

**The Long-Term Financial Sustainability
Of the Palestinian NGO Sector**

An Assessment

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EXECUTIVE SUMMARY

The NGO sector has traditionally played an essential role in delivering economic and social services in the West Bank and Gaza Strip (WBG), particularly to the most needy. However, as international donors in the mid-nineties began reallocating their resources to the emergent problems of the newly established Palestinian National Authority (PNA), funding for NGOs has deteriorated dramatically. Available data suggests that funding to NGOs fell by more than 50 percent in the second half of the 1990s. For illustration, total funding in 1995 stood only at about \$60 million, 60 percent of which went to the health sector. This funding has risen modestly since 1995, but has also shifted a way from grassroots development projects in health and education toward training programs and democracy-building initiatives. Although no reliable figure is available on the total amount of additional funding made to those NGOs during the intifada, it is evident that a number of NGOs have been able to tap new external resources. Estimates made for the **World Bank's 2002 Assessment** suggest that official donor/INGO resource flows to Palestinian NGOs may have totaled some \$80 million in 2001, with external private flows to "Islamic" NGOs providing an additional \$100 million. Despite this, the survey of NGOs conducted for the **Assessment** confirmed that many were ill-equipped financially to respond to the increase in demand for their services (particularly in welfare and health), and are now very short of funding for their regular/development programs.

This tight resource constraint is compounded by an increasingly **precarious local socio-economic situation** due to Israel's successive border closures and incursions of the Palestinian territories, and organizational / fiscal inability or unwillingness of the PNA to take over all social service delivery. With this in mind, achieving **financial sustainability** becomes a real challenge and out of necessity to many if not all Palestinian NGOs.

The underlying objective of this study was to assess the financial sustainability of Palestinian NGOs with a focus on their sources and uses of funds. Other variables such as leadership, management, governance, and community participation were also incorporated in the study but only as they related to the NGO financial viability.

It is to be mentioned that the design and objective of this study comes in the context of Phase II of Palestinian NGO Project funded by the World Bank and managed by the Welfare Association Consortium.

The methodology utilized to achieve the study objectives consisted primarily of two components:

- (1) A comprehensive review of relevant literature, including the documents of the PNGO Project - Phase I was conducted. This review deemed necessary to develop a conceptual framework for the empirical research section, and to help design the survey questionnaire.

- (2) Structured interviews with key personnel of a selected sample of leading Palestinian NGOs as well as with representatives of donor and private sector organizations were completed. Fourteen NGOs were selected to participate in the assessment which represented a range of organizations including: community, professional and facility based; health; education and welfare oriented; and geographically diverse. The sample consisted also of three donor and four private sector organizations. The data collected through these interviews or from annual reports released by sample NGOs was analyzed to determine whether those NGOs are, or have the potential to become, financially sustainable. The analysis also highlighted the key factors which contributed to, or impeded, financial viability.

For the purpose of this study, **financial sustainability** refers to the ability of an NGO to develop a diverse resources base so that it could continue its institutional structure and production of benefits for intended client population after the cessation of donor financial support. This definition encompasses the areas of: **Financial Management, Resource Mobilization, and Income Generation/Self-Financing.**

The primary findings and conclusions of the study are summarized as follows:

- The PNGO sector is quite diversified. PNGOs operate in almost all regions of the WBG, support all demographic groups, and undertake a wide range of missions. There are between 1000 and 1500 PNGOs, and approximately 920 of which can be considered active. The PNGO sector has evolved into *a two-tier system. The first and largest tier*, the welfare organizations, are the oldest form of association, dating back to the beginning of 20th century.
- The **legal Environment** in which PNGOs operate is generally positive. A new liberal and progressive NGO law came into effect in January of 2000.
- As to the **Organizational Capacity**, most PNGOs are comprised of small groups of people surviving on a project-by-project basis, with nonexistent or weak links to constituencies. There is often a lack of effective coordination among PNGOs at large, though two networks among professional leading NGOs do exist. Boards are seldom active and PNGOs continue to be dependent on the executive director's personality and skills. There is a small, but increasing number of capable and accountable PNGOs that are starting to develop management capacity base, and have some success attracting volunteers. PNGOs rarely undertake a detailed planning process, as they are dependent on international donor funding and generally respond to the priorities set by donors.
- With respect to the focal issue of **Financial Sustainability**, the PNGO sector remains extremely dependent on foreign funding. Donor funding, however, has been falling dramatically, and this trend is expected to continue in the coming years. Previously, the PNGOs received, on average, around 75% of

its funds from external donors. Domestic funding sources have not yet developed sufficiently to replace this declining foreign donor support. The national government (PNA) does not provide financial support to the sector. Contributions from private individuals and corporations remain limited, owing to the constricted Palestinian economy and the absence of required philanthropy. Some in-kind support is occasionally available from local sources, but rarely material. Earned income is not a significant part of PNGO funding although some NGOs are working to find ways to generate income. The PNGO legislation allows for economic activities and raises the prospects for further sustainability. For the most part, PNGOs have implemented proper and basic accounting techniques, have contracted independent audits, and produce annual reports. However, most are unable to engage in serious financial planning and control.

In summary, while a very few number of PNGOs have managed so far to maintain “**donor-driven sustainability**”, the challenge of long term financial sustainability for the PNGO sector is still awaiting tremendous efforts.

The Recommendations of the study are:

- PNGOs need to form a broad and unified Coordinating Forum or Council to help represent their interest and agenda, including fundraising, in relation with donor community, PNA, and the private sector.
- PNGOs need to strengthen their organizational capacity, i.e., in the area of strategic planning, information systems, performance monitoring, project management, cost recovery (effectiveness) techniques, and leadership, through tailored training programs.
- PNGOs need to develop links with constituencies and where possible broaden membership base through public image building activities and promotion campaigns.
- PNGOs, in cooperation with other sector actors, need to develop an appropriate “**Revenue-Generating Strategy**” which identifies and assess feasibility of all potential sources, and lays-out detailed action plans for transitional implementations. This strategy would be most useful if developed at the NGO level, not the sector.
- Technical assistance; which is tailored to the specific revenue generating options of each NGO including fundraising approaches and pricing of services; should be provided by the World Bank funded PNGO project at a later phase.

- PNGOs need to seriously consider setting-up “**Endowment Funds**” with the help of donors, the Palestinian diaspora, the Palestinian private sector, or a consortium that combines some or all of these actors.
- PNGOs need to consider setting-up “**PNGOs-Private Sector Dialogue Forum**” to explore and coordinate work opportunities of mutual interest. This forum might be very helpful in advancing work relationship between the two parties, and may raise awareness of the concept of corporate social responsibility in the Palestinian business community.
- PNGOs need to explore, in cooperation with related official and civic parties, the socio-economic viability of establishing a **National Lottery System** through which some cash proceeds are appropriated proportionately to pre-determined NGO activities.
- PNGOs need to coordinate the efforts towards enabling the PNA Ministry of Finance to repay them the past-due customs and VATs accrued on NGO purchases of goods and services. This might be possible by establishing a **revolving soft-loan funds** by donors.

1. BACKGROUND & RATIONALE

The NGO sector has traditionally played an essential role in delivering economic and social services in the West Bank and Gaza Strip (WBG), particularly to the most needy. Since 1967 when Israel's occupation of the WBG began, Palestinians had managed to establish hundreds of NGOs to provide a wide range of basic services in health, education, culture, social welfare, agriculture, trade and human rights. These NGOs had survived and even flourished despite of numerous occupation-induced adversities. Their mobilization of the community resources on a local and national level was evidence of a healthy and determined society, and a way of counteracting the oppressive policies of Israeli military rule.

By the early 1990s, it was estimated that Palestinian NGOs accounted for some 60 percent of Primary health services; half of secondary and tertiary health care; all of disability and preschool programs; and a sizable proportion of agriculture expansion, housing, micro-finance and other welfare services. As one might anticipate, provision of such widespread and substantial services could not have been possible without considerable external funding. Indeed, World Bank sources estimate that Palestinian NGOs were receiving an average annual amount between \$120 and \$180 million in official donor/international NGO assistance. That is in addition to around \$30 million from local fundraising and the Palestinian Diaspora.

However, as international donors in the mid-nineties began reallocating their resources to the emergent problems of the newly established Palestinian National Authority (PNA), funding for NGOs has deteriorated dramatically. Available data suggests that funding to NGOs fell by more than 50 percent in the second half of the 1990s. For illustration, total funding in 1995 stood only at about \$60 million, 60 percent of which went to the health sector. This funding has risen modestly since 1995, but has also shifted a way from grassroots development projects in health and education toward training programs and democracy-building initiatives. According to **MAS' 1999 survey**, Palestinian NGOs were thought to have received a total of about \$52 million from Consultative Group donors and another \$60 million in contributions from non-official foreign and local sources.

Although no reliable figure is available on the total amount of additional funding made to those NGOs during the intifada, it is evident that a number of NGOs have been able to tap new external resources. Estimates made for the **World Bank's 2002 Assessment** suggest that official donor/INGO resource flows to Palestinian NGOs may have totaled some \$80 million in 2001, with external private flows to "Islamic" NGOs providing an additional \$100 million. Despite this, the survey of NGOs conducted for the **Assessment** confirmed that many were ill-equipped financially to respond to the increase in demand for their services (particularly in welfare and health), and are now very

short of funding for their regular/development programs. This finding is consistent with that of **MAS survey**, which reported that 52 percent of NGOs interviewed claimed to suffer chronic budget deficits, and identified lack of funding as a primary constraint to further expansion of work in the WBG.

This tight resource constraint is compounded by an increasingly **precarious local socio-economic situation** due to Israel's successive border closures and incursions of the Palestinian territories, and organizational / fiscal inability or unwillingness of the PNA to take over all social service delivery. With this in mind, achieving **financial sustainability** becomes a real challenge to many if not all Palestinian NGOs. This issue of NGO financial sustainability has also come under the spotlight worldwide over the last few years. Where before many external donors were eager to enter into funding relationship with local NGOs, they are now less enthusiastic and are demanding more. **The demands point to the need for greater efficiency and effectiveness among NGOs as well as clear sustainability strategies. Evidently, this need is more appealing and pressing in the case of Palestinian NGOs.**

1.1 Study Objective

The underlying objective of this study was to assess the financial sustainability of Palestinian NGOs with a focus on their sources and uses of funds. Other variables such as leadership, management, governance, and community participation were also incorporated in the study but only as they related to the NGO financial viability. In particular, this study attempts to provide reasonable answers to the following research questions:

- (1) What is the existing financial structure of the Palestinian NGO sector, i.e., types and weight of funding sources?
- (2) To what extent is the Palestinian NGO sector financially sustainable?
- (3) What are the areas of potential enhancement for Palestinian NGO long-term financial sustainability, i.e., cost management, fundraising, income-generating activities, and private sector contributions?

It is to be mentioned that the design and objective of this study comes in the context of Phase II of Palestinian NGO Project funded by the World Bank and managed by the Welfare Association Consortium.

1.2 Study Methodology

The methodology utilized to achieve the study objectives consisted primarily of two components:

- (1) A comprehensive review of relevant literature, including the documents of the PNGO Project - Phase I was conducted. This review deemed necessary to develop a conceptual framework for the

empirical research section, and to help design the survey questionnaire.

- (2) Structured interviews with key personnel of a selected sample of leading Palestinian NGOs as well as with representatives of donor and private sector organizations were completed. Fourteen NGOs were selected to participate in the assessment which represented a range of organizations including: community, professional and facility based; health; education and welfare oriented; and geographically diverse. The sample consisted also of three donor and four private sector organizations. The data collected through these interviews or from annual reports released by sample NGOs was analyzed to determine whether those NGOs are, or have the potential to become, financially sustainable. The analysis also highlighted the key factors which contributed to, or impeded, financial viability.

Generalization of study findings and conclusions may be jeopardized by data limitation stemming from the small sample size. Yet, however, given the wide cross-sectional similarities among Palestinian NGOs in financing patterns, these findings and conclusions remain of practical relevance and significance.

The remainder of this study is divided into **four consequent sections**. **The first section** reviews and synthesizes available literature on the concept, application and implication of NGO financial sustainability. **Section two** presents a detailed profile of Palestinian NGOs and the socio-economic context of their operations. **Section three** reports on the survey findings as to Palestinian NGO financing and costing schemes, and their implications to the concept of financial sustainability. **The final section** concludes the study with a number of concrete recommendations that could help enhance this sustainability on the long-run.

2. FINANCIAL SUSTAINABILITY: CONCEPT & IMPLICATION

In recent years, despite the vast difference among the world's NGOs, most share **a common dilemma: lack of funds limits the quantity and/or quality of the important activities they carry out**. Unlimited needs chasing limited resources is a fundamental fact of economic life in poor countries and in rich countries as well. It affects large international NGOs down to the smallest local NGOs. Managers of NGOs must often pay as much (if not more) attention to raising funds as they do to using those funds. NGOs increasingly find that grants and donations are inadequate to meet current program needs, much less to expand program activities. This is happening against the

background of “**donor fatigue**” and declining external flows from traditional sources in the North. Where donors have not withdrawn altogether, there are significant cut backs in the amount of funding that remains available to NGOs. Whatever the reasons, NGOs could no longer take external donor funding for granted.

Furthermore, many of those donor resources from abroad that do find their way to local NGOs are available only with many **restrictions**. Donors often attach very specific limitations on how moneys can be spent either on particular issues or restricted only to programmatic expenses, leaving little opportunity for NGOs to find adequate support for their recurring and operational expenses beyond the defined project-cycle. NGOs are still forced to “**go where the money is**” regardless of whether the project priorities identified by a prospective funder suit their long-term strategic plans. This approach had led NGOs into an endless cycle of resources **dependency** whereby they remain consumers of resources rather than generators of additional ones. The current donor enthusiasm for project-based funding puts the focus on the activities of NGOs rather than on sustaining the organizations themselves. Institutional or organizational development remains a lower priority in practice. Pinter (2001, p. 201) concluded that “**international assistance from the US and other western countries has always been motivated by self-interest tempered with a dash of idealism, and historically has been in the name of helping the poor but has been structured in such a way as to bring benefits to the donor countries**”. This view of international donor priorities is shared also by Carothers (1999).

Another problem is that international grants and donations carry restrictions on the types of expenses that they may cover. The most common restriction is to cover only direct program costs, but not the cost of support services or other overhead costs incurred by the NGO. The NGOs must “**contribute**” these costs on their own, or at least cover an increasing share of these costs over time. But how? Even those NGOs fortunate enough to be fully funded in their current operations may face uncertainty over future funding. If the issues they address are still around in five, ten, twenty years, will donors keep paying program costs ad infinitum? Or will donors’ generosity shift to other more needy or more popular causes? Could local political or social problems lead to a cut-off of donor support? What if a key donor itself goes out of business? The uncertain continuity of donor funding, be it short or long term, makes it extremely difficult for NGOs to plan and implement their core activities. It may also force an NGO to live a **project-to-project existence**, being unable to make long-term plans to expand core activities or to improve the quality of program services.

Meanwhile, the local sources of funding for the NGO sector in most developing countries, whether private or public, have not yet developed to a level sufficient enough to meet demand. And while the development of a **local philanthropic base** for NGO initiative may present the most long-term and

preferable solution to NGO financing problems, this is a process which will take years of cultural, social and economic change to develop.

Mounting frustration with the current funding status quo and the desire to help NGOs function more “**autonomously**” has prompted attention among development practitioners, researches and policy makers/analysts to the concept of “**sustainable**” NGO Financing.

2.1 Financial Sustainability Defined

Financial sustainability refers to the ability of an NGO to develop a diverse resources base so that it could continue its institutional structure and production of benefits for intended client population after the cessation of donor financial support. This definition encompasses three areas described as follows:

Developing Financial Management:

- Implementing financial management systems that provide the information which enables managers to make sound financial and programmatic decisions, and thereby improve the efficiency of the organization.
- Analyzing costs to identify potential cost savings and developing policies and strategies for reducing costs.
- Improving financial projections/budgeting.

Resource Mobilization:

- Designing a comprehensive resource mobilization strategy.
- Building capacity to develop and market successful project proposals to attract new donors.
- Forging partnerships with government, other NGOs or private enterprises to use idle capacity. If exists, thereby sharing project costs and capitalizing on economies of scale.

Income Generation/Self-Financing

- Exploring income generation through the sale of products and services.
- Developing price policies and marketing strategies for products and services.

- Marketing and sale of technical assistance and soft assets.
- Maximizing membership dues and hard assets' rental fees.

2.2 Road to Financial Sustainability

Building truly “sustainable” NGO is a multidimensional challenge entailing both internal factors of strengthening organizational capacity, as well as external factors of establishing a more supportive regulatory environment and secure resources for NGO initiative. In fact, Irish and Simon (1999) stressed that an NGO must achieve organizational, self-governing capacity before it can attempt to achieve financial sustainability, and that a good legal framework for the NGO sector is a perquisite condition for both. But while ensuring organizational sustainability requires for more than simple ensuring financial sustainability, the question of how to generate a stable source of financing is indeed one of the most universally recurrent and confounding obstacles for NGO professionals, fund-raisers, and policy analyst in almost all regions of the world. For example, Szentendre (1997) reported conclusive evidence on the struggle of Central and East Europe NGOs for sustainable financing. The evidence provided indicates that nearly 75 percent of NGOs surveyed assessed their financial status as either poor, very poor or unstable. It indicates also that financial support from international donors accounts for the largest source of NGO funding in that region when compared with support from national private donations, membership dues, governmental grants and service fees. Similar evidence was also documented for the NGOs in a number of African countries (see Cannon (1999) and Hare (1996)).

Generally, NGOs can obtain funds to run their programs thru three channels:

- (1) **Interested third parties, who give to the NGOs in return, primarily, for the personal satisfaction derived from doing good (grants and donations);**
- (2) **Beneficiaries of the NGOs programs, who value their participation more than the cost (cost recovery);**
- (3) **Unrelated third parties, who will pay the NGO in return for objects of value that can make or do for them (commercial ventures).**

All forms of grants and donations are categorized as “**external**” funding sources, while cost recovery methods and commercial ventures are categorized as “**internal**” funding sources. Tables 1 and 2 present more details on every

potential source for NGO funding under the two categories without a priori analyzing the feasibility of getting positive results in each case.

Table 1: Potential Sources of NGO External Financing

I. International Assistance:

- 1. Official / Governmental Donors.**
- 2. International and Bilateral Agencies.**
- 3. International NGOs.**
- 4. International Private Foundations.**
- 5. Income from Endowment / Trust Funds.**

II. Domestic Resource Mobilization:

- 1. Wealthy Individual and General Public Donations.**
 - 2. Volunteer-Based contributions.**
 - 3. Corporate Donations.**
 - 4. Universities / Research Institutes and other Community Associations.**
 - 5. General / Local Government Budgeted Funding.**
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Source: Pellerano, M.E., and F. Frydman (2002), **Financial Sustainability Study, Inter-American Biodiversity Information Network (IABIN), Argentina: Buenos Aires.**

Table 2: Potential Sources of NGO Internal (Self) Financing

More related to program activities > Greater Risk > Less Related to Program activities

(1)	(2)	(3)	(4)	(5)	(6)
NGO/Program Revenues	Related Spin-off	Selling NGO Name	Asset Downtime	Related Extension	Unrelated Extension
Earned incomes direct from NGO/ program delivery, e.g., membership dues and service fees.	Indirect income from activities related to NGO programs, e.g., sale of product related to activities.	Marketing of NGO through product sales to NGO constituents or the public, e.g., souvenirs, hand crafts, and shirts with logo.	Income derived from use / rental of NGO assets during down-time, e.g., rental of cars or office space.	Extension of regular NGO activities to public or for-profit clients, e.g., capitalization on staff expertise and/or soft assets.	Ancillary business ventures totally unrelated to any aspect of the NGO e.g., eco-enterprise earnings and investment dividends / interests

Source: Davis. Lee (1997), “New Directions in NGO Self-Financing,” Program on Social Change and Development, the Johns Hopkins University, Nitze School of Advanced International Studies (SAIS), Washington, D.C.

Obviously, a sound strategy for NGO long-term financial sustainability should be centered on the concept of “**source diversification**” to avoid dependency on any single funding source, whether external or internal. Types and weights of resources in the NGO financial structure (mix or combination) depend to a

large extent on a number of feasibility assessment criteria. These criteria include:

- **Likelihood of Success:** It predicts the level of difficulty that NGOs anticipate in getting funds from any particular source.
- **Management Required:** It takes into consideration the skills required to administer the system in order to get funds from any particular source.
- **Level of Investment:** It considers the money that is required to launch the fundraising activity.
- **Risks Involved:** It assesses the degree of risk that could be attached to any potential source of funding.
- **Long-Term Sustainability:** It measures the permanence of any source of funding in the long run.
- **Political Consensus:** It considers the potential sources of conflicts within the NGO in order to pursue any particular funding endeavor.

Feasibility analysis of potential funding sources using these critical factors varies from one NGO to another depending on NGO's legal, organizational and operational characteristics. Yet, experiences of NGOs in many countries around the world suggest that international funding is in decline and therefore can not be relied upon for long-term financial sustainability. On the other hand, levels of domestic resources and self-financing appear to be increasing and are therefore more reliable components in long-term sustainability strategy. As Cannon (1999, p. 69) put it:

“The Process of moving an organization towards greater financial sustainability is not an easy one – there are no magic solutions----- and it takes hard work which will not bear fruit overnight. But continuing to depend on foreign donors is no alternative.”

Self-financing activities, also referred to as “**earned income**” or “**nonprofit enterprise**”, are a number of “**entrepreneurial**” strategies for cost recovery or surplus revenue-generation to create NGO own new resources to support programmatic or operational expenses. Under prevailing conditions, however, where very few NGOs can achieve 100 percent self-financing, more organizations are trying to gain control over at least portion of their funds by generating income themselves. In this contest, a rule of thumb is that NGOs raise sufficient funds from internal sources to cover their basic operating costs but approach external donors for their program costs.

2.3 Obstacles to Self-Financing

As Table 2 shows, there are many ways to become independent from the typical NGO financing circle – where NGOs have lots of funds while a project is running and practically nothing in between projects. But not all of these ways represent the same risk level as the table shows. The further The NGO strays from its core activity, the more difficulties it is likely to face. Becoming more self-financed has its pitfalls. **Internally**, NGO staff may not be willing or able to undertake fund-generating activities in which they are either not experienced, not interested or both. The second internal problem an NGO may experience when it opts to self-finance is that values of many NGO members go against the idea of making a profit, and consider the quest for profit be **unethical**.

As Richard Holloway of Pact-Zambia (2000, p. 2) put it:

“When the main purpose becomes making money-albeit this money will be used for the work of the organization – a new set of attitudes starts creeping in; and many organizations become concerned that they will loss their internal cohesion, which comes from a shared vision of a better and less exploitative society.”

To reduce risk of internal quarreling, it may help that an NGO choose self-financing method that is related to its mission and program area. Another helpful strategy to avoid causing unnecessary strain on NGOs is to separate the non-profit from the for-profit sector. **Externally**, the government and private sectors can put further hurdles on NGOs owing to self-financing activities. In many countries, there is an unclear regulatory environment for registration and tax treatment of self-financing activities of NGOs. If NGOs in direct competition with private businesses, any NGO tax advantages may generate ill-will toward them.

So that, while self-financing can be a successful resource to supplement project-donor-based support, it is far from a panacea. And mishandled efforts at self-financing can literally ruin the NGO, either financially or because internal cohesion breaks up. But it is still worthwhile to consider some of the real strategies that some world NGOs have used. Davis (1999) traced the ways that different sizes and types of real NGOs around the world were able to reach greater level of financial self-sustainability. To become more self-financed, the NGOs surveyed used all the strategies in Table 2. Strategy No. 3 (name selling) and strategy No. 5 (related extension) were used less than the other ones. But most used more than one strategy to reach its goal.

In summary, the reality is that foreign funding can never be sustainable and, therefore, NGOs are increasingly beginning to accept the need to consider

local and self-financing alternatives as a basis for future financial sustainability/viability. But reaching a point of sustainability without the foreign support seems to be a difficult task for most if not all NGOs around the world at least on the short run. However, a perfect strategy for NGO financial sustainability will be to continue to rely on foreign funding as long as possible, while at the same time exert maximum efforts to develop other local and self-financing alternatives to a stage where they become completely exploited. By doing this, NGOs will be able to gradually enhance sustainability while diversifying funding sources.

3. PALESTINIAN NGOS: CONTEXT AND PROFILE

Palestinian NGOs (PNGOs) have developed in the WBG (including East Jerusalem) for two main reasons. First, PNGOs – as throughout many Arab societies – have played a historic role in advancing the social, cultural and economic of hundreds of local communities as well as the national unit (for more details, see Ibrahim, 1992). Second, in the absence of a state and a government with endogenous institutions established to provide direct assistance to Palestinian population, PNGOs in effect took on the additional task of filling in for the non-existent or absent state. With the Israeli military occupation of WBG in 1967, these NGOs picked up the slack of Israeli neglect throughout the 1970s and 1980s. Despite Israeli continued oppressive policies, PNGOs have managed to remain responsive to the increasing socio-economic needs of the 3 million Palestinians living under occupation.

When the PNA was established in 1994, the situation changed dramatically. Some PNGOs decided to merge their activities into the PNA structure, but most did not and preferred to stay in the **“third sector” (the non-profit domain)**. NGOs, which had supplanted barely existing government services, redirected themselves to complementing the new public sector by serving those sectors and communities not reached by PNA ministries. Much of the health and education services run by the PNA are inherited from the Israeli Civil Administration. Still, Israel did not provide adequate investment during occupation to maintain staff and facilities. The result, the PNA inherited largely ineffective and handicapped service delivery schemes. This left PNGOs with significant existing capacity in the delivery of public services.

The transition was difficult for both the PNA, led in the main by PLO activists who had lived in exile since 1967, and local NGOs, who had deep-rooted experience of serving the Palestinian population. Some PNGOs found themselves with large staffs and budgets than partner ministries, which were anxious to prove their credentials to donors and citizens. Some smaller PNGOs did not survive the steep decline in international funding, as donors continued to shift their support to the newly established PNA. In fact, in a public discussion paper connected with the Palestinian NGO Project, the World Bank (1997, p.2) reported that:

“By the early 1990s, PNGOs were receiving somewhere between \$140 - \$220 million each year from outside sources. By 1994, the first full year of the Oslo process, external support contracted to about \$90 million, and in 1995 and 1996 stabilized at about \$60 million per annum – a loss in external revenue of somewhere between a half and three quarters during a six-year period.”

This was compounded by a significant economic deterioration in the WBG during the same period. By the spring of 1996, the unemployment rate reached 28 percent, while between 1992 and 1997 there was a 15 percent decline in per capita real consumption, more than 30 percent accumulated decline in per capita real GNP, and more than 38 percent losses in private investments (see, IMF (1998) and Diwank & Shaban (1999)). As a result, approximately one fifth of the population was poor by the end of 1996. Thus at a time of increasing service needs among the poor, the PNGOs had less resources than in the past.

However, despite sustained donor support to the PNA since its inception and the continued shift in external funding toward the PNA and away from PNGOs, the PNA could not fully take over service provision in the WBG at this stage of institutional development. In any event, this may not be the most efficient option, given that PNGOs have developed extensive field and technical expertise over the course of three decades of Israeli occupation, from which the PNA can even benefit.

With increasing levels of hardship amongst Palestinians as direct result of Israeli widespread and intensified aggression since September of 2000, PNGOs have once again stepped forward to provide essential services, much as in the first intifada. The seemingly return of PNGOs to their pre-Oslo roles as the mainstay for many basic services was necessitated by the fact that the ability of the poorly equipped PNA to face the social and economic challenges arising from the series of Israeli collective punishment measures over the last two years has waned. These challenges are so exemplified in many published indicators. In its very recent publication, World Bank (2002) estimates that Palestinian losses in terms of real Gross National income amounted to at least \$2.4 million by the end of 2001, which is translated into per capita real income decline by 12 percent for 2000 and by a further 19 percent in 2001. The unemployment rate has climbed from 10 percent of the workforce in September 2000 to 50 percent in year 2002. This caused poverty rate to jump from 25 percent to nearly 60 percent. Far more significant, though, are human losses to death and injury.

PNGOs have also been used by donors to channel in-kind and cash assistance to the poor and to the families of those killed, injured or imprisoned by Israeli military actions. Another area where NGOs have played an effective and growing role is in employment generation. Following a successful \$1 million

pilot in early 2001, donors have committed a further \$6 million to NGO job creation projects through the World Bank's Palestinian NGO project.

This recent increase in demand for the services of PNGOs (particularly in welfare and health) was not accompanied by sufficient additional funding. In fact, the survey of PNGOs conducted for the World Bank's 2002 assessment confirmed that 60 percent of the sample PNGOs had received at least 30 percent less funding during the intifada. In part this is due to steep losses in service charges and local contributions – up to 60 percent in the case of the former. Those NGOs that received additional funding from donors tended to be the larger and more professional ones. The funding situation and its impact on the social safety net, particularly insofar as non-emergency services are concerned, is clearly severe, however. At the same time, most PNGOs have become more convinced of the continuing need to provide their services to the poor and marginalized people of Palestine. As for the future, even when the PNA or its successor (i.e., a state of Palestine) becomes a more effective institution, PNGOs will remain vital. No government can or should attempt to provide all services needed to sustain even the wealthiest of nations.

In this Palestinian political and socio-economic context, the profile of PNGOs must be viewed and their long-term financial sustainability must be assessed.

3.1 Profile of PNGO Sector

Table 3 below presents a detailed profile of PNGOs as derived from data and information reported in prior studies and reports, with particular reference to World Bank's 1997 discussion paper on the PNGO project, MAS' 1999 survey and World Bank's 2002 survey of PNGO sector.

Table 3: A Profile of PNGO Sector

- There are between 1000 and 1500 local NGOs and around 200 international NGOs operating in WBG, two thirds of which provide social services. The total number of active PNGOs, however, is only 926. Among those local NGOs are 400 charitable societies, although at least a third are inactive for lack of funding.
- 76 percent of PNGOs headquartered in the West Bank, and 24 percent in Gaza Strip.
- 60 percent of PNGOs focus on urban areas, 29 percent on rural areas and 11 percent on refugee camps.
- PNGOs work in the following sectors: 56 percent on scientific and cultural project; 40 percent on child services; 35 percent on education; 33 percent on charitable work; 30 percent on youth; 26 percent on vocational training and rehabilitation; and 26 percent on health. Clearly, many PNGOs work on multiple issues.
- 40 percent are charitable NGOs; 30 percent are youth clubs; and 30 percent are “new” NGOs with more development focus.
- 56 percent of PNGOs in Gaza and 32 percent in the West Bank were established after the PNA.
- While most PNGOs rely on more than one source of funding, 78 percent of them rely on one source only for more than 50 percent of their budget.

Table 3 (Continued)

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- On average, between 75-80% of the total funding available to PNGOs comes from external sources (official and non-official foreign/Arab donors), followed by around 15 percent from local resources mobilization and the Palestinian diaspora, and the rest 5 to 10 percent comes from self-financing (internal) activities.
 - In 1999, 53 percent of PNGOs experienced a budget deficit.
 - A huge disparity exists in the amount of funding available to PNGOs. In 1999, the average funding per PNGO was \$160,000, while one PNGO alone had an annual revenue of around \$ 12 million.
 - 96 percent of PNGOs are officially registered with one of PNA line ministries.
 - A progressive NGO registration and operation law came into effect in year 2000.
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The two clear conclusions that can be drawn from this profile are: **First**, the PNGO sector is quite diversified, and **second**, while this sector is gaining strength overall, a decline in financial support from international donors threatens the long-term sustainability and organizational capacity of most PNGOs. Obviously, the future existence of a strong and independent third sector in Palestine depends upon the development of support from a variety of governmental, private and international sources. Philanthropy, or charitable giving, has not yet taken root in the country and contributing to positive change is not yet seen as a duty of every citizen.

4. PNGO FINANCIAL SUSTAINABILITY: A CLOSER LOOK

Analysis of the empirical data, collected through well-structured interviews/inquiries with key representatives of the PNGO sector, provided additional insights into the financial sustainability challenge facing PNGOs. Although, the focus of this analysis was on the PNGO financing sources, it also highlighted the key institutional and operational factors that contributed to, or impeded, efforts toward achieving the ultimate goal of financial viability.

4.1 Funding Sources

Table 4 presents a consolidated financial structure for PNGOs surveyed. This structure refers to types and proportions (weights) of funding sources utilized by those NGOs in recent three fiscal periods. Therefore, source proportions (percentages) were simple arithmetic averages across sample PNGOs for the three-year period. Cross-sectional differences, however, did exist among individual PNGOs as reflected in proportional ranges. Yet average source proportions are still meaningful and relevant for the purpose of assessing overall PNGO financial sustainability as was the case in this study.

Table 4: Consolidated Financial Structure of PNGOs

Financing Source	Average Percentage of Total Financing	Range
<u>External:</u>	78%	30-100%
International Donations and Grants (official/non-official, and Arab/foreign)	75%	28-100%
Endowment Funds	0%	--
Domestic resource Mobilization	3%	0-4%
Individual & Public Donations	2%	6-3%
Corporate Contributions (mostly in-kind)	1%	0-2%
<u>Self-Financing:</u>	22%	0-70%
Project/program Related Revenues (Cost Recovery)	21%	0-70%
Membership dues	1%	0-7%
Asset Downtime Income	0%	--
Related/Unrelated Extension	0%	--

Data in table 4 provides **conclusive evidence**, consistent with findings of prior research, that overall PNGOs surveyed continued to depend substantially on external sources in financing their core activities, with a share of 78 percent in total available funding. Moreover, international donations and grants continued to represent more than 95 percent of total external funds, but with large disparity exists in the amount of funding available to individual PNGOs. Some PNGO representatives interviewed complained that around 90 percent of donor funding goes to 15 percent of active PNGOs, while the remaining 10

percent goes to the rest. Obviously, endowment funds are yet to exist. By contrast, domestic resource mobilization contributed only 3 percent to the total funding (equivalent to 5 percent of external funding). Interestingly, private sector and public donations were not only negligible, but also they were mostly in-kind. However, there are indications that overall private sector contribution to PNGO financing will grow as the concept and practice of corporate social responsibility and accountability is better understood and becomes more firmly entrenched in the Palestinian society. There would seem to be tremendous potential that is yet to be fully exploited.

Interviews with sample PNGOs revealed that while foreign donor funding was in decline in the past two years, Arab donor funding was relatively increasing. This tendency is unlikely to change as long as current political and economic conditions at the local and international level continue. A list of typical foreign donors include three main groups: **First**, governmental agencies, i.e., USAID, EU Commission, CIDA, GTZ, government of Japan, SIDA, DAAD, French Development Agency, Australian Development Agency and others. **Second**, international institutions, i.e., World Bank, IMF, UNCTAD, UNRWA, UNDP, UNSCO, UNICEF, WTO, WHO, and OECD. **Third**, international NGOs and foundations, i.e., CARE, Oxfam, Save the Children of US and Britain, Ford Foundation, Fredrich Ebert Foundation, Fredrich Nauman Foundation, CRS, CHF and World Vision. Arab donations, on the other hand, came through two channels: **First**, state disbursements under the auspices of Islamic Development Bank, and **Second**, non-official Arab Relief Organizations. A large proportion of Arab funding took the form of emergency aid in response to the socio-economic crisis in the Palestinian society following the eruption of Al-Aqsa uprising against Israeli occupation. So, Arab funding can not be viewed as systematic or reliable for the long-time horizon. This contention may also apply to foreign donor funding for the reasons explained in the conceptual framework section of this study. **In all events, however, high dependency of PNGOs on external funding sources (no matter how large or diversified) will always keep them at high risk (cost) of bankruptcy.** A number of PNGOs interviewed pointed out that they entered into mid-term contractual relationship (up to 3-year period) with international donors as one component in their strategy to manage that risk.

So that, did PNGOs sufficiently utilize self-financing methods for generating resources to supplement project-donor-based support? The data in table 4 provides a “no answer” to this underlying question. Self-financing comprised just 22 percent of total funds available to PNGOs. Yet, there was significant disparity in the amount of self-financing of individual PNGOs. This means that some NGOs, particularly those operate in health and community development, were more successful in utilizing self-financing strategies than others. Almost all self-financing (96%) came in the form of cost recovery of PNGO services/products. The remaining 4% of self-financing came as member dues. This slight member contribution could be explained by the fact that most influential PNGOs are not member-based, but rather

comprised of small groups of people surviving on a project basis with nonexistent or weak link to constituencies. **No other possible self-financing sources mentioned in table 2 were even attempted.**

4.2 Funding Uses

Table 5 presents a consolidated cost structure for sample PNGOs in the 1999-2001 period. The cost structure refers to types and average proportions of PNGO expenditures. Data in the table shows that, on the average, 67 percent of all expenditures related to implementations of PNGO projects/programs, followed by 30 percent covered management overheads (recurring expenses), and the remaining 3 percent allocated to capital (durable) asset acquisition. Divergence in cost proportions among individual NGOs (as reflected in the range column of the table) may be due in part to the differential levels of efficiency and effectiveness in their organizational and operational structures.

Table 5: Consolidated Cost Structure of PNGOs

Cost Item	Average Percentage of Total Expenditures	Range
Recurring (Management Overhead) Expenses	30%	18%-50%
Capital Asset Expenditures	3%	1%-11%
Project/Program Costs	67%	30%-83%

Under the assumption that PNGOs spend all funds they receive (meaning no actual deficits exist or at minimum, if any), then some PNGOs could be classified as **“operationally sustainable”**. This means that they generated self-funding up to 70% enough to meet their running expenses (up to 22%). There were at least three PNGOs surveyed enjoy this advantage. Those PNGOs work in health and micro-credit fields, where income-generation opportunities are higher than other NGO types. Nonetheless, one could qualify this conclusion by the fact that project/program related revenues could not be possible without donor capital in the first place. **Therefore, other self-financing strategies that are less related to donor-based projects must be developed.**

4.3 Factors Influencing Financial Sustainability

Reaching a satisfactory level of financial sustainability necessarily requires more than just securing funds from diversified sources. It requires as much strengthening NGO organizational and operational capacities. There exists a causal relationship between financial sustainability and certain factors associated with NGO management, leadership, public image, service provision, and community participation. These factor could contribute to, or impede financial viability of given NGO.

Table 6 lists those factors found to have positive effect on level of PNGO financial sustainability. In other words, when compared with the most unsustainable PNGOs, the least unsustainable PNGOs were found to have some common characteristics.

Table 6: Attributes of “Least Unsustainable PNGOs”

- **Were more likely to be older.**
 - **Were more likely to have had international funds for start-up capital.**
 - **Tended to change leaders less often.**
 - **Were more likely to promote their services.**
 - **Were more likely to have well functioning accounting system and trained staff.**
 - **Were more likely to have regular external audits.**
 - **Tended to earn most of their self-financing from fees for services.**
 - **Were more likely to benefit from services provided through networks or umbrella organizations, thus benefiting from economies of scale.**
 - **Tended to have greater professionalism and western-friendly fundraising skills (in contrast to charitable societies and women's committees).**
-

Logically, those enabling attributes become disabling once inversed. On the other hand, Table 7 identifies several other factors that were found to have negative effect on the level of PNGO financial sustainability.

Table 7: Additional Attributes of “Most Unsustainable” PNGOs

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- **Had weak strategic planning which often only focused on a specific project rather than the overall NGO.**
 - **Had management systems stronger at the project level than for the NGO itself.**
 - **Tended not to use feedback information for planning and monitoring.**
 - **Tended to change leadership either frequently or not at all.**
 - **Had no business orientation at all.**
 - **Tended to rely on volunteers to both lead and manage the day-to-day operations.**
 - **Had no reserves to cover regular costs in an unstable situation.**
-

5. CONCLUSIONS AND RECOMMENDATIONS

The PNGO sector is quite diversified. PNGOs operate in almost all regions of the WBG, support all demographic groups, and undertake a wide range of missions. There are between 1000 and 1500 PNGOs, and approximately 920 of which can be considered active. The PNGO sector has evolved into *a two-tier system*. *The first and largest tier*, the welfare organizations, are the oldest form of association, dating back to the beginning of 20th century. Among those are about 400 charitable societies, although at least a third are presently inactive for lack of funding, as well as Islamic Zakat committees and other religious grassroots organizations. Funding for welfare NGOs traditionally came from public and private Arab sources and from local donations, until the early 1990s when both sources began to decline. The scope of their services encompasses education, health, and cultural activities. They also run youth and women's centers. Welfare NGOs typically serve socially and geographically excluded communities. *The second tier* includes specialized professional committees, development and research NGOs. Historically, these NGOs stem from political parties, whether pro-PLO factions or forces in opposition to the PLO. While the pro-PLO NGOs were by large integrated into the PNA structure in 1994, the others continued to provide services independently. Like most PNGOs, NGOs of this tier suffer from funding shortfalls, albeit less so because of their links with western donors. In the last eight years, they have evolved into professionally based, foreign-funded development centers with targeted clients rather than popular constituencies. In fact, one finding of this study estimates that 15 percent of all active PNGOs, mostly from the tier of professional NGOs, receive more than 90 percent of aggregate donor funding. While the remaining 85 percent of PNGOs receive less than 10 percent of that funding. While their increased professionalism is a positive change, the lack of broad-based support means less accountability for their clients.

The **legal Environment** in which PNGOs operate is generally positive. A new liberal and progressive NGO law came into effect in January of 2000. This law is the culmination of several years of PNGO coalition-building and lobbying. This law provides for easy registration of NGOs with the PNA Ministry of Interior, and outlines clear requirements relating to NGO internal governance. It requires the internal management structure of NGOs to have a clear division between staff and members. According to this law, NGOs are generally able to operate free from undue interference by PNA agencies, although they are subject to monitoring through regular reporting to the Ministry of NGO Affairs, recently dissolved and replaced by a central government agency. Furthermore, PNGOs are allowed to generate revenue through legal economic activities as far as they contribute positively to their sustainability. PNGOs are also entitled to VAT and income tax exemptions.

However, while the new law is an important first step, its implementation and impact remain uncertain.

As to **Organizational Capacity**, most PNGOs are comprised of small groups of people surviving on a project-by-project basis, with nonexistent or weak links to constituencies. There is often a lack of effective coordination among PNGOs at large, though two networks among professional leading NGOs do exist. Still, PNGOs have succeeded in lobbying on specific issues, i.e., a new NGO coalition for transparency and accountability has been formed but it is still too early to assess its effectiveness. Boards are seldom active and PNGOs continue to be dependent on the executive director's personality and skills. There is a small, but increasing number of capable and accountable PNGOs that are starting to develop management capacity base, and have some success attracting volunteers. PNGOs rarely undertake a detailed planning process, as they are dependent on international donor funding and generally respond to the priorities set by donors. There remains a great need for tailored training programs in advanced financial management and constituency building. Substantial improvement in the accountability, transparency and fundraising capacity of most PNGOs will be required to gain the trust of private individual and corporate donors to decrease dependency on foreign sources.

With respect to the focal issue of **Financial Sustainability**, the PNGO sector remains extremely dependent on foreign funding. Donor funding, however, has been falling dramatically, and this trend is expected to continue in the coming years. Previously, the PNGOs received, on average, around 75% of its funds from external donors. Domestic funding sources have not yet developed sufficiently to replace this declining foreign donor support. The national government (PNA) does not provide financial support to the sector. Contributions from private individuals and corporations remain limited, owing to the constricted Palestinian economy and the absence of required philanthropy. Some in-kind support is occasionally available from local sources, but rarely material. It is essential for the long-term sustainability of PNGOs that they develop a widespread culture of regular giving. Earned income is not a significant part of PNGO funding although some NGOs are working to find ways to generate income. The PNGO legislation allows for economic activities and raises the prospects for further sustainability. For the most part, PNGOs have implemented proper and basic accounting techniques, have contracted independent audits, and produce annual reports. However, most are unable to engage in serious financial planning and control. **In summary**, while a very few number of PNGOs have managed so far to maintain “**donor-driven sustainability**”, the challenge of long term financial sustainability for the PNGO sector is still awaiting tremendous efforts.

5.1 Recommendations

- PNGOs need to form a broad and unified Coordinating Forum or Council to help represent their interest and agenda, including fundraising, in relation with donor community, PNA, and the private sector.
- PNGOs need to strengthen their organizational capacity, i.e., in the area of strategic planning, information systems, performance monitoring, project management, cost recovery (effectiveness) techniques, and leadership, through tailored training programs.
- PNGOs need to develop links with constituencies and where possible broaden membership base through public image building activities and promotion campaigns.
- PNGOs, in cooperation with other sector actors, need to develop an appropriate **“Revenue-Generating Strategy”** which identifies and assess feasibility of all potential sources, and lays-out detailed action plans for transitional implementations. This strategy would be most useful if developed at the NGO level, not the sector.
- Technical assistance; which is tailored to the specific revenue generating options of each NGO including fundraising approaches and pricing of services; should be provided by the World Bank funded PNGO project at a later phase.
- PNGOs need to seriously consider setting-up **“Endowment Funds”** with the help of donors, the Palestinian diaspora, the Palestinian private sector, or a consortium that combines some or all of these actors.
- PNGOs need to consider setting-up **“PNGOs-Private Sector Dialogue Forum”** to explore and coordinate work opportunities of mutual interest. This forum might be very helpful in advancing work relationship between the two parties, and may raise awareness of the concept of corporate social responsibility in the Palestinian business community.
- PNGOs need to explore, in cooperation with related official and civic parties, the socio-economic viability of establishing a **National Lottery System** through which some cash proceeds are appropriated proportionately to pre-determined NGO activities.
- PNGOs need to coordinate the efforts towards enabling the PNA Ministry of Finance to repay them the past-due customs and VATs accrued on NGO purchases of goods and services. This might be possible by establishing a **revolving soft-loan fund** by donors to be used for that purpose.

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