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ANNEX 1

of the Commission implementing Decision on the Special Measure in favour of Palestine¹
2014

Action Document for Palestine

1. IDENTIFICATION

Title/Number	PEGASE: Direct Financial Support to Recurrent Expenditures of the Palestinian Authority – 2014 CRIS number: ENPI/2014/024-990		
Total cost	Total estimated cost: EUR 130,000,000 Total amount of EU budget contribution: EUR 130,000,000		
Aid method / Management mode and type of financing	Project Approach/ Direct management		
DAC-code	16010	Sector	Social/welfare services

2. RATIONALE AND CONTEXT

2.1. Summary of the action and its objectives

Most of the European Union's assistance to the Palestinian Authority (PA) is channelled through PEGASE, the financial mechanism launched in 2008 to support the PA Reform and Development Plan (2008-2010) and the subsequent PA National Development Plan (2011-2013), which aim to build strong governmental institutions as the basis for the future independent Palestinian State. The PA is now elaborating the Palestinian National Development Plan (PNDP) 2014-2016. These national plans set out a medium-term agenda for Palestinian reform and development and contain a framework of goals, objectives and performance targets.

Over the past years, the EU has been providing financial support to the PA and UNRWA to maintain the viability of the two-state solution and sustain the delivery of essential public services to the entire Palestinian population. Through PEGASE Direct Financial Support (DFS), the EU has contributed substantially to the Palestinian National Budget recurrent expenditures (€168 million in 2013), with systematic, predictable and unconditional contributions to the payment of PA civil servant's salaries, pensions and of social allowances to the poorest and most

¹ This designation does not entail any recognition of Palestine as a state and is without prejudice to positions on the recognition of Palestine as a state.

vulnerable Palestinians. This contributed substantially to State building as well as to social cohesion, economic and security stabilisation.

Consistently, the EU has been supporting the PA to implement policy reforms in public finance management, and on specific fiscal issues (such as reduction of the net lending), as well as to improve service delivery (social protection and civil service reform). Through a newly set up PEGASE window (2013) for East Jerusalem hospitals, the EU is also able to provide a crucial support to avoiding the collapse of those hospitals, which are amongst the few remaining Palestinian institutions in East Jerusalem and are providing key medical services to the Palestinian population. This support will enable the EU to push for policy reforms in the Health sector, particularly for the PA's health referral system.

2.2. Context

2.2.1. Country context

2.2.1.1. Economic and social situation and poverty analysis

The economy of Palestine has been marked by the disruption of more than forty years of occupation and conflict, during which the economic development path has paralleled political developments.

Restrictions on movement and access imposed by the Government of Israel (GoI) have deterred socio-economic development and resulted in an economy highly dependent on the Israeli market and donor aid. Obstacles for economic development are multiple and many-sided: limited access to land, water and other natural resources in the West Bank; segregation from the East Jerusalem market and inadequate public investment in East Jerusalem by the Jerusalem Municipality, as well as limited access to Area C (60% of the West Bank); de facto ban on exports from the Gaza Strip; severe restrictions on import of products considered by Israel to be of "dual use"; disrupting effects of settlement activity and settlers, notably in Area C; difficulty and uncertainty of obtaining movement permits for both Palestinian and foreign nationals.

According to a recent report submitted by the International Monetary Fund (IMF) at the AHLC meeting of September 2013, the economic situation in Palestine continues to deteriorate. The consistently strong growth in the West Bank witnessed from 2007 to 2011 (6-9% per year) was largely driven by government spending, in turn, funded by aid flows, and to a lesser degree easing of restrictions on movement and access by Israel. However, since 2012, growth has decelerated and real GDP is expected to further decrease to 1.5% in 2013.

The PA has limited control of its revenues, remaining dependent on clearance revenue transfers from Israel (Israel collects border revenues on behalf of the PA, which represent more than 65% of the PA's national budget revenues). In response to the Palestinian's bid for non-member state status at the UN on 29 November 2012, Israel stopped transferring these clearance revenues in December and January 2013 – worsening the PA's fiscal situation and creating instability in the economy. On 25 March 2013, Israel resumed transfers, but it continues to unilaterally deduct from the sums transferred, in a rather opaque manner, the cost of utilities owned by Palestinian municipalities ('Net Lending') in contravention of the provisions of the Paris Protocol.

In the short term, the PA will continue to depend on donor aid to cover its recurrent deficit, projected at over USD 1.4 billion for 2013. The projected 2013 fiscal gap amounts to around US\$0.3 billion. In spite of some increase in donor aid (USD1.3 billion against 0.8 billion in 2012, but down from USD1.8 billion in 2008), this has been insufficient to cover the deficit in the past years. Consequently, in 2013 the PA has continued to accumulate considerable debts to the banking sector and arrears to the private sector which reach more than USD0.5 million while the accumulated arrears to the pension funds is now estimated at more than USD1.4 billion. Health services have also been greatly affected. As a result of the PA's accumulated unpaid debts/arrears, hospitals in East Jerusalem have recurrent difficulties in paying salaries and are highly indebted to medical suppliers.

2.2.1.2. National development policy

In April 2011, the PA introduced its National Development Plan: Establishing the State - Building our Future (NDP), covering the period 2011-2013. The plan focused on the legal framework, organisational structures and processes, the use of technology in government, the management of financial resources and the management of human resources in civil and security sectors based on 23 sector strategies. The PA is now working on a new Palestinian development plan 2014-2016 (expected to be adopted in March 2014).

2.2.2. *Sector context: policies and challenges*

In spite of the PA's reform effort in institution-building and the delivery of public services, achievements continue to be jeopardized by the lack of progress in the peace process. At this stage is still unknown if the recent Peace initiative of US Secretary of State Kerry will yield any result. The Palestinian reconciliation efforts since 2011 did not achieve any result so far. The lack of progress on these two processes obstructs any perspective of translating institutional achievements into actual Statehood. As a result the PA fiscal sustainability continues to be a serious concern.

Set against a depressed economic and political environment, the outlook remains grim for the near future: a financing gap of approximately USD 320 million is forecast by the end of 2013. In this context, the IMF has appealed to the international community for a further commitment of direct financial assistance.

In 2013, EUR 168 million were provided for recurrent expenditures from the EU Budget through PEGASE DFS programmes. These funds were complemented with funds from EU Member States. Contribution from Member States include :Denmark (DKK 75 million for PA salaries/pensions, out of which DKK 40 million are earmarked for payments in 2014), Sweden (SEK 40 million for PA salaries/pensions), The Netherlands (EUR 2 million for PA salaries/pensions and EUR 1.5 million for salaries to the PA Civil Police/Defence), Finland (EUR 2 million for PA salaries/pensions), Luxembourg (EUR 0.7 million for PA salaries/pensions), Italy (EUR 1 million for PA salaries/pensions) and Ireland (EUR 1 million for PA salaries/pensions and EUR 0.5 million for social allowances). Austria already committed EUR 1.25 million for 2014 contributions.

Other donors, including EU Member States, are also providing support for direct financial assistance through non-PEGASE channels, either directly to the PA budget or via the World Bank Trust Fund.

According to available figures, France contributed EUR 9 million directly to the PA budget in August 2013. Other EU Member States have also contributed to the World Bank Trust Fund, which has delivered a total of over USD 164 million in 2013- including contributions from the UK (US 39 million), Australia (USD 21.3 million), Japan (USD 10 million), Norway (USD 43 million) and Kuwait (USD 50 million). Further support has been received from the United States (USD 350 million) and Arab donors (around USD 234 million in total, including Saudi Arabia (USD 164 million); Algeria (USD 26 million), Qatar (9 million), Iraq (USD 28 million) and Oman (USD 5 million)). India and Russia also contributed around USD 1 million and USD 11 million, respectively.

The EU is actively involved in key fiscal issues, such as net lending, and cooperates closely with the World Bank which is currently conducting a comprehensive review of the PA health referral system.

2.3. Lessons learnt

The implementation of the PEGASE DFS programmes builds upon the successful experience of the Temporary International Mechanism in 2006-2007. PEGASE DFS programmes are implemented in full co-ordination with Palestinian partners and in full co-operation and transparency with EU Member States, the European Parliament and other donors.

It is particularly appreciated by the Palestinian Authority for its alignment with the three years national development plans and the strong sense of ownership on the part of Palestinians, as well as for its flexibility and its catalytic nature in attracting funds from other donors without multiplying transaction costs.

The mid-term review of PEGASE, launched by the Commission in late 2009, highlighted the flexibility in planning and implementation of the programmes, the highly competent and professional staff and the use of well-proven management systems while continuously innovating – which contributed to the success of this mechanism. The final evaluation, covering the period February 2008- February 2011, confirmed these findings.

The present Action Document takes account of those recommendations of the recent European Court of Auditors report on EU Assistance to the Palestinian Authority, which were accepted by the Commission. It is understood that this is an ongoing process.

In line with the evaluation recommendations, the EU, together with the other direct financial assistance donors, has started working towards a 'results-oriented framework' which would cover both fiscal/policy reforms and service delivery. Under this framework, donors intend to further coordinate their support (in term of funding, technical assistance and policy dialogue) to the education, health and social protection sectors, as well as to help the PA in addressing key fiscal issues (such as net lending and health referral system), and policy reforms (such as public finance management and civil service reform). The definition of the results-oriented framework indicators will be fully aligned to the new PNDP 2014-2016 indicators.

2.4. Complementary actions

In 2013, a total of EUR 300 million were committed in support to Palestine from the European Neighbourhood and Partnership Instrument (ENPI), out of which EUR 168 million for PEGASE support to recurrent expenditure of the PA and EUR 80 million for United Nations Relief and Works Agency's (UNRWA) General Fund. A further EUR 52 million were allocated for projects aimed at socio-economic development and to support the institution-building agenda delineated in the Palestinian National Development Plan (2011-2013), under three focal sectors (Governance/Rule of Law; Private Sector Development and Water and Sanitation). UNRWA also received an additional allocation of EUR 10 million from the Food Security Budget Line to support its Social Safety Net Programme in 2012-2013, with the objective to provide nutrition for those refugees living in absolute poverty (95% of the funds were disbursed to date). Support to civil society initiatives was also made available from the European Instrument for Human Rights and Democracy and the thematic line Non State Actors and Local Authorities in Development. The Annual Action Programme 2014 is currently being prepared, in line with the draft new Single Support Framework 2014-2015 which is expected to be in the 2nd quarter of 2014.

2.5. Donor coordination

Local donor co-ordination has been streamlined in accordance with the conclusions of the Ad-Hoc Liaison Committee (AHLIC) meeting held 14 December 2005 in London following a proposal by the Commission, the World Bank and Norway to reform the Aid Management Structures. The Commission continues to play a leading role in these structures at all levels. Relevant platforms include: (i) the Fiscal Working Group (co-Chaired by the Ministry of Finance and the International Monetary Fund); (ii) the Public Administration and Civil Service Sector Working Group (co-Chaired by the Ministry of Planning and Administrative Development and the UK/DFID); and (iii) the Social Protection Sector Working Group (co-Chaired by the Ministry of Social Affairs and the EUREP).

The Commission plays a leading role in local EU Member States co-ordination. Complementarity and co-ordination with other EU actions are assured through regular co-ordination meetings at Headquarters and daily contacts between staff working in the European Union Representative Office (EUREP) in East Jerusalem. An EU Informal Group on PEGASE DFS was also set-up in early 2013 as a forum for information sharing and discussions around PEGASE DFS related topics (such as fiscal issues, policy reforms, service delivery). Through 2013, increased coordination with other direct financial assistance donors (mainly the World Bank and the contributors to the Trust Fund) has taken place.

3. DETAILED DESCRIPTION

3.1. Objectives

The overall objective of this temporary EU support is to maintain the viability of the two-state solution by avoiding the fiscal collapse of the PA and sustaining basic living conditions of the whole Palestinian population.

The specific objective is to support the Palestinian national development agenda and in particular:

(1) to support the PA to maintain the functioning of the administration and thus deliver to the Palestinian population (including the Palestinian refugee population) essential basic services;

(2) to improve the economic opportunities of poor, vulnerable and isolated population; and

(3) to support the PA in reducing its budget deficit and implementing its reform agenda while increasing the PA's accountability.

3.2. Expected results and main activities

Three categories of public expenditure are in principle eligible for support under this action, for a total amount of EUR 130 million which follows previous decisions committed on 2008, 2009, 2010, 2011, 2012 and 2013 funds.

Component 1: Supporting Palestinian administration and services (Indicative allocation EUR 93 million)

The EU will make available an additional contribution to the payment of salaries and pensions to the PA civil servants in the Occupied Palestinian Territory (West Bank and Gaza Strip). The objective of this activity is to support the PA to maintain the functioning of the administration and thus deliver to the Palestinian population (including the Palestinian refugee population) essential basic services. The regular contribution to the funding of the wages 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 thereby to provide services to the Palestinians in the West Bank and Gaza Strip.

Component 2: Supporting the Palestinian social protection system (Indicative allocation EUR 24 million)

The EU will make available at regular intervals direct financial support to poor and vulnerable families in the West Bank and the Gaza Strip through the PA's cash transfer programme (CTP). The objective of this activity is to ensure the continued assistance to Palestinian families living in extreme poverty, who are dependent on financial aid from the PA. This activity also reinforces the reform of the social protection system.

Component 3: Support to East Jerusalem Hospitals (Indicative allocation EUR 13 million)

The six Palestinian hospitals in East Jerusalem form an integral part of the network of health provision for the Occupied Palestinian Territory, in particular the West Bank. The Israeli annexation of East Jerusalem, although not recognised by the international community, and the construction of the separation wall/barrier has had the effect of making access to these hospitals particularly difficult for Palestinians living outside the city. In addition to the importance to the health network, these hospitals are also a symbol of continued Palestinian presence in East Jerusalem. The financial difficulties of the Palestinian Authority have resulted in a situation where many of the hospital bills underwritten by the Ministry of Health, and validated by the Ministry of Finance, remain unpaid. The hospitals are therefore, and to differing degrees, themselves in and/or worsen the PA financial crisis.

3.3. Risks and assumptions

It is expected that contributions from Member States and other donors will be made available during the implementation period to complement the proposed funds. Fluctuations in the exchange rate may have an impact on funding needs.

Full co-operation with the Palestinian Authority is essential. This co-operation needs to be maintained, in particular for the identification of eligible beneficiaries and timing of payments and for the identification of eligible expenditure.

All actions under this special measure require that no additional restrictions are imposed by the Israeli Government, for example on financial transactions, including transfer of funds between the West Bank and Gaza Strip.

3.4. Cross-cutting issues

Good governance principles are applied to the implementation mechanism and ownership on the part of the Palestinian Authority is assured. The actions proposed provide services vital to the social and economic rights of the Palestinian population.

3.5. 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 DFS programmes will be implemented in close co-operation and full partnership with the Ministry of Finance, the Prime Minister's Office, the technical Ministries and other Departments and Agencies of the PA.

PEGASE DFS programmes will be co-ordinated 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 co-ordination groups already in place such as the Local Development Forum, the AHLC structures, the co-ordination meeting between Member States and the Office of the EU Representative.

All donors supporting the mechanism will also be key stakeholders.

4. IMPLEMENTATION ISSUES

4.1. Financing agreement

In order to implement this action, it is foreseen to conclude a financing agreement with the partner country, referred to in Article 184(2)(b) of the Financial Regulation.

4.2. Indicative operational implementation period

The indicative operational implementation period of this action, during which the activities described in sections 3.2. and 4.3. will be carried out, is 18 months from the date of entry into force of the financing agreement or, where none is concluded, from the adoption of this Action Document, subject to modifications to be agreed by the

responsible authorising officer in the relevant agreements. The European Parliament and the relevant Committee shall be informed of the extension of the operational implementation period within one month of that extension being granted.

4.3. Implementation components and modules

Direct centralised management will be applied for all components.

PEGASE DFS programmes will be implemented by the Commission through the Office of the European Union Representative (EUREP), in East Jerusalem, in close co-ordination with Member States officials and with the Palestinian Authority.

Disbursements will be made by the Commission directly to the eligible beneficiaries of the PEGASE DFS programmes detailed in Section 3.2 above, following eligibility checks and verification and control procedures by external experts and international audit firms.

Subject in generic terms, if possible	Type (works, supplies, services)	Indicative number of contracts	Indicative trimester of launch of the procedure
Support to the recurrent costs of the Palestinian Authority (<i>PEGASE</i>)	Direct Financial Support	2	1st semester of 2014

4.4. Scope of geographical eligibility for procurement and grants

Subject to the following, the geographical eligibility in terms of place of establishment for participating in procurement and grant award procedures and in terms of origin of supplies purchased as established in the basic act shall apply.

The responsible authorising officer may extend the geographical eligibility in accordance with Article 9(3) of Regulation (EU) No 236/2014 on the basis of urgency or of unavailability of products and services in the markets of the countries concerned, or other duly substantiated cases where the eligibility rules would make the realisation of this action impossible or exceedingly difficult.

4.5. Indicative budget

Module	Amount in EUR thousands	Third party contribution
Component 1: Supporting Palestinian administration and services	93,000	N/A
Component 2: Supporting the Palestinian social protection system	24,000	N/A
Component 3: Support to East Jerusalem hospitals	13,000	N/A
Total	130,000	N/A

The aforementioned allocations are indicative and may be changed depending on the needs expressed by the PA and the funds received from other donors for specific

areas covered by PEGASE DFS programmes. It is anticipated that, as in earlier years, other donors will make contributions.

Funds for the necessary technical assistance, evaluation, audit and visibility actions have already been made available under separate Decisions.

4.6. Performance monitoring

A comprehensive monitoring, control and audit system will continue to be applied in the framework of the implementation of PEGASE DFS programmes, to provide reassurance over the use of funds, and the efficient and effective provision of support to the Palestinian administration and population while fully protecting donor interests.

Monitoring arrangements also include reviews to take stock of other donor contributions, reviews by the World Bank on reform progress, reviews by the International Monetary Fund (IMF) on budget execution as well as other relevant political developments.

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

4.7. Evaluation and audit

Financial experts and qualified auditors will be involved in the implementation of PEGASE DFS programmes, which will be complemented by Commission and Member States specialists and international or local experts.

Advanced monitoring, control and audit systems are set up for all of PEGASE DFS programmes. All donors contributing to PEGASE DFS programmes have full access to the corresponding monitoring and audit reports on the basis of which their contributions are disbursed.

In addition to the regular verifications and audits of eligible expenditures to identify and validate payments, annual ex-post audits of PEGASE DFS programmes will be undertaken in accordance with international standards, to provide the maximum level of assurance which will be contracted on other decisions related to the PEGASE DFS activities. Donors will be invited to participate. Contributing donors may also carry out ex-post audits of expenditures covered by their payments.

A comprehensive evaluation report covering the first three years of implementation of the PEGASE DFS programmes (2008-2011) was carried-out in 2012. The recommendations were taken into account in the implementation of the different programmes. An evaluation covering the period 2011-2013 was launched. Mid-term evaluations will be performed every 18 months and final evaluation after a 3-year implementation period in line with the PA development planning cycle.

4.8. Communication and visibility

The action will follow the EU visibility guidelines.

Progress of implementation will be communicated regularly to all stakeholders, including through a monthly bulletin. Regular meetings are held with Member States in Brussels as well as locally (EU Informal Group on PEGASE DFS).