actors are keenly aware of it. A functioning, modern budget process that provides a stable framework to the formulation of policy, its public deliberation, reliable execution and external control is clearly understood to be a defining feature of a sovereign state. Conversely, the inability of the PA to function as a capable government in 2002 was seen as a main motivation to carry out reforms, not necessarily for their own sake, but because not tackling these issues would be a permanent obstacle towards these much larger political goals. The focus on the downstream side of the budget process, reaching deep into the cash management of spending ministries, has had a substantial impact on the way the public sector operates. It has managed to remove a lot of scope for informal, discretionary action away from the centre of government.

There is much anecdotal evidence that the PFM reforms of the past years have contributed to the PA's (and international) state-building agenda for WBG. That a stronger PFM system would contribute to the PA's viability as a proto-state for the Palestinian people is an explicit motivation for virtually every official interviewed, starting with the Prime Minister himself. It sometimes seems that it is more important to senior officials to have a strong and credible PFM system as a core element of any modern state, rather than to expect the PFM system to deliver better outcomes, however defined. This emphasis on PFM reform as an exercise in state-building might to some extent explain the relative emphasis chosen by the government over the years.

This progress is limited, however, by the unresolved macro-political situation. The government in the West Bank faces limitations to its work in Gaza. At the same time, the Palestinian Legislative Council (PLC) is not operational, because the majority of delegates (from Hamas) no longer attend. Gaza and the West Bank are governed under emergency rules. Both legislative (2006-2010) and executive (2005-2009) terms have technically come to an end. In 2010 the situation is one of sustained progress, but with an uncertain future.

1 Introduction

1.1 Purpose and objectives of the study

This paper is part of a study analysing public financial management (PFM) reform initiatives in fragile and conflict-affected states (FCAS). The objective of the study is to undertake a comparative stocktaking, review and synthesis of lessons learnt about designing, implementing and assessing PFM reform initiatives in FCAS.

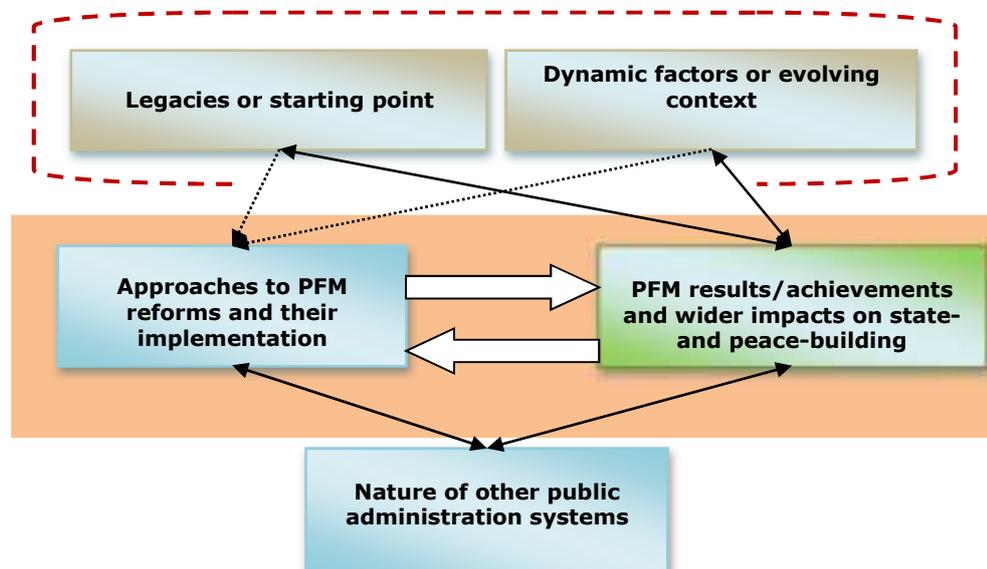
The study builds on analysis carried out in an earlier phase of the project, which allowed an opportunity to summarise the literature currently available on PFM reform initiatives in FCAS and to extrapolate key issues and themes from three desk-based case studies (Afghanistan, Cambodia and Sierra Leone). The current study (the second phase of the project) builds on these outputs, but in doing so extends the breadth and depth of the analysis as well as its reach, by carrying out multiple country case studies and exploring synergies across them.

This case study of West Bank and Gaza (WBG) is one of eight in-depth country studies that will form the basis of a synthesis paper and a World Bank Guidance Note to provide practitioners with accessible, evidence-based knowledge about PFM reform approaches in FCAS.

1.2 Study questions, framework and methodology

The overall study attempts to answer two overarching questions. First, how have PFM operations been affected by the challenges associated with state fragility? Second, have the design and implementation of PFM operations contributed to sustainable progress in the development of PFM systems, as well as to wider state- and peace-building objectives?

Figure 1: Summary of contextual factors and reform interactions



The study focuses on issues and processes related to the expenditure side of PFM. For the purpose of this analysis, public expenditure management is divided into the following stages of the budget cycle: budget formulation; budget execution; and audit, evaluation and accountability. The study also looks at the legal and institutional framework. It does not examine revenue generation and management or the agencies responsible for the collection of revenues (i.e. customs and the tax administration). The study examines developments over time; across budget cycle functions; across concentrated and de-concentrated agencies (finance ministries, line ministries, sub-national entities etc.) and across actors and stakeholders.

The case studies analyse the relationships between the dimensions (i.e. the arrows) in Figure 1 in order to understand better the PFM reform trajectory in each country. By accounting for the nature of the country context, they examine reform efforts from a political economy perspective.

1.3 Activities carried out

This case study covers the period from 2002 to 2010. It analyses the trajectory of PFM reforms in WBG starting from the way PFM functioned within the Palestinian National Authority (PA) at the turn of the last decade, through several distinct reform phases to its current state.

It is based on a review of available documentation and data, fieldwork interviews in Ramallah, Nablus and Jerusalem and follow-up telephone interviews with other stakeholders. The fieldwork was carried out in August 2010.

2 Reform environment

2.1 Country context and indicators of ‘fragility’

The political history of WBG over the past two decades has been turbulent. At the outset of the 1990s, the territories were administered by Israel, with municipal governments in many cities considerably predating the 20th century. After the 1993 Oslo Agreement, the administration of WBG was then successively handed over to the newly created PA, whose political history can be roughly divided into four phases, which coincide with the major high and low tides of reform.

First, until around 2002, the PA had been growing into a personalised and rather informal administration, very much centred on the person of Yassir Arafat as President. Against a backdrop of continued negotiations over the future of a possible Palestinian state until the failed summit at Camp David in 2000, the founding period of the PA was dominated by the need to ensure stability and responsiveness to the political demands of the day. Many key positions at the time were filled according to political criteria. According to most sources relating to this period, the result was a very inefficient administration prone to considerable leakage of funds, which was not very capable of delivering key public services, and which was overstaffed (Brynen, 2007). The Second Intifada and the deterioration of political and economic relations with Israel after 2000 quickly created a critical situation whereby pressure to reform became very difficult to resist.

Second, between 2002 and the end of 2005, there was a first wave of reforms. By 2002, the suspension of customs-clearance transfers from Israel,¹ along with the economic crisis that followed the intifada, pushed the PA into a critical and clearly unsustainable position and also prompted donors to become much more forceful in their demands for reform. Salam Fayyad, former representative of the International Monetary Fund (IMF), was appointed Minister of Finance in the summer of 2002 and embarked on an ambitious set of reforms of the public finances, which generally impressed professionals and the international community – slow to start, they continued unabated after Mahmud Abbas succeeded Arafat to the presidency in 2004. These reforms did not, however, prove sufficient to sway a disenchanted electorate. In January 2006, the political party Hamas won a strong majority in the Palestinian Legislative Council (PLC) and gained the right to form the next government.

Third, from early 2006 until mid-2007, the Hamas-led government and the subsequent separation of Gaza and the West Bank dominated the agenda. During the Hamas-led government era, the donor community, along with Israel, implemented a near-total boycott of the Palestinian executive. Interactions took place only with the presidential office and via non-governmental organisations (NGOs), international organisations and informal channels. Many reforms that had painstakingly been implemented during the preceding years quickly fell apart, or, more often, became dormant.

Finally, from 2007 to the present, there has been a renewed effort to implement reforms and a gradual improvement of governance in many areas. For a brief period between March and June 2007, a unity government of Hamas and Fatah was in office, but this fell apart violently after Hamas formed the *de facto* government in Gaza. After the separation of Gaza, President Abbas eventually appointed a caretaker government in the West Bank led by Salam Fayyad as Prime Minister. Under the new government, which remains in office, many advances of the pre-2007 period were quickly restored, and then built on. From a reform perspective, the three years until 2010 were a period of stability, with the focus of attention gradually moving from how

¹ The government of Israel collects customs and value-added tax (VAT) charges on behalf of the PNA and transfers these funds on a monthly basis. In 2005, the PNA collected about 39% of its non-official development assistance (ODA) revenues of \$1233 million from domestic sources and 61% from clearances (World Bank, 2007). In the same year, ODA amounted to an additional \$754 million (see Annex 4). In 2008, according to IMF staff estimates, the proportion of clearance revenue had risen to 73% and was projected to vary at around two-thirds of total revenue for the coming years until 2011.

best to respond to a multidimensional emergency to how best to ensure sustainable stability and more gradual improvements. This progress has been limited by the unresolved macro-political situation and the *de facto* government in Gaza. At the same time, the PLC is not operational, because the majority of delegates no longer attend. Gaza and the West Bank are governed under emergency rules. Both legislative (2006-10) and executive (2005-9) terms have technically come to an end. In 2010, the situation is one of sustained progress but an uncertain future.

There are several key factors driving WBG's fragility. The first and most obvious point to make is that WBG is not a state. It does not have sovereign control over its borders or its territory and depends on external actors (donors and customs clearances forwarded by Israel) for much of its income. The relationship with Israel is the salient political issue and, over the PA's lifetime, every major political upheaval had immediate adverse effects on the functioning of the administration. Furthermore, WBG is very much an emerging polity, with a political system that is far from settled. The polity does not have much experience of organised groups and parts of society expressing their grievances and interests through the institutions of representative democracy. Instead, at least until 2007, there have been numerous interruptions to the political process, including the arrest of many legislators and the consequent suspension of legislative business, as well as the violence in Gaza, which to date have not been resolved.

The socioeconomic situation in WBG, however, is much better than in many other fragile states in this study's sample, with the exception of Gaza in recent years, where the situation has worsened dramatically. The official poverty rate in Gaza exceeded 50% in 2007, whereas it stood at 19% in the West Bank. Life expectancy at birth for WBG in 2008 stood at 73 years, which is higher than the average for the Middle East and Northern Africa (70) and that for lower-middle income countries (68). A similar picture can be found for literacy rates (94% against 73% and 83%, respectively) and child malnutrition (2% of children under five against 26% for lower-middle income countries).² All of this has to be seen in context, of course. Even though key development indicators for Palestinians in WBG are much better than those of people in many fragile states, and also better than those in many Middle Eastern countries, they are far below those in Israel, where per capita income is many times higher (gross national income (GNI) per capita was \$1,564 versus \$24,678 in 2010).

One important source – and expression – of fragility is the labour market. While never satisfactory, the situation has worsened considerably since 2000. With population growth of around 3.5% (the population rose from 3.6 million in 2006 to 3.8 million in 2008), around 45,000 new entrants have to be absorbed into the labour market each year (World Bank, 2007). During the 1990s, a large number of people were able to work in Israel or benefited from relatively open exchange with the much larger Israeli economy. After the beginning of the Second Intifada, both of these factors fell sharply, with highly adverse effects on economic growth and employment. The situation was exacerbated after 2006 by the international boycott. In 2006, unemployment rose to about a quarter in all of WBG, and more than 35% in Gaza (*ibid.*).

Table 1: PA expenditures 2009 (%)

	Wages and salaries	Operational expenditure	Transfer expenditure	Capital expenditure	Development expenditure	Total
Share of type of expenditure in total expenditure	50.2%	15%	26.6%	1.7%	6.5%	100%

Source: World Bank (2010).

These developments took place against the backdrop of a very large public sector payroll. The initial expansion of public employment was used as a source of patronage and as an instrument to manage political control. Over the past decade, there has been consistent

² Figures in this paragraph come from <http://data.worldbank.org>

pressure from donors, who identified the public wage bill as a key threat to fiscal sustainability, highlighting in particular the lack of payroll controls in the security services. In 2005, the PA had almost 150,000 employees (both security and civilian) on its payroll, about a third more than in 1999 (Ahern, 2010b). Their number rose to 169,000 in 2007, owing to successive waves of political hiring carried out by successive governments. Between 2007 and 2008, the new government succeeded in reducing numbers to 143,000, although it has risen again a bit since then. The deterioration of the economic situation since the Second Intifada continues to make it politically extremely challenging to reduce public employment, since this has constituted one of the few remaining welfare buffers available to the PA. There seems to be a consensus among the international community that the salaries of the PA need to be paid to maintain political stability, especially in moments of crisis. In 2009, wage bill payments reached 22.4% of gross domestic product (GDP) (OPM, 2007). The vulnerability of the PA's revenues to external factors, which can directly affect its ability to pay its employees, makes this an issue of critical importance for its leadership as well.

2.2 Sources of influence on PFM reform

2.2.1 Political governance and leadership

The political governance situation of WBG over the past decade has been volatile and uneven, although several key factors have become more favourable over time. In very simplified terms, it can be said that, before around 2002, there was little political backing for fundamental PFM reforms, and the political leadership at the time did not see the PFM system primarily as a tool to deliver efficient public services and maintain fiscal discipline. When the first wave of reforms was implemented under the leadership of then-Minister of Finance Fayyad, they took place against considerable resistance from beneficiaries of the *status quo*. Fayyad was appointed by then-President Arafat at a time of grave fiscal difficulties and under strong international pressure (For contemporary coverage see, e.g., Bennet, 2003 and Zacharia, 2002). During the crisis following the time of the Hamas-led government, PFM reform was very clearly not a priority issue, and only since 2007, and only in the West Bank, have the reforms enjoyed sustained and profound backing from the political leadership, led again by now-Prime Minister and Minister of Finance Fayyad. Since the Fayyad government has been in office in the West Bank, PFM reforms have been a priority, with close attention from the most senior officials of the government. However, there are doubts over how deep the support for reforms reaches, because the absence of a functioning legislature means that both government and opposition political parties cannot formally debate the merits of any political or institutional reforms. Anecdotal evidence suggests that the current reforms are well supported, but there is very little systematic evidence to underpin this.

2.2.2 Public sector management

It should be noted that the PA governs a relatively small territory, and has not existed very long as a public administration in its current form. It has roots in the administrative traditions of its neighbouring countries, predominantly Egypt (which inspired the administrative regulations and procedures used in Gaza) and Jordan (similarly for the West Bank), but also in the Israeli civilian administration that existed before the PA was established. As a result, many current staff in key positions have been present since the creation of the PA or shortly thereafter, and many official functions are identified just as much with the incumbent as they are with the office.

Numerous studies point out that the big weakness of the civil service has been lack of control over hiring, both in terms of numbers but also regarding the qualifications of staff hired; these issues characterised the PA during its first decade especially. There have been marked improvements in payroll controls and generally in human resource management since about 2008, but the legacy of earlier years still looms large.

On the other hand, the capability of the core ministries and agencies of the PA is substantial, and probably much higher than in most if not all countries commonly thought of as fragile. This is not to say that the PA is able to execute all the policies it sets itself, or that it does very well on service delivery, or that it is able to implement all reforms without technical difficulties.

It does, however, have the capacity to formulate political and technical reform priorities, rank them and push forward with their implementation, selectively seeking external aid where needed. This capacity to formulate, prioritise and sustain reforms is something taken for granted in high-income countries, but not at all in fragile states. It is impossible within the scope of this study to assess how far this capacity reaches, but it certainly applies to the central agencies of the PA.

One key factor to explain this capacity is the skill and quite unusually long retention of key staff, especially in the Ministry of Finance (MoF). In 2009, the MoF employed 807 professional staff³ at its headquarters – a further 535 work at the Ministry of Planning (MoP) and a total of 467 at the tax, customs and procurement agencies. Almost all high-ranking officials in the MoF have been part of the PA since the mid- to late 1990s and have risen through the ranks over the past decade. These officials entered their agencies at a time when many top positions were taken up by political appointees, but have over time taken up posts of increasing responsibility, at the same time as incompetent officials have been sidelined. According to the World Bank, non-retiring staff departures numbered less than 1% of the total at the MoF, a figure broadly mirrored at other central agencies.⁴ The available evidence suggests that officials in the MoF, as well as other key economic and fiscal policy agencies (it is not possible to say much about agencies outside the scope of this study), have been promoted mostly on merit since 2002/03.

Earlier studies of the PA pointed out that many key positions were taken up by returnees with political connections who were not necessarily qualified for the technical requirements of their post. According to the Minister of Finance Fayyad, however, it has been possible to largely sideline less competent staff and await their retirement, structuring key administrative procedures and the management of reforms around those officials who have proved themselves willing and able to support the direction of reforms.⁵ Officials express a strong sense of pride in their work, and describe working in the civil service as a contribution to the establishment of an eventual Palestinian state. In what is a rather fortunate side-effect of the economic climate, public sector employment is seen as highly desirable, with few private sector alternatives available.

2.2.3 Public expectations and public accountability

According to studies of the period, public disenchantment with perceived corruption and incompetence was a crucial factor making the reforms of 2003-5 possible (Brynen, 2007), combined with external pressure from donors. The call for reforms in 2002, followed by the appointment of Salam Fayyad as Minister of Finance, came after intense pressure from opposition groups and other actors outside the government to change the way the PA was run. In theory, WBG's governance has regular democratic accountability through legislative and executive elections, and one could argue that the upset victory won by the Hamas political party in 2005 was an expression of public dissatisfaction with the PA up to that point. During the unity government in 2006/07, it cannot be known how the relationship between public expectations and government performance evolved, because the public agenda was dominated exclusively by the emergency situation. Since 2007 and the *de facto* government in Gaza, governance has bifurcated. In practical terms, this current study of the political situation in WBG applies only to the West Bank.

Currently, several key mechanisms of formal democratic accountability are suspended. Since several legislators were arrested in 2006, the PLC has not had a quorum to take formal decisions and is essentially also suspended, even though its administrative apparatus continues to function. New elections for either branch of government have not been scheduled and their current terms have since expired. For the moment, the government is trying to supplement the lack of formal accountability by increasing other forms of reaching the

³ Defined here as having at least a Bachelor's degree or equivalent.

⁴ The figures in this paragraph are taken from the CFA Database maintained by PREMPS.

⁵ Interview with Salam Fayyad, 19 August 2010.

population. This includes active outreach to civil society organisations (CSOs) and other measures.

While the formal legislature is not currently able to hold the government to account, numerous newspapers and radio and television channels are widely available to the population and also widely used, although the media is reportedly quite politicised. Reporting suffers from restrictions imposed by the government of Israel, conflicts within the Palestinian polity and, in particular, the severe limitations in Gaza (Freedom House, 2010). There are not many organised societal groups with an agenda that encompasses fiscal or economic policy, with the notable exception of the local branch of Transparency International. Transparency Palestine pursues an active agenda that explicitly identifies shortcomings in the current state of the public finances, and engages directly with officials of the PA.

The government seems to acknowledge that, for a sustainable, democratic state, formal representative institutions are irreplaceable. That said, its intensified and deliberate outreach, including specifically to CSOs like Aman Transparency Palestine, seems motivated at least partially by the need to have some form of communication with the population while the legislature is defunct. To the extent that it is possible to extrapolate from the limited information available, it seems that the second wave of PFM reforms, launched in 2008, enjoyed, at the time, some popular support, and that some headline improvements in PFM were clearly visible to the public. The overnight establishment of the treasury single account (TSA), for instance, was reported in the international media (Bennet, 2003), and was a salient local issue at the time.

2.2.4 International engagement and modalities of external support

Engagement of external actors is enormously important for the operation of politics and government in WBG. The donor community is heavily involved in supporting the PA, which receives a significant amount of its revenues from external sources. According to a 2006 Public Expenditure and Financial Accountability (PEFA) assessment, it reached about 40% of total revenues at that time. Given WBG's particular political status, aid modalities are fairly complex. Support from the World Bank is given in the form of grants, via a trust-fund arrangement. Other donors use a variety of mechanisms, from project aid to budget support. Budget support through several donor funding mechanisms was budgeted to reach about \$663 million in 2005 (OPM, 2007). Net ODA increased significantly after the crisis of 2006, from \$1.45 billion to \$2.59 billion in 2008. The Development Assistance Committee (DAC) of the Organisation for Economic Co-operation and Development (OECD) does not provide net ODA:GDP ratios for WBG, but it does note that the ratio of ODA per capita in 2008 (\$668 per capita) was almost 20 times the average for fragile states (\$36), and by far the highest in the world (OECD, 2010). The largest donors in 2007/08 were the European Commission (EC), the UN Relief and Works Agency (UNRWA) and the US.⁶ Up until the 2009/10 period, it was estimated that virtually all investment spending was financed from external sources, although the PA has since made an effort to make more of its own resources directly available for some key investment projects.

WBG is not a sovereign state and therefore cannot become a member state of the World Bank or the IMF, or use the funding mechanisms normally available to member states. Instead, assistance since 1993 has been provided vis-à-vis the Trust Fund for Gaza and West Bank. This is replenished from the Bank's surplus income. Between 1993 and 2010, a total of \$608 million was invested in the trust fund, the last replenishment in June 2010 being for \$55 million. Since 2002, this assistance has been provided in grant form. The Bank currently focuses its budget support on reforms in two policy areas: strengthening the government's fiscal position and improving PFM. While the Bank also conducts projects covering a much wider range of development issues, the PA's reform efforts in the area of PFM are at the centre of its policy engagement in WBG. Since 2007, the relevant reform programme has been the Palestinian Reform and Development Plan (PRDP), which is the government's development strategy for the years 2007-10. This will be followed by a similar strategy, the Palestinian

⁶ See www.oecd.org/dac/stats

National Plan 2011-13. The World Bank's development policy operations to support PFM reforms are funded from the trust fund and linked to policy objectives agreed with the government.

The use of technical assistance to support reforms within the PA seems to be somewhat uneven. The MoF emphasises its great reluctance to accept any form of directly embedded TA, with advisors or consultants working on-site only to supplement capacity. Multiple sources support this impression, but practices seem to differ notably at other ministries and agencies, where embedded TA⁷ had been involved at least in some instances. Overall, it appears that donors make known their preferences about certain aspects of PFM reform through various forms of institutionalised dialogue with the PA, but ultimately the government is relatively firmly in charge of decisions regarding what reforms to pick up and when.

In general, the leverage of external actors to impose certain reform steps on the PA is probably much more limited than then numerical weight of external assistance would suggest, because of the overwhelming importance of the general political situation, which tends to dictate the agenda of interactions between the PA and the international community much more than any technical concern arising from the PFM sphere.

2.3 Conclusions

The reform environment for PFM in WBG is fragile and promising at the same time. It is promising because the administrative structures of the PA are sufficiently capable that a determined reform champion has found enough organisational support to plan and implement major reforms to the way the public sector operates. There is ample evidence that, during two reform periods, a first wave between 2003 and 2005 and a second between 2008 and 2010, such a constellation was in place and substantial progress was achieved. However, the reforms are still precarious, and progress is fragile and reversible. WBG is not a sovereign state and the operations of the PA are very vulnerable to disruptions of its revenues, the two largest sources of which (clearance revenues and external aid) can be disrupted by means almost completely beyond the PA's control. The period of 2006/07 shows how the larger political situation can deteriorate sharply almost overnight, in turn reversing many of the gains of previous reforms. The same episode also showed that, once stability was restored, many reversed advances turned out to be merely dormant, and could be re-established quite quickly. There is nevertheless a strong sense that such external events could overtake the PFM reform agenda in the future and jeopardise the gains of recent years.

⁷ Understood here to mean consultants who provide TA while being based within a ministry on a long-term basis. There is a widespread assumption that these consultants tend to undertake line functions eventually, without being formally charged to do so. In the ministries studied for this report, there were no instances of consultants being explicitly hired into line functions or functions of government outsourced to consulting firms, as is sometimes the case in other fragile states emerging from conflict.

3 Approach to PFM reform

3.1 Starting point of PFM reforms

The baseline period of PFM in WBG is the time between the start of the Second Intifada in 2000 and the beginning of the first wave of PFM reforms under Minister of Finance Fayyad in late 2002. Many of the salient features of the PFM system had of course been in place before, but the fiscal crisis precipitated by the intifada threw the existing shortcomings into very sharp relief. The two salient features of the PFM system at the time were its fragmentation and its high degree of informality.

Informality was an element of administrative practice. The PA allowed a very high degree of discretionary space for the Office of the President, and frequently responded to short-term requests for direct expenditures or hire staff. Many of these were in response to petitions from citizens addressed directly to the president. The status of the formal budget was weak. A budget was presented to the PLC starting in 1996, after initial resistance from the PA, but deviations and virements without involvement of the concerned ministers or the PLC were common. The budget was not submitted to a formal external audit or revisited by the PLC in any form after being passed. There was no serious effort to plan or control spending based on efficiency or fiscal discipline considerations. Short-term cash needs were satisfied by borrowing from commercial banks or outright build-up of arrears. By the turn of the decade, the fiscal situation was suffering from high deficits and arrears.

The budget process was fragmented on both the revenue and the expenditure sides. The PA did not have a functioning electronic financial management system, and not all expenditures were recorded in the budget to begin with. According to numerous accounts, it was common practice for donors to enter agreements for individual investment projects directly with spending ministries, without notifying either the planning or the finance ministries. As a result, there was no central knowledge of the real size or composition of the investment budget, making it impossible to develop a credible medium-term perspective on the PA's fiscal position or its overall development policy. The MoP was in charge of the investment budget and investment planning and maintained its own set of relationships with ministries and donors on these matters, whereas the MoF was in charge of recurrent spending. This institutional separation, as so often happens in countries with separate planning ministries, contributed to a lack of coordination between investment and recurrent spending, exacerbating the fragmentation of the budget process.

Revenues were equally fragmented at the time. The government drew significant income from excises for petroleum, tobacco and alcohol, among other items. These revenues were not accounted for centrally and were handled entirely off-budget. Each ministry handled multiple accounts with commercial banks without central control or reporting, and own revenues from fees and other small sources were often spent directly at the source without transfer to the Treasury. As a result, the MoF and all other central agencies were not able to know the PA's current income or cash position at any given point in time. Combined with a high degree of informality, this fragmentation of the PA's finances was very inefficient and created significant opportunities for misappropriation and outright corruption, which tainted the PA's image among the population.

3.2 Progress of PFM reform

The phasing of PFM reforms in WBG between 2002 and 2010 was shaped almost entirely by political events beyond the sphere of public finance. The leaders of PFM reform for the most part managed to turn necessity into virtue and deliberately managed reforms opportunistically, instead of relying on a preconceived implementation plan. The reform period can be divided into three very distinct phases. Between 2002 and 2005, there was a first wave of reform following the appointment of Salam Fayyad as Minister of Finance in the summer of 2002. This period came to an abrupt end after elections brought the Hamas-led government into office in

early 2006. In 2006 and 2007, most activities were put on hold and many reforms were reversed or lay dormant. In June 2007, after the breakup between Hamas and Fatah, and between Gaza and the West Bank, the current government under the leadership of Prime Minister Fayyad took office. It first restored the advances of 2005 in the West Bank and has been working since about 2008 on broadening and deepening the reforms.

The first phase of reform started out from a state of acute fiscal (and political) crisis. Prime Minister Fayyad likened the challenge to a 'house on fire',⁸ which demanded immediate response. The structural challenges of PFM can be summarised as informality and fragmentation, whereas the immediate crisis was primarily one of credibility. The PA was under significant external pressure for not being able to control the flow of public funds and thus allegedly allowing money to be taken out of the official budget and used for terrorist activities. Such allegations led to sharp drops in external aid and a suspension of clearance transfers from Israel. Arrears had reached \$370 million in 2000 and were rising (IMF, 2003); the government faced an acute cash shortage.

The leadership within the MoF seemed conscious of their limited capacity to fight for political backing for contentious changes and to supervise their technical implementation at the same time. Although staff within the MoF were willing to move on several fronts, the first-phase reforms were rather focused. The emphasis was clearly on centralisation and control of cash for both revenues and expenditures. During the first year of reforms, the treasury single account (TSA) was established and all private bank accounts held by ministries were closed. Efforts were made to ensure that an increasing amount of government revenues would be consolidated in the TSA. Expenditures were similarly centralised, removing spending discretion from line ministries. In particular, salary payments were taken over directly by the MoF. The following years until the end of 2005 saw further efforts to bring extra-budgetary revenue sources into the formal budget and their cash flows into the TSA, and expenditure controls were further extended, for instance by including salary payments for all security services. Political considerations made it necessary to move in fits and starts over time, taking advantage of opportunities when they presented themselves.

Successive efforts by the MoF to limit the ability of sector ministries to run separate commercial bank accounts also made it much more difficult for them to maintain direct relations with donors regarding individual donor-funded projects, which, according to officials at the MoF and MoP, had been a persistent problem. The last step in these efforts came in 2009 with the introduction of zero-balance accounts, which caused many donor and ministerial accounts to close – although reliable figures to quantify these developments are not available. There is no information on the extent to which aid has been brought on budget as a result of the reforms – officials noted that some off-budget donor funding continues.

In general, these efforts have been quite successful and have managed to develop a substantial degree of central control over public spending by the MoF. The reforms have by their nature been politically very challenging, but also have been technically achievable over a rather short period of time. The accounts centralisation is a case in point: after the necessary preparations, the switch to the TSA happened in a single day, by obliging commercial banks to transfer any remaining balances from accounts held by government actors into the central account.

The step-by-step expansion of early gains was not made necessary so much by time-consuming technical work but rather by the political need to gather support. In this sense, the first phase reforms could be characterised as quick wins that delivered visible results almost instantly. It is striking that reforms of budget preparation and planning in general were not emphasised at all during this time. It is impossible to say if or when the MoF would have shifted to a more medium-term reform stance, because this period came to an abrupt end after the change in government at the end of 2005.

⁸ Interview with Salam Fayyad, 8 August 2010.

The period of the Hamas-led government and its immediate aftermath, that is, the time between the start of 2006 and mid-2007, saw an almost complete, if temporary, reversal of these advances. Almost immediately after the new government took office, external donors decided they could not continue any form of direct support to the PA. Any formal contacts were limited to the Office of the President. In combination with the collapse of the customs clearances withheld by the Israeli government, the PA found itself virtually without income. The TSA quickly fell out of use and it became impossible for the MoF to maintain central control over expenditures. Donors devised mechanisms to pay the salaries of PA employees directly through payment mechanisms with commercial banks, whereas ministries resorted to a number of short-term fixes, among them reopening separate bank accounts to handle own revenues, in order to be able to spend their limited funds on other current expenditures. Given the particular circumstances of the time, a suspension of most regular PFM systems became inevitable. Generalisable conclusions on how to deal with sharp reversals in the political environment of reform based on the WBG experience should therefore be made with a great deal of caution.

When the next government, led by Salam Fayyad as Prime Minister and Minister of Finance, came into office in 2007, the first priority was to re-establish the previous systems. The government achieved this much more quickly than during the first phase. It had to struggle against a similar short-term crisis in 2007/08, caused by the break-off of Gaza and the need to re-establish orderly relations with donors and reconstitute a formal cash-management system. Several government interviewees stated that they nevertheless managed to recover and surpass the *status quo ante* in the first half of 2008.

The legislative implications of the reforms were apparently quite modest. The Basic Law, passed in 1997 and ratified in 2002, contains some provisions regarding PFM, which are expanded on in the Organic Budget Law of 1998, which provides the legal framework for the budget process. The Annual Budget Law authorises the procedures for that year, which are further specified in guidelines and regulations maintained by the MoF. Significant changes to budgetary procedures are usually codified through the annual budget law of that year. While the provisions of the Annual Budget Law and supplementary regulations have seen changes from year to year, the Organic Budget Law itself did not change during the reform period. According to the World Bank's 2007 Public Expenditure Review (PER), the Organic Budget Law provides a reasonable basis for budget management, despite some shortcomings, that is, being too general in some parts and not comprehensive. Some of the reforms carried out between 2002 and 2005 did in fact have a basis in the law, which previously had not been implemented. This applies, for instance, to the internal audit function (World Bank, 2007). After the appointment of the caretaker government in 2007, the government continued to apply the legislative provisions of the budget process, and annual budget laws are being prepared. They are not, however, debated or authorised by the legislature.

After the separation of Gaza, the government in the West Bank lost access to the previously used computerised accounting system and was forced to quickly restore this function in order to be able to process payments. A new system, previously in use in the Ministry of Education and Higher Education (MoEHE), was developed using software developed by a local company. This started to process the salaries of PA employees in early 2008 after less than half a year of development. It has since been expanded into something akin to an integrated financial management information system (IFMIS) and was rolled out to sector ministries in 2009. The Budget Office started to use a budget module to prepare the annual budget in 2010; also in 2010, the government started to use the system for all cash payments and established effective commitment controls at spending units.

It was only in 2009/10 that the government branched out from focusing mostly on budget execution to address budget preparation as well. The 2007-10 development plan had been developed by the MoP with the help of external consultants and without much input from the MoF. Integration of the recurrent budget and the investments laid out by the plan, as well as general cooperation between the two ministries, was previously regarded as poor (Ahern, 2010b). This dynamic began to change under the caretaker government. The 2009 budget

draft was based on submissions from line ministries grounded in an integrated format showing investment and recurrent spending side by side. The draft was prepared by joint teams composed of both finance and planning officials. At the same time, the Budget Office and other units of the MoF and the MoP have embarked on a multiyear effort to introduce a programme budget. As part of the government's 2011-13 development plan, the MoP⁹ and the MoF prepared a PFM reform plan over the summer of 2010, which might bring more of a medium-term perspective to PFM reform efforts. How much of an impact it will have on the shape and direction of PFM reforms remains to be seen.

3.3 Design basis for PFM reform

The design basis for reform in WBG is fairly unconventional compared with other countries, with a more clearly established 'hour zero' of post-conflict reconstruction. During the key early phases of reform, there do not seem to have been any comprehensive efforts to assess the situation on the ground and respond with a plan that addressed multiple aspects of the PFM system. This does not mean, however, that international actors were not engaged in this area. Instead, there was much more of an ongoing policy dialogue between the government and international actors, in particular the IMF, on the salient policy challenges. The main issues of concern to the international community in the period of around 2000-02 were fairly well known to the government, and decisions on whether or not to move forward with reforms in particular areas did not depend on expert input about the technical details of how to do so.

After reforms began to move forward in 2002, there is no evidence that this happened based on a preconceived plan or formal diagnostic study. One should note, of course, that Minister of Finance Fayyad, as former IMF Representative, and the top officials in the MoF were well aware of the reform options available to them. International donors continued to provide strategic advice on PFM. For instance, the World Bank has prepared a number of high-profile reports since 2002 (Ahern, 2010a; 2010b; World Bank, 2004a; 2004b; 2007), although there have been fewer prominent publications in recent years. In interviews conducted for this study, there was almost unanimous agreement among officials that – implicitly – there is an understanding of what 'ought to be done' to address the key deficiencies of the PFM system in WBG. Officials often saw a need to consult external advice on the technical details of implementation in a particular area, but not on the reform design as such. Recently, there has been a shift in emphasis regarding reform planning. In the context of increasing cooperation between the MoF and the MoP, the former drafted a PFM sector reform strategy that is part of the new three-year Palestinian development strategy for the years 2011-13 (MoF, 2010). The impact of this on future reforms remains to be seen.

3.4 Implementation modalities of support for PFM reform

Since the inception of the PA, donors have utilised several generations of multi-donor trust funds (MDTFs) to deliver funds to the PA. Starting with the launch of the Public Financial Management Reform Trust Fund (the Reform Fund) in 2004, these funds were linked explicitly to a policy reform agenda heavily centred on PFM (Scanteam, 2007). It is important to note that not all donor-funded budget support is channelled through MDTFs, and what does not thus remains outside the policy framework established by successive versions of the Reform Fund. In 2008, the Palestinian Reform and Development Plan Trust Fund was established to support the implementation of the PRDP. Both trust funds received substantial contributions from other bilateral and multilateral donors, including the EC, UK, Japan, France and the Netherlands, among others. Between 2001 and 2009, the World Bank administered trust funds totalling \$897.45 million, of which \$640 million went towards budget support (IEG, 2010).

Apart from budget support, the World Bank implemented three development policy grants between 2004 and 2009. In 2004, the PFM Reform Structural Adjustment Operation provided

⁹ The MoP is formally in charge of the development budget, the government's medium-term strategies and, by implication, the dialogue with donors over development projects, which make up the largest part of the government's investment budget.

\$20 million to strengthen the PA's fiscal position, and in fiscal year 2008/09, the Palestinian Reform and Development Policy Grants I and II provided \$40 million each (IEG, 2010: 65).

In 2006, it was decided that international donors could no longer interact formally with the different bodies of the PA, although some contacts continued as long as direct engagement with officials affiliated with Hamas was avoided. Progress on reforms that were part of the policy dialogue came to an end with the interruption of normal relations between the international community and the PA, and aid flows through the regular government channels stopped. Together with the cessation of any transfers from Israel to the PA, this quickly caused a severe fiscal crisis in WBG, and the PA could no longer afford to maintain regular salary payments. After the first months in office of the Hamas government, the EC and other donors determined that it would be counterproductive to allow essential services in WBG to be disrupted and leave salaries of civil servants unpaid. They developed a new instrument called the Temporary International Mechanism (TIM) to facilitate such funds. This provided financing for around 150,000 heads of households, as well as payments towards utilities (such as the Gaza power plant). With the contributions of the EC, European member states, Switzerland and Norway; around \$500 million was disbursed. In early 2008, this was replaced by a mechanism called PEGASE, which operated under similar rules (EC, 2009).

The particular noteworthy element of these two EC-led funding instruments is that they provided direct quasi-salary payments to Palestinian civil servants in a situation where formal cooperation with the government was considered unacceptable. To determine that the civil servants in question were qualified to receive payments, donors cooperated with local commercial banks to facilitate direct payments and set up an independent system to control, verify and audit payroll information. After normal relations with the PA were resumed, payments were directed into the PA's TSA and distributed through the government's regular payroll system. The payroll audits, carried out by an international audit firm, still continue. This mechanism allows participating donors to maintain a degree of direct fiduciary control over the use of their aid. Between the World Bank's and the EC's trust fund arrangements, a large number of DAC and regional donors contribute direct funding to the PA's budget – tied at least nominally to a policy reform agenda heavily emphasising PFM reforms. At least indirectly, this provides substantial political support to the PA's technical reform agenda in this area.

3.5 Coverage of PFM reform

The PFM reforms of 2003-5 and 2008-10 differ notably from patterns found in many fragile states and low-income countries in general. Andrews (2010) finds that reforms in low-income countries tend to emphasise the upstream part of the budget process over the downstream, and activities that could be carried out within central ministries over those that involve the coordination of several actors, be they spending ministries or lower levels of government. Instead, PFM reforms in WBG deliberately emphasised reforms to budget execution over budget preparation, and deliberately sought to tie expenditure operations of spending ministries under closer control of the MoF. Although the MoF initiated many reform steps in-house, it did not limit itself to parts of the budget process that could conceivably be done within the ministry without the involvement of other actors. In particular, financial management and accounting reforms were directed towards integrating the ministerial budget process into a system run out of the MoF.

Table 2: Coverage of reform efforts in WBG

Budget cycle#	Upstream					Downstream					
	P	P	P	P/AP	AP	E	E	E	Exec	AU	AU
(De-) concentrate (C/DC)	C	C	C	C	DC	DC	DC	DC	C	DC	DC
Emphasis	Multiannual forecasting	Investment planning	Strategic planning	Budget preparation	Legislative analysis	Cash management	Procurement, payroll	Internal control, audit, monitoring	Accounting and reporting	External audit	Legislative scrutiny
2002-5	-	-	-	-	*	***	**	**	**	-	*
2005-7	X	X	X	X	X	X	X	X	X	X	X
2007-8	*	*	*	*	-	***	**	**	***	*	-
2008-10	*	*	**	**	-	***	**	***	***	*	-

Note: *** indicates broad, deep and sustained reform efforts, ** significant efforts effecting change in practice and over time and * marginal efforts, pilots, isolated attempts at reform.

#Using a standard four-phase division: preparation (P), approval (AP), execution (E) and audit (AU).

Please note that this table relies on a long list of reports covering a number of years and sectors, often unevenly. Every individual entry should be taken with considerable caution. The table does not aim to give a precise assessment of reforms in one particular area, but rather to indicate how the relative emphasis on different areas took shape and evolved over time.

The Financial Control Department of the MoF established financial controllers within spending ministries; accounts and salary payments were centralised; an IFMIS was set up and commitment controls were eventually established. The Accounting, Audit and Control Units within the MoF became the operational leaders of reform, whereas the Budget Office was occupied mostly with the day-to-day operations of viring expenditures according to short-term needs. This is a very good example of how a central finance ministry can gain control over a fragmented expenditure process. This emphasis did, however, rely on a prioritisation of attention and resources by the government. Notable weaknesses in planning and budget preparation were not tackled over sustained periods of time, reflecting the fact that the government gave budget-execution priority.

Table 2 provides a brief summary of the reform coverage over time. It indicates that early reforms focused on downstream efforts of the budget process. However, the reforms are perhaps more appropriately characterised as focused on the execution phase of the budget cycle, mostly excluding other downstream efforts, such as external audit and legislative oversight. Upstream efforts were mostly absent from the early phases of reform and indeed became a significant part of the overall agenda only from about 2008 onwards, when reforms branched out much more broadly from their early core. Significantly, the WBG reform trajectory included both centralised actors (clearly the MoF itself, but also the MoP, the Palestinian Monetary Authority and the Palestinian Investment Fund (PIF) – the holding company for state-owned assets established in 2003 – who are regarded as technically competent and strong entities) and decentralised actors. The MoF notably extended its work on financial management into the spending ministries and is further seeking to decentralise audit and control to financial control units within these, although, in general, administrative capacity in sector ministries is very uneven and often does not equal that in the central agencies.

It seems clear from the way the reform coverage evolved that the PA had a fairly coherent understanding of what 'basic reforms' meant in the context of WBG, and that the MoF focused most of its attention quite deliberately on strengthening those basics, namely, establishing a solid degree of central control over key areas of budget execution. This was clearly the case

before 2005, and then again as the government tried to restore earlier achievements in the second half of 2007 and early 2008. There was a sense among some donors in 2008 that reform efforts began to drift after the government felt that the basics had been restored, as the earlier sense of urgency to rescue the house on fire was replaced by different needs, entailing the broadening and deepening of the reforms.

3.6 Approaches to capacity development

Despite its current fragility, WBG has many characteristics of a middle-income country, including its education institutions, particularly a small group of domestic universities that produce capable graduates for the civil service. Many top officials tend to complement their higher education with degrees from abroad. Within the civil service, officials at the highest technical levels very often have a long public sector service record, often within the same ministry or agency. Generally, fluctuation and staff turnover are very low.

There are two factors that reduce fluctuation below the level that might be expected. First, interviews with numerous officials in different parts of the PA seem to confirm a strong sense of national purpose among public officials. Many of them framed their work within the PA as a contribution to the eventual establishment of a Palestinian state, with a corresponding obligation not to leave at a time when their work might be crucial to the viability of such a state. The caveat, however, is that while this kind of special motivation has certainly contributed to a shared *esprit de cadre*, it might not last indefinitely, and in particular might not survive many more political vicissitudes over the coming years. Second, the public sector is currently acting as a hirer of last resort, while prospects in the private sector continue to be much worse than they used to be a decade ago. As a result, young, capable civil servants who might otherwise be poached by private sector companies after a few years often stay on and apply and develop their skills within the career stream of their ministry.

The consequence of longer and more stable public sector careers is that donor efforts at developing local capacity have better chances at succeeding, because individuals who are trained or advised remain in the civil service longer. This differs markedly from almost all other fragile states in this study's sample, and also from many developing countries in general. It should be noted that this generally favourable impression has been confirmed by observers in contact with the key central ministries and agencies of the PA, and things might be much more uneven and possibly worse in other parts of the public sector.

Unfortunately, the degree of internal human resource stability is limited by the broader political instability. The most notable event in this regard was the breakup of the West Bank and Gaza in the wake of the establishment of the *de facto* administration in Gaza in 2007. Previously, the PA's ministries and agencies had maintained a careful territorial balance between the West Bank and Gaza, with many key ministries and key units within ministries located in Gaza. After 2007, movement and access to Gaza became severely restricted. For the government in the West Bank, this meant many key parts of the machinery of government, including information technology systems, files, offices and the staffing of entire units, became unavailable. The Budget Office, for instance, had to be reconstituted in Ramallah from scratch. The effect of the separation of Gaza was probably the most crucial short-term challenge for the government to overcome between mid-2007 and early 2008.

It is also important to note that the fact that many high-level officials in central agencies are seen by external observers to have been promoted on merit (in contrast with the patronage-based networks of officials that reportedly dominated the PA in its earlier years) does not equal a formal, meritocratic human-resource-management system. As far as the available sources provide information, there does not seem to be a formalised approach to the MoF's medium-to-long-term staffing policy and its organisational structure. Since 2007, the Office of the Minister of Finance has been held by the prime minister himself, with no deputy minister or permanent secretary holding authority over the whole ministry. The success of the reforms to date seems to rely on the personal work of a dedicated team at the MoF and the leadership of the prime minister; this lack of institutionalisation could be a challenge for future incumbents.

The multilateral donors in WBG have over the years adopted a stance towards capacity development that relies mostly on intermittent analytical and advisory work, as well as extensive training in some key areas. Their focus on providing guidance and support to key reformers whenever demand arose allowed a strengthening of critical parts of the administrative structure. At the same time, many bilateral donors continue to implement individual TA projects. Some of these were reported to be quite successful and of high technical quality, but they also sometimes raised criticism in central ministries as being not very well focused and not necessarily responding to government demand. Within central ministries, there is a certain reluctance to accept extensive direct TA from donors.

At the MoF in particular, the official policy stated by senior officials is that resident technical advisors are not acceptable to the government, because they are perceived as inevitably being drawn into line functions without a proper transfer of skills. With very few exceptions, the MoF has insisted on TA being delivered exclusively in intermittent form, through trainings, visits and issue-focused technical advisory work. In contrast, the MoP, among others, relies on a more traditional setup, with resident advisors based within the ministry, in particular in support of the drafting of the last two medium-term development plans. There were differing opinions among interviewees about the relative merits of these two positions. Several donor officials noted that, in the critical period after 2007, the MoP was technically stronger and much quicker to resume critical work because of its ability to draw on in-house consultants. However, officials from both ministries stated that they felt more comfortable without advisors, even if that might result in short-term delays to reform implementation.

3.7 Conclusions

The past decade has seen substantial reforms to the PFM system in WBG. The accelerating fiscal crisis gave a new finance minister a mandate to implement ambitious reforms between 2003 and 2005. Progress was made in fits and starts. The broader political environment determined the degree to which reforms could advance, and, notably in 2006/07, caused the reversal of much progress, if only temporarily. The government deliberately emphasised reforms that would strengthen the credibility of and its control over budget execution. These reforms were for the most part constrained by political conditions, not by capacity or financial constraints. Where resources or capacity were lacking, the government possessed enough central-management capability to direct external assistance towards areas of priority. As a consequence of this strategy, not all fields of PFM that international experts considered crucial were given a similar degree of attention, which occasionally caused friction between donors and the government. On the whole, however, the international community supported the broad reform agenda of the government in 2003-5 and has done since 2007.

4 PFM achievements and shortcomings

4.1 Impact and sustainability of reforms on PFM performance

It seems clear that serious reforms began in 2002 from a relatively low starting point in most areas of PFM. The fiscal crisis at the time, combined with the underdeveloped systems and procedures across all phases of the budget cycle, created a sense of urgent emergency among donors and the government. It is beyond doubt that, by 2010, many substantial reforms were carried out successfully, and that these reforms profoundly changed the practice, as well as the formal setting, of PFM.

It is much more difficult, unfortunately, to properly assess the success of these reforms in a comparative and reliable way. Expert reviews carried out over the past two years emphasise strongly that reforms have proceeded in many fields, although obviously many challenges remain. However, over the entire reform period, only one PEFA assessment has been carried out (in 2006), which only partially captures even the first wave of reforms. Since it took place at a time of acute political and fiscal crisis, it is very hard to extrapolate, or reconstruct, how scores might have looked before or after this one snapshot view. At the time, the PFM system did not score very well, with only 4 'B' scores and 12 'D's (out of a total of 28 indicators in the PEFA framework – see Annex 1).

Since then, qualitative reviews have found substantial improvements to 1) the credibility of the budget; 2) comprehensiveness and transparency; 3) predictability and control; and 4) accounting, recording and reporting. Improvements to 5) policy-based budgeting and 6) external scrutiny and audit have been rather more modest (Ahern, 2010b). Over the entire period 2006-2010, no significant deterioration could be found, although of course some areas saw quite significant, but temporary, setbacks for certain periods of time. Without being able to quantify it, the PFM reform record can be called broad and substantial.

- 1 **Credibility of the budget.** The annual budget is a credible predictor of actual expenditures at the aggregate level, which differs from earlier years when spending on aggregate and within categories evolved through the year with limited constraint by the annual budget. Significant variances during budget execution remain a constant activity for the Budget Office. The introduction of control mechanisms over payments and the public payroll have significantly reduced the discretion of spending units to undercut the provisions of the annual budget. The level of arrears has been much reduced from earlier years. Arrears still recur as a problem, often because of unanticipated shortfalls in donor funding or political crises that disrupt the transfer of revenues from Israel. The government can and does resort to borrowing from local banks, but their limited capacity to lend sometimes leads to arrears.
- 2 **Comprehensiveness and transparency.** Both have been much improved. With the introduction of the TSA, most revenues and expenditures are now centralised within the PA. Monthly reports of the PA's fiscal operations, revenues, expenditures and financing sources are made available in a timely fashion on the internet. Most assets of the state are now held by the PIF, which is operated as a private company with 100% ownership by the PA.
- 3 **Predictability and control.** Cash management has not been sufficiently strengthened, despite the introduction of the TSA for national funds. A system for commitment controls has been designed but not introduced so far. Improved payroll controls have much improved the realism of the recurrent budget. A system of financial controllers in spending ministries has been established; controllers are posted to ministries but report to the MoF.
- 4 **Accounting, recording and reporting.** The previous computerised accounting system was lost to the PA in Ramallah in 2007 after the separation from Gaza. A new, bespoke accounting system, which is now successively being turned into a full IFMIS, was set up and began processing payments at the start of 2008. The electronic system forms the basis of monthly reports and, since 2009, annual financial statements. The final accounts

of fiscal year 2008 have been audited by the external auditor – the first time since 2003 that any external *ex-post* scrutiny has been given to the government's accounts.

- 5 **Policy-based budgeting.** For most of the period studied here, budget preparation was not a reform priority. The PEFA assessment found this to be a weak area, and some elements have since started to be addressed. Cooperation between the MoF and the MoP increased considerably after 2007. In 2009, the government for the first time presented a combined development and recurrent budget, based on the joint work of the two ministries. It is expected that reforms currently underway on budget preparation will yield more results in the future, but, given their recent nature, the impact so far has been limited. At the moment, it is still fair to assume that the annual budget is prepared in a mostly incremental, bottom-up fashion.
- 6 **External scrutiny and audit.** External scrutiny has clearly been limited by the political developments from 2006 onwards. The PLC has not been able to convene since it currently lacks a quorum. Both the legislative and the presidential terms have now expired (in 2010 and 2009, respectively). An external audit institution (the State Audit and Administrative Control Bureau (SAACB)) was established in 2005, but became operational only in 2008. This is building capacity slowly and cannot yet be considered fully effective. For the audit of the 2008 financial accounts, it contracted Deloitte to provide technical support.

4.2 Linking PFM reform achievements to state-building goals

There is much anecdotal evidence that the PFM reforms of the past years have contributed to the PA's (and the international) state-building agenda for WBG. That a stronger PFM system would contribute to the PA's viability as a proto-state for the Palestinian people is an explicit motivation for virtually every official interviewed, starting with the prime minister himself. It sometimes seems that it is more important to senior officials to have a strong and credible PFM system as a core element of any modern state than to expect the PFM system to deliver better outcomes, however defined. This emphasis on PFM reform as an exercise in state building might to some extent explain the relative emphasis chosen by the government over the years.

Reforms that build up credibility and control aim for a very traditional core capability of a modern state, in a way that a performance budget or a medium-term forecasting function does not. The reforms have also served to counter the fragmentation and informality that used to be pervasive in WBG. Again, centralisation of authority and the formalisation of administrative procedure are classic steps of the transformation from a pre-modern to a modern state that establishes the bureaucratic means to raise significant revenues from its citizens and is able to provide significant services in return (Rueschemeyer and Evans, 1983; Tilly, 1992).

There is a direct connection between PFM reform and state building in WBG, and the key political actors are keenly aware of it. A functioning, modern budget process that provides a stable framework for the formulation of policy, and its public deliberation, reliable execution and external control, is clearly understood to be a defining feature of a sovereign state. Conversely, the inability of the PA to function as a capable government was seen as a main motivation to carry out reforms, not necessarily for their own sake, but because not tackling these issues would be a permanent obstacle to achieving these much larger political goals.

The focus on the downstream side of the budget process, reaching deep into the cash management of spending ministries, has had a substantial impact on the way the public sector operates. Doing this has managed to remove a lot of scope for informal, discretionary action away from the centre of government. The linkages with wider objectives of state building are difficult to measure (see Section 4.2), but anecdotal evidence at least suggests these positive effects. There seems to be a perception that the PA is currently run by officials who mean well (even if outcomes are not always good), and that corruption, at least of the flagrant kind, is much less of a problem than it used to be.

Any assessment of governance outcomes in WBG suffers from the relative paucity of comparative time series data. Since WBG is not a sovereign state, it is not included in many of the standard comparative datasets. Nevertheless, the World Bank's Governance Indicators for

WBG offer some glimpses at changes over time¹⁰ (Kurtz and Schrank, 2007; Kaufmann et al., 2009). The WBG score for government effectiveness over the past decade consistently ranks at around the lowest 10% of the global survey. The two exceptions were the year 2004, when the percentile ranking went up to 20%, only to fall back again, and then 2009, when it exceeded the 20th percentile. This trajectory is broadly consistent with the broader political context, which saw substantial reforms in 2003-5, which were then reversed, to be followed by a steady recovery since 2008. The control of corruption data tells a similar story. Scores tend to rank in the lowest teens, only to reach the 40th percentile in 2004 and then again in 2009. The latest scores are a bit more reliable as the data foundation for WBG has become broader, but generally these trends have to be taken with caution, because of the sensibility of the aggregated scores to outliers among the very few available sources for WBG.¹¹

4.3 Linking context to PFM reform approaches

The governance of public finances in WBG during the first decade of the PA evolved into a fragmented and informal system that allowed much discretionary freedom to the Office of the President and the political leadership to channel public money very inefficiently and with a great deal of leakage. Ultimately, this situation seems to have caused great dissatisfaction in the population over the PA's perceived inability to deliver basic public services and act as a credible proto-state for the Palestinians. The system did not exist for an extended period of time and it certainly did not reach an equilibrium stage – it became highly unstable in the years leading up to 2002 and beyond.

Nevertheless, public sector governance did not evolve into its ultimately unsustainable form by accident, as it clearly served a purpose for some groups in the polity of WBG. Apart from the fact that the leadership of the PA after its inception did not have any experience in running a government, which could have contributed to a less orderly administration, one would assume that many officials and political actors affiliated with the government did benefit from the *status quo*. Some analysts point out that President Arafat considered it important to have discretion over the PA and its funds so as to manage the political upheavals of the time and ensure short-term stability in times of crisis. The PA is a creation shaped by the specific circumstances of the international conflict over WBG, and it received high sources of income from external sources, quasi-rents that insulated the leadership of the PA to some extent from discontent among its voters.

Only when public and international discontent over the PA's inefficiency grew to critical proportions, combined with a perception among the population that the government could not deliver on its elemental *raison d'être* during the crisis of the Second Intifada, did a window of opportunity arise for substantial reforms to the PFM system. Many ideas on how PFM could be changed on the technical level had been present among operational staff of the MoF and other agencies for some time before. The new minister of finance then became a capable and credible champion of reform. But only the combination of a suddenly favourable reform environment, a certain groundswell of technocratic enthusiasm within the administration, and a credible champion at the highest level proved sufficient to overcome inertia and opposition to implementing change.

The engagement of the international community at the time was probably a necessary element to prompt reforms, but in and of itself was clearly not sufficient. The specific combination of international actors is necessarily very different in fragile states, but, in the case of WBG, it is very clear that the technical concerns of the international financial institutions (IFIs) over how

¹⁰ See <http://www.govindicators.org>

¹¹ There is also, separate and apart from the data issues specific to WBG, an ongoing academic debate over the Worldwide Governance Indicators, specifically their methodological limitations and their ability to measure such an ill-defined concept as governance. The percentile rankings of the indicators alone also give only a qualified indication of progress over time, because they are normalised around the mean for each year. This report does not seek to base any strong claims relating to the available governance indicators for WBG; they are used merely as additional information to at least illustrate some of the trends that emerged from the interviews with officials, donor representatives and external observers.

public finances are run are secondary to the broader political agenda. Those concerns moved forward only because they are in alignment with higher-level political goals.

4.4 Linking context and reform approaches to reform results and achievements

The specific reforms carried out in WBG, that is, their sequencing, prioritisation and emphasis, have been the result of a largely endogenous process driven by a small group at the centre of government. This is not to say, of course, that the reform content as such is unique to WBG or without influence from abroad. To the contrary, many reforms reflect international thinking on the subject and would not be considered out of the mainstream. The prime minister himself has a background in multilateral development organisations, and many officials are keenly aware of the latest professional developments in their respective field. In its capacity to set its own priorities, the MoF is somewhat atypical for a fragile context, and much more akin to its middle-income neighbours, which now look towards WBG as a regional leader in at least some areas of PFM.

Over the entire period of analysis, international donors (first and foremost the IMF and the World Bank) offered detailed analytical work on all areas of PFM. The IFIs have not, however, dominated the operational reform agenda or forced reforms in any particular area. The initiative has very clearly been with the government, specifically the MoF, which has apparently been very careful not to allow outsiders too much access to its own decision making. The reforms that have happened have been the result of often difficult political and administrative deliberations, and there is every indication that they are 'owned' by the government, or at least by the MoF.

There is a prevalent sense among officials that the emergency period has come to an end and the basic elements of a stable budget process are now mostly in place. There is little indication from officials that the systems are alien to them or inappropriate to their needs. Instead, almost every department within the MoF is able to recount anecdotes of pushing ahead with an initiative against donor advice or rejecting a donor initiative in favour of something been planned in-house – and finding themselves ultimately vindicated by success. This was the case, for instance, with the government's plan to develop its own electronic accounting system after several failed or aborted previous attempts.¹² Conversely, officials in the Budget Office noted that they had been repeatedly advised by some donors since 2004 that it would be good to develop a more performance-oriented budget preparation format, but felt this to be enough of a priority only after the reforms to budget execution had reached a degree of maturity (in about 2008). According to some interviewees, it required strong lobbying even then to give this reform momentum when there was no consensus across the different departments within the MoF that performance budgeting was a worthwhile effort.

Assuming politics continues to move forward in a broadly stable fashion, it would be difficult to see how the gains could be reversed, at least in the short term. This is, however, a big assumption. The political situation being what it is, there is a distinct possibility that the future will see a new government reversing certain features of the PFM system, and, given enough time, it could succeed. The lack of checks and balances of the political system, as it now stands, means a determined executive could create substantive negative change unchecked by domestic veto players.

4.5 Conclusions

The experience of PFM reforms in WBG between 2002 and 2010 is noteworthy, but its relevance to other countries (fragile or otherwise) needs to be qualified. WBG is a middle-income country that shares some characteristics with the experience of the newly formed countries in the Balkans, but is very different from low-income countries or failed states elsewhere. Furthermore, the peculiar nature of the Israeli-Palestinian conflict and its salience as an issue of high international politics means that some of the dynamics of politics are not likely to be found in many other countries.

¹² This particular instance was mentioned by both staff in the MoF and external observers.

The success story of WBG could be summarised thus. In 2002, the country found itself with a fragmented, personalised and informally organised public sector in general and PFM system in particular. Its inability to deliver either an internationally credible proto-state or a stable operation of public finances (and consequent service delivery) had become apparent to most domestic and international stakeholders. There was a drawn-out build-up of domestic pressure over the PA's perceived corruption and inability to deliver, as well as concurrent international pressure over its non-credibility as a source of stable and reliable government and governance for WBG. These pressures were brought to a head by the crisis that resulted from the Second Intifada. These factors created the political space for a technical, reformist minister of finance to take office, supported by the international community and at least tolerated by the most important domestic veto players. Up until late 2005, PFM was quite competently run and determined reforms to budget execution began to change the way the public sector operated. Most of the achievements of the first wave of reforms were frozen or became immaterial during the Hamas interregnum, however. The TSA fell out of use, because ordinary revenues from external donors and clearances had stopped and normal budgetary operations ceased as a result of the cash shortage. Knowledge of these systems did not disappear, however, and many control functions remained intact, where applicable – for instance, financial controllers in line ministries continued to check invoices. Since most officials remained in place during this period, the *status quo ante* was restored rapidly after 2007. Since 2008, reforms have been broadened and deepened to the point where all the basic elements of a soundly operating PFM system seem to be in place.

The type of PFM reforms and their sequence is notably different from what has been observed in many low-income countries. There has been a marked and deliberate emphasis on budget execution, to the exclusion, at least at first, of efforts to strengthen budget preparation. At least during the second phase of reforms, efforts were not limited to the concentrated entities in the core executive, but also extended to spending ministries. The reforms could draw on a fairly broad and deep cadre (by the standards of a small and fragile state) of competent officials, who enjoyed a modestly meritocratic career path within the MoF and associated agencies after 2002. The reforms also benefited from a core capacity within the core executive to set priorities and steer a complex reform process according to the domestic political priorities of the day, even if the capacity to implement all aspects of these reforms clearly depended on support from donors and external technical experts. This reform-management capacity is very often lacking in low-income countries and is perhaps the clearest expression that WBG is not a typical fragile state.

The sustainability of the current state of PFM remains an open question. Many core elements of the current system, such as the TSA, have now been practised throughout multiple budget cycles and are therefore probably accepted as standard practice among staff. Yet the events of 2006-7 have shown that in WBG there is a real risk that a political reversal will bring about a situation whereby, whether by intentional design of the government or not, progress on PFM reforms is threatened and reversed. While in the past these periods were massively disruptive to the operations of the PA, they also turned out to be reversible. However, over the past decade, much of the achievements have been associated closely with the current Prime Minister Salam Fayyad. Fayyad was able to use the political space available to him and to maintain the political balance among domestic political actors (some of whom had a strong vested interest in the *status quo*) and international donors to deliver an ambitious reform agenda. At the same time, since 2007, he has led the reforms without having to formally co-opt political opponents into the reform agenda, because legislative approval had no longer been possible – or necessary. Alternative channels to mediate opposing interests surely exist, but without the same legal power that a functioning legislature would provide. The next time a change in the highest offices of the executive takes place, much will depend on the precise circumstances of the changing political balance to determine if the support for PFM reforms holds firm. Until such a time, a question mark will remain over the future of the current achievements.

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Annex 1: PFM performance report scores

This PEFA Scoreset was informally prepared in 2006 for the World Bank's 2007 PER. It mostly covers the years of 2003-5.

Credibility of the budget	
PI1: Aggregate expenditure out-turn compared to original approved budget	B
PI2: Composition of expenditure out-turn compared to original approved budget	C
PI3: Aggregate revenue out-turn compared to original approved budget	B
PI4: Stock and monitoring of expenditure payment arrears	D+
Comprehensiveness and transparency	
PI5: Classification of the budget	B
PI6: Comprehensiveness of information included in budget documentation	B
PI7: Extent of unreported government operations	C+
PI8: Transparency of inter-governmental fiscal relations	D+
PI9: Oversight of aggregate fiscal risk from other public sector entities	D+
PI10: Public access to key fiscal information	C
Policy-based budgeting	
PI11: Orderliness and participation in the annual budget process	C+
PI12: Multiyear perspective in fiscal planning, expenditure policy and budgeting	D
Predictability and control in budget execution	
PI13: Transparency of taxpayer obligations and liabilities	n/a
PI14: Effectiveness of measures for taxpayer registration and tax assessment	n/a
PI15: Effectiveness in collection of tax payments	n/a
PI16: Predictability in the availability of funds for commitment of expenditures	D+
PI17: Recording and management of cash balances, debt and guarantees	C
PI18: Effectiveness of payroll controls	C+
PI19: Competition, value for money and controls in procurement	n/a
PI20: Effectiveness of internal controls for non	D+
PI21: Effectiveness of internal audit	C
Accounting, recording and reporting	
PI22: Timeliness and regularity of accounts reconciliation	C
PI23: Availability of information on resources received by service delivery units	D
PI24: Quality and timeliness of in-year budget reports	B
PI25: Quality and timeliness of annual financial statements	D+
External scrutiny and audit	
PI26: Scope, nature and follow-up of external audit	D
PI27: Legislative scrutiny of the annual budget law	C+
PI28: Legislative scrutiny of external audit reports	D

Annex 2: Table mapping reform measures by actors and PFM dimensions

	Budget formulation	Budget approval	Budget execution	Audit, evaluation, accountability	Legal framework and institutional rules
2002-5: first reform period					
MoF/MoP	<ul style="list-style-type: none"> • Efforts to bring donor-funded projects on budget • 2003 budget prepared in accordance with budget calendar, based on realistic revenue assumptions 		<ul style="list-style-type: none"> • Consolidation of revenues and expenditures into TSA • Establishment of PIF to consolidate state-owned enterprises and commercial activities of PA • Strengthening of procurement function in MoF • Computerisation of payroll records, efforts to enforce payroll controls by MoF • Unification of treasury and accounting systems of West Bank and Gaza • Efforts to reduce arrears 	<ul style="list-style-type: none"> • Establishment of Internal Audit Department in MoF • Monthly expenditure reports published by MoF 	<ul style="list-style-type: none"> • Annual budget laws of 2003 and 2004 used as vehicles to change budget process, often in concert with donors via conditionality of budget support
Sector ministries			<ul style="list-style-type: none"> • Closure of separate commercial accounts, control over revenues, procurement, hiring and expenditures successively surrendered to MoF • Financial Control Department established in MoF, control officers in ministries start reporting to MoF instead of own minister in 2004 		
External audit/ legislature					External Audit Law passed by PLC in 2004

	Budget formulation	Budget approval	Budget execution	Audit, evaluation, accountability	Legal framework and institutional rules
2007-10, second reform period					
MoF/MoP	<ul style="list-style-type: none"> • Several new departments established in MoF to compensate loss of Gaza and restructure ministry to reflect reforms • PRDP 2007-10 prepared by MoP, no integration with MoF, poor link with budget • Teams from MoF and MoP jointly prepare budget draft in 2009 to support integration of investment and recurrent budget • Cooperation between MoF and MoP to implement first steps towards programme budget • MoF Budget Office starts using budget module integrated with accounting system 		<ul style="list-style-type: none"> • Restoration of 2005 <i>status quo</i> after disruption in 2006/07 • Establishment of new computerised accounting system after loss of Gaza, begins operation in early 2008 • New PA accounting system developed by MoF in Ramallah – first time budget control, payments and accounting are integrated into single system • Payroll database of civilian and security personnel integrated and linked to accounting system • Continued efforts to integrate remaining holdouts into payroll system • Continued efforts to limit arrears 	<ul style="list-style-type: none"> • Efforts to strengthen financial reporting to enable external scrutiny of PA accounts • In 2007/08, financial controllers become responsible for checking payroll • Monthly reports on fiscal performance resume based directly on data from accounting system • 2008 financial statements prepared 	2010: new procurement law prepared that brings legal framework into line with international practice
Sector ministries	<ul style="list-style-type: none"> • Starting with 2009 budget, ministries prepare investment and recurrent budget proposals in a single format and submit both to MoF • In 2010, full devolution of responsibility for payments process to line ministries • Internal audit function devolved to line ministries on pilot basis 		<ul style="list-style-type: none"> • Rollout of accounting system to sector ministries in 2009 • In 2009, ministries are linked to accounting system and responsibility for payment processing starts to be devolved from MoF; ministry expenditures from donor sources subject to same controls as budgetary expenditures • Establishment of commitment controls through IT system in 2010 		
External audit/ legislature				<ul style="list-style-type: none"> • External audit office starts operating in 2008 • External auditor undertakes audit of 2008 final accounts 	2008 financial statements audited by SAACB

Annex 3: Reform period public expenditure data

	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005
GDP (million current US\$)	3,220	3,361	3,701	3,944	4,169	4,113	3,332	2,833	3,144	3,607	4,016
General government final consumption expenditure (million current US\$)	596	742	812	899	990	1,112	964	865	926	1,133	1,308
General government final consumption expenditure (% of GDP)	18	22	22	23	24	27	29	31	29	31	33

Source: World Development Indicators.

Annex 4: External aid data

	1995	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009
Total ODA (all donors, commitments, current US\$ million)	270	394	331	403	379	492	498	511	755	594	948	966	1,437	2,309	264
Total ODA (all donors, disbursements, current US\$ million)								365	504	595	775	1,016	1,373	2,060	154
PFM ODA (all donors, commitments, current US\$ million)				6	1	1	0	2	12	3	4	1	3	37	
PFM ODA (all donors, disbursements, current US\$ million)								1	1	2	7	6	5	41	- 0

Source: OECD DAC.

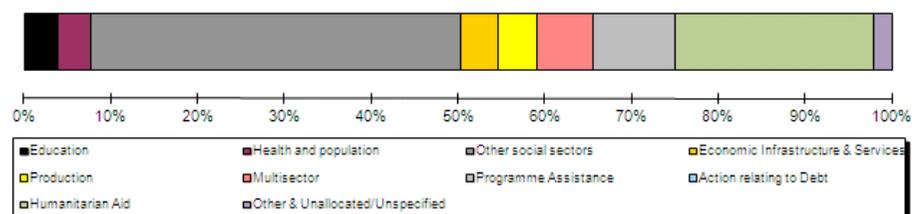
Palestinian Adm. Areas

Receipts	2006	2007	2008
Net ODA (USD million)	1 450	1 873	2 593
Bilateral share (gross ODA)	54%	46%	54%
Net ODA / GNI
Net Private flows (USD million)	- 6	- 8	3

For reference	2006	2007	2008
Population (million)	3.6	3.7	3.8
GNI per capita (Atlas USD)

Top Ten Donors of gross ODA (2007-08 average)	(USD m)
1 EC	602
2 UNRWA	480
3 United States	351
4 Norway	111
5 Spain	88
6 Germany	77
7 France	65
8 Sweden	63
9 United Kingdom	63
10 Netherlands	53

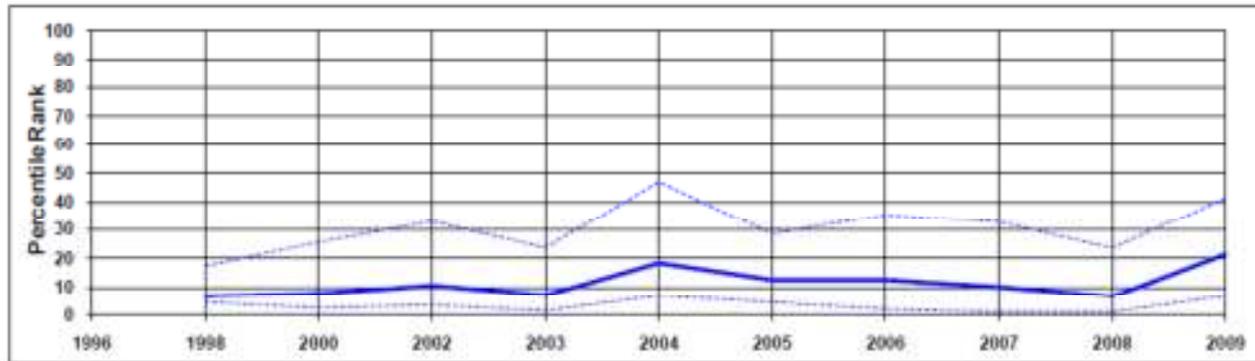
Bilateral ODA by Sector (2007-08)



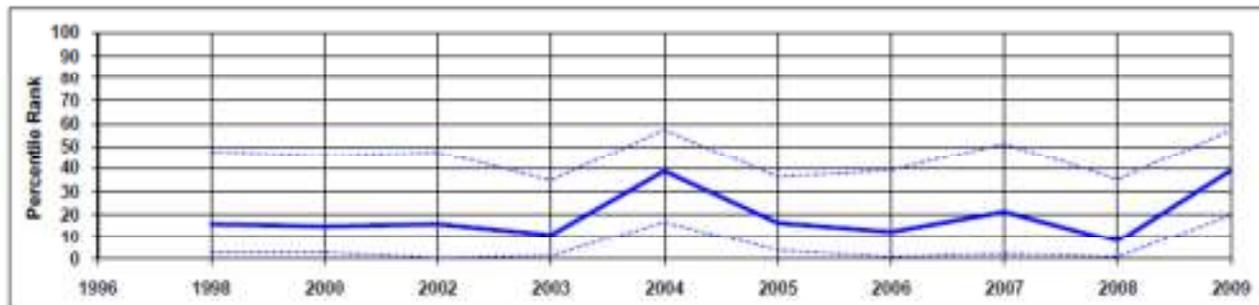
Sources: OECD, World Bank. www.oecd.org/dac/stats

Annex 5: Governance data

WEST BANK/GAZA, 1996-2009
Aggregate Indicator: Government Effectiveness



WEST BANK/GAZA, 1996-2009
Aggregate Indicator: Control of Corruption



Annex 6: List of people interviewed

Name	Post	Organisation
Salam Fayyad	Prime Minister and Minister of Finance	MoF, Ramallah
Mona Masri	Deputy Minister	MoF, Ramallah
Yousef Al-Zumor	Accountant-general	MoF, Ramallah
Farid Ghannam	Budget Director	MoF, Ramallah
Mazen S. Jadallah	Assistant Deputy Minister	MoF, Ramallah
Yousef Qadah	Gender Director, General Accounts Directorate	MoF, Ramallah
Bashar Jumaa	Head of PRDP Team	MoP, Ramallah
Jihad A.A. Draidi	Acting Director, General Projects	MoEHE, Ramallah
Bassam F. Jaber	Director General	Ministry of Public Works and Housing, Ramallah
Fayek Eddik		Ministry of Public Works and Housing, Ramallah
Qasem A. Maani	Director, International Cooperation Department	Ministry of Health, Ramallah
Mohammed Atyani	Financial Director	Ministry of Health, Ramallah
Mohammed Abu Alrub	General Auditor	SAACB, Ramallah
Jamal Abu Baker		SAACB, Ramallah
Lana Assi		SAACB, Ramallah
Faysal Othman		SAACB, Ramallah
Shateh Hussieni	Deputy of the Governor	Palestinian Monetary Authority, Ramallah
Hatem Yousef	Advisor of Prime Minister for Institutional and Economic Development	Syada, Ramallah
Mohammad Mustafa	Chairman and Chief Executive Officer	PIF, Ramallah
Louai Kawas	Director, Finance and Administration Department	PIF, Ramallah
Mohammad Salah Al-Dian	Budget Committee Clerk	PLC, Ramallah
Mohammed Al-Ramahi	Financial Manager	Municipal Development Fund, Ramallah
Azmi Shuabi		AMAN Anti-corruption Commission, Ramallah
Hafeth Al-Bargouthy	Director-general and Editor-in-chief	Alhayat newspaper, Ramallah
Adly R. Yaish	Mayor	Nablus municipality
Raja Al-Taher	International Relations Officer	Nablus municipality
Magdi Fahed	Financial Manager	Nablus municipality
Sahar	Director of Education	Directorate of Education and Learning, Nablus
Husien Abdel-Hak	Head of Buildings	Directorate of Education and Learning, Nablus
Rania Khdashe	Head of Finance	Directorate of Education and Learning, Nablus
Ishak Al-Samiry	Action Public Relations Head	Directorate of Education and Learning, Nablus
Roy Dickinson	Head of Operations	EC
Smita Choraria	Governance Advisor	Department for International Development
Oussama Kannan	Representative	IMF, Ramallah



Overseas Development Institute
203 Blackfriars Road
London SE1 8NJ
UK

Tel: +44 (0)20 7922 0300

Fax: +44 (0)20 7922 0399

Email: publications@odi.org.uk

Website: www.odi.org.uk