1. IDENTIFICATION

<table>
<thead>
<tr>
<th>Title/Number</th>
<th>PEGASE 2012: Support for the recurrent expenditures of the Palestinian Authority – Part II (ENPI/2012/023-843)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total cost</td>
<td>EU contribution: EUR 31,000,000</td>
</tr>
<tr>
<td>Aid method/Method of implementation</td>
<td>Project approach – direct centralised management</td>
</tr>
<tr>
<td>DAC-code</td>
<td>16010 Sector Social/welfare services</td>
</tr>
</tbody>
</table>

2. RATIONALE

2.1. Sector context

Since its establishment in early 2008, the PEGASE mechanism has sustained the efforts of the Palestinian Authority (PA) in the four key sectors of the Palestinian Reform and Development Plan (PRDP), i.e. governance, social development, economic and private sector development and public infrastructure.

The Palestinian Reform and Development Plan (PRDP), presented by the PA for a three-year term (2008-2010), received an unprecedented level of external support in its period of implementation. The PRDP was superseded in 2011 by the National Development Plan covering the period 2011-2013 - to which the EU has expressed continuing support. The document reiterates the PA's commitment to the effective protection and promotion of the fundamental values of human rights, democracy and the rule of law.

Since mid-2011, the PA has been experiencing a serious fiscal crisis, as not enough donor funds have been made available to cover its recurring budget deficit. In 2011, EUR 145 million were provided from the EU Budget through PEGASE Direct Financial Support programmes (PEGASE DFS). These funds were complemented with contributions from EU Member States and other donors, albeit at a lower level than previous years. In 2011, donors’ contributions through PEGASE DFS added-up to EUR 32.6 million, including: Spain (EUR 20 million), Sweden (SEK 60 million, equivalent to around EUR 6.6 million), Finland (EUR 2 million), Switzerland (CHF 2.5 million, equivalent to approximately EUR 2 million), Ireland (EUR 1.5 million) and Luxembourg (EUR 0.5 million). The success for channelling donors’ support through PEGASE was confirmed by the contribution in 2011 from the Government of Japan for nearly EUR 6.3 million for the PEGASE "Private Sector Reconstruction in Gaza" programme.

France made a total contribution of USD 15 million to the PA, but not through PEGASE DFS. Other EU Member States contributed to the World Bank Trust Fund.

Other donors also provided support for direct financial assistance through non-PEGASE DFS channels, including directly to the PA budget or via the World Bank...
Trust Fund. In 2011, further support was received from Saudi Arabia (USD 183 million); Algeria (USD 53 million); the USA (USD 52 million); the United Arab Emirates (USD 42 million); Oman (USD 10 million); Egypt (USD 1.7 million) and the World Bank Trust Fund (USD 166 million).

The economic outlook remains bleak for 2012, with overall growth anticipated to stagnate at 7%. On the fiscal front, initial data points to a recurrent deficit at USD 1.1 billion. To date, donors have committed USD 610 million in recurrent budget aid – leaving a financing gap of USD 500 million for the fiscal year. In this context, shortfalls in donor aid are posing serious risks to the economy as well as to the PA's capacity to cover essential expenditure. Support committed to the PA budget in 2012 includes USD 185 million from Arab donors and USD 139 million via the World Bank Trust Fund. A first tranche of EUR 132.2\(^{28}\) million from the EU budget was frontloaded through PEGASE DFS to help the PA with the payments of PA salaries/pensions at the beginning of the year. This first allocation will be completed by funds under this Decision, to reach an annual contribution of EUR 156 million from the EU budget. Additional support from EU Member States and other donors through PEGASE is expected, but not yet confirmed.

The PA remains committed to budgetary and fiscal transparency, with systematic publication of the budget law.

2.2. Lessons learnt

With the objective of continuing to build on the successful policy dialogue undertaken with direct financial support leverage, the amount allocated to the payment of social allowances through PEGASE DFS will be increased by EUR 1 million. In turn, it will be agreed with the Beneficiary Country, and reflected in the relevant Financing Agreement, that the PA will commit to establish and sustain, with at least the equivalent amount, a "Small Grants Fund" to commission innovative social protection services for vulnerable groups at regional level. In line with the national sector strategy, the establishment of the Fund will support the dual reform process objectives: (i) to improve local delivery and planning of social services through institutionalised public-private partnerships, and (ii) to de-concentrate services delivery at sub-national level. The management of the Fund will be supported, facilitated and monitored by an EU-funded technical assistance project which will seek to empower the Ministry of Social Affairs in its leading role in the development and operation of a modern system of social protection.

Actions under PEGASE DFS build upon the successful experience of the Temporary International Mechanism in 2006 and 2007. PEGASE is implemented in full co-operation with Palestinian partners and in full co-operation and transparency with EU Member States, the European Parliament and other donors. The PEGASE system is particularly appreciated by the PA for its alignment with the National Development Plan and the strong sense of ownership from the Palestinians, as well as for its flexibility and its catalytic nature in attracting funds from other donors without multiplying transaction costs.

The results of the mid-term review of PEGASE, launched in 2009, showed that the flexibility in planning and implementation, the highly competent and professional

\(^{28}\) This includes EUR 1 million from the Government of Austria as assigned revenue.
staff, the use of well-proven management systems and at the same time innovative approaches introduced, have contributed to the success of this mechanism. A final evaluation of the first three years of the mechanism is underway.

2.3. Complementary actions

In 2011, a total of nearly EUR 600 million was committed by the European Union for the benefit of the Palestinian population: EUR 328 million from European Neighbourhood and Partnership Instrument (ENPI) allocations, out of which EUR 145 million for PEGASE support to recurrent expenditure and EUR 86 million for United Nations Relief and Works Agency's (UNRWA) General Fund. Additional EUR 75 million was allocated for projects aimed at social and economic development and institution-building in support of the Palestine National Development Plan. A further EUR 12 million was allocated to other projects merely in the field of civil society initiatives e.g. the Partnership for Peace Programme. In 2011 UNRWA also received EUR 10 million from the ENPI allocations for 2 projects in the Syrian Refugee camps and a further EUR 5 million allocation from the Food Security Budget Line to provide assistance for its Social Safety Net Programme to provide nutrition for those refugees living in absolute poverty. As humanitarian assistance to the Palestinian population in the Occupied Palestinian Territory (West Bank and Gaza Strip) and to Palestine refugees in Lebanon and Syria EUR 50 million have been committed. Nearly EUR 20 million has been mobilised from other thematic budget lines such as the Food Security budget line for civil society initiatives, from the European Instrument for Human Rights and Democracy, from both the thematic lines Non State Actors and Local Authorities in Development and Investing in People. EUR 50 million was mobilised in 2011 from the Instrument for Stability for actions aimed at improving the economic situation in the Gaza Strip through a job creating programme, for upgrading the flow of goods to and from the Gaza Strip and for the Nahr el Bared Camp in Lebanon. Finally, EUR 9.65 million were allocated from the Common Foreign and Security Policy for continued support to the European Union European Union Border Assistance Mission in Rafah crossing (EUBAM) and the European Union Co-ordinating Office for Palestinian Police Support (EU COPPS) missions in the West Bank and Gaza Strip.

A first decision for the commitment of 2012 funds was taken by the Commission in December 2011. In total, on decision of the budgetary Authority, using both 2011 and 2012 commitments, EUR 200 million were allocated for the 2012 budget at the end of 2011. This amount was increased with EUR 1 million assigned revenues from Austria. Consequently, EUR 132.2 million were allocated to the PA to meet salary and social allowance costs for the first part of the year, and EUR 68.8 million to UNRWA’s General Budget. As in previous years part of this assistance was "front-loaded" taking into account that other donors are not usually able to mobilise funds so early in the year.

2.4. Donor Co-ordination

The Commission plays a leading role in the aid management structures at the level of the bi-annual Ad Hoc Liaison Committee (AHLC), the most recent one being hosted by the European External Action Service (EEAS) on 21st March 2012 in Brussels, as well as 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 Office of the
European Union Representative in East Jerusalem (EUREP). The PA made known to potential donors at the Sharm-el-Sheik Conference in March 2009 that PEGASE was amongst its preferred delivery mechanism for channelling funds. High level international donor co-ordination continues to take place regularly.

3. DESCRIPTION

3.1. Objectives

The objective of this action is to support the Palestinian National Development Plan by helping the PA to:

- finance its budget deficit and implement its reform agenda;
- meet its obligations towards civil employees, pensioners and poorest citizens;
- maintain the functioning of the administration and the provision of essential public services to the population.

3.2. Expected results and main activities

Under this action, it is intended to provide direct financial support to the recurrent costs of the PA through the following activities:

Component 1: Supporting Palestinian administration and services (Indicative allocation: EUR 13 million)

The EU will make available a contribution to the payment of salaries and pensions to the PA civil servants/pensioners in the West Bank and Gaza Strip. The objective of this activity is to help the PA meet its financial obligations towards civil employees and pensioners. 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 11.8 million)

The EU will make available, at regular intervals, contributions to the payment of allowances to beneficiaries of the cash transfer programme run by the Ministry of Social Affairs. The objective of this activity is to ensure continued assistance to households living in extreme poverty in the West Bank and Gaza, who are dependent on financial aid from the PA. This activity reinforces the reform of the social protection system and improves PA public finances by reducing pressure on the budget.

Component 3: Private Sector Arrears (Indicative allocation EUR 0 million. This component is kept in case of request for re-activation by the PA)

The PA is seeking to develop a market economy led by the private sector. The EU supports the creation of a proper environment for Palestinian businesses to flourish by providing a facility for the payment of debts which the PA has built up towards
private sector businesses for the purchase of goods and services. Previous contributions in the framework of this component have resulted in a rapid injection of funds into the economy, providing relief to Palestinian businesses and raising their purchasing power. They further secured the employment of thousands of Palestinian workers and consequently, ensured that the provision of services to the administration could continue. The situation has become particularly acute in the health sector in East Jerusalem.

**Component 4: Audit, verification, monitoring and technical assistance (Direct Centralised Management – Indicative allocation EUR 6.1 million)**

High standards of control are achieved through audit, verification, control and monitoring systems governing the above-mentioned PEGASE DFS programmes, as well as other PEGASE DFS programmes implemented during the period covered by this action. These systems are implemented under the continuous overview of an independent team of auditors. The latter is in charge of identifying PEGASE eligible beneficiaries and/or invoices on the basis of eligibility criteria defined by the EU in the relevant audit plans. Moreover, to ensure high standards of verification of individual recipients of funds, and in order to avert any risk of misuse of funds, all direct beneficiaries of contributions channelled through PEGASE DFS are screened against international sanctions lists and other ad-hoc lists. Consultancy and technical assistance will also continue to be used to allow for proper technical identification, implementation and follow-up of PEGASE DFS programmes and PEGASE-related activities in support to the key sectors of intervention defined in PA national agendas.

3.3. **Risks and assumptions**

It is expected that contributions from EU 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.

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. **Crosscutting issues**

Good governance principles are applied to the implementation mechanism and ownership on the part of the PA is assured. The actions proposed provide services vital to the social and economic rights of the Palestinian population. Specifically, regular policy dialogue and planned interventions in support to the PA’s plan to modernise and upgrade civil service towards greater effectiveness and efficiency – with a focus on human resources management – contribute to achieving transparency and good governance principles. Co-ordination with the World Bank continues to further consolidate the reform of social protection in both West Bank and in the Gaza Strip.

3.5. **Stakeholders**

The direct beneficiary of the action is the Palestinian population in the West Bank and Gaza Strip.
Eligible beneficiaries and expenses are identified through a system based on strict and objective criteria set by the EU and based upon requests and information provided by the PA.

PEGASE DFS programmes are 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 and UNRWA.

PEGASE DFS programmes are co-ordinated locally with the EU Member States, other international donors and international organisations. In order to do so, full use is made of the existing local co-ordination groups already in place such as the Local Development Forum, the AHLC structures, the co-ordination meetings between EU Member States and the EU Delegation.

All donors supporting the mechanism will also be key stakeholders.

4. IMPLEMENTATION ISSUES

4.1. Method of implementation

The project will be implemented through the signature of a Financing Agreement between the European Union represented by the Commission and the Palestinian Authority.

Direct centralised management will apply for all components.

4.2. Procurement and grant award procedures

All contracts implementing the action must 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.

Participation in the award of contracts for the present action shall be open to all natural and legal persons covered by the ENPI Regulation (EC) 1638/2006. Further extensions of this participation to other natural or legal persons by the concerned authorising officer shall be subject to the conditions provided for the Article 21 (7) of the above Regulation.

4.3. Indicative budget and calendar

The maximum contribution under this Decision is EUR 31 million. The contribution is indicatively distributed as follows:

<table>
<thead>
<tr>
<th>Component</th>
<th>Method of Implementation / Type of contract</th>
<th>Amount (EUR)</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Component 1: Supporting the Palestinian administration and services</strong></td>
<td>Direct centralised management/ Direct Financial Support</td>
<td>13,000,000</td>
</tr>
</tbody>
</table>
### Component 2: Supporting the Palestinian social protection system

Direct centralised management/ Direct Financial Support  
11,800,000

### Component 3: Supporting the settling of PA arrears to the private sector

Direct centralised management/ Direct Financial Support  
0

### Component 4: Audit, verification, monitoring and technical assistance

Direct centralised management/ Service contract  
6,100,000

### Annual financial audit of PEGASE DFS programmes

Direct centralised management/ Service contract  
100,000

**TOTAL**  
31,000,000

Allocations under components 1 to 3 above are indicative and may be re-allocated depending on the needs expressed by the PA and the funds received from other donors.

The period of implementation of the current action is 66 months, 54 for the operational phase and 12 for the closing phase. The funds under components 1 to 3 are however expected to be totally disbursed by the end of 2012.

### 4.4. Performance monitoring and criteria for disbursement

PEGASE will continue to 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.

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.

The Commission may carry out Results Oriented Monitoring (ROM) via independent consultants.

### 4.5. Evaluation and audit

Financial experts and qualified auditors and advisors will work for PEGASE which will be complemented by Commission and EU Member State specialists and international or local experts.
Advanced monitoring, control and audit systems are set up for all of PEGASE DFS 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.

In addition to audits and verifications of eligible expenditures to identify and validate payments, annual financial audits of the programme will be organised in accordance with international standards with a view to providing the maximum level of assurance. Donors will be invited to participate.

Mid-term evaluations will be performed every 18 months and final evaluation after a three-year implementation period in line with the PA development planning cycle.

Evaluations and audits of other PEGASE-related activities in support to the key sectors of intervention defined in PA national agendas might also be included.

4.6. Communication and visibility

The action will follow the EU visibility guidelines\textsuperscript{29}.

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

\textsuperscript{29} http://ec.europa.eu/europeaid/work/visibility/index_en.htm.