

ANNEX I

to the Commission Decision on a Special Measure (Part III) in favour of Palestine, to be financed from the general budget of the European Union

Action Fiche for Palestine

1. IDENTIFICATION

Title/Number	Governance Programme ENPI/2013/024-708		
Total cost	Total estimated cost: EUR 26,500,000 Total amount of EU budget contribution: EUR 13,000,000 The action is co-financed (joint co-financing) by: Kreditanstalt für Wiederaufbau (KfW) for an amount of EUR 13,500,000		
Aid method / Method of implementation	Project approach: Component 1: Indirect centralised management with KfW Component 2: Direct centralised management- procurement of services		
DAC-code	15112	Sector	Decentralisation and support to subnational government
	15111	Sector	Government administration

2. RATIONALE AND CONTEXT

2.1. Summary of the action and its objectives

The proposed project aims to support general governance in Palestine, by supporting municipalities after the 2012 local elections and by strengthening the PEGASE¹ programme's efficiency and leverage in providing direct financial support to the Palestinian Authority (PA).

¹ Mécanisme Palestino-européen de Gestion de l'Aide Socio-économique

The *Palestinian Municipality Development Programme* (MDP) contributes to developing the 134 Palestinian municipalities in Palestine. It provides them with technical assistance to improve service delivery, transparency and civil participation. Under this new measure, municipalities will benefit from capital investment based on the priorities they defined in their *Strategic Development Investment Plan* (SDIP). Special attention will be given to social accountability and gender mainstreaming.

Since 2008, PEGASE has provided systematic support to the PA in building strong governmental institutions that could be the basis for a future independent Palestinian State. This includes (i) institutional capacity building in governance, social development, economic and private-sector development, and public infrastructure, and (ii) funding for the PA's recurrent costs of delivering basic public services, such as salaries/pensions, and social allowances in the West Bank and Gaza Strip.

2.2. Context

2.2.1. Country context

2.2.1.1. Economic and social situation and poverty analysis

Palestine's economy has been marked by over 40 years of occupation and conflict, during which economic growth paralleled political developments. The obstacles imposed by Israel have deterred growth and resulted in an economy that is highly dependent on the Israeli market and on donor aid. The Palestinian economy is characterised by: low levels of investment; low exports; geographical fragmentation; a decline of the industrial and agricultural sectors; a skills deficit across all sectors; high unemployment rates (of women and youth in particular); and rising poverty levels, despite a certain comparative advantage arising from a workforce that has low wages compared to its high level of education.

Since mid-2011, the PA has been experiencing a serious fiscal crisis. Its liquidity problems have resulted in the PA paying its salaries and pensions with delays and in instalments on several occasions. In addition, the PA has accumulated significant domestic payment arrears, notably to the private sector. Moreover, the situation has been aggravated by several instances of Israel withholding the transfer of 'clearance revenues' due to political developments. Although Israel has resumed the transfer of the clearance revenues, the outlook for the near future remains challenging. In September 2012, disturbances and demonstrations against the PA took place, in the wake of increasing prices, high unemployment and the PA's inability to pay the previous month's civil service salaries.

In April 2013, Salam Fayyad resigned as Prime Minister of the Palestinian Authority. A new government, led by Rami Hamdallah, was formed at the beginning of June 2013. According to the May agreement between Fatah and Hamas this Cabinet should make way for a consensus government by 15 August 2013.

During the past years the Middle East Peace Process has largely stalled, with little progress made during 2012. In December 2012 the Council concluded that "*In light of recent developments and taking into account previous Council Conclusions, the European Union firmly believes that now is the time to take bold and concrete steps towards peace*" underlining "*the urgency of renewed, structured and substantial*

peace efforts in 2013” and declared that “*towards this end, it is ready to work with the US and other international partners, including within the Quartet*”. The United States’ Secretary of State Kerry launched a new initiative to resume the peace talks recently.

2.2.1.2. National development policy

The three-year ‘Palestinian Reform and Development Plan 2008-2010’ (PRDP), which laid out a three-year fiscal and policy agenda for reform and development, received an unprecedented level of external support, notably from the European Union (EU). Subsequently, in August 2009, Prime Minister Fayyad presented the PA’s ‘Ending Occupation, Establishing the State (Programme of the 13th Government)’ plan. Based on the PRDP, it aimed to build strong governmental institutions that could serve as the basis of a future independent Palestinian State within a two-year timeframe.

In August 2010, the PA presented a new document called "Homestretch to Freedom", which reviewed the achievements made in the first year of the aforementioned "Ending Occupation, Establishing the State" and put forward plans for its second and final year. In April 2011, during the Ad Hoc Liaison Committee (AHLC) in Brussels, the PA presented the "National Development Plan" (NDP) for the years 2011-13 to the donor community. The NDP is consistent with "Homestretch to Freedom" and the PRDP and has also received donor support. The PA has now started working on a new Palestinian NDP to take over from 2014.

2.2.2. *Sector context: policies and challenges*

The Palestinian population is largely urban, with 72% living in 134 municipalities. The population is approximately 4 million. Municipalities, which existed prior to the establishment of the Palestinian Authority, have a clear role as the closest level of governance, representation and accountability for citizens. However, municipal governments face profound challenges in meeting their responsibilities. Budgets have been shrinking due to the on-going conflict, poor municipal management, and a culture of non-payment amongst users, eroding the coverage and quality of municipal services. Although municipalities can access seventeen revenue sources,² collections are also extremely volatile. Consequently, although the 134 municipalities are required to provide basic services within 27 functions mandated by law, only three functions (solid waste management, street maintenance and water supply) are consistently provided by the majority of municipalities. It is doubtful that municipalities could finance extensive service improvements in the current fiscal context.

Nonetheless, the PA and municipalities have demonstrated significant progress in municipal and local development. In 2005, the PA established the Municipal Development and Lending Fund (MDLF) to address municipalities’ financing and capacity building, followed, in 2009, by the Municipal Development Programme

² This includes: user fees for electricity, water, solid waste collection, slaughterhouses, and public markets; building permits and fees for signs collected locally; property tax, professional tax, and transportation tax, collected nationally.

(MDP)³ to implement the local government goals of the Palestinian Reform and Development Plan (PRDP). The MDLF was established in October 2005 by Ministerial Decree, with the legal mandate to provide direct development assistance to municipalities by providing them with transparent, rules-based and efficient financing, and for implementing national policies in the local government sector, as required by the Minister of Local Government. The PA's practical achievements have included the development of a unified chart of accounts and standard budget guidelines.⁴ Finally, since 2008, the Ministry of Finance has been rolling out a programme to improve property-tax collection, supported by the Japanese International Cooperation Agency and the Danish International Development Agency (DANIDA). Collection increased from USD 10 million in 2006 to USD 30 million in 2010. These improvements have resulted in approximately 112 municipalities graduating to a higher performance ranking, according to a national municipal performance ranking system developed as part of the PA's MDP.

As regards component 2 of this programme, the European Union has supported the Palestinian national reform agenda and general PA governance capacity by providing direct financial support for the PA's recurrent expenditures, through PEGASE, since 2008. To date, close to EUR 1.5 billion have been channelled through this mechanism, mainly towards the payment of salaries of PA civil servants/pensioners, social allowances for the poorest citizens, and arrears. Implementation of PEGASE direct financial support programmes (known as 'PEGASE DFS') builds on advanced monitoring, control and audit systems, as well as on technical support for identifying, implementing and follow-up of programmes. This support contributes to the PA's overall governance efforts, and is channelled through the PA treasury. It involves intensive policy dialogue with the Ministry of Finance, which is progressively becoming the PA's sole contracting authority for all partially-decentralised projects funded by the EU. Other line ministries (including for justice, water and public works) have over time benefited from capacity-building support from the European Union.

2.3. Lessons learnt

The MDP is continuously being assessed and reviewed. The lessons drawn from phase 1 of the Municipality Development Plan (MDP) were presented during a pre-appraisal visit for phase 2, from 6-16 November 2012. They included the following:

- The objective of phase 1 of the MDP was to improve municipal management practices to lead to more transparency. According to the latest progress review, phase 1 is meeting its key performance indicator targets, and in some cases even exceeding them.
- Participation in decision-making on capital investment projects could be improved.

³ The Municipal Development Project 1, in support of the Municipal Development Programme, was financed by 7 funding partners and is a precursor to this project.

⁴ First supported by the EMSRP (Emergency Municipal Services Rehabilitation Project) 1 and 2, and now by Municipal Development Project 1.

- The principles of social accountability, sustainability and transparency should be fostered when delivering municipal services.
- Results, including municipal performance rankings and the Municipality Development and Lending Fund's (MDLF's) annual reports, should be published.
- Gender mainstreaming should be introduced into the MDP.
- The present Results-Based Outcome Monitoring methodology used at present could be improved by complementing it with a participatory monitoring and evaluation approach that focuses on institutional learning.

2.4. Complementary actions

In 2012, the MDLF completed the Emergency Municipal Services Rehabilitation Programme (EMSRP II) which had been funded by several international partners. The objective of the EMSRP was to rehabilitate damaged infrastructure such as solid waste collection, street lightning, water and electricity supply. In addition, the MDLF completed the Local Development Programme (LDPI), with support from the Danish Government. The LDPI was a pilot programme that created local government clusters made up of local-government units. The idea was to cluster small government units and integrate them into existing municipalities. In addition, the MDLF is currently implementing the Local Government Capacity Building Project (LGCBP), also with support from the Danish Government. This project supports the Ministry of Local Government in its work on building capacity in financial management and accounting, as well as in the planning of small-scale infrastructure for village councils. The World Bank has recently financed a study to assess the generation of municipal revenue, focusing on three key areas: expenditure and service delivery, municipal revenue and service delivery, and municipal entrepreneurship.

Last but not least, the Japan International Cooperation Agency is currently supporting the Local Financial System by assisting municipalities in developing a property-tax system.

2.5. Donor coordination

Donor co-ordination takes place in various forms under the Local Development Forum (LDF) and its four "strategy groups", amongst them the Local Government Sector Working Group, which meets 3-4 times per year and is led by the Ministry of Local Government and co-chaired by Denmark. Ad-hoc meetings of international partners are called when developments in the sector so require.

Multi-donor supervision meetings on the Municipal Development Programme, led by the MDLF, are held on a semi-annual basis. For the MDP programme, planning and implementation, including financial management, procurement, reporting, monitoring and evaluation, are fully coordinated by the funding partners and aligned with MDLF procedures. The MDLF, and therefore the MDP programme, has provided an excellent and widely acknowledged platform that acts both as a way of coordinating donors and as a common funding channel.

3. DETAILED DESCRIPTION

3.1. Objectives

The overall objective is to improve municipal management practices for better service delivery and municipal transparency.

The specific objectives are:

- Better service delivery in the Gaza Strip, to be achieved through municipal Grants for Capital Investment and operating expenditure (except salaries);
- Better capacity of municipalities, to be achieved through capacity-development packages;
- More citizen participation in improving local governance.

The proposed project supports all 134 municipalities in Palestine. It is difficult to estimate the project's direct beneficiaries who benefit from capital investment since these are demand driven. Consequently, the number of direct beneficiaries for capital investment will only be known at the end of the project. Other project beneficiaries include: the 134 municipalities benefiting from technical assistance; users/citizens using customer services centres; and the implementing agency i.e. the MDLF.

3.2. Expected results and main activities

Component 1: Municipality Development programme — Phase 2

The main **expected results** are:

- Improved capacity for municipalities to deliver better service to the Palestinian people, which means upgrading their performance category compared to phase 1;
- Implemented and completed capital investment projects (with final acceptance certificates);
- Social accountability and transparency measures applied by municipalities by the end of phase 2;
- Engagement of citizens in participatory evaluation and in updating the process of establishing *Strategic Development Investing Plans*.

The **main activities** are:

- Municipal Grants for Capital Investment. Performance-based grants are to be allocated for capital investment in accordance with the mandate of municipalities, as well as for the operating expenditures of municipalities in the Gaza Strip.
- Technical assistance to municipalities and the MDLF. This aims to: i) support municipalities in improving their performance and ii) strengthen the MDLF's capacity to assist the PA in municipality development.

-Project Implementation Support and Management Costs. This includes: financing goods and consulting services to improve management practices, outreach and communication; local technical consultants; and the MDLF management fee.

Component 2: Specific audit and monitoring measures

The main **expected results** include ensuring the PA's general governance capacity, by enforcing advanced monitoring, control and audit systems for all PEGASE programmes of direct financial support. These systems ensure the efficient and effective provision of support to Palestinians, while protecting the interests of donors participating in PEGASE by ensuring that funds are disbursed with full transparency and accountability and in compliance with the relevant agreements between the EU and the PA.

Moreover, the ability of the Ministry of Finance to act as Contracting Authority for all partially decentralised contracts funded by the EU will be enhanced. Staff from line ministries, including for justice, water and public works, will also benefit from technical assistance as part of EU-PA cooperation.

The **main activities** include:

- Purchase of software solutions to screen beneficiaries against international sanctions and other lists;
- Audit and verification services and evaluation of PEGASE DFS programmes;
- Technical assistance and consulting services related to PEGASE DFS programmes;
- Capacity building and technical assistance within the Ministry of Finance, the Ministry of Public Works and Housing, the Ministry of Justice and the Palestinian Water Authority.

3.3. Risks and assumptions

The implementation of EU's support to Palestine is subject to unusual types and high levels of risk, namely those arising from the continued Israeli occupation of the West Bank, the persistent blockade of Gaza, the on-going separation between the West Bank and Gaza Strip, the violent conflict between Palestinians and Israel, and the conflict between Palestinian factions. In particular, all projects are at substantial risk from unpredictable Israeli policies and actions e.g. further restrictions regarding the trade of goods and the free movement of service providers; military actions in the Gaza Strip; demolitions and settler activity.

Municipal Risk: there is an additional risk specific to the municipalities, as their capacity for sub-project implementation is not always sufficient. The project therefore provides for the possibility of additional support in the form of local technical consultants, selected through procurement procedures.

As regards the risk related to municipalities' budget management, including for those located in the Gaza Strip, no sub-funds will be transferred. The MDLF will pay

contractors and suppliers directly, on behalf of the municipalities, according to the sub-grant agreements between the MDLF and each municipality.

As regards the project risks for stakeholders and donors, it is assumed that municipalities will not jeopardise the MDP's incentive system.

3.4. Cross-cutting issues

Good governance: Municipalities will propose priority sub-projects for capital investment, based on a consultative planning process and agreement in municipal councils. The project aims to improve local good governance and accountability of local government bodies towards their citizens. Components 1 and 2 contribute to good governance by promoting high standards of financial management. The recurrent costs of maintaining the infrastructure projects built into the MDP's framework will be financed by the municipalities, though they are relatively limited due to the nature of the works. The Ministry of Education and Ministry of Health will pay for the salaries of employees recruited to work in the new schools and clinics.

Gender equality: Gender equality will be promoted in both components. In component 1, special attention will be given to strengthening women's influence during the process of developing the Strategic Development and Investment Plan (SDIP), which is a participatory process during which priority infrastructure projects are chosen. In order to ensure that women express themselves freely, the power imbalances between men and women will be addressed. It is moreover expected that additional social infrastructure built in the framework of the MDP, such as kindergartens and clinics, will create additional job opportunities, particularly for women.

Environmental sustainability: Environmental sustainability will be promoted throughout component 1 activities. The sub-projects to be funded include the development and rehabilitation of municipal small-scale infrastructure. The expected environmental and social impacts of these sub-projects are expected to be positive.

The MDLF has developed the Environmental and Social Management Framework (ESMF) to set up procedures and mitigation measures related to the MDP's environmental social impact. The ESMF is based on the World Bank's environmental and social policies.

3.5. Stakeholders

The 134 Local Government Units (LGU) are the programme's direct beneficiaries. They will be responsible for implementing the sub-projects they identify through a participatory public consultation process.

The programme's other stakeholders are the MDLF and the Ministry of Local Government. The MDLF will be responsible for project implementation. It is managed by a Board of Directors chaired by the Minister of Local Government. Its 11 members include representatives of: the public sector (Minister of Planning and Administrative Development, Minister of Finance, Minister of Public Works and

Housing, Ministry of National Economy); civil society (Engineers Association, Banking Association, Association of Palestinian Local Authorities, women's association); and 2 mayors.

Civil society organisations participate in developing municipalities' Strategic Development and Investment Plans (SDIP) and are therefore key stakeholders.

4. IMPLEMENTATION ISSUES

4.1. Financing agreement

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

The indicative operational implementation period for this action, during which the activities described in sections 3.2. and 4.3. will be carried out, is 60 months. This period may be modified if necessary, with any changes to be agreed by the authorising officer responsible for the agreement.

4.2. Implementation components and modules

4.2.1. *Component 1: Indirect centralised management with Kreditanstalt für Wiederaufbau*

This action, which aims to enhance the capacities of the Palestinian municipalities, will be implemented through indirect centralised management with Kreditanstalt für Wiederaufbau (KfW), in accordance with Article 54(2)(c) of the Financial Regulation 1605/2002. This is justified because KfW has been a long-term partner of the Ministry of Local Government and the MDLF (since 2005). It is the largest single donor to the programme and a reliable partner for implementing infrastructure projects. It has channelled its funds through the Municipality Development and Lending Fund (MDLF) since the beginning. The KfW has provided EUR 32 million of funding so far. Another EUR 13.5 million are planned to fund the first phase of the MDP2.

KfW has a proven track record in implementing large-scale infrastructure programmes in harmony with other donors. As the majority of EU funds to the MDP will be used for implementing infrastructure projects, KfW has the required experience and expertise. KfW is currently implementing water and sanitation projects in the municipalities, which is a focal area of action for the EU, and is strongly involved in the MDLF's institutional development, an area the EU would like to support during MDP2. Furthermore, KfW has proved to give adequate attention to gender, social accountability and youth participation.

KfW will be responsible for the overall administration of all activities.

It intends to sub-delegate the implementation tasks related to the MDP project to the Municipality Development and Lending Fund (MDLF), a semi-governmental organisation set up to: i) enable local government units to provide quality services and achieve sustainable development according to national plans and policies, ii)

ensure sound coordination of action in the sector, and iii) provide a harmonised funding channelling system for the following funding partners: the Palestinian Authority, Agence Française de Développement (AFD), the Belgian Development Agency (BTC), the Danish International Development Agency (DANIDA), Deutsche Gesellschaft für Internationale Zusammenarbeit (GIZ), Kreditanstalt für Wiederaufbau (KfW), the Swedish International Development cooperation Agency (SIDA), the Netherlands, Switzerland and the World Bank.

For the MDP project, the MDLF has developed efficient, transparent, non-discriminatory procedures to rank municipalities, allocate grants for capital investment and capacity development, and help them to plan and implement projects that improve municipality services. A procurement manual has been developed to help municipalities meet their obligations in managing works and supplying contracts. The municipalities are responsible for procurement and tendering, as well as for contracting out the work (under close supervision of the MDLF which ensures that all contractual obligations are met). The MDLF makes payments directly to the contractors.

All tender, procurement and payment procedures followed in the MDP project are those of the MDLF, agreed on and validated by all financial partners involved in phase 1 (AFD, BTC, JICA, KfW, SIDA, World Bank).

Specific provisions will be included in the delegation agreement.

The change of method of implementation constitutes a substantial change except where the Commission "re-centralises" or reduces the level of budget-implementation tasks previously entrusted to the agency.

4.2.2. Procurement (direct centralised management) shall apply to component 2

Subject in generic terms, if possible	Type (works, supplies, services)	Indicative number of contracts	Indicative trimester of launch of the procedure
PEGASE DFS related programmes	Services	6	Q3 2014

4.3. Scope of geographical eligibility for procurement in direct centralised and decentralised management

Subject to the following, geographical eligibility will be determined according to the rules set out in the basic act for the place of establishment and for the origin of supplies and materials purchased.

In accordance with Article 27(4) of the basic act, the Commission decides that natural and legal persons from the countries eligible for funding under ENPI are eligible to participate in procurement procedures under this action because ENPI co-funds it.

The authorising officer responsible may extend the geographical eligibility in accordance with Article 21(7) of the basic ENPI act, if products and services are not available in the countries concerned, in cases of extreme urgency, or if the eligibility rules would make implementing this action impossible or exceedingly difficult.

4.4. Indicative budget

Components	Amount in EUR thousand	Third-party contribution
Municipality development programme, phase 2 (indirect centralised management)	7 300	13 500
Specific audit and monitoring measures (direct centralised management)	4 800	
External evaluation and audit	300	
Communication and visibility	100	
Contingencies	500	
Totals	13 000	13 500

4.5. Performance monitoring

The Commission may carry out Results Oriented Monitoring (ROM) via independent consultants, starting from the sixth month of project activities. This monitoring will be finalised at the latest 6 months before the end of the operational implementation phase. Sex-disaggregated data will be used when possible.

The implementing agencies will be responsible for continuous day-to-day technical and financial monitoring. Projects will be subject to internal and external results-oriented monitoring. Internal monitoring will be carried out by the implementer, the beneficiary institution/s and the delegation. External monitoring will be carried out by external consultants contracted by the European Commission.

The MDP's financing partners meet twice per year for a supervisory visit to monitor the programme's progress. The results of each mission are recorded and will be included in the annual report.

4.6. Evaluation and audit

a) The Commission or the Delegated Body for component 1 will carry out external evaluations, as follows:

- a possible mid-term evaluation visit;
- a final evaluation, at the beginning of the last phase;
- a possible ex-post evaluation.

b) The Beneficiary and the Commission will analyse the conclusions and recommendations of the mid-term evaluation and jointly decide on the follow-up action to be taken and any adjustments necessary, including, if indicated, reorientation of the project. Reports from other evaluation and monitoring visits will be given to the beneficiary, who will take into account their recommendations.

c) The Commission will inform the Beneficiary at least 6 days in advance of any planned visits. The Beneficiary will work efficiently and effectively with the monitoring and/or evaluation experts, and will provide them with all necessary information and documentation, as well as access to the project premises and activities.

4.7. Communication and visibility

The action will follow the EU's communication and visibility guidelines, which can be found here:

http://ec.europa.eu/europeaid/work/visibility/documents/communication_and_visibility_manual_en.pdf.

Information and communication activities to raise awareness of the action itself, of EU support and the impact of this support will be carried out. Each contractor will be responsible for implementing communication activities in line with the EU guidelines and in consultation with the EU office in Jerusalem. The beneficiary/contractor will inform the EU of upcoming communication activities and will invite the EU to relevant events.