



COMMISSION OF THE EUROPEAN COMMUNITIES

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Proposal for a

COUNCIL REGULATION (EC)

amending Council Regulation (EC) No 1734/94 of 11 July 1994 on financial and technical cooperation with the Occupied Territories

(presented by the Commission)

EXPLANATORY MEMORANDUM

1. In accordance with Article 2.1 of Regulation 1734/94, the setting up and improvement of institutions necessary for the working of the public administration is crucial to the development process in the West Bank and Gaza Strip. The Commission does not normally support the recurrent costs of such institutions, preferring to target grants from the Community budget for the purpose of development, to invest expenditures. There is therefore no explicit provision made in 1734/94 for recurrent cost-type support.

However, under current circumstances, the functioning of the Palestinian Authority and indeed of other Palestinian public institutions is severely compromised by budgetary difficulties. This has required that the Community, along with other donors, support the budget of the Palestinian administration for a temporary period.

The present Regulation would bring Regulation 1734/94 on financial and technical cooperation with the Occupied Territories into line with this reality, thus providing a solid legal base for actions of recurrent cost support to the Palestinian administration, out of the Community budget.

The line of action has been recommended to the Commission by the Court of Auditors, in its 1995 report on financial and technical support to the Middle East Peace Process.

2. The Council announced at the Donors Conference of October 1993, following the Declaration of Principles between Israel and the PLO, that the Commission and the EIB would commit 500 MECU to the development of the West Bank and Gaza Strip for the years 1994-98, and that half of this commitment would be fulfilled by loans from the EIB. To formalise this, the Council amended Regulation 1763/92 (which at the time was the Regulation governing EIB off-protocol lending in the Mediterranean), to allow such lending in the West Bank and Gaza Strip as well as the other Mediterranean partners. In its letter of 11th July to the Bank, the Commission also stated that by the end of 1996, the Commission and the Council would examine 'what measures, if any, might be required to allow the Bank to continue the interventions

foreseen in favour of the Territories up to the end of 1998'. (The Council formally adopted the renewal of EIB mandates on 14th April 1997 until 2000 - CD 97/256/EC)

The 'Joint Commission/EIB report to the Council' on the 'situation of EIB lending' in the West Bank and Gaza Strip, and on a possible 'extension of the EIB mandate' to finance projects in these areas, sets out the constraints to fulfilling the mandate given to the Bank by the Council in October 1993 (following the Declaration of Principles between Israel and the PLO), to lend 250 MECU out of the Bank's own resources by 1998.

These constraints include:

- the substantial foreign aid pledged for the West Bank and Gaza Strip being greater than the real absorptive capacity of the economy;
- the availability of donor grants, which tend to crowd out loan finance;
- a relative lack of project preparation capacity on the part of Palestinian institutions;
- relatively limited private investment opportunities in the West Bank and Gaza Strip, even under normal conditions;
- the precarious budgetary position of the Palestinian Authority; and
- the reluctance of the Palestinian Authority to borrow at market rates, due to its limited debt-bearing capacity.

In this report, the Bank and the Commission conclude that the EIB will be unable to fulfill the *political* mandate entrusted to it by the Council in October 1993, following the Declaration of Principles between Israel and the PLO, of lending 250 MECU in the West Bank and Gaza Strip by 1998 - unless the conditions applying to the fulfilment of that mandate are altered on the basis of the following elements:

- the extension of its mandate in the West Bank and Gaza Strip to 2000;
- project-by-project examination of the possibility of blending grants - for feasibility studies, technical assistance and parallel financing - out of the resources available to the Community, with Bank lending;
- project-by-project examination of the possibility of extending interest rate subsidies to loans made by the European Investment Bank to all public sector projects in the West Bank and Gaza Strip, not just environmental ones, to be financed out of the budgetary resources available to the Community.

The latter two measures could make EIB loans more attractive to the Palestinian Authority. Although the Commission and the Bank are of the view that, 'in any event, ...the Bank's commitment in GWB up to 1999 will fall short of the original mandate to lend up to 250 MECU', the Report states that were such actions as the above to be taken, the total of EIB lending *plus* the additional budgetary resources blended with them, could amount to a total which may be 'acceptable to the Palestinian Authority'.

Only the latter of the three actions recommended in the Report and detailed above would require regulation.

On 14 April 1997 the Council adopted new EIB lending mandates. As far as the Mediterranean region is concerned, the new mandate does indeed cover the West Bank and Gaza Strip, and extends until end January 2000.

The Commission is already engaged in project-by-project examination of the possibility of blending grants - for feasibility studies, technical assistance and parallel financing - out of the resources available to the Community, with Bank lending, under Regulations 1488/96 and 1734/94.

However, legal provision would need to be made to extend the possibility of interest rate subsidies to projects other than environmental in the West Bank and Gaza Strip. The minutes of the Council meeting of 11th July 1994 state: 'The Council and the Commission declare that the possibility of applying interest rate subsidies for all of the EIB's loans foreseen in favour of the Occupied Territories will be examined at the appropriate time'. The present legal basis for granting interest rate subsidies to EIB loans in the Mediterranean region is the MEDA Regulation (1488/96). However, under this Regulation the Commission may not extend interest rate subsidies financed by the budgetary resources of the Community to projects undertaken by the Bank unless these are in the environmental sector.

The Commission is unwilling to propose amendment to Regulation 1488/96 (MEDA) to allow extension of interest rate subsidies to projects other than environmental. To allow exception to the general principle enshrined in MEDA that only environmental projects may be subject to interest rate subsidy, would, in the view of the Commission, set a dangerous precedent.

Therefore the proposed amendment would therefore be made to 1734/94.

At present this Regulation permits the Commission to commit Community aid in the West Bank and Gaza Strip, for investment projects, feasibility studies, technical assistance and training (Article 2.2), in the following priority areas (Article 2.1): infrastructure, production, urban and rural development, education, health, the environment, services, foreign trade, the setting-up and improvement of institutions necessary for the proper working of the public administration and the advancement of democracy and human rights. The Regulation at present specifies that Community financing for projects and operations covered by this Regulation will be in the form of grants.

It is already stated at Article 3 that 'The aid referred to in this Regulation may be combined with the Bank financing from own resources...'. This amendment would enable the Commission to grant interest rate subsidy to Bank loans made to public sector projects in the areas set out in the Regulation and recalled above.

The procedures pertaining to the granting of interest rate subsidies to loans accorded by the Bank in the West Bank and Gaza Strip shall be those laid down under the Regulation 1488/96 (MEDA). These ensure that the Mediterranean Committee is duly consulted on the project on which it is proposed to grant an interest rate subsidy. The subsidy rate shall be 3%.

To summarise, the purpose of the proposed amendment is to allow the possibility of applying interest rate subsidies to all public sector loans in the West Bank and Gaza Strip.

FINANCIAL ANNEX

Relevant articles of the Community budget

B7-420

Description of action

Amendment of Council Regulation 1734/94 to provide the legal base for recurrent cost support out of the Community budget for the Palestinian administration.

Amendment of Council Regulation 1734/94 to provide the legal base for interest rate subsidy out of the budgetary resources available to the Community, to loans made out of EIB own resources for projects in the West Bank and Gaza Strip.

Financial implications

None (the Decision will have no bearing on financial allocations already made to the budget Article concerned).

PROPOSAL FOR A COUNCIL REGULATION (EC)

amending Council Regulation (EC) No 1734/94 of 11 July 1994 on financial and technical cooperation with the Occupied Territories

THE COUNCIL OF THE EUROPEAN UNION,

Having regard to the Treaty establishing the European Community, and in particular Article 130w thereof,

Having regard to the proposal from the Commission,

Acting in accordance with the procedure referred to in Article 189c of the Treaty,

Whereas Council Regulation (EC) No. 1734/94 of 11th July 1994 on financial and technical cooperation with the Occupied Territories, recognises that the setting up and improvement of institutions necessary for the working of the public administration is crucial to the development process in the West Bank and Gaza Strip,

Whereas temporary support is necessary for the recurrent cost of the Palestinian public sector,

Whereas is necessary to amend Council Regulation 1734/94 to provide explicitly for such support,

Whereas Article 3 of Council Regulation (EC) No. 1734/94 of 11 July 1994 on financial and technical cooperation with the Occupied Territories extends the possibility of the combination of Community measures in the West Bank and Gaza Strip with Bank financing from own resources,

Whereas it is considered desirable that the possibility of interest rate subsidy is extended to projects in the West Bank and Gaza Strip in the priority areas laid down in Article 2(1) of that Regulation,

Whereas it is necessary to amend Council Regulation 1734/94 to allow for such a possibility,

HAS ADOPTED THIS REGULATION:

Article 1

1. Article 2(2) of Council Regulation (EC) No. 1734/94 of 11 July 1994 on financial and technical cooperation with the Occupied Territories is replaced by the following:

‘Community aid may be given for investment projects, feasibility studies, technical assistance and training, and for temporary support for the recurrent costs of the Palestinian public administration.’

2. Article 2(3) is amended as follows:

‘Community financing for projects and operations covered by this Regulation shall be in the form of grants or interest rate subsidies on lending by the Bank out of its own resources. The subsidy rate shall be 3%.’

Article 2

Article 4 of Council Regulation (EC) No. 1734/94 of 11 July 1994 on financial and technical cooperation with the Occupied Territories is replaced by the following:

‘1. Financing decisions on projects and operations to which grants are made under this Regulation shall be adopted in accordance with the procedure laid down in Article

5.

‘2. Financing decisions on overall allocations for technical cooperation, training and trade promotion shall be adopted in accordance with the procedures laid down in Article 5.

‘The Commission shall keep the Committee referred to in Article 5 regularly informed of the use made of these overall allocations.

‘3. Decisions amending decisions adopted in accordance with the procedure provided for in Article 5 shall be taken by the Commission where they do not entail any substantial amendments or additional commitments in excess of 20% of the original commitment.

‘4. Financing decisions on interest rate subsidies shall be adopted in accordance with the procedure laid down in Article 12 of Council Regulation No 1488/96 of 23 July 1996.’

Article 3

This Regulation shall enter into force on the third day following its publication in the *Official Journal of the European Communities*.

This Regulation shall be binding in its entirety and directly applicable in all Member States.

Done at Brussels,

FINANCIAL STATEMENT

Article B7-420 : Community operations connected with the Israel/PLO peace agreement

ECU '000 000

Outturn 1996		Appropriations authorised 1997		Appropriations requested 1998		% change	
Commits	Payments	Commits	Payments	Commits	Payments	Commits	Payments
1	2	3	4	5	6	7=5/3	8=6/4
52	49.4	50.0	50.0	50.0	50.0	0	0

1. TITLE OF OPERATION

See below

2. BUDGET HEADING INVOLVED

See below

3. LEGAL BASIS

Council Regulation (EC) 1734/94 of 11 July 1994

4. DESCRIPTION OF OPERATION:

4.1 General objective

The economic and social effects of a long occupation are to be seen in the territories of the West Bank and Gaza Strip. The social and economic infrastructure is weak and ineffective, and the economic indices fall far below the levels reached by neighbouring countries. Before the West Bank and Gaza Strip can actually be properly integrated into the regional economy and particularly into the Euro-Mediterranean area, donors must aim towards the rehabilitation and institutional, social and economic development of the Palestinian people.

The general objective of this budget heading is therefore to finance basic social and economic infrastructure projects, with the emphasis on education. The Commission also considers it particularly important to secure the institutional development of the Palestine administration, in order to restore infrastructure and services to the inhabitants and raise their standard of living. Economic growth may also be promoted through the support provided under this same heading for the private sector.

The Commission, among other donors, has already been asked to contribute over a temporary period to the operating costs of the Palestine administration, in order to maintain services for the Palestine people while the new administration is being set up.

The Community's efforts are being carried out not only in the context of the Middle East peace process, but also in the context of the efforts of all the donors involved in developing the West Bank and Gaza Strip. These donors are all working in accordance with the priorities communicated to them by the Palestinian Authority.

4.2 Period covered and arrangements for renewal or extension

5 years (1994-98)

At the end of this period, account being taken of the advice given by the Commission's Technical Assistance Office (ECTAO) in the West Bank and Gaza Strip, a decision will be taken, if necessary, to continue the Community's financial aid. The Commission might seek to change the legal basis and present its proposal for an amount to the budgetary authority.

5. CLASSIFICATION OF EXPENDITURE OR REVENUE

5.1 Non-compulsory expenditure

5.2 Differentiated appropriations

5.3 Type of revenue involved: none

6. TYPE OF EXPENDITURE OR REVENUE

- *100% grant*
- *Grant for cofinancing with other sources in the public and/or private sector:* financing in parallel with the European Investment Bank could possibly be considered for certain projects, particularly infrastructure projects.
- *Interest subsidies*
- *Other: none.*
- *Should the operation prove an economic success, is there provision for all or part of the Community contribution to be reimbursed?* No.
- *Will the proposed operation cause any change in the level of revenue? If so, what sort of change and what type of revenue is involved?* No.
- *Redeployment:* in cases where the Commission could set up revolving funds for certain projects.

7. FINANCIAL IMPACT

7.1 Method of calculating total cost of operation for 1997

At the 1993 donors' conference the sum of ECU 250 million from the Community budget was announced for the five years 1994-98, i.e. about ECU 50 million a year from this budget heading, up to 1998 inclusive.

The Palestinian people of the West Bank and Gaza Strip suffer from a shortage of social facilities, with an unacceptable level of basic infrastructure such as schools, medical services and other social support systems. There is therefore an unlimited call for expenditure on infrastructure and the establishment of government and public administration institutions.

Out of its package of ECU 50 million, the Commission intends to commit some 15% in 1997 in order to make up the public-sector budget deficit, 65% for infrastructure projects, especially at municipal level and more especially in education, leaving another 10% for institutional support operations. The Commission will also commit some ECU 5 million for technical assistance, which includes not only operations involving the management and monitoring, including

financial monitoring, of projects, but also the preparation of its major infrastructure projects (e.g. feasibility studies).

7.2 Itemised breakdown of cost

CA/PA in ECU '000 000

Breakdown	Budget 97	PDB 98	% change
CA public deficit	7.5	7.5	0
CA infrastructure	32.5	32.5	0
CA institutional support	5	5	0
CA technical assistance	5	5	0
EC TOTAL	50	50	0

8. FRAUD PREVENTION MEASURES: RESULTS OF MEASURES TAKEN

The Commission is aware of the fact that the Palestinian administration is relatively inexperienced, and that its financial monitoring rules and procedures were established only recently. The ECTAO technical assistants monitor the Commission projects, on the basis of advice from European consultants paid by means of commitments under this budget item (under the heading of technical assistance). In the case of Community contributions to operating costs, the Commission places the main emphasis on financial monitoring and audit.

These measures do not in any way undermine the normal checks by the Commission and the Court of Auditors, it being laid down in all the financial agreements for Commission projects that the right of subsequent access by the Commission and the Court is guaranteed for all projects.

9. ELEMENTS OF COST-EFFECTIVENESS ANALYSIS

9.1. Specific quantifiable objectives, target population

- *Specific quantifiable objectives, target population:*

The target population group is still the Palestinian people of the West Bank and Gaza Strip, which have some 2.3 million inhabitants (a number likely to increase in the next few years with the return of many exiles to these territories), and especially the poorest among them. These people live mainly in the Gaza Strip (where almost three-quarters of the population are refugees, but also in the municipalities and rural regions of the West Bank, where the infrastructure is often rudimentary and in any event generally ineffective).

The Commission's intervention strategy has been laid down in accordance with the priorities of the Palestinian Authority. Like all donors, the Commission depends on the priorities laid down by the Palestinian Authority, which always follows the advice of the World Bank in this matter.

The Palestinian Authority is expected to make known a list of its priorities for 1997, and its long-term development strategy (at present in the course of preparation), at the next meeting of the Consultative Group chaired by the World Bank, expected to take place in autumn 1996. (It should nevertheless be borne in mind that the new Palestinian Authority, which is being set up on a permanent basis following the January 1996 elections, may still not have definitively determined its priorities by that date.)

In the light of the priorities established in this way, the Palestinian Authority presents to the Commission its requirements for the use of Community funds.

In terms of investment, the Commission could bear the cost of providing infrastructure in the areas of health, education, and production, for example, but it is probable that in 1997 - provided this fits into the long-term development strategy of the Palestinian Authority and in its list of priorities - the emphasis will be placed on the one hand on primary, secondary and university education and on vocational training, and on the other on the development of urban and rural infrastructure (sanitation, sewerage, solid waste and energy).

The establishment of the Palestinian Authority's institutions, including its ministries, the municipalities, the Council and other central bodies, will also be given priority.

The Commission will also provide the technical assistance required for implementing aid of this kind, and the cost of drawing up, managing and monitoring projects (from the financial and other aspects).

It should also be said that the preparation of projects, and their implementation, takes place in accordance with the Commission's "Logical Framework Approach". This approach is aimed not only at the proper preparation of projects and the effectiveness of their implementation, but consequently also at the observance of the criterion of cost-effectiveness and sustainability as compared with the alternatives.

The success of the Commission's objectives can be measured against the attainment of the Palestinian Authority's priorities and, more specifically, the projects which come under the specified development strategy. If account is also taken of the activities of other donors, the Commission will consider that its objectives have been attained in so far as basic social infrastructure has been established or replaced, where the (above-mentioned) services to the Palestinian population are improved, becoming more effective and better targeted, and where the Palestinian administration is better equipped to operate and plan its services.

As regards a possible Community contribution for covering the public sector's budget deficit, the Commission will take account of the progress made by the Authority towards balancing the budget through efficient revenue collection and above all strict control of expenditure.

During the entire implementation period, the Commission Representative in the West Bank and Gaza Strip will take charge of coordinating projects with other donors, through the "Local Aid Coordination Committees" set up by the donors and the Palestinian Authority, and with the support of the team of technical assistants in the field and possibly consultants funded by this budget heading. Consultations can reduce the danger - arising from the large number of donors -

of duplication of effort. Furthermore, these consultations can ensure that maximum benefit is derived from the activities of all concerned, especially if each donor sets his priorities in the sectors in which he is most experienced and best placed to ensure the most effective action possible.

9.2. Grounds for the operation

- *Need for Community financial aid*

The Community assistance given to the Palestinian people forms part of the funds earmarked for the development of the Mediterranean area. This financial support policy involves strengthening the political, economic and social balance of the Mediterranean region and hence the southern frontiers of the European Union.

The Palestinian population has undergone a lengthy process, during which the social and economic infrastructure has been declining, and there is a need to replace this infrastructure and to set up a viable, efficient Palestinian administration which can cope with rebuilding these territories. It would be impossible for the Palestinian people to fit into the regional economy or the Euro-Mediterranean area unless they achieved economic development more on a par with the economic levels already attained by neighbouring countries. There is no point in aiming at development of this kind until the basic infrastructure is in place and an efficient administration has been set up.

Furthermore, given that the rehabilitation of the territories is the focus of an unprecedented international effort involving at least 40 donors, the European Union could hardly fail to join in this effort.

- *Choice of ways and means*

In the form of grants.

- *Main factors of uncertainty which could affect the specific results of the operation*

Even if the political situation is still precarious, the main risks stem from the Palestinian administration's relative lack of capacity and experience. In view of

the large volume of international financial aid, and the number of sectors and projects to which donors are required to contribute, the danger is that the inexperienced Palestinian Authority, despite the support of the Local Aid Coordination Committees, might be unable to programme this aid effectively and in a targeted manner.

In order to minimise the dangers of poorly targeted aid, the Commission is taking care to ensure the closest possible coordination with other donors and of course with the Authority itself.

9.3 Monitoring and evaluation of the operation

- *Performance indicators selected*

The Commission applies the Logical Framework Approach to all its projects. It ensures that these projects are monitored by consultants in all the major sectors, and that, where appropriate, they are also evaluated in order to determine whether it is worth continuing or extending an operation.

- *Details and frequency of planned evaluation operations*

In 1997, an overall evaluation of aid was undertaken, following the Council resolution of 1 June 1995. It takes in all the operations financed under heading B7-420 over the last ten years. It is due to be completed in June 1998.

- *Assessment of the results obtained*

The Commission is aiming not only to slow down the process of socio-economic deterioration, but also to improve the basic infrastructure and the establishment of government institutions, in order to raise the standard of living of the inhabitants of the West Bank and Gaza Strip, and promote economic growth. It is still difficult, however, to measure the results obtained, given the inability of the Palestinian bodies to provide reliable statistics.

This having been said, and given that the Commission is already entering the second stage of infrastructure operations in the West Bank and Gaza Strip, its operations in these areas will be carried out on the basis of evaluation of the

operations completed, and the results of the evaluation will become a factor in the decision-making process.

The European objective for the Mediterranean region is to integrate the countries around Europe in a Euro-Mediterranean area. Three objectives will be set for integration: peace, democracy, rule of law; sustainable economic and social development; sociocultural dialogue and civil society (objectives of MEDA heading B7-410). Although certain aspects of the Commission programme are aimed in these three directions, and although the territories concerned can receive some of the funds from heading B7-410, it is nevertheless necessary for the basic social infrastructure and the government institutions to be established. The Commission will use this separate heading to place the emphasis, particularly for the next few years, on the rehabilitation of West Jordan and Gaza Strip, so that these territories can truly become a part of the Euro-Mediterranean area.

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