



Working Paper

# Supporting public financial management in conflict-affected situations: Adapting to change in the Occupied Palestinian Territories

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DRAFT – NOT FOR CIRCULATION OR QUOTATION

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## Abstract

This paper traces the introduction of public financial management (PFM) processes and systems in the Occupied Palestinian Territories since they came under the control of its current government, the Palestinian Authority (PA). A number of factors combined make for an extremely challenging context for external actors to catalyse change – these include: non-existent formal central government functions at the time the PA was established, major restrictions in the movement of goods and people, ill-designed donor budget support and a very asymmetric distribution of power that favours the status quo.

The scenario after the Oslo Accords until around 2002 was characterised by a personalised and informal administration centred on President Arafat. While subsequent donor-supported formal PFM systems introduced between 2002 and 2012 were almost entirely driven by conflict and political problems, reform in this area has become increasingly isolated from the political arena. An unelected government, donor-dependency and a suffocating and chronic (yet low-level) conflict are increasingly de-incentivising long-term institutional reform. Such a complex problem requires multi-faceted solutions.

This paper describes a dual delivery model adopted by the Palestinian Governance Facility (PGF) encompassing adaptive interventions that support longer-term PFM improvements combined with the introduction of a selective workstream targeting service delivery needs in the health sector. This focuses on the management of external medical referrals, which emerged as a political problem. A flexible development assistance delivery model can allow reform areas not anticipated at project design to be tackled as they emerge on the political agenda. The project log frame (although not flexible by design) allowed a series of small, gradual interventions to be introduced, in sharp contrast to the traditional pre-planned ‘projectised’ approach that has been the standard in the development industry. Combining longer-term PFM/governance reforms with immediate, problem-driven, service delivery improvements may help achieve developmental impact and open space for political capital. A constant examination of contextual issues and re-programming of project activities are offering lessons from which to learn and adapt. This is providing the project with a platform to innovate and keep trying ‘new things’ across workstreams. The ideal coalition involves flexible, aligned donors and relevant ‘institutional entrepreneurs’ from within local organisations, with direct access to politicians. It should be involved in analysis and reform implementation. If high-level government buy-in falters, a coalition of technocrats may help construct and broker problems from which to gain political access.

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## List of abbreviations

DFID	Department for International Development
GDB	General Directorate of Budget
IFMIS	Integrated Financial Management Information System
IMF	International Monetary Fund
LMAs	Line Ministries and Agencies
MoF	Ministry of Finance
MoH	Ministry of Health
MoP	Ministry of Planning
OPM	Oxford Policy Management
OPTs	Occupied Palestinian Territories
PA	Palestinian Authority
PFM	Public Financial Management
PGF	Palestinian Governance Facility
PLC	Palestinian Legislative Council
PMO	Prime Minister's Office

# 1 Introduction

Public financial management (PFM) reforms have been implemented around the globe over the last two decades, but many simply have not met expectations. Conventional aid interventions are often insufficient to deliver and sustain developmental impact (Andrews, 2013). A growing body of literature and evidence demonstrates that support aimed at providing technical ‘fixes’ to externally defined ‘problems’ ignores important characteristics of the processes of change that we understand as ‘development’. In practice, PFM does not lend itself to ‘one-size-fits-all’ approaches. Effective PFM reforms are complex and depend on political and organisational change at the centre of government. This requires strong leadership that helps open and protect the policy space for reform, coupled with a deep understanding of national traditions, capacities and needs.

Three related trends of thinking have highlighted the problematic assumptions that underpin these conventional approaches in recent years. First, ‘systems thinking’ has emphasised how the interlinkages between multiple problems means that major social issues can only be solved through action at the system level, or at least through understanding these interactions at the system level (Meadows 2008; Williams and van ‘t Hof, 2014). These interactions can distort, amplify or dampen the effects of an intended intervention depending on the circumstance. The second trend is the increased attention given to the related concept of ‘complexity’ (Ramalingam, 2013). Processes of social change are, unlike those typical of the physical sciences, non-linear and unpredictable. Agents operate, learn and adapt within particular historical contexts and with changing motivations. Third, political economy factors have been increasingly invoked to explain the perceived failure of development interventions (Unsworth, 2010). Asymmetric power relations and entrenched institutional structures influence choices in ways that often challenge and constrain the behaviours that development interventions seek to realise.

The influence of these intellectual trajectories on the field of international development has led to the emergence of a number of movements that seek to promote new ways of delivering more effective development assistance. At their core, these initiatives argue that aid programmes should tackle problems identified on the basis of strong political insight and analysis, trial multiple potential solutions and adapt these on the basis of rapid feedback and changing context to re-design the programme over time. In view of the growing interest in ‘doing development differently’ and ‘thinking and working politically’ to deliver more effective development assistance, there is a need for operational models that illustrate what this can mean in practice and how best to respond to the challenges involved in so-called ‘adaptive management’.<sup>1</sup>

In their review of the current literature, researchers at the Developmental Leadership Programme identified a lack of in-depth examination of context-specific issues that shape programming, insufficient discussion of the change process, and insufficient attention given toward how political context influences aspects of adaptive programming (Dasandi *et al.*, 2016). The Occupied Palestinian Territories (OPTs) present an interesting case study for further learning on these aspects in conflict-affected situations. This paper seeks to contribute toward addressing the weakness of the current literature by examining how changes in context have presented different challenges and opportunities for introducing PFM systems and processes in the OPTs. The paper identifies and reflects on two distinct waves of PFM developments at the Palestinian Authority (PA) that have been supported by donors since halfway through the Second Intifada in 2002. Both of these have been unconventionally opportunistic and adaptive in nature, yet in very different ways. In particular, it draws on the experience of the author in managing and providing technical inputs in the Palestinian Governance Facility (PGF) during the introduction of a second wave of processes

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<sup>1</sup> For a comparative summary of these initiatives, see Algosio and Hudson (2015).

and systems, describing the dual delivery model that has been applied at the Facility.<sup>2</sup> It encompasses adaptive interventions that support longer-term PFM and governance improvements, combined with the introduction of a selective workstream targeting service delivery. Particularly, it focussed on the management of external medical referrals, which emerged as a political problem the government was pressed to do something about.<sup>3</sup> The paper highlights how the log frame (not flexible by design) was regularly adapted and introduced a series of small, gradual interventions to support these longer and shorter term reforms, in sharp contrast to the traditional pre-planned 'projectised' approach that has been the standard in the development industry. The paper analyses experiences in the West Bank only as PGF has not operated in the Gaza Strip.

## 1.1 A changing context in a fragmented piece of land

**The OPTs present a very challenging reform environment**, with a fragile nascent state beset by both internal and external issues. The Oslo Accords of 1993 created the PA, the functions of which involve the limited self-governance of parts of the West Bank and the Gaza Strip. Interim self-government was to be granted by Israel in phases. Until a final status accord was established, the West Bank and Gaza would be divided into three zones: 'Area A' under complete control of the PA; 'Area B' under Palestinian civil control and Israeli security control; and 'Area C' under complete Israeli control (these areas were Israeli settlements and 'security zones').<sup>4</sup> The Oslo Accords neither defined the nature of the post-Oslo Palestinian self-government and its powers and responsibilities, nor did they define the borders of the territory it eventually would govern. However, a core issue of the Oslo Accords was the withdrawal of the Israeli military from Palestinian territories. The plan was a withdrawal in phases and a simultaneous transfer of responsibilities to the PA for managing security.

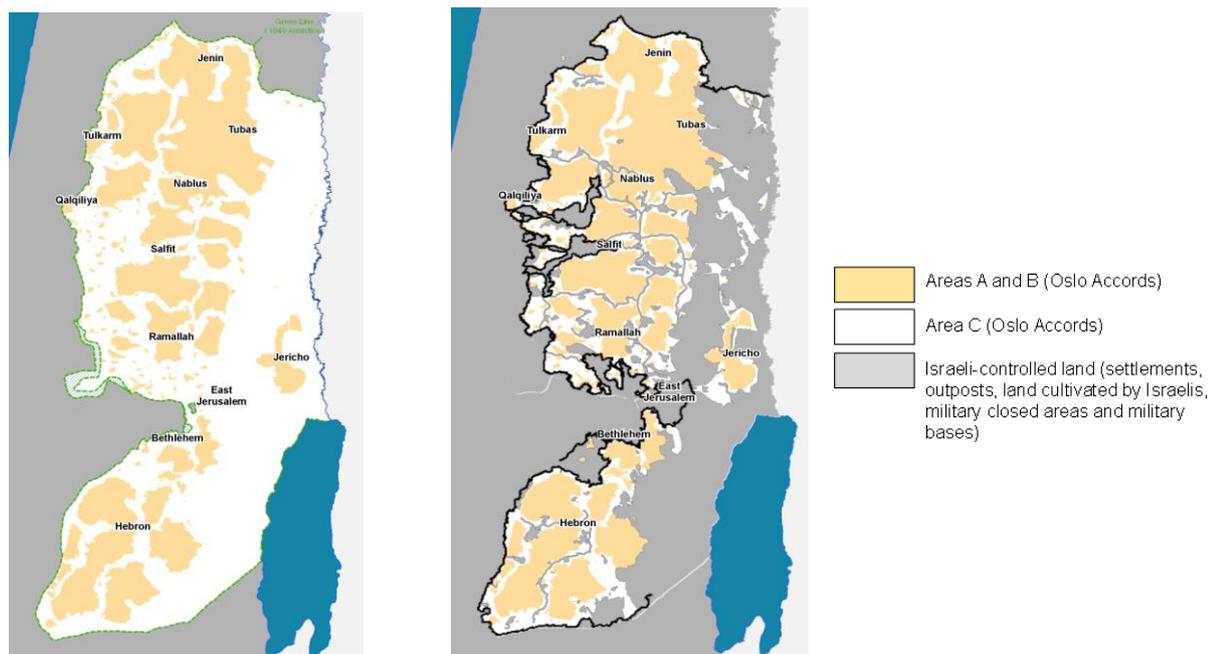
The UK's vision for the OPTs, which the PGF has been supporting, is a negotiated settlement that leads to a sovereign, democratic and contiguous Palestinian state. This is based on 1967 borders with agreed land swaps, with Jerusalem as a shared capital, living in peace and security with Israel (DFID, 2014). More than 20 years after the Oslo Accords, however, the two-state solution that most international donor organisations favour is still not forthcoming. Figure 1 below presents maps of the West Bank following the Accords and the situation today. As a low-level chronic conflict lingers on, the division of the West Bank into areas, expanding Israeli settlements, permanent Israeli military bases and fire zones, and a system of restricted roads, closures and check points have led to further fragmentation of the OPTs.

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<sup>2</sup> The PGF project is a long-term assignment related to PFM implemented with support from the UK Department for International Development (DFID).

<sup>3</sup> External medical referrals are patients treated outside of the Ministry of Health using public funds, most often in private sector East Jerusalem hospitals within the OPTs, although also in Israeli facilities (plus occasionally Egyptian and Jordanian).

<sup>4</sup> See [www.jmcc.org/fastfactspag.aspx?tname=92](http://www.jmcc.org/fastfactspag.aspx?tname=92) for the full text.

**Figure 1: Map of the West Bank, post-Oslo Accords and today**

Source: Office for the Coordination of Humanitarian Affairs, Occupied Palestinian Territory, United Nations.

### **Particular issues arise from the existing situation that severely impact the reform environment.**

First, the Oslo Accords set in motion the creation of interim government structures that had to develop from scratch. Post-colonial centre-of-government institutions, with existing policies and systems on which to build or reform, did not exist at the time of the establishment of the PA. One thus has to look at international donor support to the PA as a matter of true state-building. In short, this means by and large 'introducing' processes and systems (otherwise non-existent) rather than supporting government reform. Additionally, the fragmentation of the territories poses significant challenges for the PA in terms of it delivering public services to its citizens. The system of roadblocks and checkpoints inflicts major restrictions to the movement of people, goods and services. It also produces a very asymmetric distribution of power, two prime examples of which are the administration of clearance revenues by Israel and the lack of a Palestinian sovereign currency.<sup>5</sup> The former represent the majority of the PA's revenues (73% in 2015, or around 16% of GDP) and the revenue-sharing arrangements with Israel have been less than optimal from the PA's perspective (World Bank, 2016). The latter implies that the Palestinian Monetary Authority cannot address any economic shocks or imbalances through monetary policy.

The OPTs are also a donor-dependent economy, with annual external donor support to the PA providing most of the remainder revenues and accounting for about 10% of GDP over the past four years, yet declining (IMF, 2015). External aid has been consistently used as the mechanism for plugging the PA's regular budget deficits and has focused on recurrent expenditures. These are all sources of fragility, which make the PA very vulnerable to disruptions in its main revenue streams – a situation that can reverse reform gains very quickly. In a much-internationalised conflict, the donor community has been heavily involved in supporting the PA. Due to the territories' particular political status, aid modalities are complex. Support from the World Bank is given in the form of grants, via a multi-donor trust fund. Other aid agencies use a variety of mechanisms, ranging from project aid to budget support.

<sup>5</sup> The government of Israel collects customs and value-added tax charges on behalf of the PA and makes transfers to the PA on a monthly basis.

Since halfway through the Second Intifada, in 2002, PFM developments in the OPTs have been unusually problem-driven and followed a step-by-step expansionary approach as opportunities arose. However, the political economy under which they were introduced and its relationship with the technical responses adopted vary remarkably. From 2002 until the start of PGF implementation in 2012, the introduction of formal PFM systems and processes (focussed on budget execution) were seen as a government priority and enjoyed high-level political leadership. The phasing of a first wave of PFM developments was shaped almost entirely by political events beyond the sphere of public finance (Krausse, 2012). Under strong PFM leadership, they drove and dictated what was needed and implementable. In the more recent context within which PGF has operated, the introduction of a second wave of PFM processes and systems (centred on strategic planning and budget preparation) has lacked such strong political buy-in. What has now become a chronically suffocating conflict has had a devastating effect on civil service morale and, combined with the long-standing international community commitment to a two-state solution (that in reality has not been forthcoming), increasingly poses a fundamental dilemma: While the donor commitment to the PA would provide for long planning horizons around which state-building vision and strategy could be developed, it has also partly contributed to developing a deficit gap-plugging culture that is not conducive to structural reform. In turn, the PA is seen as failing to provide quality public services, which is increasingly causing public dissatisfaction and gradually eroding the social contract between the PA and its citizens. Longer-term planning and budgeting PFM reforms appear to be more isolated from key political events and the evolution of the conflict. Supporting the introduction of PFM process and systems in this context has required a constant examination of contextual issues, efforts to regain high-level political access, re-programming of project activities and adaptive solutions.

## 2 PFM systems and conflict

### 2.1 Brief history of the key events

Before the Oslo Accords the OPTs were administered by Israel, although municipal governments in many Palestinian cities dated back more than a century. Between 1993 and 2002, the PA grew into a personalised administration centred on the charismatic figure of President Yasser Arafat. Many negotiations on potential Palestinian statehood took place during the decade that followed the creation of the PA, culminating in the failed summit at Camp David in 2000. The Second Intifada, a period of mass protest and high-intensity Israeli–Palestinian violence, broke out thereafter. Brynen (2007) describes an informal, overstaffed and very inefficient administration prone to considerable leakage of funds, which was not very capable of delivering public services, during this period.

#### First wave of PFM developments

It was halfway through the Second Intifada, in 2002, when formal PFM systems started being introduced under the auspices of a new Minister of Finance, Salam Fayyad. The PA's fiscal position was extremely delicate at the time and the Authority needed external support. International aid was difficult to channel through a PA that lacked formal processes, systems and legitimacy, however. Donors were aware that the PA could not control the flow of public monies through its budget and there were a number of allegations that funds were being diverted for terrorist activities. These factors created the political space for a technocratic, reformist minister of finance with an IMF background to take office (Krausse, 2012). Two phases can be identified between 2002 and 2012 as far as the introduction of PFM processes and systems are concerned. The first one ended with Hamas' election win in January 2006, which led to the separation of the West Bank and Gaza between Fatah and Hamas and the *de facto* dissolution of the Palestinian Legislative Council (PLC). The second is the period between late 2007 (when Fatah regained control of the PA in the West Bank) and May 2012, during the first year of implementation of the PGF. These two phases identified in this first wave of PFM developments offer rich experiences.

Allegations regarding the funding of terrorist activities by the PA led to a suspension of clearance transfers from Israel and sharp drops in external aid in 2002. Rising arrears, a bloated civil service and the inherent wage bill meant that the government was faced with acute cash shortages and was unable to meet salary payments. In a context where public employment had been used as a source of patronage and as an instrument to manage political control, this economic problem was also a political one (Krausse, 2013). There has also traditionally been a consensus among the international community that PA salaries had to be paid in order to maintain political stability. During this period, Fayyad provided the leadership needed to address these issues and centralised cash controls, giving the Ministry of Finance (MoF) sole responsibility for paying salaries. The focus on solving the wage arrears problem provided political and donor support for this entry point to introduce new systems. This led to the establishment of a treasury single account and the closure of all private bank accounts held by line ministries and agencies (LMAs). Despite the fact that many of these processes came into disuse during the intermission period that ended with the separation of the West Bank and Gaza, they were swiftly re-introduced from 2007 onwards during Fayyad's second term.<sup>6</sup> A system that, prior to Hamas' impasse, had been in use in the Ministry of Education and Higher Education was quickly adapted to accommodate all salary payments and was expanded into an automated accounting system. It then added on a budget preparation

<sup>6</sup> During most of this period he was also Prime Minister.

module, thus growing into something like an integrated financial management information system (IFMIS), which was subsequently rolled out to all LMAs.

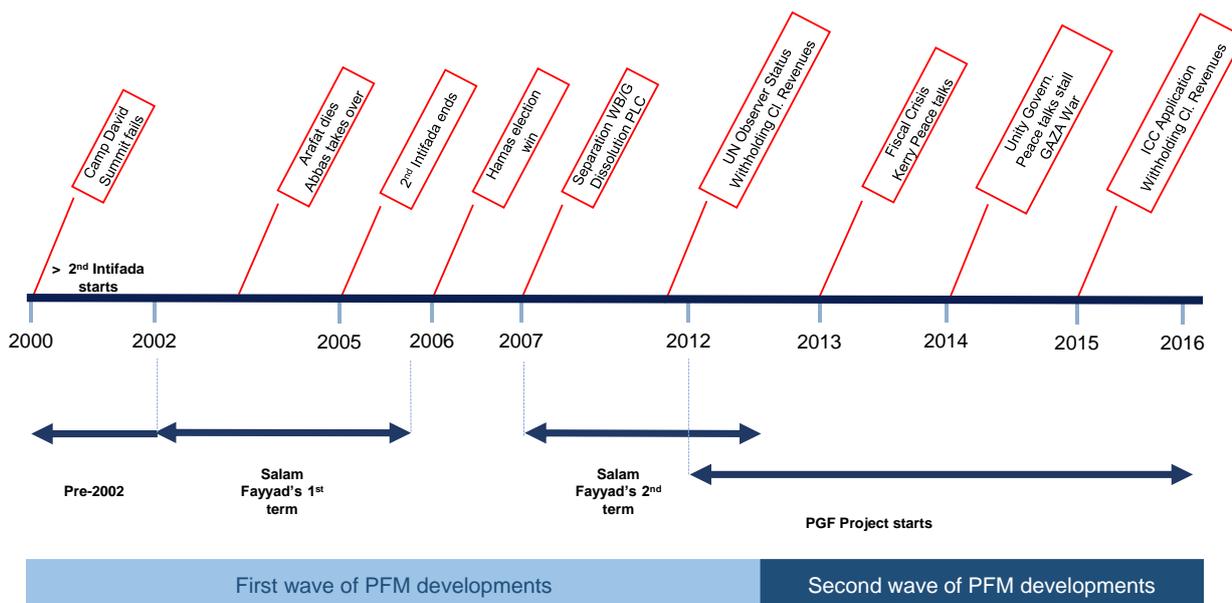
Most processes introduced over this ten-year period were uniquely driven by immediate political problems, were PA-led and placed a significant and deliberate emphasis on budget execution (downstream budgeting), to the exclusion, at least initially, of efforts to strengthen budget preparation (Krausse, 2012). They were not centred so much on the technicalities of the new processes, which were not excessively demanding (Krausse, 2013). Krausse (2012) also recognises that *'there is no evidence that this happened based on a preconceived plan or formal diagnostic study. One should note, of course, that the Minister of Finance, as former IMF Representative, and the top officials in the MoF were well aware of the reform options available to them'*.<sup>7</sup> Early areas of donor-supported PFM reforms in many developing economies have centred on planning and budget preparation reforms, such as the introduction of performance and programme budgeting. On various accounts, these have failed as they have often been introduced as signals by governments to receive external funding, have lacked political leadership, and not addressed the local context and immediate political problems (Andrews, 2013; CABRI, 2013). This was not the case in the OPTs during this period, however. Politically visible problems were in downstream budgeting, namely cash control and salary and arrears payments, which were the areas the government prioritised and that were subsequently supported by donors. These present insightful experiences in and of themselves and are well documented by Krausse (2012).

## **Second wave of PFM developments**

The second wave of donor-supported PFM developments in the OPTs, which is the focus of this paper, offers valuable adaptive lessons on rather opposite grounds. A changing set of political dynamics and contextual circumstances and technically more demanding processes have posed a very different set of challenges. PFM systems and processes focus on major weaknesses in strategic planning and budget preparation. They started being introduced towards the end of the first wave of PFM developments and throughout the PGF project, supported (by design) with traditional, projectised, aid. In the context of a chronic conflict and weaker PFM political stewardship, a much less fruitful dialogue between the PA and the donor community on salient PFM issues has occurred. It appears that the nature and pace of the reforms are now less linked to immediate political problems and the evolution of the conflict itself.

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<sup>7</sup> This does not mean, however, that international actors were not engaged in this area. Instead, there was much more of an ongoing policy dialogue between the government and international actors, in particular the IMF, on emerging policy challenges.

**Figure 2: PFM developments and landmark events**

Source: Author.

The following section briefly examines the evolving context under which the PGF was designed and has operated, as well as the relationship between the introduction of PFM processes and systems and key points in the conflict during the same period.

## 2.2 PFM systems and conflict during PGF

Interest in introducing PFM systems and processes around strategic planning and budget preparation (upstream budgeting) picked up toward the latter part of Fayyad's second term. At the time, these reflected donor concerns over budget allocations, a pressing need to align budgets with the broader developmental needs of the to-be Palestinian state, and to bring more of a medium-term perspective to PFM reform efforts. PFM improvements in these areas started on the back of successful budget execution reforms, increased cooperation between MoF and the Ministry of Planning (MoP),<sup>8</sup> and the PA's new automated accounting system, which was developed by MoF as part of the budget execution reforms and that later on integrated a budget module for use by the General Directorate of Budget (GDB). The software solution adopted and rolled out to all sector ministries incorporated programme budgeting functionality into its design, although the reform processes and capacity development associated with such PFM innovation had not been established.

### Miscalculations in project design

With the reform momentum set in motion and the UN bid for Palestine to become a state in September 2011, the PA was declared 'ready for statehood' by representatives of the international community. Against this backdrop, the DFID-funded PGF was designed as a technical advisory project that aimed to improve public administration and PFM in the OPTs. Unlike recent large-scale reform interventions funded by DFID and other donor organisations,<sup>9</sup> which are 'flexible and adaptable' by design, PGF initially adhered to the traditional projectised approach to aid with a

<sup>8</sup> However, the Palestinian Reform and Development Plan (PRDP) 2007–2010 was prepared by MoP, without integration with MoF and with poor links with the budget.

<sup>9</sup> See, for example, the Pyoe Pin programme in Myanmar, the Facility for Oil Sector Transparency and Reform (FOSTER) in Nigeria, and Ghana Oil and Gas for Inclusive Growth (GOGIG) programme.

well-defined log frame. It targeted improvements predominantly in ‘upstream’ planning and budgeting. The main components of the project initially covered support to programme-based budgeting, macroeconomic and fiscal management, and revenue administration. The business case envisaged that a programme-based budgeting system, which has often been seen as a standard technical innovation, would be fully established and resources would be allocated and spent against the PA’s strategic priorities by the end of the intervention. The programme was designed under an apparent assumption that a normal planning and budgeting process, on which a programme-based budgeting system would be built, existed in the PA and that such a system was in operation and broadly fit for purpose. However, when dedicated technical assistance got underway, it quickly became clear that a normal budget preparation process was absent altogether.<sup>10</sup>

## Political turmoil upon start up

In addition, the run up to the PGF support programme and its first year of implementation coincided with a shaky political period at the PA.<sup>11</sup> In 2011, the PA’s President Mahmoud Abbas and Hamas’ leader Khaled Mashal signed the Cairo agreement to form a transitional government of technocrats to prepare for legislative and presidential elections in the OPTs. In June of that year, the negotiations were postponed indefinitely, however, and Abbas changed the focus on a bid for UN recognition for Palestinian statehood in September 2011, instead of forming a unity government (*Telegraph*, 26 June 2011). Abbas expressed his concern over a government with any Hamas involvement because of the international opposition to such a government (Associated Press, 30 June 2011). Pending further Fatah–Hamas negotiations, Fayyad remained Prime Minister and Minister of Finance of the caretaker government. Following the February 2012 Doha agreement and the successive May 2012 Cairo accord, which also failed to be implemented, Abbas asked Fayyad to form a new Cabinet, without Hamas’ involvement (*Los Angeles Times*, 16 May 2012). On 16 May 2012, a reshuffled Cabinet came into being. Fayyad gave up his post as Minister of Finance in favour of Nabeel Kassis. The PA faced an estimated financing gap of about \$500 million. Eight new ministers were added to the new 21-member Cabinet, while two ministers were replaced (JMCC, 16 May 2012). On 3 March 2013, Finance Minister Kassis resigned amid deepening economic malaise in the West Bank. The PA faced a huge budget deficit due to decreasing donor funds and the withholding of clearance revenues imposed by Israel. Salary payments for some 150,000 PA employees were delayed. On 13 April 2013, Fayyad resigned from his prime minister position. Abbas accepted his resignation but asked him to remain as interim prime minister of the PA until a new government could be formed (*New York Times*, 13 April 2013). On 6 June 2013 Fayyad was replaced by Rami Hamdallah, who at the time of writing is still in post. In short, the start of PGF saw three ministers of finance in less than a year and the dismissal of the head of the Revenue Council, a position that is yet to be filled.

## Chronic conflict, low morale and perverse incentives

Since then, a number of events have worsened the prospects for an independent Palestinian state, and the high-level political appetite for longer-term centre-of-government PFM and public administration reforms that would underpin it, which PGF has been supporting. The 2013 peace initiative by US Secretary of State John Kerry did not deliver significant progress and stalled in 2014. In the same year, a military conflict broke out in Gaza between Israel and the Hamas-led administration. The PLC remains suspended and democratic parliamentary elections have not

<sup>10</sup> Key missing features were: a clear budget preparation calendar; budget preparation instructions, schedules and deadlines; budget preparation processes for projects; top-down budget preparation ceilings; budget appropriations prepared independently of projections for the resource envelope; analysis of ministry budget submissions; and a budget hearings process.

<sup>11</sup> The implementation phase of PGF started in March 2012 and runs until March 2017.

taken place in the OPTs since 2006. Overall public support for the unelected Fatah-led PA is steadily diminishing and the expectation that the PA could deliver a solid social contract is weakening, causing disenchantment among citizens. The donor community remains committed to a two-state solution and is expected to provide further, yet decreasing, funding. This provides long planning horizons around which state-building vision and strategy could theoretically be developed. However, the demoralising and chronic nature of the conflict and the deficit-plugging culture that (largely) unconditional aid has contributed to develop are, to an extent, hindering structural reforms.<sup>12</sup> A recent evaluative review of DFID's State-building and Service Delivery Grant and the PGF found that large questions remain about whether the current approach of donor support being used to pay for primarily recurrent costs of the PA will do enough to foster the economic improvements necessary for long-term fiscal sustainability (ODI, 2015). In connection with this, it is almost as if the accountability chain through the PA bureaucracy is fading. Finally, the high turnaround in ministers of finance, lack of political access by PGF advisers, and the weaker PFM leadership observed since the start of the second wave of improvements have resulted in the absence of a government-owned strategy for reform in the upstream areas of planning, budgeting and revenue management. This makes it extremely difficult for the PGF to fully align with government priorities.

## **What to do?**

As a result of all these factors, the incentives and willingness of the PA to undertake complex centre-of-government PFM reforms to deliver long-term improvements in government effectiveness is seen to have weakened over the life of PGF.<sup>13</sup> Inevitably, this presents a context that is markedly different to the first wave of PFM developments, which makes the adoption of a Problem-Driven Iterative Adaptation (PDIA) approach and the achievement of developmental impact all the more challenging. Any public policy issue anywhere will systemically have both technical/economic and political elements, but these are likely to be especially inter-related in the case of the conflict-affected OPTs and their rapidly evolving context. This means that the attempted solutions must be equally multi-faceted.

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<sup>12</sup> With wars in neighbouring Syria, Iraq and Libya and the threats posed by the so-called Islamic State and the migrant crisis, international attention has diminished.

<sup>13</sup> A view also shared by ODI (2015).

### 3 A dual delivery implementation model

Faced with an unstable political landscape (especially at the MoF), flawed project design, a ‘theoretically’ rigid log frame, a lack of PA-led reform direction and weak incentives, the PGF, implemented by Oxford Policy Management (OPM), adopted a flexible development assistance delivery model. The advisory team invested time and effort in gaining in-depth understanding of the political dynamics in the OPTs, discussing how change processes were likely to occur and constantly scanning the context to identify opportunities for reform. Despite the project pre-stipulating a set of defined activities and outputs to be achieved, DFID understood and facilitated log frame changes that were more likely to deliver impact. This even included allowing for reforms in non-core PFM areas, which were not anticipated at project design, to be tackled as they emerged onto the political agenda.

A **dual delivery model** is currently being applied, encompassing **adaptive interventions that support longer term PFM and governance improvements**, combined with the introduction of a **selective workstream targeting of immediate service delivery needs in the health sector**. This targeting focuses on the management of external medical referrals, which emerged as a political problem. The approach to reform in both areas has been largely problem-driven and opportunistic but recognises varying levels of political access. Quick wins in service delivery that showed visible impact helped gain traction in the new health workstream, providing greater political legitimacy, lessons to learn from, and a strong investment case to continue to support longer-term PFM reforms. In turn, the PFM component was adapted to emerging technical needs and to what was actually implementable, working with a coalition of technocrats, with whom problems are being constructed and brokered to gain political access.

The log frame (not flexible by design) allowed a series of small, gradual interventions to be introduced, in sharp contrast to the traditional pre-planned ‘projectised’ approach that has been the standard in the development industry. This is providing the project with a platform to innovate and keep trying ‘new things’ across workstreams. PGF provides inputs in many areas where other donors are not active, and in doing so it is not duplicating the actions of others. Reflections presented in this paper cover work undertaken primarily until the end of 2015.

#### 3.1 Longer-term PFM improvements

A conundrum at the start of the PGF project was that the budgeting workstream had been commissioned to fix ‘teething problems’ in a relatively minor component of an otherwise functional planning and budgeting system. In reality, however, the fundamentals of that system had yet to be put in place. In addition, MoF staff were seemingly unaware that the basic pillars for strategic planning and budget preparation had not been established – they did not know what they did not know. With three ministers of finance in less than a year, there was no real demand within MoF to develop these fundamentals and no formal mandate from the project terms of reference to go beyond ‘programme budgeting’. This meant that, in order to make tangible progress, project activities would have to be re-programmed and adapted to the technical problems at hand. Against this backdrop, the PGF advisory team decided to build on the basic IT functionality for programme budgeting that had recently been bolted onto the IFMIS, improve it and develop processes and government capacity around it. The team then used a ‘strengthened approach to programme budgeting’ as an entry point for a much wider programme of planning and budgeting reform.

## **Evolving political dynamics require a different approach**

With the political turmoil and significant turnover in ministers of finance and DFID advisers at the time the Facility was being set up, direct political access to the highest echelons of MoF quickly dissipated. Programme budgeting, the proposed standard solution that featured in the terms of reference, which the GDB (overseen by Farid Ghannam) had expressed interest and some commitment to, was used as a lever to develop strong and credible relationships with MoF technocrats. These mainly included the most senior civil servant in the Ministry, Ghannam himself, and key civil service personnel at the GDB and the International Relations Department. Around them, PGF advisers took a step-by-step approach to unfold the breadth of basic planning and budgeting processes that had to be established and supported their introduction at the pace that was technically possible and absorbable by MoF. Introducing new budget preparation processes and systems and rolling them out across government is a slow enterprise. Opportunities to explore (and raise awareness), test (and build acceptance) and roll out (and embed) certain procedures only present themselves once in each annual budget preparation cycle. It is only through repetition that they have any chance of sinking in and sticking. Unlike the experience seen during the first wave of PFM developments, PGF was unable to support reforms around political problems emerging at MoF, for the reasons outlined earlier. If anything, the collapse of the Unity Government, the Gaza war and the fiscal crises that followed the granting of UN observer status to Palestine and the application to the International Criminal Court slowed down, rather than accelerated, the planning and budgeting reforms. A different approach was therefore needed.

## **Building trust and scoping what is feasible**

2012 was largely devoted to raising awareness and building knowledge of planning and budgeting among GDB staff, then using this learning experience as a basis for them to facilitate a change in budget programme structures across the PA. This resulted in modest quick wins consisting of budgets across government being presented on core service delivery responsibilities of LMAs. However, such changes demonstrated added value, making it possible to identify an internal support team of reform entrepreneurs within GDB and build trust with them. This also provided an opportunity to scope the basis for the strengthened approach to programme budgeting and to clearly identify the basic pillars that were missing in the budget preparation process, as well as ascertain the pace and sequencing at which they could be rolled out. With that knowledge platform set up, subsequent options for systems and processes could be discussed, developed and promulgated. Log frame changes could then be proposed to DFID, understood and accepted as they unfolded, to reflect the need to establish procedures not envisaged at project design.

## **Consolidating gains and expanding into un-programmed areas of reform**

Work during 2013 and 2014 consolidated gains on budget programme structures and began the process of establishing planning and budget preparation procedures that required LMAs to specify planned and affordable service delivery outputs. LMAs were required to submit for the first time planning and budget information to MoF. Practical training and mentoring was then provided to GDB to develop skills and practice in analysis of submissions, developing a 'challenge function' within the Directorate. Capabilities and tools for managing the preparation of the national budget were established, in particular by setting out an internal GDB process for annual review of its own work and for establishing a clear GDB workplan for managing the preparation of the budget. Demand within the GDB for a comprehensive budget preparation calendar then emerged, which evidenced the need for LMAs to follow the detailed budget preparation instructions and provided the space to design a comprehensive budget call circular.

## **PA operates its first ever complete budget preparation process**

On the back of new systems and processes introduced over the previous budget cycles, MoF issued a concise budget preparation calendar in 2015 with the re-designed budget circular. It contained detailed budget preparation instructions, schedules, deadlines and pro-formas issued to LMAs. This allowed an orderly process within which to prepare top-down budget preparation ceilings, explicitly linked to expenditure projections from the macroeconomic framework, which were issued to all LMAs in a second instalment of the circular. As capabilities within GDB in the analysis of LMA budget submissions grew, a formal budget hearings process could also be held in 2015, for the first time, for 18 of the largest and most important ministries. The draft 2016 budget was presented to Cabinet in December of 2015 and signed into legislation in early January 2016, almost three months earlier than had been the case in any of the preceding years. The PA had managed to operate a complete budget preparation cycle (Johnson, 2015).

## **Major risks to sustainability**

Tangible progress has been achieved throughout the life of the PGF, although all new PFM processes and systems introduced face risks to their sustainability in different ways. Coupled with the fragility associated with the conflict itself, the largest threat to sustainability is not the technical difficulty of the emerging planning and budgeting system but rather the effectiveness of PA management. A fundamental problem across much of the PA is an apparent disconnect between the most senior position in each LMA and the day-to-day management and implementation of policy, planning and budgeting. The deficit gap-plugging nature of donor support, which focuses on (largely unconditional) salary payments, may well be a contributing factor to this disconnect.<sup>14</sup> A related problem is the absence of senior management teams within LMAs that work cohesively and collegiately on policy, planning and budgeting. As a result, senior managers within sector ministries are not seen to lead policy, planning and budgeting in a manner that generates the desired depth and quality of accountability for performance across the government (Johnson, 2015). It is as if the accountability chain has blurred.

## **Gaining high-level political access**

PGF has supported the preparation and introduction of basic planning and budgeting processes through various budget cycles under strong commitment by a technocratic civil service. In the current context, the most significant challenge is the need to access political leaders so that they engage, drive and sustain the foundations established, carrying the broader PA bureaucracy with them. A number of approaches, rooted in a good understanding of the political economy and change processes, are being pursued to access the Minister of Finance through a network of institutional entrepreneurs within MoF and, more recently, through the Prime Minister's Office (PMO).

In 2015, under PGF advice, the Director of Budget recommended that the Minister of Finance obtain a Cabinet Decision mandating the establishment of planning and budgeting management teams in all LMAs to support the new PFM developments, which materialised. This just begins to lay out accountability arrangements for successful policy, planning and budgeting in the PA. At the time of writing this paper, the team was taking a problem-driven approach to fiscal policy.<sup>15</sup> A technical briefing was presented to the Minister of Finance explicitly demonstrating the future debt implications of current expenditure decisions. The main headline from this was that continuation of

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<sup>14</sup> At the same time, however, there is also a tacit consensus among the international community that PA salaries have to be paid in order to maintain political stability.

<sup>15</sup> In a similar way to the more politically-driven developments seen in the first wave of PFM reforms.

the current structure of expenditure implied an increase in the debt stock that would make the government and/or the PA pension fund insolvent at some point in the next six years. The underlying aim of the briefing was for the Minister to realise the need to establish a macroeconomic advisory group that would discuss and agree macroeconomic and fiscal policy options, something that had until now, been fully absent. The note sought to bring disruption to the fore and encourage reflection, fostering critical reform conditions. This problem-driven approach is rooted in communicating losses (i.e. the loss to government by not changing – the pension fund goes bust – is more than the loss of changing) (Andrews, 2013). This can help to show why incumbent rules of the game do not work, focusing stakeholders on searching for new solutions and helping to mobilise groups of agents supporting change through ‘entry points’. This hypothesis is still largely untested in the OPTs and it is premature to assess its impact. If successful, however, it may also provide an entry point through which the Minister could be more heavily involved in the planning and budgeting processes and systems that are being put in place, and in new areas as they emerge. The framing of the problem may help, not only build buy-in for standard PFM measures, but also lead to an iterative response.

Toward the end of 2015, the government decided to promote a new approach to national planning by introducing a more focused high-level National Policy Agenda at the PMO to replace the previously comprehensive and detailed National Development Plan document. The advisory team is working in close coordination with key PMO staff and consultants so that the government uses this as an opportunity to ensure that the new national plan joins up and is fully consistent with the planning and budgeting processes. However, technical assistance and the government are just two pieces of the puzzle. Coordinated efforts by the donor community, through effective conditional funding, strengthened technical working groups and project steering committees, as well as a more direct dialogue with the PA on PFM issues, may exert further leverage for problem-driven reform and adaptive solutions.

### **Long-distance race, gradual impact**

The advisory team was conscious that the introduction of centre-of-government PFM processes and systems, and the intrinsic public administration and governance reforms that go with them, have medium-term horizons and can only deliver tangible impact in the long run. By routinely re-programming the log frame at DFID annual reviews, a number of new activities and outputs were introduced, opportunistically, as learning loops fed through and a better understanding of what was feasible unfolded. In parallel, the team scanned context in the sector ministries with whom we worked and selectively targeted an area in the health sector that emerged as a political problem out of the 2013 fiscal crisis.

## **3.2 Shorter-term service delivery gains<sup>16</sup>**

### **Identifying the problem**

A dual delivery model is being applied, supporting impactful service delivery alongside the core and structural (state-building) PFM developments. As part of the project, the advisory team considered how to improve the operational efficiency of the Ministry of Health (MoH). Despite not being part of the original project design, this area of reform soon emerged as a priority, which was understood and facilitated by DFID. Working together with MoH and its Deputy Minister, the advisory team identified a number of areas to focus on – the most pressing being external referrals. At the end of 2013, the Deputy Minister (with one year remaining in office) perceived the

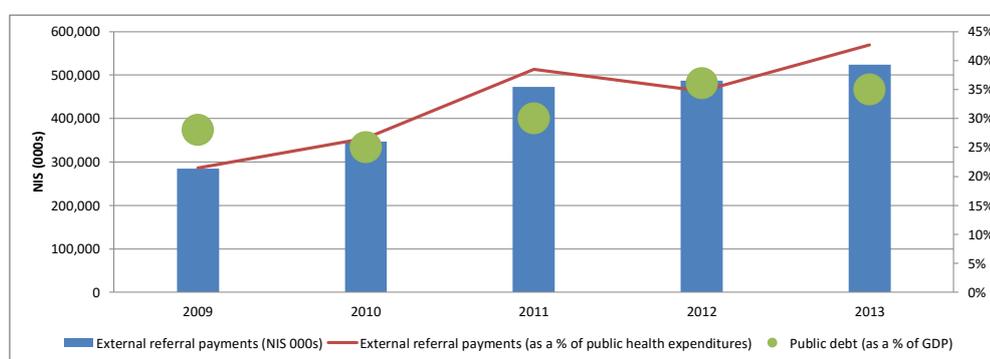
<sup>16</sup> This section is based on Pijuan and Whitaker (2016a).

exploding external referral costs as a major political problem for government and was keen to ‘do something about it’.

MoH was unable to identify the full costs (liabilities) of referring patients as its data covered only payments in a given year – often significantly in arrears, rather than that year’s referrals. Apart from weak record-keeping, MoH was also limited in its cost control ability due to external politics. Israeli hospitals were able to extract any payment they wished for the patients they received, requesting these sums be deducted directly from the OPTs’ clearance revenues, over which Israel had control.

2013 payments were around NIS 524 million (US\$ 145 million), equivalent to around 43% of public sector health spending (Figure 3), in a context of mounting public debt. This covers Gaza as well as West Bank patients – MoH is responsible for both, despite only having political control over the West Bank.

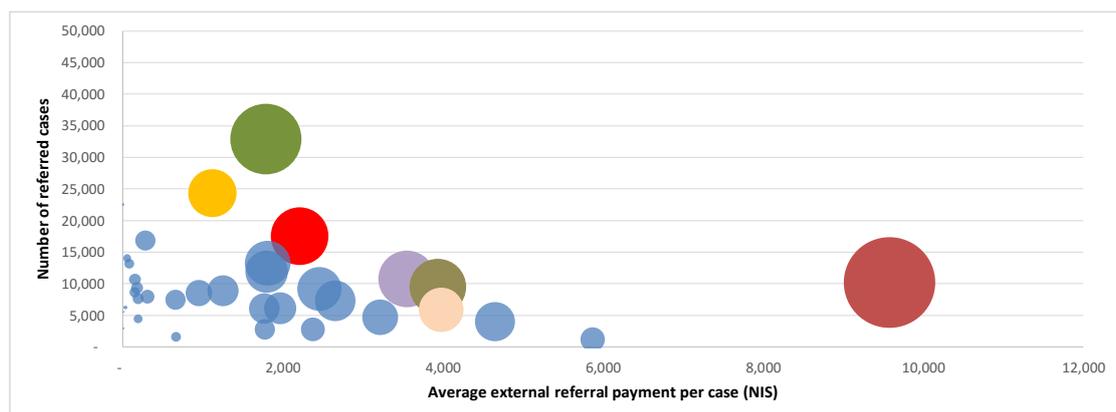
**Figure 3: Growth of the external referrals problem**



Sources: West Bank and Gaza, MoH, MoF, PA.

NB: The true cost of external referral payment will have been higher than this due to subsequent revisions not included in the MoH annual data.

To ensure the most efficient, targeted use of resources, the project team searched for a single therapeutic area to pilot as a reform. Cardiac catheterisation (i.e. the insertion of artificial tubes to improve blood circulation in the heart) was selected because it was a substantial source of referrals that had grown rapidly and was likely to continue to do so due to increasing levels of cardiovascular disease among Palestinians. Also, unlike the largest cost area oncology (see Figure 4), it was an area where the advisory team believed MoH’s capacity to treat patients itself could be built relatively cost-effectively. After an initial equipment investment, marginal treatment costs are relatively low and predictable. The potential technical solution was driven by feasibility and provided an entry point to build from.

**Figure 4: Shape of the problem**

Source: 2013 data, West Bank and Gaza, MoH, PA.

NB: The true cost of average external referral payment will have been higher than this due to subsequent revisions not included in the MoH annual data.

### Problem-driven, flexible and adaptive responses

Modifications to the log frame allowed the consultants to broaden the scope of the project with a new workstream beyond core PFM reform. Preliminary small interventions were introduced and tested. Through stakeholder mapping, the team initially identified key agents (including donors) around which coalitions and working partnerships could be built. We then conducted focused political economy analyses, breaking down the referrals problem in cardiac catheterisation using an Ishikawa/fishbone diagram (see Figure 5). This helped the team identify root problem causes (e.g. a disadvantageous position relative to external hospitals) and sub-causes (e.g. lack of linguistic capacity), which pointed us to 'entry areas' for reform. The strategy employed by the team remained flexible and reactive to help ensure that opportunities could be used whenever they emerged and to ensure challenges were addressed rapidly (Pijuan and Whitaker, 2016b). Key considerations and issues were as follows:

- Collaborating with other stakeholders was important to ensure that work was complementary and without duplication;
- The original contact point, the Ministry's Planning Directorate, was not amenable to reform and so building a relationship with other influential stakeholders – e.g. the Deputy Health Minister – became a key priority;
- Staff turnover (including the resignation of the Deputy Health Minister) and the decentralised nature of MoH meant the cultivation of relationships with several 'institutional entrepreneurs' was vital;
- Face-to-face interviews with MoH's chief cardiologist suggested that, while MoH had adequate equipment to carry out many more catheterisation procedures, what was lacking was further training for junior cardiologists, as well as better public appreciation of its capabilities;
- Furthermore, there was a lack of clear guidelines regarding when a patient could be referred externally, compounded by a potentially perverse incentives structure for referring doctors, receiving hospitals and patients themselves, which was encouraging referrals;
- The relationship between MoH and the external non-Israeli hospitals was unsatisfactory: procedures were not well defined; prices were not effectively negotiated; and there was

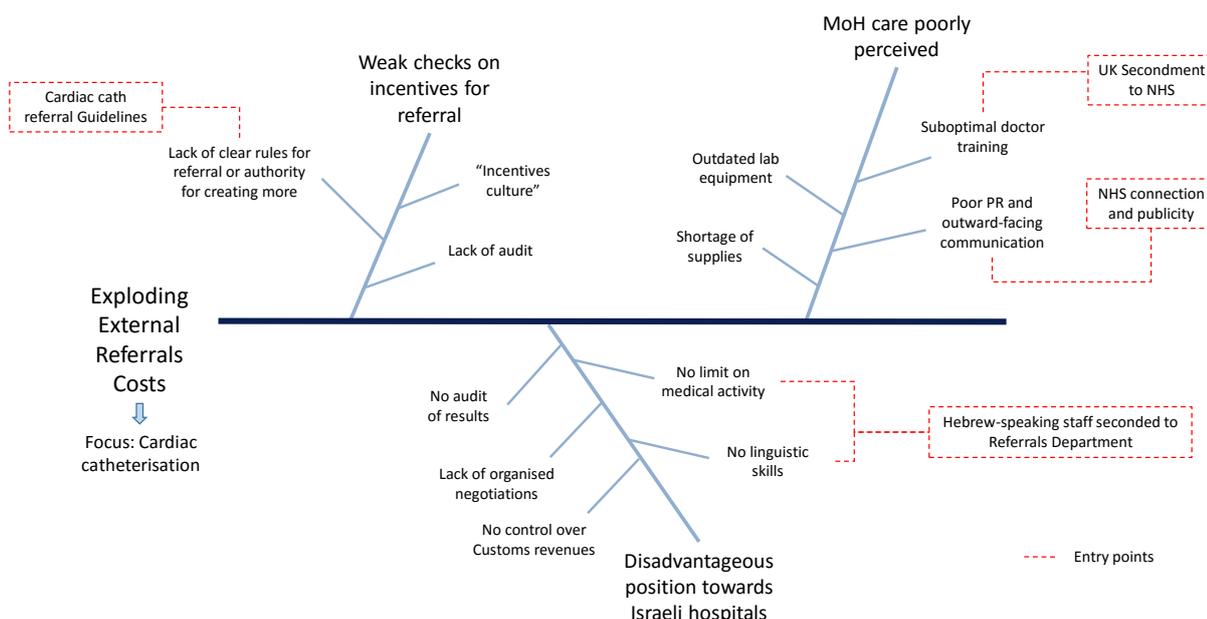
virtually no clinical or financial audit after patients had been treated. Bills were paid, albeit unpredictably and sometimes years in arrears (leading to higher prices).

The situation was even more pronounced with Israeli hospitals, which had the right to take revenues directly from OPT’s clearance revenue account, while a lack of linguistic ability at MoH restricted communication between the two entities. At the Deputy Minister’s suggestion, the project team organised a cardiac catheterisation workshop, bringing in an internationally renowned UK cardiologist. This provided external authority and helped all of the OPTs’ cardiologists agree to a new set of external referrals guidelines. These included rules for when a patient might be referred and how they should be treated in either MoH or external facilities.

The team adapted and scaled up support opportunistically in response to initial positive results. MoH’s chief cardiologist, Dr Mohammed Batrawi, became an ally of the reform efforts and nominated junior staff for a planned UK secondment that would raise their training level. A junior PGF staff member who spoke Hebrew was hired and seconded to the Referrals Department. To help enhance collaboration with other stakeholders, this staff member worked closely with USAID-funded counterparts, who developed a complementary programme incorporating: further disease-specific workshops with the same format as the cardiac one; negotiations with external hospitals, selecting a shortlist that would receive larger volumes in exchange for better prices; and improvements to the Department’s IT, so that all relevant information was captured (a World Bank audit project had found that clinical information was lacking from 70% of files). A new Referrals Departmental head became a third ally of the reform – important in an organisation in which distinct power bases sometimes pushed in opposite directions.

While the departure of the Deputy Minister was a blow (no replacement had been appointed more than a year later), a number of other external events have had a positive impact. International pressure led to the OPTs receiving the right to better information about customs deductions by Israeli hospitals (several of which had also entered financial distress themselves, stimulating their willingness to negotiate). At the same time, MoH continued a policy to maintain some flow of patients to private (generally non-profit) Palestinian hospitals in East Jerusalem, as part of a political aim of protecting Palestinian institutions there from Israeli pressure to close.

**Figure 5: ‘Fishbone’ of problem causes, sub-causes and ‘entry points’**



Source: Pijuan and Whitaker (2016a).

## **A continuing process...**

While addressing the external referrals problem is a long-term endeavour, there are clear initial signs of improvement. MoH cardiac catheterisation procedures rose from an average of 10 per day in 2013 to 13 per day in 2014 and in the first quarter of 2015. At the same time, the average cost of a cardiac catheterisation referral fell from NIS 10,748 in 2013 to NIS 9,864 the following year. The official report of external referral expenditure fell from an estimated 43% of public sector health spending in 2013 to 31% in 2014. Preliminary 2015 data also showed a significant fall in overall referral numbers. Rising rates of chronic non-communicable diseases and increasingly expensive new treatments for these mean that demand pressure for the clinical interventions liable for external referrals is likely to continue. However, some quantifiable results are starting to manifest themselves on the back of improved functionality. In turn, this has provided greater political legitimacy, which is allowing the project to keep trying 'new things' and support the investment case for (slower) long-term PFM reforms.

## 4 Conclusions

This paper has considered how context-specific issues and an understanding of the change process have presented opportunities for introducing PFM systems and processes in the OPTs. It has identified and reflected on two distinct waves of PFM developments at the PA that have been supported by donors since halfway through the Second Intifada in 2002. Both of these have been unconventionally opportunistic and adaptive in nature, yet in very different ways. In particular, the paper has drawn on the experience of the author in managing and providing technical inputs in the PGF during the introduction of a second wave of processes and systems.

Pre-2012, PFM processes and systems introduced were largely PA-led, problem-focussed and almost entirely driven by conflict and political realities. In many respects, they followed a Problem-Driven Iterative Adaptation (PDIA) approach to development (Andrews 2013). The PGF started off on the back of these. A changing set of political dynamics, contextual circumstances and technically more demanding processes, however, have posed a very different set of challenges. A projectised log frame with flaws in design, subsequent weakening of PFM political leadership and a chronic low-level conflict, meant that the PA's incentives and willingness to undertake complex centre-of-government PFM reforms were reduced during the implementation of the PGF (*vis-à-vis* the first wave of PFM developments). Longer-term planning and budgeting PFM reforms now appear to be more isolated from key political events and the evolution of the conflict. This has presented a context that made the adoption of a PDIA-type approach and the achievement of developmental impact all the more challenging. This is the nature of working in conflict, however: gains can be reversed quickly and/or the context can shift rapidly. Conflict, nonetheless, may create opportunities for problems to be solved and entry points for reform in other technical areas.

The paper has highlighted how the log frame (not flexible by design) was regularly adapted in response to emerging issues, allowing for a series of small, gradual changes to be introduced to address them. DFID understood that a non-linear, flexible intervention was key to supporting government in a rapidly changing environment. The paper has also presented evidence of a dual delivery model that may be applied in such contexts. Recognising differing levels of political access, the approach has encompassed adaptive interventions that support longer-term PFM and governance improvements, combined with the introduction of a selective problem-driven workstream targeting service delivery. Diversifying across different technical components may open space for political capital. Quick wins in the health sector that showed visible impact helped gain traction in a new workstream, providing greater political legitimacy, lessons to learn from, and a stronger investment case to continue to support longer-term PFM reforms. In turn, the PFM component was adapted to address flaws in design, using a 'strengthened approach to programme budgeting' as an entry point for a much wider programme of planning and budgeting reform. Despite weak PFM leadership, the project team has worked with a coalition of technocrats and focussed on embedding key processes and procedures by brokering technical problems. In turn, the team is more recently constructing a problem around a salient fiscal policy issue in an attempt to bring disruption to the fore and encourage reflection, fostering critical reform conditions and generate political traction. This hypothesis is still largely untested in the OPTs, however, and it is premature to assess its impact.

This project has highlighted a number of key lessons that may be broadly applicable in a range of development programming contexts:

1. A flexible development assistance delivery model can allow reform areas (not envisaged at project design) to be tackled as they emerge in the political agenda. Combining longer-term PFM/governance reforms with immediate, problem-driven, service delivery improvements may help achieve developmental impact and open space for political capital.
2. Traditional 'gap-filling' aid may be counter-productive – in the current project, if donors had merely continued to cover the external referrals cost, this would have provided more revenues for interests that abused the system, increasing their stake in its continuance and ability to block reform.
3. A complex problem requires a multi-faceted solution. The process of constructing problems using various techniques, such as fishbone diagrams, can help analyse the local context and determine a practical and politically feasible entry point that draws agents together.
4. Where resources are constrained a pilot may be an effective initial step. Small improvements in functionality around the problem can provide greater legitimacy for all involved in addressing the problems, in turn, allowing the reforms to gain momentum.
5. The ideal coalition involves flexible, aligned donors and relevant 'institutional entrepreneurs' from within local organisations, with direct access to politicians. This coalition should be involved in analysis and reform implementation. If high-level government buy-in falters, a coalition of technocrats may help broker and construct problems from which to gain political access.

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