ANNEX 1

PROGRAMME DOCUMENT

1. BACKGROUND

The present situation of crisis, started in September, 2002, with its military and political effects, has a deep impact on the economic scenario of WBG: damage to the infrastructures, as well as severe restrictions on movements of the population and finally on the overall level of economy of WBG.
The private sector has absorbed much of the impact of the crisis to the economy. Private agriculture and commercial assets have suffered over half of all physical damage estimated to be approximately US $ 1 billion. Commercial bank credit to the private sector has declined over the past two years of conflict.
Since one of the key sectors of the country's economic and social growth is represented by the strengthening of local Small and Medium Enterprises, it is very important to support the private sector. The main donors to the Palestinian Private Sector were USAID and the European Union (EU).
In May 1997 Italy undertook to provide US $ 60 million of preferential loans to the Palestinian National Authority (PNA). This development became possible with the entering into force of Italian Law N. 558 of 26 October 1996.
Out of the $60 million commitment, US $25 million dollars of the pledge have been earmarked as a credit line to support the development of small and medium size enterprises in the Palestinian private sector through an on lending scheme to these enterprises as per MOU Serri/ Shaat of May, 1997 under AID number 6522. In addition, Italian DGDC pledged US $ 1.5 million bilateral grant to the Ministry of Economy, Trade and Industry as per MOU Serri/Shaat of June 1998.
The Italian MAE-DGCS, by means of staff-technical missions and the appraising documents of the local staff of Italian General Consulate of Jerusalem (Local Technical Unit of Co-operation), prepared a Programme Document, which identifies and describes the activities to enhance and strengthen local SMEs.
Italian Steering Committee has approved the Programme Document for Co-operation and Development, on March 29, 2004 after a preliminary and positive appraise of Palestinian Authorities. The Programme's financing, of total value from Italian Party of 25,422,250 €, is made-up by a Grant of 422.250,00 € and a Soft Loan of 25,000,000.00 €..

2. OBJECTIVE

The Programme *Overall Objective* is to contribute to support the economic and living conditions of Palestinian people by creating jobs and generating economic growth and income in the economy of the Palestinian Territories (WBG).
Within the context of the Overall Objective, the PROGRAMME'S PURPOSE is the support to Palestinian SMEs, in order to save their actual level of production seriously menaced by the on going crisis.

3. ACRONYMS AND DEFINITIONS

The words and acronyms mentioned in the Program Agreement and related Annexes have the following meaning:

AGREEMENT:	The present agreement between the Parties for the implementation of the Programme

BORROWER:	The Palestinian Ministry of Finance (in this agreement and in the Programme Document the Borrower is indicated as MOF)
CLSC	Credit Line Steering Committee
CREDIT LINE	Facility available, as soft loan, to the MOF, for on-lending to selected SMEs through eligible Palestinian Private Banks (PPB).
IFIT	Italian Financial Institution that manages the Soft Loan funds of the Agreement on behalf of Italian Ministry of Economy and Finance.
LENDER:	Italian Government
LOAN	The Soft Loan granted by the Italian Government to the benefit of the Palestinian National Authority, represented by the Ministry of Finance
MAE DGCS:	Ministry of Foreign Affairs of Italy – Directorate General for Development Co-operation
MOF:	The Palestinian Ministry of Finance
MoNE:	The Palestinian Ministry of National Economy
MOP:	The Palestinian Ministry of Planning
PBC:	Palestinian Banking Corporation (PBC) selected by the *MoF* to be one of the on-lender under the Program provisions, legally established in the Palestinian Territories (in accordance with the Banking Laws of the Palestinian Monetary Authority), for the instalments of the credit fund.
PPB:	Private Palestinian Banks, selected by the *MoF* to be the on-lender legally established in the Palestinian Territories (in accordance with the Banking Laws of the Palestinian Monetary Authority), and complying with the requirements set up in this Agreement.
PMA:	The Palestinian Monetary Authority.
PMU:	Project Management Unit at the International Relations Department of the Palestinian Ministry of Finance in charge of the implementation of the Programme
PROGRAMME:	The project to be implemented under this Agreement: Revitalization and enhancement of the private sector*:* Financial Support to Private SMEs.
ON-LENDING AGREEMENT:	Agreement between the MOF and the eligible PPB and PBC, which provides the legal framework for the utilisation of the Credit Line according to the PROGRAMME.
SME:	Small Medium Enterprise, as defined under the Laws on SMEs of Palestine
PROJECT SUB-LOAN:	Soft loan granted by the MOF to the eligible *PPB* to finance SMEs projects.
TA SUB-LOAN:	Soft loan granted by the MOF to the *PPB* to finance Technical Assistance.
SUBSIDIARY LOAN	Soft loan granted by the eligible *PPB*to a SME on a project-by-project basis in accordance with the Programme and the Project eligibility criteria.
TA:	Technical Assistance provided under the Programme

UTC: Central Technical Unit of the MAE - DGCS

UTL: Local Technical Unit of the Italian Consulate General in Jerusalem

4. FUNDING

The Programme will be financed as follows (see Table 1 below):

a) Grant of 249.000,00 € to be utilised for the setting-up of a Local Liaison Office at the Italian Cooperation Office of the Italian Consulate General in Jerusalem.
b) Grant of 173.250,00 € for Technical Assistance, provided by Italian experts directly selected by MAE-DGCS, to support the PMU during start-up, and monitoring phases.
c) Soft Loan of 25,000,000.00 € to be utilised for the Credit Line made available to eligible *Palestinian Private Banks and the Palestinian Banking Corporation for the granting of loans in favour of SMEs*.

TABLE 1 – FINANCIAL SCHEME

Activities	Description	Grant (€)	Soft Loan (€)	Local Gov.(€)	TOTAL (€)
Local Liaison Office at Italian Cooperation Office in Jerusalem	Local Funds	249.000,00	0,00	0,00	249.00,00
TA Services for PBC *for first tranche of credit line*	Service Contract between PBC and each eligible PPB with an Italian Specialised Firm		200.000,00 (*)	0	200.000,00
Credit Line for Palestinian SMEs	Medium Term Credits		24.445.625,00	0	24.445.625,00
Auditing	Contract between MOF and *an international Auditing firm*		354.375,00(*)		354.375,00
TA for start up and monitoring	Italian Experts directly managed by MAE – DGCS	173.250,00			173.250,00
	TOTAL	422.250,00		0,00	25.422.250,00

(*) The sum indicated are estimated as a maximum.

In order to ensure a rapid and flexible provision of funds to the SMEs, a special fund will be set-up within the Agent Bank (as indicated by MOF) for the credit facility (see point a above). The credit facility will be disbursed in three instalments, each of which must respect an equal territorial distribution. The Grant (of points a and b above) will be disbursed according to the procedures and regulations of Italian Law 49/87. This procedure has the aim of ensuring maximum Programme ownership by Palestinian National Authority, and favouring local Programme management and coordination.
In view of the above structure, the MOF will acquire an external independent auditor of international standing, which has to be approved by the MAE-DGCS and IFIT (see chapter 5 hereinafter). The Agreement foresee special safety clauses which ensure that the MOF will reimburse to MAE-DGCS any costs which are not deemed correct by the latter and IFIT, despite a positive appraisal by the auditor.

5. EXPECTED RESULTS AND INDICATORS

The Programme is expected to reach a combination of results with an impact on: SMEs, in terms of improving their technical, market and management skills;. and on the availability of funds for medium term specialised loans and availability of Foreign Direct Investment . The above mentioned results favour the development of the local SMEs.

The Programme's expected results can be summarised as follows:

a. For SMEs: better access to domestic and foreign market information, improved management skills, higher product quality (through better technologies), wider international relations with foreign business associations. These results would lead to an increase in sales and the opportunity to allocate new products on the market.
b. Increased availability of medium-long term capital and increased availability of Foreign Direct Investment.

The Programme monitoring indicators will be based on the following:

a- The number of SMEs which, having benefited from the Programme services (through the Special Unit), invest in the reorganisation of their administrative and management systems to increase their bank ability; the number of SMEs requesting product certification to access foreign markets, or to increase their domestic market share; the number of SMEs requesting services to support their loan submittal to the private banks.
b- The number of loans granted by *PPB* by the end of the Programme, measured together with its medium-long term exposure level.

These indicators will be checked periodically according to a plan, which will be prepared together with the Palestinian parties during the start-up phase of the Programme, beginning from the first Programme year.

6. ACTIVITIES

a) Grant of 249.000,00 € to be utilised for the setting-up of a Local Liaison Office at the Italian Cooperation Office in Jerusalem to connect the Programme with the other initiatives planned and under financing by Italian Authorities in the sector. The grant will be disbursed and managed as "Local Fund", by the Italian General Consulate of Jerusalem (Local Technical Unit of co-operation).
b) Grant of 173.250,00 € for Technical Assistance, provided by Italian experts directly selected by MAE-DGCS, to support the PMU at the International Relations Department of the MOF during start-up, and monitoring phases.
c) Soft Loan of 25,000,000.00 € to be utilised for the Credit Line made available to eligible *PPB* for the granting of loans in favour of SMEs. The *PPB* will receive the loan, under concessionary terms, on the basis of the single projects presented by the SMEs. The eligibility criteria for the projects are set-out in ANNEX 2 to this Agreement. The *PPB* take on the loan risk. The Agreement envisages that the MOF will be covered against the risk of non-utilisation or misallocation of funds by *PPB*.
d) During the starting up phase the Credit Line will also be utilised for Technical Assistance Programme in order to set up a specialised service for medium term credit in the *PBC* and to any other eligible PPB, up to an amount of 200,000 €.
e) MOF will select an Italian specialised firm (Italian expert) to provide the TA according to a specific set of Terms of Reference, formulated by *PPB* and *PBC* and agreed upon by MOF and Italian MAE-DGCS. The Company (expert) should be selected by MOF according to the procedures foreseen in the Annex 3.
f) If in the future some PPB will apply for participating and operating this Credit Line, the steps and procedure to follow will be the same.
g) According to the programme the Credit Line will be disbursed in three anticipated tranches and will be managed as a Revolving Fund.
h) In order to accomplish a proper set of internationally agreed auditing criteria, the MOF will select a primary internationally experienced AUDITING COMPANY, that will consider the regularity and compliance of all procedures and transactions to the conditions established in the Programme Agreement.

i) The selection will follow a specific set of Terms of Reference, formulated by MOF and agreed upon by Italian MAE-DGCS. The Company has been selected by MOF according to the procedures foreseen in the Annex 3. The Auditing contract has beeen financed through soft loan proceedings except for taxes / VAT costs.
j) TA detailed series of activities is set out below in relation to each of the expected results, so as to ensure the achievement of the Programme's specific objective.

7. PROGRAMME GOVERNANCE

The programme will be managed as follows:

- The Italian MAE-DGCS, acting as financing body, will supervise the Programme implementation and disbursement of funds jointly with the MOF, acting as the beneficiary.
- In order to facilitate the managing and the implementation of the Programme, the MOF, in agreement with MAE-DGCS, will set up a *(i)* Credit Line Steering Committee (CLSC), *(ii)* and Programme Management Unit (PMU) at the International Relations Department of the MOF.
- The Italian MAE-DGCS will supervise and monitor the programme implementation using its own technical structures (local technical unit at Italian Consulate General, Cooperation Office in Jerusalem and Central Technical Unit in Rome) and expatriate experts. The Italian Party will also give the responsibility of signing and managing the Financial Convention for the soft loan to IFIT.
- Namely, the main characteristics of PMU and CLCS will be:
    i. PMU: for the management of the Programme, to be set up within the International Department of the MOF, and will be composed by local personnel, staffed by the same MOF, and will benefit of TA provided by Italian short-term experts, selected by MAE – DGCS. The PMU main tasks are detailed in the table below, and include: support to the MoF in carrying out its activities (such as the selection of the independent auditing company, supervision of tender for the selection of the company to provide the TA services for PPB; ex-post verification on compliance of each loan approved and disbursed under the credit line provision by participating PPB with set SME's eligibility criteria; support to the CLSC for the monitoring of the Program, and check of loan performance. PMU will also provide all the necessary contacts with the On-Lender for the soft loan. MOF will be responsible for the management of the loan funds.
    ii. CLSC: for the management of the Programme. The CLSC will be composed by representatives of MOF and Palestinian relevant ministries involved in the private sector development and international cooperation and private sector representative in the implementation of the Programme. A representative of the Italian General Consulate/UTL could attend to the meetings of CLSC as an observer. The CLSC main tasks are detailed in the table below and consist in: establishing the eligibility criteria for SME's projects, verifying, through the PMU ex post verification process, the compliance of each loan approved and disbursed under the credit line provision by participating PPB with set SME's eligibility criteria. CLSC will also proceed to a periodical revision of the table "terms and condition for the on lending credit for *PPB* and sub lending for SME" (see ANNEX 2), according to the actual market conditions.

As key, the main actors and related responsibilities can be summarised as follows:

ACTOR	TASKS AND RESPONSIBILITIES
SMEs	Reimburse loans to ***PPB* /*PBC***

PPB and PBC	Operate the Credit Line, under special concessionary terms. Eligible PPB will profit of the TA loan. PPB uses the Credit Line funds on the basis of an on-lending agreement, which will establish the operational frame, to be signed by the same PPB and the MOF. The PPB can finance a SME' project as per on-lending agreement with the MOF and on the basis of a sub-loan agreement with the involved SME. Each project should be processed by the internal credit analysis and must be approved by the bank board. Only PPB, being responsible of the commercial risk, will undertake the decision to finance a SME' project. MOF will have only the charge to verify on the application of the eligibility criteria set, taking in mind that the commercial risk is fully borne by the PPB.
PMU	Provides technical support to MOF in the management and in the administration of the Programme, assisted by Italian experts, and it will also prepare the Term of Reference for the tender to select the Auditing Services. The tender for auditing Services and TA services to PPB will be issued and managed by MOF after the "No objection" by MAE-DGCS. PMU, eventually assisted by the experts, shall provide also technical services to MoF to promote the credit line (web site, publication of articles, production of information materials, etc.), to verify ex-post the eligibility of each SME's project approved by PPB under the credit line provision and update and maintain the accounting record of the soft loan with all the relevant documentation.
CLSC	Will manage the Programme implementation establishing the eligibility criteria for SME's projects, verifying the procedural compliance of the SME' projects, through the PMU ex post verification activity. The CLSC will also verify the market adequacy of the terms and conditions for the on lending credit for *PPB* and sub lending for SME. Will monitor and supervise the implementation of the Programme, verifying its effectiveness and efficiency and issue recommendations on the Programme implementation and procedures. The monitor in process will be followed according to a monitor indicator matrix (see **LOGICAL FRAMEWORK** 1).
MOF	MOF will sign this Agreement, will manage the Programme, availing of the assistance of CLSC and of PMU. It will be responsible of the management of the soft loan funds. MOF will also select, according the procedures set up in this Agreement, the International firms to provide auditing services. MOF will also staff the local personal of PMU, will call the CLSC meetings. MOF will also issue the official requests for the disbursement of the tranches of the soft loan and grants funds. In addition, MOF has to ensure availability of the financial resources for the salaries and premises for PMU' staff, has to adopt EU procurement rules adapted to the specificity of Italian Soft Loan, (see ANNEX 3) and has to reimburse any sums which MAE-DGCS deems not appropriately utilised, as per the positive approval of the auditor.
MoNE	Will verify the compliance of the Programme's activities with the sectoral policies and will attend to CLSC activities.
MAE-DGCS	It will sign this Agreement and it will ensure the flow of funds. MAE-DGCS will carry out the provision of experts for the start-up, management and monitoring of the Programme. It will authorize the disbursement of the soft loan and related grant funds..
Italian General Consulate-UTL	It will also participate to CLSC meetings as observer, and will issue recommendations to the Parties when necessary and monitor the progress of the credit line.
IFIT	IFIT will sign the Financial Convention with the Palestinian Ministry of Finance and, thus, will manage the Italian Soft Loan Funds. IFIT will also disburse the second tranche. The disbursement will take place after a positive evaluation (issued by IFIT and MAE-DGCS) of the International Auditing Firm report upon the first tranche management on the soft loan funds.

8. MONITORING AND EVALUATION

The Programme indicators related to the specific objective, detailed in the Logical Framework (see Table 2 – LOGICAL FRAMEWORK), are designed to assess the overall impact on the beneficiary

SMEs, and if possible also at a more general level. The PMU has the task of collecting the necessary data in relation to the PPB loan portfolio to SMEs (under the Credit Line).

The Logical Framework details the types of indicators which can measure to what extent the Programme's specific objective and expected results are met; such indicators will also serve to measure the Programme's cost effectiveness from an economic point of view. During monitoring, a careful analysis of the indicators should avoid any macro economic distortions caused by the Programme.

The monitoring results, together with the indications provided by the CLSC and the Italian Consulate General/UTL in Jerusalem, allow for Programme adjustments so as to enhance its successful outcome.