

# Action Fiche

## 1. ARTICLE IDENTIFICATION

Title	PEGASE: Support to Recurrent Expenditures of the PA		
Total cost	€176 million maximum (EC Contribution)		
Aid Method	Project approach – Centralised Management		
DAC-code	16010	Sector	Social/welfare services

## 2. RATIONALE

### 2.1. Country context

On 17 December 2007, France co-hosted a major conference for international donors, at which over \$7.7 billion of assistance was pledged. The European Union (Member States and European Commission) alone pledged a total of \$3.4 billion to be committed over the next three years (2008 – 2010) in support of the Palestinian Reform and Development Plan (PRDP) presented by Prime Minister Fayyad.

In the next three years, the Palestinian Authority must meet the difficult challenges which have been set out in the PRDP, including an average annual deficit of \$1.3 billion in order to cover essential recurrent budgetary expenditures. The PRDP calls for a significant share of donors' funds to be devoted to help the PA alleviate its budget deficit and avert a fiscal crisis.

To help the PA administration to face this critical situation, the European Union, fully aware of its responsibility of lead donor for Palestine, has launched a new mechanism incorporating the flexibility and diversified instruments required to support efficiently the PRDP. The Temporary International Mechanism (TIM) is presently phased out to be progressively replaced by PEGASE without any interruption between the two systems. PEGASE began on 1 February 2008.

The social ministries account for the majority of PA expenditure. The first priority of the PRDP is to secure sufficient donor funding to ensure that service delivery can continue in the areas of health, education and social services. The wage bill accounts for almost half of the yearly public expenditure and the vast majority of civil servants work in the education and health sectors, as teachers, doctors and nurses.

In 2008, the PRDP budget needed to support the payment of salaries to civil servants amounts to \$734 million (€506 million).

The PA is also conscious of the need to ensure that adequate social protection mechanisms are available to vulnerable citizens and a key emphasis of the PRDP is to ensure a social safety net system which is efficient, targeted and affordable.

The total estimated PRDP needs for budget expenditures for social protection schemes of the Ministry of Social Affairs in 2008 amount to \$102 million (€70 million).

In addition, the PA needs to ensure the continued provision of essential public services for the benefit of ordinary Palestinians, including the continued provision of electricity to households, schools, hospitals and public services. The PA's public finance reform objectives set out in the PRDP aim to significantly reduce net lending, which includes payment for certain essential public services, from 10.6% of the GDP in 2007 to 7.8% in 2010. In 2008, the total estimated net lending needs for budget expenditures for the Gaza Power Plant supplies alone amount to \$154 million (€106 million).

Another key issue for the PA public finance management is the settling of debts towards private sector businesses. Reducing the stock of arrears is essential to inject funds in the economy, which provides financial relief to the private sector, it raises purchasing power and helps the survival of businesses. It also contributes to job maintenance and creation, ensures that the provision of services to the administration can continue, and improves cash flow of the Ministry of Finance and indirectly the financial exposure of banks.

The total estimated PRDP needs for budget expenditures to support the payment of arrears in 2008 amount to \$125 million (€86 million).

## **2.2. Lessons Learned**

Actions under PEGASE will build upon the successful experience of the Temporary International Mechanism in 2006 and 2007 and will be taken forward in full coordination with our Palestinian partners and in full cooperation and transparency with EU Member States, the European Parliament and other donors.

An independent external evaluation of the TIM was launched in May 2007 and covered all activities since the beginning of TIM at the end of June 2006 to the end of June 2007. The main conclusions of the evaluation stated that TIM has been an innovative instrument, capable, in a very difficult and complicated environment, to quickly mobilise resources from a number of different donors and to target them efficiently to the most needy, at a time when political constraints impose that, in order to participate, potential donors must assure transparency and accountability which can be provided only by rigorous and complete fiduciary procedures. It also noted that TIM was viewed positively and directly improving living conditions for a large amount of the Palestinian population. The overall efficiency of TIM (Windows 2 and 3) was the most appreciated feature. A final evaluation of TIM is being undertaken and results will feed into the implementation of PEGASE.

## **3. DESCRIPTION**

### **3.1. Objectives**

The objective of this action to be implemented through **PEGASE** is to support the Reform and Development Agenda of the Palestinian Authority by helping the PA to:

- reduce its budget deficit and implement its public finance reform;
- meet its obligations towards civil employees, pensioners and vulnerable sectors of Palestinian society;
- maintain the functioning of the administration and the provision of essential public services to the population;
- reduce the net lending and the stock of arrears due to the private sector.

### **3.2. Expected results and main activities**

Five categories of public expenditure will be eligible for support under this action, for a total amount of €176 million:

#### *Component 1: Supporting Palestinian administration and services*

PEGASE will make available a monthly contribution to the payment of salaries and pensions to the PA civil servants in the West Bank and Gaza. The objective of this activity is to help the PA meet its financial obligations towards civil employees and pensioners. The contribution to the funding of the wage expenditure for civil servants reinforces the PA's public finance management and public finance reform implementation. At the same time, it allows the administration to function and therefore to provide services to the Palestinians in the West Bank and Gaza.

#### *Component 2: Supporting non-salary costs of the social ministries*

PEGASE will make available a contribution to the World Bank's Emergency Services Support Programme (ESSP) – as long as it remains operational – which has been financing non-salary recurrent expenditures of the ministries of health, education and higher education such as rent, maintenance, essential supplies, drugs, vaccines, lab materials, school supplies and training materials, furniture, equipment for shelters as well as basic goods and services related to the operation and maintenance of water and sanitation networks in the West Bank and Gaza. Like the previous component, this action will contribute to continued service provision for the benefit of the population.

#### *Component 3: Supporting the Palestinian social protection system*

PEGASE will make available at regular intervals direct financial support to vulnerable families in the West Bank and Gaza. The objective of this activity is to ensure the continued assistance to poor and vulnerable Palestinian families dependent on financial aid from the PA administration. This activity reinforces the reform of the social protection system and improves PA public finances by granting the PA budget a reduction of expenditure through the coverage of allowances due to the beneficiaries of the Ministry of Social Affairs' (MoSA) cash support programme.

#### *Component 4: Supporting the provision of essential public services*

The objective of this activity is to help the Palestinian Authority ensure the continued provision of essential public services for the benefit of ordinary Palestinians. In particular, the fuel deliveries to the Gaza Power Generating Company (GPGC) will

be funded under this component. This ensures the continued provision of electricity to households, schools, hospitals and public services in the area. The reimbursement of the costs of other public services, for example, health referral costs etc. is also foreseen.

#### *Component 5: Supporting the settling of PA arrears to the private sector*

The objective of this support is to help the PA reduce the stock of arrears due to the private sector including arrears of VAT refunds in the West Bank and Gaza. At the request of the Ministry of Finance the EC will help to clear arrears to the private sector following an auditing and verification process against agreed criteria. The settlement of arrears represents an important contribution to the PA budget by reducing its debt to the private sector and to the Palestinian economy by addressing one of the major causes of the crisis of the private sector.

### **3.3. Stakeholders**

The direct beneficiary of the action is the Palestinian population.

Eligible beneficiaries and expenses are identified through a system based on strict and objective criteria set by the European Commission and based upon requests and information provided by the Palestinian Authority.

PEGASE will be implemented in close cooperation and full partnership with the Prime Minister's Office, the Ministry of Finance and the technical Ministries and other Departments and Agencies of the PA.

For the contribution to the ESSP the main interlocutor will be the World Bank, which is managing the programme in cooperation with the Palestinian Authority.

PEGASE will be coordinated locally with the EU Member States, other international donors and International Organisations. In order to do so, full use will be made of the existing local coordination groups already in place in liaison with the PA administration and the Office of the Quartet Special Representative like the Local Development Forum, the AHLC structures, the coordination meeting between Member States and the EC Delegation etc.

All donors supporting the mechanism will also be key stakeholders.

### **3.4. Risks and assumptions**

Keeping the current rate of disbursement, over €100 million will have been disbursed by June, the timing of the proposed review. By that time it will be clearer to what extent contributions from Member States and other donors can effectively be mobilised. Some Member States have expressed an interest in contributing.

The above mentioned operations are based on full cooperation with the Palestinian Authority. This cooperation needs to be maintained, in particular for the identification of eligible beneficiaries and timing of payments and for the identification of eligible expenditure and arrears.

All actions under this special measure require that no restrictions are imposed by the Israeli Government, for example on the delivery of fuel into the Gaza Strip, or on financial transactions.

If the Agreement on Movement and Access is gradually implemented following negotiations post-Annapolis, PEGASE can be a powerful instrument at the disposal of the PA government, of Europe and of the International Community, to mobilise resources thereby contributing to the successful recovery of the Palestinian economy and the construction of a Palestinian State based on peace and prosperity.

### **3.5. Conditionalities**

PEGASE projects and actions will be included in the permanent macro economic and public financial management oversight coordinated by the IMF and the World Bank in collaboration with the PA government.

It will follow PRDP objectives and indicators and apply the priorities decided by the PA to develop the different programmes, reforms, projects and actions financed under the four main axes previously described.

### **3.6. Crosscutting issues**

Good governance principles are applied in the implementation mechanisms.

## **4. IMPLEMENTATION ISSUES**

### **4.1. Implementation Method**

This ENPI project will be financed under a financing agreement signed with the PA Ministry of Finance;

- component 2 (non salary-costs of social ministries) will be implemented under joint management through a contribution agreement with the World Bank which will comply with the requirements laid down in Articles 53d of the FR and 43 of its Implementing Rules.

- Other components (recurrent expenditure) will be implemented under centralised management.

PEGASE will be implemented locally by a Commission team of EC officials, in close coordination with Member States officials and with the Palestinian Authority.

Expenses will be paid from bank accounts open locally by the Commission either directly to the benefit of Palestinian Authority suppliers or to the Palestinian Authority, on the basis of eligibility checks processed by international and local experts. These modalities have already been implemented within the previous TIM mechanism

## 4.2. Procurement and Award of Grant Procedures

All contracts implementing the action will be awarded and implemented in accordance with the procedures and standard documents laid down and published by the Commission for the implementation of external operations, in force at the time of the launch of the procedure in question.

The essential selection and award criteria for the award of grants are laid down in the Practical Guide to contract procedures for EC external actions. Full financing can be applied in the cases provided for in Article 253 of the Implementing Rules of the Financial Regulation where financing in full is essential to carry out the action in question.

For activities implemented through an international organisation, all contracts implementing the action must be awarded and implemented in accordance with the procedures and standard documents laid down and published by the international organisation concerned and in conformity with the relevant Community legislation.

The West Bank and Gaza are territories facing a crisis, as defined in Article 168(2) of the Implementing Rules of the Financial Regulation. As a result negotiated contracting procedures or grant direct award may be used in accordance with applicable provisions.

## 4.3. Budget and calendar

The maximum contribution to PEGASE – Support to Recurrent Expenditures under this decision is €176 million. Keeping the current rate of disbursement, over €100 million will have been disbursed by June, the timing of the proposed review. By that time it will be clearer to what extent contributions from Member States and other donors can effectively be mobilised. Some Member States have expressed an interest in contributing. The contribution is indicatively distributed as follows:

*Component 1: Supporting Palestinian administration and services (€95 million)*

*Component 2: Supporting non-salary costs of the social ministries (€5 million)*

*Component 3: Supporting the social protection system (€10 million)*

*Component 4: Supporting the provision of essential public services (€56 million)*

*Component 5: Supporting PA arrears to the private and social sectors (€10 million)*

PEGASE operations are gradually taken over from the TIM without any interruption as from the 1 February 2008. PEGASE runs for a 3 year period in line with the PRDP and will cover the financial years of 2008, 2009 and 2010.

The funds under this decision will not be sufficient to cover the PA needs for the whole year 2008 and will indicatively be disbursed by the end of June 2008. Therefore additional donor resources will be necessary in order to continue to cover the above mentioned recurrent expenditure.

#### **4.4. Performance monitoring**

PEGASE will implement a comprehensive monitoring, verification and control system to provide reassurance over the use of their funds, and the efficient and effective provision of support to the Palestinian administration and population while fully protecting donor interests.

Payments will be executed in accordance with EC regulations. A sophisticated and uniform financial reporting system will be implemented, giving detailed information on all operations processed. Individual beneficiaries as well as businesses will be uniformly checked against international sanctions lists.

Depending of the type of project and programme financed, of the characteristics of the sector of activity concerned, of the geographical location, of the payment system used and of donors requests, specific ex-ante, real-time and/or ex-post monitoring and control procedures will be put in place.

#### **4.5. Evaluation and audit**

Financial experts and qualified auditors will work for PEGASE which will be complemented by EC and Member States specialists and international or local experts.

Apart from regular monitoring, control and audit systems and operations specific to each programme or project, regular financial system audits of the global mechanism will be implemented each year. Reports will be published.

Advanced monitoring, control and audit systems are set up for all of PEGASE's activities. All donors participating in PEGASE have full access to the corresponding monitoring and audit reports on the basis of which their contributions are disbursed.

As well as audits of eligible expenditures to identify and validate payments, the PEGASE team will organise a general ex-post audit of the programme in accordance with international standards with a view to providing the maximum level of assurance. Donors will be invited to participate. In addition, contributing donors may carry out ex-post audits of expenditures covered by their payments.

In addition, a mid-term evaluation report of PEGASE will be issued in mid-2009 and a comprehensive final evaluation report will be undertaken by the end of 2010.