



COMMISSION OF THE EUROPEAN COMMUNITIES

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COMMUNICATION FROM THE COMMISSION
TO THE COUNCIL AND THE EUROPEAN PARLIAMENT

**ON FUTURE EUROPEAN UNION ECONOMIC ASSISTANCE TO THE WEST BANK
AND THE GAZA STRIP**

COMMUNICATION FROM THE COMMISSION TO COUNCIL AND PARLIAMENT ON FUTURE EUROPEAN UNION ECONOMIC ASSISTANCE TO THE WEST BANK AND THE GAZA STRIP

I. INTRODUCTION

This Communication is made in response to the Council Declaration on the Middle East Peace Process of 2 October 1995, which invited the Commission to present concrete proposals on this issue (*see full text of the Council Declaration*).

This Communication outlines the key elements of a common European Union strategy to be agreed upon following the signature of the second Interim Agreement signed by the P.L.O. and Israel on 28 September 1995. This common strategy should be adopted prior to the international conference on assistance to the Palestinians scheduled to take place before the end of the year.

The goal of EU assistance to the Palestinian people of the West Bank and the Gaza Strip should be to support Palestinian political, institutional and economic empowerment.

II. EUROPEAN UNION STRATEGY

1. Political empowerment

The democratic legitimacy of the Palestinian Authority is the central piece for Palestinian political empowerment. The European Union support to the holding of the first Palestinian general electoral process should be the focus of the Union's efforts.

2. Institutional empowerment

It is vital to create sound Palestinian governmental and administrative structures, able to assume the administration of Palestinian self-rule in the West Bank and the Gaza Strip including, inter alia, the provision of an overall legal framework, the provision and administration of essential public services and the programming and implementation of the significant volumes of international assistance to the Palestinian people.

3. Economic empowerment

It is essential lay the foundations for sustainable social and economic development in the West Bank and the Gaza Strip. A sound twin strategy aimed at achieving a balanced budget and sustainable development is a prerequisite of economic empowerment. Integration of the Palestinian economy at regional and international level is also an objective of maximum priority.

III. EUROPEAN UNION PRESENT ASSISTANCE TO THE WEST BANK AND THE GAZA STRIP

1. Political empowerment

In the Declaration of Principles of 13 September 1993 Israel and the P.L.O. agreed to the holding of Palestinian elections following Israeli redeployment from the West Bank and the Gaza Strip.

On 19 April 1994 the Council adopted a joint action in support of the Middle East Peace Process committing the EU to the implementation of a coordinated programme of assistance to the preparation and observation of Palestinian elections.

On these basis the Community started providing technical support to the Palestinian Authority for the preparation of the elections. Assistance has focused on drafting the electoral law, establishing the national and district election offices, establishing a press office, drawing of polling districts, carrying out a civic education campaign, training election officers and provision of electoral equipment (ballots, etc).

Foreshadowing the second Palestinian-Israeli Interim Agreement of 28 September 1995 by which the Union is requested to participate in and coordinate the international observation of the Palestinian elections, on 25 August 1995 the Council decided to deploy a 300-strong electoral observation team and to set up a European Electoral Unit to coordinate the international observation operation.

The Union is in the process of gradually deploying a 300-strong observation team on the ground to cover the whole electoral cycle from the beginning of the registration process. The European Electoral Unit is already set up and will be deployed on the field by early November 1995.

A total of 17.6 MECU has been provided so far out of the Community budget in assistance for the preparation, observation and coordination of international observation of the elections (*see Table I for details*).

2. Institutional empowerment

The Community started providing direct support to Palestinian institutions in the West Bank and the Gaza Strip in 1987. Following the first P.L.O.-Israel Interim Agreement of May 1994, which established the Palestinian Authority in the Gaza Strip and Jericho, this assistance focused on technical and financial support to the new administration. This comprises technical assistance, equipment and funding the start-up costs of such bodies as, among others, the Palestinian Central Bureau of Statistics, the Palestinian Broadcasting Corporation, the Project Management Unit for rehabilitation of ex-detainees and the Palestinian Energy Center. The Community has recently offered a programme of technical support to the ministries of the PA. In addition, a development programme of assistance to Palestinian local authorities has been launched.

In view of the transfer of further spheres of powers and the territorial enlargement of Palestinian autonomy as per the second P.L.O.-Israel Interim Agreement of 28 September 1995, present programmes of assistance to institutional building will have to be extended in time and in size.

Institutional building assistance provided so far from the Community budget amounts to 12.1 MECU (*see Table II for details*).

The Community has, since the establishment of the PA, committed considerable grant resources to the recurrent costs of the Palestinian administration. This assistance has focused on universities and community colleges, primary and secondary education centres, the police force and the unit of rehabilitation of ex-detainees. The Commission believes it is necessary to maintain this support for a limited period with a view to rapid and rational progress towards a Palestinian balanced budget.

At present, the total of Community financing of the recurrent costs of the Palestinian administration amounts to some 80 MECU (see Table III for details).

3. Economic empowerment

Total Community assistance to the Palestinian population of the West Bank and the Gaza Strip since the signature of the Declaration of Principles of September 1993, amounts to 215.3 MECU in grants (see Table IV for details). The qualitative and quantitative expansion of Palestinian autonomy has substantial economic implications which require a continuation of the assistance effort on the part of the international donor community.

The European Union is as a whole (Community, European Investment Bank and Member States) so far providing 183 MECU for Palestinian development in 1995 alone (see Table V for details), that is, 45% of the entire donor effort, making the Union by far the largest donor to Palestinian development. According to World Bank figures, the three next largest donors are Saudi Arabia (76 MECU/19%), the US (64 MECU/16%) and Japan (30 MECU/8%).

As to the Community itself, it has provided development assistance to the Palestinian population of the West Bank and the Gaza Strip since 1980, at first through NGOs, and since 1987, through Palestinian institutions. In addition to this, it has provided support to Palestinian refugees through UNRWA since 1971 (between 1993 and 1995, 136 MECU).

Following the September 1993 Declaration of Principles, Community funding for Palestinian development was substantially increased. At the Washington donors conference of October 1993, the Council pledged 500 MECU to the development of the Occupied Territories for 1994-98. This package would comprise 250 MECU in grants from the Community budget (50 MECU per year) and 250 MECU in long term loans through the European Investment Bank.

Since 1993, the Commission has used grant funds to support the development of the Palestinian administration, especially of the education sector, but also to finance large scale projects of basic infrastructure. The Community has more than lived up to its pledge. The grant component has been greatly exceeded in both 1994 and in 1995. An amount of 75 MECU was committed out of the Community budget in 1994, and some further 88 MECU will have been committed by the end of 1995.

The European Investment Bank has signed with President Arafat a Memorandum of Understanding to assure a Palestinian Authority guarantee of loan financing. It is in the process of committing the available funds in loans for a number of large scale infrastructure developments, and, to stimulate economic development, as credit for Palestinian commercial enterprises through local banks. It has already finalised an agreement for one of such credit lines through two local banks for an amount of 26 MECU.

IV. PROPOSED PLAN OF ACTION

1. Political empowerment

The Union's current involvement in supporting Palestinian political empowerment is already substantial and only requires its continuation without any additional financial effort. The Union should continue to provide technical support to the Palestinian Authority for the holding of Palestinian elections. The gradual deployment on the field of the European Electoral Unit, as well as of the 300-strong observation team, will also ensure that the Union is perceived as a vital partner in this field.

2. Institutional empowerment

The Union should support the extension of the Community's present programmes of assistance to Palestinian institutional building. These programmes will have to be adapted to the new situation created by the extension of Palestinian autonomy. They will also have to be tailored to the needs of individual Palestinian ministries and local authorities, in order to pass on expertise in the administration of public services, and to advise on future strategies and policies.

3. Economic empowerment

Consistent with the objectives of EU assistance to the Palestinian people, and in line with the strategy laid out in the present communication, the Union should adopt the following positions in the lead up to the ministerial donors conference, and beyond.

A. Tripartite Action Plan (TAP)

The European Union introduced to the international community the idea of a Tripartite Action Plan in order to help balance the Palestinian Authority budget. Agreed by the Palestinian Authority, Israel and the international donor community on 25 April 1995, the TAP obliged all parties to take action together to address the structural deficit of the Palestinian Authority (*full text of the TAP in Annex A*). The framework set up by the TAP has proved its effectiveness so far by achieving a substantial reduction of the Palestinian Authority budget deficit. In the light of the challenges posed by the economic consequences of the expansion of Palestinian autonomy, the TAP needs to be reviewed.

The Union should play a central role in the review of the Tripartite Action Plan. It should argue to the other donors, to the Government of Israel and the Palestinian Authority, that:

the TAP should specify the actions to be taken by the Palestinian Authority to improve fiscal administration and expenditure control, and economic management more generally, and, crucially, set up a timeframe for the implementation of such actions;

the TAP should be more detailed regarding the actions to be taken by Israel to facilitate the cross-border passage of goods, labor, Palestinian Authority staff and consultants, and project staff and project equipment;

donors should not be expected to provide support for start-up costs beyond a certain period, but the deficit problem should be treated according to a medium term framework.

This will permit the setting of a realistic timetable for the elimination of the deficit and the thus the phasing out of donor contributions.

the TAP should define more precisely the means by which international monitoring of the performance of all three parties to the Plan should be effected.

B. Development strategy

The donor approach to the development of the territories has so far been piecemeal. In order to ensure the effectiveness of any fresh donor funding while avoiding the fragmentation of donor efforts, it is necessary that a sound, comprehensive and long-term development strategy be designed. It is essential that the Palestinian Authority prepares, adopts and presents to the donors its own development strategy, within the context of a macroeconomic framework also defined by the PA. Such strategy should, in the context of a medium-term macroeconomic framework, establish the preconditions necessary for the attraction of foreign non debt-creating investment flows, for the promotion of private investment and for the creation of jobs. The Union should assist the Palestinian Authority in its efforts to prepare such a strategy which is to be owned by the Palestinian people.

The Community should argue for the creation of a special working group, formed by the Palestinian Authority, the three main bilateral donors (EU, Japan and the US), the United Nations Special Coordination Office (UNSCO), the World Bank and the IMF, to assist with the preparation of such a development strategy, including actions in the field of industrial cooperation (the main elements of such a strategy are outlined in Annex B).

To promote a coordinated approach, the Union should actively support the Palestinian Authority in its efforts to ensure that all new funding be programmed in line with the Palestinian Authority development strategy.

C. Trade

The Community has taken steps towards the integration of Palestinian economy at regional and international level. At present all Palestinian manufactured products enjoy free access to the Community market and key Palestinian agricultural products are granted, according to Council regulations, free or concessional access. However, these concessions have not so far generated significant trade flows to the European market as expected, mainly due to institutional obstacles. Thus, in addition to granting further agricultural trade concessions, the Community should explore practical means to promote Palestinian exports.

4. Future Community Assistance

The Community should remain committed to play a central role in the effort of providing assistance to the West Bank and the Gaza Strip.

The Commission is engaged in discussions with the Palestinian Authority for the programming of grant funds for 1996 and beyond, always taking care to coordinate the programming and implementation of Community funding with the Member States and other donors.

In addition, the Commission is negotiating a convention between the Community and UNRWA to govern the Community contribution to this Agency for the years 1996-98.

In order to facilitate the commitment of available resources, the Commission is also discussing with the European Investment Bank a formula which would allow for subsidising the interest rates through a contribution from the Community budget.

5. Euro-Mediterranean Partnership

The Union has invited the Palestinian Authority to participate as a full partner in the Euro-Mediterranean Ministerial Barcelona Conference of November 1995. The Conference will mark the launching of the Euro-Mediterranean Partnership based on the progressive establishment of a free trade area and a substantial increase in financial cooperation in accordance with the conclusions of the European Council in Cannes. This multilateral framework for Euro-Mediterranean relations aims at complementing bilateral relations between the Union and its Mediterranean partners. Membership to this Partnership will bring added value to relations between the Palestinians, the other Mediterranean partners and the Union.

As to the bilateral relations between the Community and the Palestinian Authority, the Commission, in the light of the conclusions of the General Affairs Council of 2nd October 1995, is exploring suitable solutions to create a bilateral framework for relations in the context of the Euro-Mediterranean policy, taking into account present legal limitations.

V. CONCLUSIONS

The Commission proposes that the Council adopts the foregoing strategy and proposed plan of action as the basis for a European Union common position on future assistance to the West Bank and the Gaza Strip in view of the Ministerial Conference to take place on this issue before the end of 1995.

The Commission calls upon the Presidency to organise the necessary coordination meetings to prepare the position of the Union at the Conference.

TABLE I

European Union assistance to Palestinian elections¹

1. Assistance to the preparation of elections (European Commission)

Project	Amount
Financial assistance to the Palestinian Commission for Local Government and Elections	1,766,725
Civic education campaign and press office	891,663
Support of the registration process	1,391,386
Drawing of polling districts	221,324
Training of election officers	629,946
Polling day and the count	835,289
Technical assistance	1,080,715
Equipment	775,710
Total	7,592,758

2. Observation of elections and coordination of the international observation (European Union)

Project	Amount
European Electoral Unit and logistics support team	3,400,000
European Union observers (300 observers)	4,300,000
Equipment and premises	1,150,000
Local personnel	150,000
Contingencies	1,000,000
Total	10,000,000

¹all figures in ECU

TABLE II

European Community assistance to institutional capacity building since September 1993²

Project and year of commitment.	Committed
Various projects - 1993	0.3
Palestinian Broadcasting Corporation - 1993	2
Palestinian Bureau of Statistics - 1994	1.4
Equipment for Police Force - 1994	5
Support for Ministry of Social Affairs (through Programme for Rehabilitation of Ex-Detainees) - 1994	0.4
Palestinian Energy Centre - 1994	0.5
Institutional support programme (various ministries and municipalities) - 1995	2.5
Total	12.1

TABLE III

Support to the recurrent costs of the Palestinian administration since September 1993

Project and year of commitment	Committed	Disbursed
Universities and community colleges - 1993	15	14.8
Rehabilitation of ex-detainees - 1994	10	5
Palestinian police force ³ - 1994	15	15
Universities and community colleges - 1995	15	10.8
Primary and secondary schools ³ - 1995	10	10
Support for the recurrent costs of the PA ³ (to be committed in Nov)	15	0
Total	80	55.6

²all figures in MECU³These items are included in the budget of the Palestinian Authority, other items can be counted as contributions to the recurrent costs of the public sector more broadly

TABLE IV

**Community financial and technical assistance to the West Bank and the Gaza Strip
committed since September 1993**

1. Total financing made available by the Community to projects for implementation solely in the West Bank and the Gaza Strip

1993	1994	1995	TOTAL	DISBURSED
51.9	75.4	88	215.3	95.5

2. Projects financed under direct aid budget line and financed solely in the West Bank and the Gaza Strip

Budget line	Project description/sector	1993 Sep-Dec	1994	1995	Disbursed
Direct Aid (B7-711)	Universities and community colleges - recurrent costs			15	10.8
Direct Aid (B7-711)	Primary and secondary schools - recurrent costs			10	10
Direct Aid (B7-711)	Gaza City solid waste programme - completion			5	0
Direct Aid (B7-711)	Institutional support programme			2.5	0
Direct Aid (B7-711)	Municipal support programme			10	0
Direct Aid (B7-711)	Completion of the construction of the Khan Younis hospital			7.5	0
Direct Aid (B7-711)	Final technical preparations of elections			2	
Direct Aid (B7-711)	Contribution to the recurrent costs of the Palestinian Authority ⁴			15	0
Direct Aid (B7-711)	Housing programme		10		5
Direct Aid (B7-711)	School construction and rehabilitation		10		4.5
Direct Aid (B7-711)	Credit for SMEs/development bank		8		2.5
Direct Aid (B7-711)	Rehabilitation of ex-detainees		5.5		2.6
Direct Aid (B7-711)	Support for Palestinian police force		20		15.8
Direct Aid (B7-711)	Demographic indicators		1.4		1.1
Direct Aid (B7-711)	Election registration materials		0.1		0.05
Direct Aid (B7-711)	Technical assistance	5	5		5.4
Direct Aid (B7-711)	Universities and community colleges - recurrent costs	15			17.8
SUB-TOTAL		20	60	67	72.75

⁴As contribution to PA budget 1996, conditional on respect of Tripartite Action Plan

3. Projects financed under other budget lines and implemented in the West Bank and the Gaza Strip

Budget line	Project description/sector	1993 Sep-Dec	1994	1995	Disbursed
Common Foreign and Security Policy	EU operation for the observation of Palestinian elections, and for the coordination of the international observation operation			10	0
Reconstruction and rehabilitation	Supplement to project for the rehabilitation of ex-detainees		4.5		2.4
Regional cooperation	Rafah sewage project	15			0.9
Regional cooperation	Radio/TV project	2			0.8
Environment	Rafah municipality and Gaza City solid waste disposal programmes	2.8	0.8		2.3
Democracy and human rights in developing countries	Assistance for election preparation		1.5	0.9	approx. 0.5
Energy cooperation in third countries	Palestinian Energy Centre		0.5		approx. 0.3
MEDA	Private sector development programme			3	0
Actions in favour of democracy and human rights (various budget lines)	Various projects	0.3	0.3	0.5	approx. 0.5
NGO co-financing	Health	0.6	0.6	0.5	
	Education	0.2	0.9	0.5	
	Support to women	0.1	0.1	0.1	
	Economic development	0.4	0.4		
	Agriculture	0.1	0.02		
	Environment	0.02			
	Human Rights	0.02	0.02		
	Social Welfare		0.1	0.5	
NGO co-financing		1.4	2.1	1.6	approx. 1.2
European Commission Humanitarian Office,	Food aid and medical supplies	10.4	4.7		approx. 13.9
Population			1	4.7	0
SUB-TOTAL		31.9	15.4	20.7	22.8

4. Regional projects in the Mediterranean area in which Palestinian organisations are involved

		1994	1995
Regional cooperation/MEDA	Microprojects	0.5	1
Med programmes	Peace Network		1.4
	Med Urbs	2	0.7
	Med Media		1.8
	Med Campus		1.1
Med programmes		2	5

TABLE V

European Union contributions to Palestinian development: 1995 commitments
(grants - unless otherwise specified)⁵

	MECU
Belgium	6.2
Finland	2.6
France	8.8
Germany	5.4
Ireland	0.7
Italy	14
Luxembourg	1.5
Netherlands	7.4
Spain	5.9
Sweden	13.8
United Kingdom	5.2
European Union	87.9
European Investment Bank (loans)	24.6
TOTAL	184.4

⁵source: AHLC Secretariat, July 1995

ANNEX A

TRIPARTITE ACTION PLAN ON REVENUES, EXPENDITURES AND DONOR FUNDING FOR THE PALESTINIAN AUTHORITY

THE AD-HOC LIAISON COMMITTEE (AHLC) MET IN PARIS ON APRIL 27-28 1995 TO CONSIDER THE NEW REQUIREMENTS CONCERNING FINANCING FOR PALESTINIAN SELF-GOVERNING ARRANGEMENTS IN THE WEST BANK AND GAZA.

DISCUSSION AT THE MEETING FOCUSED ON HOW DONORS COULD ASSIST THE PALESTINIAN AUTHORITY (PA) IN FINANCING ITS BUDGET DEFICIT FOR THE PERIOD APRIL 1, 1995 THROUGH DECEMBER 31, 1995. THE DISCUSSIONS LEADING TO THIS ACTION PLAN TOOK PLACE IN ACCORDANCE WITH THE EXISTING AGREEMENTS BETWEEN THE PLO AND ISRAEL, INCLUDING THE SEPTEMBER 13, 1993 DECLARATION OF PRINCIPLES ON INTERIM SELF-GOVERNMENT ARRANGEMENTS (THE "DECLARATION OF PRINCIPLES"); THE AGREEMENT ON THE GAZA STRIP AND THE JERICHO AREA, SIGNED AT CAIRO ON MAY 4, 1994 (THE "MAY 4 AGREEMENT" OR THE "GAZA/JERICHO AGREEMENT"); AND THE AGREEMENT ON PREPARATORY TRANSFER OF POWERS AND RESPONSIBILITIES, SIGNED AT EREZ ON AUGUST 29, 1994 (THE "AUGUST 29 AGREEMENT"). THE DISCUSSION ALSO TOOK NOTE OF THE OSLO DECLARATION OF SEPTEMBER 13, 1994 SIGNED BY CHAIRMAN ARAFAT, FOREIGN MINISTER PERES, AND FOREIGN MINISTER GODAL AND THE "UNDERSTANDING ON REVENUES, EXPENDITURES AND DONOR FUNDING FOR THE PALESTINIAN AUTHORITY, OCTOBER 1, 1994 - MARCH 31, 1995" (THE "UNDERSTANDING") SIGNED IN BRUSSELS ON NOVEMBER 30, 1994.

ATTENTION WAS ALSO PAID TO THE NECESSITY OF ENSURING THE LONGER TERM SOLVENCY OF THE PALESTINIAN AUTHORITY BUDGET AS WELL AS THE DEVELOPMENT OF THE PALESTINIAN ECONOMY. IN FACT, THE CURRENT SITUATION REQUIRES THAT, ASIDE FROM ADDRESSING THE SHORT TERM PROBLEM OF FINANCING THE PALESTINIAN AUTHORITY'S BUDGET, ACCOMPANYING MEASURES ARE UNDERTAKEN TO ASSIST THE PALESTINIAN ECONOMY, WHICH WILL IN THEMSELVES IMPROVE THE REVENUE BASE OF THE BUDGET. THE CONCERTED COOPERATION OF THE PALESTINIAN AUTHORITY, THE GOVERNMENT OF ISRAEL AND THE DONORS IS REQUIRED TO MOVE THE PA TO A POINT WHERE EXPENDITURES CAN BE MET BY REVENUES.

THE PARTICIPANTS AT THE MEETING WELCOMED THE PROGRESS THAT HAS BEEN ACHIEVED SINCE SEPTEMBER 13, 1993 AND CONCLUDED THAT FURTHER PROGRESS WOULD DEPEND UPON GOOD WILL AND SINCERE EFFORTS OF THE PALESTINIANS, ISRAELIS, AND THE DONORS, BASED UPON A CLEAR UNDERSTANDING OF THE STEPS EACH WAS PREPARED TO TAKE.

PALESTINIAN REQUIREMENTS AND RESPONSIBILITIES

THE PALESTINIAN AUTHORITY ADVISED THE DONORS OF THE FINANCIAL REQUIREMENTS FOR THE NINE MONTH PERIOD APRIL 1, 1995 THROUGH DECEMBER 31, 1995 ARISING FROM THE MAY 4TH AND AUGUST 29TH AGREEMENTS. THESE REQUIREMENTS ARE REFLECTED IN THE "PALESTINIAN AUTHORITY'S DRAFT BUDGET FOR APRIL - DECEMBER 1995" PRESENTED AT THE MEETING BY THE PA REPRESENTATIVE (SEE ATTACHED). THESE REQUIREMENTS DO NOT INCLUDE ADDITIONAL FINANCIAL NEEDS WHICH MAY RESULT FROM THE INTERIM AGREEMENT TO BE CONCLUDED BETWEEN ISRAEL AND THE PLO.

IN CONNECTION WITH THESE FINANCIAL REQUIREMENTS, THE PA STRESSED ITS COMMITMENT TO THE FOLLOWING STEPS:

FISCAL POLICY

1. ENSURE A FUNCTIONAL TAX COLLECTION SYSTEM THROUGHOUT THE WEST BANK AND GAZA.
2. CONTINUE TO IMPLEMENT IMF RECOMMENDATIONS ON IMPROVING ITS TAX ADMINISTRATION AND EXPENDITURE MANAGEMENT BY THE DATES INDICATED (SEE ATTACHED).

3. PREPARE QUARTERLY REPORTS FOR THE AHLC ON TAX COLLECTION AND EXPENDITURES, IN CONJUNCTION WITH THE IMF

4. CONTINUE EFFECTIVELY TO UTILIZE IMF ASSISTANCE TO IMPROVE THE OPERATION OF THE TAX SYSTEM, INCLUDING THE IMF OFFER OF RESIDENT ADVISERS PARTICULARLY WITH RESPECT TO BUDGETING, TREASURY AND REVENUE ADMINISTRATION. BY MAY 15, THE PA WILL ALSO APPOINT QUALIFIED AND FULLY AUTHORIZED DIRECTORS FOR THE CENTRAL BUDGET OFFICE, CENTRAL TREASURY, AND INTERNAL AUDIT UNIT IN THE MINISTRY OF FINANCE.

5. FREEZE SALARIES AND HIRING AT LEVELS CONTAINED IN THE BUDGET, CONSISTENT WITH THE REQUIREMENT FOR EXPERTISE WITHIN THE PA AT SENIOR LEVELS.

6. CENTRALIZE ALL FISCAL REVENUES, FISCAL EXPENDITURES AND THE PAYMENT PROCESS PLACING THESE UNDER THE DIRECT CONTROL OF THE MINISTRY OF FINANCE BY JUNE 30.

7. DISCUSS WITH ISRAEL AND RESOLVE BY JUNE 1 OUTSTANDING ISSUES RELATED TO TAX CLEARANCES AND COOPERATION IN THE JOINT ECONOMIC COMMITTEE.

8. MAINTAIN TAX OPERATIONS IN THE WEST BANK, IN ACCORDANCE WITH THE AUGUST 29 AGREEMENT, AND THE NOVEMBER 30, 1994 UNDERSTANDING.

9. ESTABLISH BY OCTOBER 1995 A SINGLE BUDGET FORECAST FOR 1995, BINDING ON ALL MINISTRIES AND COVERING ALL PUBLIC ACTIVITIES FOR WHICH CENTRAL ADMINISTRATION IS RESPONSIBLE, WHICH REPRESENTS THE PRINCIPLE THAT REVENUES MUST LEAD EXPENDITURES.

10. ESTABLISH A COMPREHENSIVE TAXATION PLAN FOR 1995-1996. IN THE CONTEXT OF PREPARING THE ANNUAL BUDGET FOR 1996, THE PA WILL SET REALISTIC REVENUE TARGETS BASED ON MEDIUM-TERM FISCAL AND MACROECONOMIC FRAMEWORKS. THE PA WILL ALSO PROVIDE FOR ADEQUATE PERSONNEL WITH APPROPRIATE EXPERTISE AND SYSTEMS SUPPORT, AND ESTABLISH PROCEDURES, SO AS TO MEET REVENUE TARGETS IN 1995-1996.

11. MAKE BEST EFFORTS SO THAT DONOR SUPPORT FOR START-UP COSTS WILL NOT BE REQUIRED BEYOND DECEMBER 31, 1995. THE DONORS UNDERTOOK TO REVIEW THE CONTINUING NEED FOR START-UP COSTS BEYOND THAT DATE PRIOR TO THE END OF THE YEAR.

GENERAL ECONOMIC POLICY

1. BY MAY 15, PREPARE AND CIRCULATE TO DONORS A DOCUMENT OUTLINING FUNCTIONAL DIAGRAMS AND POLICY RESPONSIBILITIES OF PEC/DAR, THE MINISTRY OF ECONOMY AND TRADE, THE MINISTRY OF INTERNATIONAL PLANNING AND COOPERATION, THE PALESTINIAN MONETARY AUTHORITY (PMA) AND THE MINISTRY OF FINANCE. SPECIFICALLY, THE DOCUMENT SHOULD IDENTIFY A SINGLE POINT OF CONTACT FOR EACH OF THE FOLLOWING: FINANCE (INCLUDING TAXATION AND EXPENDITURES), ECONOMY AND TRADE (INCLUDING TRADE, PRIVATE SECTOR INVESTMENT AND COMMERCIAL CONTRACTING), THE DEVELOPMENT PROGRAM (INCLUDING AID COORDINATION) AND MONETARY AFFAIRS (INCLUDING BANKING).

2. BY MAY 15, DESIGNATE ITS REPRESENTATIVES TO THE JOINT LIAISON COMMITTEE ESTABLISHED PURSUANT TO THE NOVEMBER AHLC MEETING IN BRUSSELS. THE COMMITTEE, AS THE PRIMARY FORUM FOR WORKING OUT PROBLEMS RELATED TO THE OVERALL ASSISTANCE EFFORT, SHOULD MEET BY MAY 31.

3. BY JUNE 1, 1995, UNIFY THE COMMERCIAL AND INVESTMENT CODES OF GAZA/JERICHO AND DEVELOP APPROPRIATE IMPORT AND EXPORT PROCEDURES BETWEEN GAZA/JERICHO AND THIRD COUNTRIES. ESTABLISH A CLEAR LIST OF PRIORITIES FOR INVESTMENT AND TECHNICAL ASSISTANCE, THAT CAN BE MADE AVAILABLE TO BOTH DONORS AND THE PRIVATE SECTOR.

4. DECENTRALIZE PROJECT IMPLEMENTATION, DESIGN AND EXECUTION THROUGH:

PECDAR UTILIZING MUNICIPALITIES, VILLAGE COUNCILS, NGO'S, MINISTRIES AND UN AGENCIES IN ACCORDANCE WITH EXISTING SYSTEMS AND REGULATIONS.

5. FINALIZE WITH ISRAEL A JOINT CONCEPT PAPER ON INDUSTRIAL ZONES AND CONTINUE TO WORK WITH THE DONORS AND THE WORLD BANK ON THE ESTABLISHMENT OF INDUSTRIAL ZONES.

6. WORK TOWARD THE ESTABLISHMENT OF AN APPROPRIATE REGULATORY FRAMEWORK FOR THE MOBILIZATION OF PRIVATE SECTOR INVESTMENT.

7. EXPEDITE NEGOTIATIONS WITH ISRAEL ON THE ARRANGEMENTS REGARDING THE GAZA HARBOR, IN ACCORDANCE WITH THE MAY 4 AGREEMENT.

ISRAELI REQUIREMENTS AND RESPONSIBILITIES

TOGETHER WITH THE PALESTINIANS AND THE DONORS, ISRAEL INTENDS TO CONTINUE ITS OWN EFFORTS TO CONTRIBUTE TO THIS PROCESS. IN PARTICULAR, ISRAEL INDICATED IT IS COMMITTED TO THE FOLLOWING STEPS:

FISCAL POLICY

1. COOPERATE WITH THE PA TO ENSURE A FUNCTIONING TAX OPERATION IN THE WEST BANK. ISRAEL WILL EXPEDITE TRANSFER TO THE PA OF ALL TAXES DUE PURSUANT TO THE AUGUST 29 AGREEMENT AND ALL OTHER RELEVANT AGREEMENTS.

2. WITH RESPECT TO GAZA/JERICHO, COOPERATE WITH THE PA IN SUPPORTING THE NEWLY ESTABLISHED TAX STRUCTURE. ISRAEL WILL RESPOND POSITIVELY TO A PA REQUEST TO REESTABLISH THE COMPUTER CONNECTION FOR THE TAX SYSTEM IN GAZA/JERICHO. ISRAEL ALSO WILL ENSURE MONTHLY TRANSFERS OF TAXES PROVIDED FOR IN THE MAY 4 AGREEMENT.

3. DISCUSS WITH THE PA AND RESOLVE OUTSTANDING MAY - DECEMBER 1994 VAT CLEARANCES FOR GAZA/JERICHO.

4. DISCUSS AND RESOLVE WITH THE PA OUTSTANDING ISSUES RELATED TO TAX CLEARANCES AND COOPERATION IN THE JOINT ECONOMIC COMMITTEE.

5. COOPERATE WITH THE PA TO PROVIDE TRAINING FOR PALESTINIAN TAX ADVISERS FOR THE NINE MONTH PERIOD, AS REQUESTED BY THE PA.

6. ISRAEL WILL ENSURE THAT AGREED TAXES RELATED TO ECONOMIC ACTIVITY IN THE WEST BANK AND GAZA WILL ACCRUE TO THE PA ACCORDING TO THE MAY 4 AND AUGUST 29 AGREEMENTS.

GENERAL ECONOMIC POLICY

1. DESIGNATE THE DIRECTOR GENERAL OF THE MINISTRY OF FINANCE AS ITS CENTRAL POINT OF CONTACT ON ECONOMIC ISSUES RELATING TO THE PALESTINIAN ASSISTANCE EFFORT.

2. ISRAEL IS COMMITTED TO THE RELEVANT PROVISIONS OF THE MAY 4 AGREEMENT AND WILL CONTINUE TO DO ITS UTMOST TO EASE THE TRANSFER OF GOODS BETWEEN ISRAEL AND GAZA/JERICHO, GAZA AND THE WEST BANK, THE WEST BANK AND JORDAN, AND GAZA AND EGYPT, CONSISTENT WITH ITS SECURITY CONCERNS.

3. FINALIZE WITH THE PA A JOINT CONCEPT PAPER ON INDUSTRIAL ZONES.

4. ENSURE THE SWIFT INSPECTION AND PASSAGE OF GOODS DESTINED FOR DEVELOPMENT PROJECTS IN THE WEST BANK AND GAZA.

- 5. EXPEDITE NEGOTIATIONS WITH THE PA ON THE ARRANGEMENTS REGARDING THE GAZA HARBOR, IN ACCORDANCE WITH THE MAY 4 AGREEMENT.
- 6. TAKE ALL POSSIBLE CONTINGENCY MEASURES IN ORDER TO MAINTAIN MAXIMUM POSSIBLE PALESTINIAN ECONOMIC ACTIVITY WHENEVER SECURITY MEASURES ARE APPLIED, IN ACCORDANCE WITH THE RELEVANT AGREEMENTS BETWEEN THE PARTIES.

ISRAEL STANDS READY TO CONSULT WITH THE AHLC, THE PA AND RELEVANT INTERNATIONAL FINANCIAL INSTITUTIONS TO ENSURE THIS EFFORT IS A SUCCESS.

DONOR REQUIREMENTS AND RESPONSIBILITIES

THE AHLC DELEGATIONS WELCOMED THE PRESENTATION BY THE PA. THE AHLC DELEGATIONS ALSO WELCOMED THE SUPPLEMENTARY EFFORTS ANNOUNCED BY THE ISRAELI DELEGATION TO EASE THE BUDGETARY DIFFICULTIES OF THE PA AND TO ASSIST THE PALESTINIAN ECONOMY, AND ITS INTENTION TO PURSUE THESE EFFORTS. THE DELEGATIONS EXPRESSED THEIR WILLINGNESS TO WORK COLLECTIVELY TO MAKE BEST EFFORTS IN ADDRESSING THE FINANCING GAP DESCRIBED IN THE PALESTINIAN PRESENTATION. THE AHLC DELEGATIONS STRESSED THE NEED FOR ALL DONORS TO IMPLEMENT PROMPTLY THEIR PLEDGES MADE AT THE OCTOBER 1993 DONORS CONFERENCE TO SUPPORT MIDDLE EAST PEACE AND AT THE SUBSEQUENT THREE AHLC MEETINGS IN PARIS AND BRUSSELS. THE AHLC AGAIN CALLED ON DONORS TO DEVOTE 25 PERCENT OF THEIR OVERALL PLEDGES TO START-UP COSTS. THE AHLC DELEGATIONS COMMITTED THEMSELVES TO PROCEED AS FOLLOWS:

- 1. FOR THE PERIOD APRIL 1, 1995 - DECEMBER 31, 1995 THE DONORS WOULD STRIVE TO PROVIDE ADDITIONAL SUPPORT FOR START-UP COSTS AS OUTLINED IN THE PA BUDGET.
- 2. IN ADDITION, DONORS ACKNOWLEDGE THAT UNDER THE TERMS OF THE BRUSSELS UNDERSTANDING (COVERING OCTOBER 1, 1994 - MARCH 31, 1995) CERTAIN EXPENDITURES WERE NOT FULLY COVERED. TO ADDRESS THIS ISSUE, DONORS WILL ENDEAVOR TO PROVIDE THE REQUIRED FUNDS, INCLUDING \$15.85 MILLION FOR THE POLICE. DONORS ALSO INDICATED THAT THEY WILL MAKE AN EFFORT TO EXPEDITE THE RELEASE OF OUTSTANDING PLEDGES FOR START-UP COSTS MADE IN BRUSSELS. FINALLY, THE AHLC CALLED UPON DONORS TO RELEASE NOW ANY UNCOMMITTED BALANCE OF THEIR 1994 PLEDGES TO THE HOLST FUND.
- 3. DONORS NOTED THAT ALL DONOR FUNDING FOR START-UP COSTS WOULD REQUIRE THE PALESTINIANS TO CONTINUE TO MEET ALL ACCOUNTABILITY REQUIREMENTS FOR THE HOLST FUND, UN PAYMENTS TO THE POLICE, AND BILATERAL MECHANISMS. DONORS HAVE AGREED TO EXTEND OPERATION THROUGH DECEMBER 31, 1995 OF BOTH THE IBRD'S HOLST FUND AND UN'S POLICE DISBURSEMENT MECHANISMS.
- 4. DONORS NOTED THAT THE GOVERNMENT OF ISRAEL AND THE PLO ARE CONTINUING THEIR NEGOTIATIONS ON THE TRANSFER OF ADDITIONAL SPHERES AND THEIR FINANCING. THEY ALSO NOTED THE WILLINGNESS OF ISRAEL AND THE PA TO KEEP THE DONORS INFORMED OF THE PROGRESS OF THESE NEGOTIATIONS.
- 5. DONORS INDICATED THAT THEY WOULD CONTINUE TO SEEK TO RAISE THE NECESSARY RESOURCES FOR QUICK-DISBURSING JOB CREATION PROJECTS. THE DONORS INDICATED THEIR WILLINGNESS TO OFFER PREFERENTIAL TRADE ACCESS FOR PALESTINIAN GOODS. THEY ALSO DECLARED THEIR READINESS TO OFFER INCENTIVES AND GUARANTEES FOR PRIVATE INVESTMENT IN THE WEST BANK AND GAZA. THEY STATED THAT THEY WILL CONSIDER FAVORABLY, IN DUE TIME, THE FINANCING OR CO-FINANCING OF PROJECTS FOR THE GAZA HARBOR AND THE INDUSTRIAL ZONES.
- 6. THE DONORS REQUESTED THAT THE AHLC SECRETARIAT AND IMF CONTINUE TO REVIEW ACTUAL REVENUE COLLECTIONS. THE AHLC SECRETARIAT AND THE IMF WOULD ALSO CONTINUE TO REVIEW THE RECORD OF PALESTINIAN AND ISRAELI EFFORTS TO ESTABLISH AND OPERATE TAX SYSTEMS, EXERCISE FISCAL CONTROLS, AND REPORT THE RESULTS TO THE

DONORS. THE DONORS NOTED THAT IF THESE REPORTS REVEALED ANY PROBLEMS WITH REVENUE COLLECTION, EXPENDITURES, OR INSTITUTIONAL DEVELOPMENT, THE AHLC WILL CONVENE TO CONSIDER THE MATTER.

7. THE DONORS STRESSED THAT THEIR OWN CONTINUING EFFORTS WOULD BE CONTINGENT UPON PERFORMANCE BY PALESTINIANS AND ISRAELIS IN IMPLEMENTING THE STEPS DESCRIBED IN THIS ACTION PLAN. THE DONORS NOTED THE PALESTINIAN PLEDGE TO MAKE BEST EFFORTS SO THAT DONOR SUPPORT FOR START-UP COSTS WILL NOT BE REQUIRED BEYOND DECEMBER 31, 1995. THE DONORS UNDERTOOK TO REVIEW THE CONTINUING NEED FOR START-UP COSTS BEYOND THAT DATE, PRIOR TO THE END OF THE YEAR.

8. DONORS NOTED THAT THE PA'S DRAFT BUDGET FOR APRIL-DECEMBER, 1995 IS BASED ON A NUMBER OF KEY ASSUMPTIONS, TO BE MONITORED BY THE IMF AND THE AHLC SECRETARIAT.

AHLC RESPONSIBILITIES: THE AHLC WILL BE RESPONSIBLE FOR A PERFORMANCE REVIEW PROCESS TO OVERSEE THE IMPLEMENTATION OF THIS ACTION PLAN. THE AHLC ASKED THE IMF TO MONITOR THE PALESTINIAN BUDGET. IT APPOINTED THE AHLC SECRETARIAT TO FOLLOW-UP ON DONOR CONTRIBUTIONS AND THE IMPLEMENTATION OF THE PUBLIC SECTOR INVESTMENT PROGRAM. THE AHLC WILL UTILIZE THE LOCAL AID COORDINATION COMMITTEE (LACC) AND THE JOINT LIAISON COMMITTEE (JLC) TO OVERSEE ON A CONTINUING BASIS THE IMPLEMENTATION OF THE ACTION PLAN BY THE PA, GOVERNMENT OF ISRAEL AND THE DONORS. ON BEHALF AND UNDER THE INSTRUCTION OF THE AHLC, THE LACC AND THE JLC WILL REVIEW THE QUARTERLY REPORTS PREPARED BY THE PA IN CONJUNCTION WITH THE IMF AND INFORMATION PROVIDED BY THE AHLC SECRETARIAT ON STEPS TAKEN TO IMPLEMENT THIS ACTION PLAN. THE AHLC WILL MEET TO MONITOR THE SITUATION AT THE REQUEST OF THE CHAIR UPON THE RECOMMENDATION OF ANY OF ITS MEMBERS.

ATTACHMENTS:

- IMF RECOMMENDATIONS
- PA DRAFT BUDGET FOR APRIL-DECEMBER, 1995

FOR THE PLO
FOR THE BENEFIT OF
THE PALESTINIAN AUTHORITY

FOR THE GOVERNMENT OF ISRAEL

FOR THE AD HOC LIAISON COMMITTEE

APRIL 27, 1995

ANNEX B

ECONOMIC ASPECTS OF THE STRATEGY FOR THE PALESTINIAN TERRITORIES.

The signing of the Interim Agreement on 28 September signals a new era in Palestinian autonomy and means that international donors will have to rethink their priorities and action. The European Union believes the Palestinians should be helped to draw up a comprehensive strategy within an appropriate macroeconomic framework which takes account of medium-term imperatives and acts as a reference point for the action of donor countries.

As the EU sees it, this strategy should have three interdependent goals:

- *to sustain a balanced budget,*
- *to kick-start productive investment,*
- *to help draw the emerging Palestinian economy into regional and world trade.*

To do this, the EU suggests a two-pronged approach, including:

- *a redefined and stronger Tripartite Agreement to consolidate progress made on the budget;*
- *the swift creation of a coordination group to outline a development plan for the West Bank and Gaza Strip.*

I. SUSTAINING A BALANCED BUDGET

1. Good budgetary prospects for 1995 and beyond

For the first time since the Palestinian Authority was set up, budgetary prospects are looking good. This should help calm the ongoing tension which has so far marked international assistance to the Palestinians.

- This year, there are few additional deficits to be covered.¹ Initial indications post-1995 are also very encouraging.
- Implementation of the Interim Agreement is expected to have a positive effect on tax receipts. Next year's deficit should be halved to USD 75 million. Tax receipts for 1997 should meet the Administration's current expenditure and there could even be a budget surplus in 1998.

¹ This is due in part to one-off factors (exceptional tax refunds by the Israelis) but also to encouraging developments such as:

- (i) a tight squeeze on spending (e.g. freeze on civil service pay and recruitment, freeze on police recruitment);
- (ii) the benefits of a new tax collection system;
- (iii) the prompt transfer of tax receipts by the Israelis.

2. Risks

However, for this to happen, a number of conditions must be met.²

The main risks have to do with the assumptions on which the budget forecasts are based, namely that: (i) budget policy remains problem free and (ii) security does not deteriorate (no repeated sealing off of the Palestinian Territories, reducing the number of Palestinian workers in Israel to 35 000).

Another risk concerns the timetable for transferring authority since any additional delay would have immediate effects on tax receipts.³ More generally, the alternative economic policy scenarios drawn up by the IMF show that the above factors (number of workers in Israel or transfer timetable) have a marked impact on budget equilibrium.

3. EU proposal (TPA)

The TPA has been instrumental in steadily reducing the Palestinian Authority's deficit by encouraging:

- (i) Palestinians to implement an extremely prudent budgetary policy;
- (ii) Israelis to make taxation transfers on time and
- (iii) donor countries to take steps to meet any outstanding deficit.

The TPA has also enabled the ad hoc liaison committee and the IMF to play a real part in overseeing the respective commitments of the three parties. Even though budget prospects have improved, the EU feels that the TPA must remain in place not only because of the potential loss of control over taxation outlined above but also because the impact the transfer of authority under the Interim Agreement will have on taxation has not yet been fully gauged.

However, although the TPA must remain, changes are required to it:

- it must be simplified and made to focus on issues directly relevant to the budget. Any provisions in the Agreement which refer to other matters such as investment or industrial zones must be deleted;
- obligations (such as the timetable for the steps to be taken by the Palestinians and the Israelis) must be clarified and made more binding. Monitoring mechanisms must therefore be strengthened;
- the TPA must take a medium-term view. The search for a lasting solution to the Palestinian tax deficits must look beyond the short term if persistent factors are to be accommodated alongside purely cyclical ones. The fact that we are not yet certain of the economic and fiscal consequences that the transfer of authority will

² In addition to budget discipline and tax collection efforts.

³ For example, forecasts for 1996 state that by the time of the elections in March the Palestinian Authority will be in receipt of all levies on oil and all customs clearances on direct imports.

have increases the need to develop a medium-term approach. The EU would therefore ask that the working party suggested below be given explicit responsibility for analysing - as quickly as possible - what impact the Agreement will have on the budget.

II. ENSURING THAT PRODUCTIVE INVESTMENT GETS OFF THE GROUND

1. Situation: delays and weaknesses. It is true that investment in infrastructure could have been more substantial if (i) conditions on the ground have been more favourable and (ii) the administration of the aid, notably on the Palestinian side had been more effective. However, one of the key reasons for the lack of investment has been the unexpected surge of recurring costs which have needed some 150 million dollars more to finance than anticipated over the last 18 months.

2. Approach. Private investment will of necessity be the driving force of economic growth and the main source of employment. Private investment must, however, be made easier in two ways: (i) an enhanced programme of public investment to restore the basic infrastructure indispensable for a resumption in economic growth, (ii) promotion of an investor-friendly legal and regulatory climate and (iii) underpinning institutional structures.

3. European Union proposal

Bilateral cooperation. As set out above, the EU has already carried out an in-depth study to determine the content of and arrangements for its assistance in 1996 on the strength of intense consultation with the Palestinian Authority.

Multilateral approach. The EU is proposing that a task force be set up as soon as possible to help the Palestinians hammer out the exact content, priorities, schedule and arrangements for their development strategy. This strategy would also serve as a framework for the intervention of donor countries and would be made up of the three main donors, the European Union, the United States and Japan, together with the IMF, the World Bank and the UN special coordinator. Its prime objective would be to help the Authority put the finishing touches to its public investment programme for which it has received help from the World Bank, taking care to integrate the programme into the macro-economic background and affording it a medium term dimension. This task force should be set up at the next meeting of the Consultative Group in Paris and would put forward a detailed work programme at the ministerial coordination meeting in December on Palestine.

III. INTEGRATING AN EMERGING ECONOMY INTO REGIONAL AND GLOBAL TRADE

1. *The challenges.* Lasting economic development of the West Bank and Gaza Strip must go hand in hand with the integration of the Palestinian economy into regional and global trade in goods, services and technology, and this therefore constitutes one of the main planks of the European Union's proposed development strategy. Such integration, which should be gradual and consistent with the E.C. / Israel Association Agreement, is warranted on a number of counts. Market discipline and competition are necessary to bring about a change in thinking (there has been a trend in some quarters to consider the issues in isolation), to grasp the expected opportunities of progress toward peace and stability in the region, and to be able to make inroads into certain European or world markets. The small scale of the West Bank and Gaza Strip economy, coupled with its marked dependence on the outside world, lend weight to this need for relevant international specialization.

2. *EU proposal.* The Palestinian Authority would be helped to devise a development strategy that fosters the integration of the West Bank/Gaza Strip into regional and world trade. We propose a three-pronged approach:

- *Regional integration.* There would be two goals to pursue: (a) helping the Palestinians play a full role in the increasing number of regional projects and programmes forming part of the peace process, which concern transport links, power links, energy and water, and (b) encouraging the Palestinian Authority to negotiate trade accords with other countries in the region.
- *International integration.* There are two avenues that could be followed: (i) encourage the industrialized countries to follow Europe's example and grant far-reaching trade concessions to Palestinians goods and services and (ii) help the Authority to approach the WTO with a view to familiarizing the Palestinians with that institution's practices and rules.
- *EU-Palestinian bilateral relations.* Bilateral relations between the European Union and West Bank/Gaza Strip should be bolstered on a number of fronts: the Union has already decided to make the Palestinians a fully fledged member of the Barcelona Forum. The Community could, moreover, look at the possibility of strengthening and extending the trade concessions it has already granted to Palestinian products (their key farm products already enjoy free or preferential access and manufactures enjoy free access). The Community could also embark on exploratory talks with the Palestinian Authority to step up and formalize bilateral relations and - in the light of the conclusions of the General Affairs Council of the 2nd October 1995 - extend their scope to economic, trade and institutional cooperation.

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