

EC ASSISTANCE TO THE PALESTINIANS

Introduction

1. This paper is presented in the context of ongoing discussions on EU relations with the Palestinian Authority following the formation of the Hamas-led Palestinian Government. It proposes a number of measures to be taken regarding ongoing and future EC financial assistance.

State of play

2. The Commission and the Council Secretariat presented a joint note to the Gymnich meeting of 10/11 March 2006 on EC assistance following the formation of the new Palestinian Government, the content of which was endorsed by Foreign Ministers. The note presented EC support in four broad categories:

BREAKDOWN OF EC SUPPORT TO THE PALESTINIANS	
<i>(approximate figures based on EC support over last 5 years)</i>	
Humanitarian assistance including food aid	20%
Social, economic and emergency aid involving direct interaction with national and local authorities, including budgetary support and capacity building	48%
Support to refugees through UNRWA General Fund and other UN agencies	22%
Support to specific projects including NGOs	10%

3. On the basis of this note, and a follow-up review, the Commission has concluded that approximately 45% of EC financial assistance requires a direct legal or financial link with the PA. This support falls almost exclusively under the second category – social, economic and emergency aid.
4. The GAERC meeting of 10/11 April 2006 endorsed the Commission decision to take precautionary measures to protect the financial interests of the EU by temporarily putting on hold financial and technical assistance to the Palestinian Authority Government. In concrete terms the following measures have been taken:
 - Budgetary support through the World Bank Trust Fund has been temporarily suspended;
 - Projects managed through or in direct contact with PA ministries have been temporarily suspended;
 - Experts and consultants (numbering approximately 20 to 30) who work with and in the premises of the PA Ministries have been temporarily withdrawn;

- Funds in project accounts managed by PA Ministries are blocked for the moment and no new payments are being made;
 - No new financial decisions involving the PA Government are being taken during the current period (see point 6 below).
5. The Commission has currently a total of 34 operational contracts where there is a financial or technical link to the PA Government/Ministries. The temporary suspension of payments so far affects €31 million, currently held in project bank accounts (Infrastructure Facility, Health, Tax Computer System). Potentially, a further €32 million remains to be paid under contracts already signed and for which bills have not yet been received (Infrastructure Facility, Health, Audit and Control, Education, Tax Computer System), and €17.5 million is held in the World Bank Trust Fund. €46 million has been committed but remains to be contracted (Cargo Terminal, Customs, Nablus City Restoration, Health,).
 6. The Commission has stated that these measures are of a temporary nature and that the situation is being reviewed with a view to taking a definitive decision as soon as possible and in light of the position taken by Member States with respect to relations with the Palestinian Authority and the possible evolution of the PA position.

EU policy on contacts with the Palestinian Government

7. The question of whether and how the EU may be able to work with the Palestinian Government depends on how it reacts to the principles that the Council and the Quartet have laid down i.e. the renunciation of violence, recognition of the state of Israel, and acceptance of existing agreements.
8. The experience of Commission in the Palestinian context is that, when implementing financial assistance with the PA, it is difficult to avoid contacts at Ministerial level. Given the hierarchical nature of the Palestinian administration, contracts are almost always signed by a Minister and for the purpose of implementing projects with the PA, technical contacts with Ministers are unavoidable.
9. The Commission assumes that as long as there is no change in the position of the PA Government regarding the Quartet conditions, there can be no business as usual. There can therefore be no political contacts. This has certain consequences that are described below.
10. The Council may however wish to decide to permit limited contacts with PA Ministries and Ministers for specific practical purposes such as implementing key strategic financial programmes, ensuring security for international staff or addressing urgent global issues such as avian flu. Under the current conditions, concern regarding anti terrorist legislation and the risk of litigation in a number of countries has been expressed to the Commission by several contractors and consultants. This is therefore something the Council may need to examine further on the basis of the national laws of Member States and of other international partners.

The humanitarian situation and the impact of suspension of aid to the PA

11. With March and April PA salaries yet to be paid, International Financial Institutions and the UN predict a deterioration in the humanitarian and security situation in the Palestinian Territories within 2-3 months. The UN estimates that poverty rates will increase to 74%. Over 152,000 people are employed by the PA and their salaries support approximately 1 million people. It is estimated that PA employees in turn have run up personal debts of \$340 million which they are unable to repay and which are having a knock-on effect on the retailing and banking sector.
12. The impact of the temporary suspension of part of the EU aid package has, contrary to press reports, had a very limited impact on the humanitarian situation. . The impact would be far greater if these projects were to stop definitively and, more importantly, if future assistance from all donors - not just the EC - was held back. This applies, in particular to budgetary support to the Palestinian Authority. Suspension of technical assistance, while less dramatic in its immediate impact, would have the more long term effect of undermining progress that has been made in building up institutions of a future Palestinian state.
13. The looming crisis is not the result of suspension of aid – nor will the crisis be averted by a resumption of direct aid. The key underlying factor is the continued freeze in Israeli transfers of PA fiscal revenue and the strict Israeli policy on closures and other restrictions. Israeli policy on closures has hardened on security grounds following a number of attacks by Palestinian militant groups on Israeli targets culminating in the recent terrorist attack in Tel Aviv. Restrictive Israeli measures have however led to increasing difficulties in getting food and basic commodities into the Palestinian Territories and Palestinian exports have virtually ground to a halt.
14. The latest tightening of this policy has had a dramatic effect on the banking sector with a shortage of hard currency in the Palestinian Territories and difficulties to transfer money into Palestinian banks. Added to this is a refusal of a number of banks to do business with the PA out of fear of litigation in particular in the US.
15. A full resumption of EU aid at current or even increased levels will not be able to stave off the crisis. At most it will provide only minor and temporary alleviation of the plight of the Palestinians. Key to averting this crisis will be a resumption of Israeli tax transfers and an easing of movement restrictions. At the same time attacks by Palestinian militant groups against Israel must cease.

Options for ongoing assistance

The Commission believes that efforts should be made to continue aid with a clear humanitarian impact as well as assistance that requires no direct links with the PA Government.

Humanitarian assistance and assistance for basic human needs

16. Humanitarian aid, by its very nature and because of the humanitarian imperative to meet the basic human needs of the population, must continue even if a certain level of contacts with the PA are required for this purpose. Humanitarian aid is implemented in accordance with the principles of humanity, neutrality, and impartiality.

17. The EC humanitarian office, ECHO, is proceeding with a decision for a total of €34 million for humanitarian operations in the Middle East of which €30 million is for the Palestinian Territories. In case of a serious worsening of the humanitarian situation in the Palestinian Territories ECHO may need to call on additional funding later in the year. ECHO would be prepared to respond and to increase its humanitarian assistance primarily through UN agencies (UNWRA and WFP) and the International Federation of the Red Cross (ICRC)..
18. Concerning Food Aid and Food Security a number of ongoing projects should continue. The Commission is, for example, proceeding with a series of decisions as set out in the annual work-plan prepared last year for assistance which does not pass through the Palestinian Authority totalling €21 million. This comprises an allocation of €15 million to UNRWA, a €5 million allocation to the World Food Programme (WFP) and a €1 million contribution to the International Red Cross. Part of the WFP allocation passes through the PA, and this is being reviewed. In addition, a direct allocation via the PA of €6 million in 2006 will need to be reviewed and the Commission is recommending that this money be reallocated through an international organisation.
19. Ongoing projects with UNRWA providing refugee support should continue but the international community should remain vigilant to any changes to the PA education curriculum which has to be used in UNRWA-run schools. UNRWA is seeking additional funds and the US has already indicated that it will redirect some of its aid, however there are capacity and management questions that UNRWA may need to address in order to manage any significant increase in financial contributions.
20. For ongoing and pipeline contracts and projects where there are no financial, legal or technical links with the PA Government the Commission believes that these should continue. For example, this includes ongoing actions for Human Rights (EIHDR) and co-financing with NGOs. It also includes MEPP projects, some private sector support and East Jerusalem projects.
21. This leaves a limited number of ongoing projects with financial and legal links with the PA Government which will need to be reviewed in the context of political developments.
22. These projects concern both institution building and infrastructure. Clearly if the current political climate does not change many of these contracts, which are now informally, temporarily put on hold, might need to be formally suspended. This would have several implications.

Institution-building projects

23. Suspending institution building projects would affect virtually all of the Commission technical assistance programmes. Such an action would seriously undermine efforts to strengthen good governance. For example, stopping the programme to train auditors within the PA Ministries would reduce the degree of financial control in the PA.
24. Continuing all ongoing technical assistance programmes whilst, however, eliminating any further financial flow through the PA would help maintain a certain level of transparency and democratic accountability and to preserve an administration for the Palestinian

people. This would ensure continued high levels of financial transparency within the PA and would also allow the EU to continue to complement the EU BAM operation for instance – as this is dependent on a functioning Palestinian customs administration. A strict control of these funds is possible as these are projects supporting specific expenditure that are subject to regular audits. However, the political risk is that some level of contact would be required with the PA Ministries and possibly PA Ministers.

25. In summary, in order to continue these projects the Commission would have to ensure that there are no financial flows through the PA Ministries. One option that is being considered is to work through the Presidency's Office or independent agencies. This approach would require the political endorsement of EU Member States and of course the agreement of the PA President's Office.
26. Under the current circumstances, the Commission believes that there are a number of technical assistance programmes that serve the strategic interest of the EU and therefore should be continued whilst avoiding financial flows through the PA Ministries. These include modernisation of the judiciary, support to the Central Elections Commission, tax and customs modernisation and training in financial control. Given the nature of these projects technical contacts with the Palestinian administration would continue (e.g. training of staff).

Infrastructure projects

27. As regard infrastructure the Commission could formally suspend projects and recall funds held in PA bank accounts. However, this will require active cooperation from the PA Government including its willingness to return the funds. Continuing all ongoing infrastructure programmes with strengthened auditing capacity would result in considerable political risks as funds normally flow through the PA and implementation of the programmes would require technical contacts with PA Ministers. This approach would require a political endorsement of EU Member States.
28. Regarding emergency utility payments, the Commission has already disbursed €20 million out of €40 million of its Interim Emergency Facility which it established in January 2006 to pay for fuel and other essential services. This programme has no financial flows through the PA as utility companies are paid directly although it does require technical contacts with the Finance Minister. In order to continue payments from this vital programme, whilst avoiding direct contacts with PA Ministers, if such contacts are deemed unacceptable, the Commission could look at ways to work with the President's Office as the main contact point within the PA.

Options for future assistance

29. If the PA Government fails to live up to the Quartet principles and if the Israeli policy of closure and the freeze in tax transfers continues, there will be a crisis in the Palestinian Territories in the next two to three months which will see greatly increased unemployment and poverty levels, and possibly the breakdown of law and order.
30. In such a crisis situation the international donor community will have a strong imperative to intervene. One must be clear however that with current or even substantially increased

levels of funding, the EU will not be able to stave off a crisis but might be able to avert, or delay a collapse. The dilemma is how to do this without engaging with the PA.

31. The Commission has already committed two thirds of this year's EC financial programme by responding to the emergency situation in the Palestinian Territories. Its commitment and disbursement rates are better than any other donor and improve on the performance of previous years. Remaining funds, under current budgets, would amount to a maximum of around €80 million. Intervention to avert a crisis would, therefore, require the concerted efforts of all donors and possibly an increase in Community funding through a call on the Emergency Reserve of the EC budget.
32. Under the current circumstances, the aim of future assistance will be to mitigate against the rapid decline in living standards of the Palestinian people. As long as direct contacts with PA Ministers and financial flows through the PA Ministries are not possible, the only politically viable way to do this is via direct management with limited contact with the Palestinian Government. In concrete terms donors would need to fully control all identification, tendering, procurement, contracting, payments and auditing.
33. An international supervisory mechanism could be established for this purpose to pool donor funding to meet basic needs to the Palestinian population. This mechanism could be established in cooperation with the UN, the WB, the IMF and major donors. It would in essence constitute a mechanism where funds could reach key sectors without having to pass through the Palestinian Authority. In order to coordinate such a mechanism on the Palestinian side the PA President could act as an interface between the international community and the Palestinian Authority. Donors could channel funds through such a mechanism for a number of clearly defined expenses in sectors such as health or education. The World Bank has indicated that it is informally examining options available to develop a scheme through an existing or a new mechanism, however no decision has been taken.
34. The humanitarian nature of health expenditures is not in question and it would be relatively easy to control against the risk of misuse when dealing with a well-defined group of health sector workers and hospitals delivering essential services to the Palestinian population.
35. The education sector could also be considered. If however the education sector was supported, the international community would have to remain vigilant to changes in the content of the curriculum by the Palestinian Authority.
36. An international mechanism of the kind described above is not sustainable over the long term and would only have a limited impact on service delivery in the absence of tax transfers by Israel. One of the main aims, therefore, of establishing such a mechanism should be to facilitate the resumption by Israel of tax transfers to specific earmarked areas covering basic needs of the Palestinians. An international mechanism that supervises the financial flows to specific categories of PA expenditure whilst not passing through the PA Ministries should provide the necessary reassurances that there is a way for Israel to transfer money for basic services that would not fall into the hands of Hamas.
37. There are a number of risks involved which will need to be taken into consideration by the EU. A key danger is that the international community becomes the surrogate payer of

salaries for certain groups of workers making it difficult to stop. This is a new situation. Until now, neither the EC nor other international donors have taken on the responsibility for salary payments; instead budgetary support and other forms of assistance have allowed the PA to set aside the necessary funding for the monthly wage bills. Given the limited resources available there will be difficult choices as to what kind of expenditure can be covered. This may create tensions within the Palestinian Authority. Financial control and auditing mechanisms would need to be rigorous to ensure that there is no misuse of funds. And finally, an agreement of the PA President would be required as he would, de facto, play the role of go-between for the international community. As the crisis in the Palestinian Territories deepens, however, it is likely that the needs will outweigh the risks involved.

38. In terms of capacity building to meet strategic EU objectives, the EU could consider working with governmental bodies that, whilst financially dependent on the PA, are autonomous and independent in operational terms. These include: the Central Elections Commission, the External Audit Institution, Supreme Judicial Council, the Palestinian Monetary Authority, and the PLO Negotiations Affairs Department.
39. Regarding civil society organizations, the indications that we have received from several NGOs is that they are nearing maximum capacity and they would not be able to absorb any substantial increase in funding. It is highly unlikely that NGOs would be capable of or willing to replace the role of the Palestinian Authority in providing basic services for the majority of the population
40. In the private sector there are a number of organisations that are already heavily subsidised by the donor community, such as trade and industry associations, but that might be able to broaden their scope of activities.
41. Finally, in the event the PA President assumes a more important role in liaising with the international donor community on matters relating to financial assistance, his office will require institution building support. The Commission has already received requests for assistance from President Abu Mazen for capacity building to which it intends to respond favorably.