

Access to Finance in the occupied Palestinian Territories (oPt): Overcoming a rigid framework

Stephen Royle¹

In the modern era a domestic financial sector plays a vital role in the development of an economy by obtaining deposits and investing in initiatives that help build capacity and growth. However, for both historical and contemporary reasons this process has largely avoided Palestinians situated in the West Bank or Gaza. As Roulet² argues, the current situation in the oPt is akin to “*occupation-violence*” where *occupation breeds violence, which justifies occupation, which breeds violence, etc. In the middle of this cycle, the economic development is limited, and depends on how tight the military occupation is: number and fluidity of checkpoints, degree of curfews, etc.*³

In reality, because of the occupation a rigid framework has been imposed leading to the implementation of securitised policies and regulatory mechanisms (financial) that have restricted the movement and interactive capabilities of those living in the West Bank and Gaza, and ultimately weakened the prospect of a Palestinian state attaining self-sufficiency. Owing to the instability then, industries, businesses and livelihoods are confronted with a high degree of uncertainty which in sum makes the oPt an inadequate environment for investment. The local banking sector is therefore part of this rigid framework and must respond to both risk and regulations when formulating a strategy for long term prosperity. However, by having to take its own survival into consideration, the banking sector has contributed towards the detachment of Palestinians in the West Bank and Gaza from the formal financial sector, impacting upon development and stability.

Conditions for Investment

Since 1967 Palestinians in the West Bank and Gaza have been denied the necessary resources needed for industrial development, particularly land and water. For example, the agricultural sector has often been cited as a potential stimulant for growth, but since 1999 its contribution to GDP has decreased from 9.3% to 4% during the first quarter of 2012³. In the West Bank for example, closures (through roadblocks, checkpoints and curfews) and in some cases inefficient farming methods have contributed to this degradation. However, much of the contemporary decline is attributable to the Oslo Interim Agreement of 1995, which divided the territory into ‘zones’ (A, B, C) as part of an incremental transition to a two state solution. This transition has failed to materialise and instead Israel has increased its administrative control over the land and its resources, particularly in Area C which accounts for 63% of the West Bank, much of which is fertile (notably 46% of the land in the Jordan Valley) and where one third of the West Bank’s underground water supply resides. This area remains largely inaccessible to Palestinians, particularly those seeking permits for larger scale agricultural or industrial opportunities. Conversely, Israeli settlements in the Jordan Valley are able to flourish grossing an estimated NIS 500 million annually (approximately £89 million as of March 2013)⁴.

The above examples along with the worsening conditions in Gaza, highlight the difficulties the oPt faces in enticing either local or external investment. To compound matters, the PNA is reliant on tax

¹ Stephen Royle is a PhD candidate at Lancaster University. The interviews detailed in this paper were carried out during a visit to the West Bank in November 2012.

² L. Roulet (2005) Israel – Palestine Center for Research and Information (IPCRI): Microfinance in Palestine in 2005: Overview of Impact and Potential, Recommendations to the Main Actors of the Sector, pp 5.

³ World Bank Report (to the AHLC), September 2012, ‘Fiscal Crisis, Economic Prospects: The Imperative for Economic Cohesion in the Palestinian Territories’, pp 17.

⁴ B’tselem 2011, cited in MAS, Palestine Economic Research Institute, The Economic Base of Israel’s Colonial Settlements in the West Bank, 2012, P. 34.

collection, particularly from Israel, and donor support⁵ and is therefore unable to act as a guarantor having accumulated NIS 4.8 billion of public debt as of 2012⁶. With a weakened 'government' unable to steer a coherent fiscal policy or protect investment, the financial sector has succumbed to international regulation and in some banking cases, direct intervention.

Restrictions on Financial Access

Delivering a development strategy that includes industrial expansion under these conditions is inherently unrealistic, which has been typified by the banking sectors reluctance to invest in what would be vital industries due to high levels of instability and concerns regarding repayment. Through recognition of this and in order to safeguard the financial sector, the Palestinian Monetary Authority (PMA) has sought to strengthen its capacity, which *'with IMF technical assistance, have enabled the application to all banks in the West Bank and Gaza (WBG) of a rigorous supervision and regulatory framework through regular on-site and off-site supervision'*.⁷

From a macroeconomic perspective, stability during the economic downturn has been of the utmost importance and therefore the promotion of financial durability, banking efficiency and transparency have become even more important for the oPt considering the securitised environment. Since 2008 this has included the implementation of Basel standards. For example, in accordance with Basel I capital holdings were increased from US\$20m in 2008 to US\$35m at the end of 2009. In aspiring to meet the standards of Basel II (implemented during 2012), the PMA set a capital benchmark of US\$50m and required that 15% of net profit (after tax) be used as an additional buffer (IMF, April 13, 2011). This had an immediate effect on the banking sector, as the IMF (2011:14) state the *'PMA has also applied Basel standards and procedures when liquidating two banks in 2010'*. A new Banking Law was devised in 2010 to coincide with the changing economic circumstances which are expected to be reinforced with the implementation of Basel III during 2013.

Adopting international standards has undoubtedly improved the stability of the Palestinian banking sector, strengthening the individual institutions considerably. Abu-Rub and Abbadi⁸ believe the PMA's decision to implement the minimal banking capital following Basel has aided the sector's increase in 'net equity' to US\$1.1 billion, a true reflection of improvement. Sherin Al-Ahmad of the PMA (ICMA, 2011) affirms this upward trend by stating between 2006 and 2011 banking assets *'increased by 55%, paid in capital by 79%, deposits by 65%, and non-performing loans decreased from 14.5% to 2.6%. Alongside this, profits for the overall industry increased by more than 170% since the end of 2006'*⁹.

By 2012 this improvement was shared amongst eighteen commercial banks, eight of which are locally owned¹⁰ and ten foreign¹¹ (PMA, Sept 23 2012). Banks that struggle to maintain the standards, particularly smaller ones, have been encouraged to merge. In defending this action PMA

⁵ The current arrangement still draws its policy framework from the Paris Protocol of 1994 which according to UNCTAD (May 1, 2009, 'Policy Alternatives for Sustained Palestinian Development and State Formation', New York and Geneva, pp 1.) *'...locked in the economic structural distortions and fragilities that began with the Israeli occupation of the West Bank and the Gaza Strip in 1967, and has perpetuated the dependence of the Palestinian economy on that of Israel'*.

⁶ World Bank (2012), pp 7.

⁷ IMF (April 13, 2011), Macroeconomic and Fiscal Framework for the West Bank and Gaza: Seventh review of progress, staff report for the meeting of the Ad Hoc Liaison Committee, Brussels, pp 3.

⁸ Nour Abu-Rub, Suleiman M. Abbadi (2012), 'Variables Used by the Palestinian Banks' Managers to Measure Their Banks' Performance, International Research Journal of Finance and Economics, Issue 90 pp 126-127.

⁹ International Capital Market Association (ICMA) (2011), 'Palestine Monetary Authority: Striving for stable banks', <http://www.icmagroup.org/assets/documents/Media/Interview%20with%20Sherin%20Al-Ahmad%20-%20PMA.pdf>.

¹⁰ The six standard commercial are; Bank of Palestine P.L.C, Palestine Investment Bank, Palestine Commercial Bank, Al Quds Bank, Al Rafah Microfinance Bank, and two Islamic banks; Arab Islamic Bank, Palestine Islamic Bank.

¹¹ The foreign banks are; Cairo Amman Bank, Arab Bank, Jordan Kuwait Bank, Jordan Ahli Bank, Bank of Jordan, HSBC Bank Middle East Limited, Egyptian Arab Land Bank, Union Bank, The Housing Bank for Trade & Finance, Jordan Commercial Bank

Governor Dr. Jihad al Wazir stated this is "*not only for profitable reasons but also to face the requirements of the coming stage, such as the expansion in international trade particularly at a time when the Palestinian Authority seeks to join the World Trade Organization (WTO)*"¹².

For Palestinian economist and consultant Dr. Bassim Makhoul, the PNA (and PMA for that matter) are overly concerned with raising capital and not the banking sectors main purpose of generating development via the simple practice of turning deposits into investments, something smaller banks can do very well. What Makhoul suggests is that in a region that requires local financial input, credit supply to SMEs for example is being stifled by macroeconomic aspirations. Instead, banks are opting for investments via lower risk individual loans. He added

When you provide retail loans to individuals, most of the time they are used for importing goods from outside of Palestine, for example consumer goods from Israel, and therefore add very little to Palestinian growth and development.

It has become evident therefore that the PMA and the banking sector have adopted '*conservative processes in granting loans*' and even when finance is made available they '*do take more than enough collateral due to the exceptional situation in Palestine*'¹³. It is practical for the banks to follow regulation but there is also a requirement to operate with a degree of flexibility. For example, during an interview carried out in November 2012, a security force member working out of Ramallah drew attention to a growing concern amongst public sector workers in the oPt

Our salaries use to be covered by the donors (it was intimated that this was primarily the U.S.) and our payments were always received on time and in full. Because of the personal financial stability achieved under this process we were able obtain loans from banks to get married, buy cars and even get mortgages. However, since the PNA assumed responsibility for our salaries the payments are not always on time and when they arrive they are often reduced. I received two thousand shekels this month (approximately \$500) but from this amount the bank took sixteen hundred and I am unable to re-negotiate this. I have a wife and two children, how am I supposed to feed them. Many of my colleagues are in the same position, and if the situation does not improve and we cannot get more pay, we will strike.

This is typical of the situation confronting public sector workers, particularly in the West Bank, and many others who took advantage of the donor inspired financial boom following the end of the Second Intifada. Since then statistics suggest that personal debt has doubled to approximately US\$750 million between 2008 and 2011¹⁴ and with the economy showing little sign of real growth while under the occupation, it highlights the conditions that the banking sector has to contend with. It is therefore understandable that banks are increasingly seeking external investment opportunities in an attempt to secure their own survival. In the meantime their revenue depends on deposits and stricter policies regarding loan selectivity and repayment. The majority of risk is therefore being transferred to the customer who under the circumstances is exposed to market frailties, as highlighted in the case of the security officer. The concern is that over time this could transform into further instability.

¹² PIFBS, Bank Mergers Between Global Requirements and Palestinian Reality, accessed Jan 3 2010 <http://www.pifbs.com/etemplate.php?id=115>.

¹³ S. Timewell (April 2010) 'Palestinian banks count on deposits', The Banker.

¹⁴ E. Sanders (March 18, 2012) 'Palestinians are up to ears in debt', L.A. Times. <http://articles.latimes.com/2012/mar/18/world/la-fg-palestinian-debt-20120318>

Nevertheless, this situation is a symptom of the rigid framework imposed upon the oPt and the boundaries in which its institutions have to work within. The PMA are therefore obliged to maintain regulatory standards, and in the case of the banking sector survival has been prioritised. For example, the Palestinian Islamic Bank (PIsB) as a local institution has been forced to confront the circumstances. In November 2012, Regional Manager (West Bank), Imad A. Al-Asadi, stated

We want to ensure the bank continues to grow so we can improve upon the size and scope of facilities that we provide. To do this we are looking to invest outside of Palestine (beyond the West Bank and Gaza) to help with the building of the bank's financial foundations. We cannot make profit by investing in Palestine alone as there is too much uncertainty and we cannot guarantee our own survival under these circumstances. It is therefore important that we develop ourselves and increase our own sustainability before we play an important role in the development of Palestine.

Conclusion: Preventing further instability

As this paper has shown, investment into the oPt requires the removal of a rigid framework and the provision of stable foundations, where access to resources and the freedom to interact naturally with both internal and external parts (through trade for example) is guaranteed. Only then will this entice investment and enable the local banking sector to reattach itself to the Palestinian development programme which in turn will have positive ramifications for the society it serves. Temporary bridges such as those provided by the microfinance sector have offered some form of relief (particularly through the Deprived Economic Empowerment Programme, DEEP) but even it faces the same challenges under current conditions and in many cases relies on the input of donors. It is estimated therefore that with a potential market of 200,000 people only 18% are being serviced by microfinance loans¹⁵.

In brief, maintaining the supply of donor funding will only serve immediate purposes and therefore for long term development to occur, Palestinians in the West Bank and Gaza require freedom and access to resources in order to cultivate the foundations of an economy. With a guaranteed stable opening the financial sector, particularly local banks, can play an active role by investing and through the provision of services. However in order to achieve this, considerable political concessions are required but this should not deter international participants from taking smaller (albeit still important) steps that could promote a more positive outlook, particularly when considering the blockade of Gaza and access to area C in the West Bank.

¹⁵ UNRWA (2010), MFI Annual Report 'Realising Self-Reliance', pp 23.