An Evaluation of Issuing Palestinian Currency

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ABSTRACT

This research is based on the subject of 'The Importance of Palestinian currency issuance in Palestinian state and its urgent need to stabilize its economy in numerous manners.'

The issuance of Palestinian currency is one of the most critical and sovereignty matters for the Palestinian people while it's still dealing with various other currencies such as USD, NIS, Euro and Jordan Dinar, etc. This study reveals the factors, reasons, hurdles of the failure of Palestinian economy in currency matter and how this currency matter reflects on the overall economic development of Palestine.

After the deep study and analysis it is still recommended that this subject needs further research and examination that focus on studying the Palestinian economy as the subject touches the components of the Palestinian economy particularly under the Israeli occupation, the resulted obstacles and accords that hinder the development of the Palestinian economy and deprives the people from progress, stability and development.

To clarify this subject for the readers, it has been necessary to present a brief history of the Palestinian Monetary System to understand the following terms:

First: The extent of the availability of factors, economic and financial conditions as well as the basic components related to the process of issuing the Palestinian national monetary.

Second: Knowing the fears and warnings that hinder the process of issuing the Palestinian monetary.

Third: Identifying the monetary policies in Palestine during the Israeli imperative period from one aspect and during the Palestinian National Authority system in other aspect.

In this study, researcher presented the most important points that assure the lack of certain factors such as the financial and economical, and in addition to the components of issuing the Monetary of Palestine under the Israeli occupation while controlling its economy, land, marine and air crossings.

Keywords: Central bank, Palestinian Monetary Authority, Palestinian currency.

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Anahtar kelimeler: Merkez Bankası Filistin Para Otoritesi, Filistin Para.

To my beloved family

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INTRODUCTION

1.1 Background of the Study

Throughout the history Palestine has played a vital role in the region in terms of religion, culture, commerce and politics. This fact can never be denied. According to the geographical aspect, Palestine is located in the middle of Mediterranean Sea and Jordan River and other nearby regions. Right from the beginning, Palestine has controversial issues about its region because of its importance.

Different supremacies had acquired this region in different paces of time. Because of this uncertain situation, Palestine governance failed to sustain its systems and the Monetary System is the one which affected by this the most. As different rulers have enjoyed their attorney over the Palestine, they brought their cultures and economies but as with their empire all the systems got vanished. Palestine is facing a very vagueness situation in their monetary system.

The uncertain situations of monetary system in Palestine form the basis of this study in order to find out the root cause of this issue. Monetary system of Palestine is a very agile topic which directly affects its economy. The researcher aims to gather a genuine fact to devise the hypothesis that is presented at the end of this chapter.

This topic for the research is chosen to illuminate the following aspects:

- Reason of fall down of the Monetary System of Palestine and related issues.
- Potential currency that might be issued in Palestine.
- Importance of currency in sovereignty of any state.
- Role of Palestine National Authority and Palestine Monetary Authority in the issuance of new currency.

Economists believe that currency of any state represents its sovereignty and independence but as Palestine has always been dependent on the other powers in different periods of time, it has not just lost its independence but also its sovereignty in terms of its own currency. This situation also emerges the crisis of inflation, raised the unemployment rate, the scarcity of investment opportunity and the economic fall.

1.2 The Problem of the Study

The purpose of this study is to analyze the factors, forces and challenges in front of the Palestinian Monetary Authority and to deal with them in the following aspects:

1. Why the issuance of new currency is highly needed in Palestine?
2. What are the factors that disturbed the smooth flow of monetary system?
3. What are the forces in favor and in against to prevail the monetary system?
4. What are the potential currencies in the monetary system?

1.3 Organization of the Study

The study actually consists of 8 chapters and each of them defines different aspects and facts. Chapter 1 is introduction and Chapter 2 describes the history of Palestine and the effects of this fluctuating situation on the monetary system. Chapter 3 enlightens the Palestine monetary policy with relation to Israel Mandate and the effect of dealing with foreign currencies in Palestine economy. Chapter 4 explains all the journey of Palestine monetary policy. Chapter 5 discusses the factors and constraints influencing the Palestine monetary system. Chapter 6 introduces the advantages that Palestine can get if it succeeds to develop a sound monetary system. Chapter 7 analyses the entire hypothesis and Chapter 8 presents the findings of the research by proving one hypothesis in the light of the facts and research. It also presents suggestions and reconditions in the prevailing situation of Palestine.

1.4 Objectives of the Study

This study primarily aims to identify the reason of the downfall of the Palestinian monetary system and its economy. For this reason it’s required to explore the history, the impact of different political scenarios on the economy and monetary system and different constraints affecting the operations of the authorized bodies.

This study also squeezes the conclusion of the overall situation of the Palestine Region, which led the audience to derive a proposal that may aid this agile dilemma of the inappropriate currency.

1.5 Arguments

The following hypotheses are presented as a result of a careful analysis of history, facts and circumstances:

1. Paris Economic agreement is an obstacle for the Palestinian authority for the issuance of new currency.
2. Palestine monetary authority is inadequate to sustain economically and to issue new Palestinian currency.
3. Palestine authority is incompetent to use fiscal and monetary policy tool because it’s dependent on Israel’s economy.

The overall research revolves around the above mentioned hypotheses to identify which one is true.

Chapter 2

LITERATURE REVIEW

A healthy economy always depends on the efficient transfers of resources from people who are net savers (surplus) to firms and individuals who need the capital. The financial system is the set of the implemented procedures that track the financial activities of a country, which allows the transfer of money between the saver and the borrowers. The financial system plays a crucial role in the economy's use of currency and on its development. Every financial system is also governed by a Central Bank who regulates it.

In Palestine, the Palestine Monetary Authority is the supremacy and earlier it almost pays responsibility to Central Bank except dealing with the subject of issuance of the currency. In contrast, former Palestine Monetary Authority's roles included developing the strategy of transfer to Central Bank and the issuance of the new national currency.

This study is qualitative in nature, based on data gathered from both Palestinian monetary authority online sources and Eastern Mediterranean University's library, by accepting the fact that the researcher was unable to collect the secondary data for the analysis.

2.1 Previous Studies

Priewe (2012), who has broad vision and keen eyes on macroeconomics, economic development and economic policies, discovered the optimum currency area (OCA) theories in which he reconsidered a European perspective. Briefly, he presented his work only as a few similarly structured economies (hence small), with strong trade connections, with banking union and fiscal transfers. He believes that developing countries should focus on the monetary cooperation in different forms but be very prudent to embark on a CU. Especially developing countries should maintain tools to depreciate the currency to avoid long-term over valuation.

Mongelli, Smets and Noblet (2008) argues upon the European economy with monetary integration and the optimum currency area theory. One can conclude his studies as they based on intuitions behind the OCA theory that were remarkably resilient and are still active in the debate in monetary unions. Various advancements in economic theory have made it possible to progress from the early OCA to a new OCA theory.

Thomsom (1999) aims to define the role of central bank in money and payments systems. In brief, economists agree on the structure and the performance of institutions by taking the market structure, technology and incentive into consideration. Central banks are particularly interested to study because of their fundamental role in macroeconomic policy. Moreover, the possibility of market failure in financial and payment market may indicate additional roles for a central bank. The jury and great thinkers are still conversing on the appropriate role for the central bank specifically in aspect of the Federal Reserve.

Taylor (1999) devotes himself to illuminate the effectiveness of central bank independence versus the policy rules. The conclusion of his study says that "changes in macroeconomic performance during the past half century were closely associated with changes the adherence to rules based on monetary policy, and the degree of monetary independence at the fed," but change in economic performance was not associated with a change in central bank independence. The formal central bank was not able to generate the required outcomes of the monetary policy independently.

Hanker (1993) in his studies investigates the currency boards and looks into the distinguishing features of the currency boards and central banks. His researches are based on data taken by the Central bank that compare the performance of currency. The arguments against the currency boards are numerous and evaluated. In developing countries, currency boards are superior to central banks by applying an irremediableness criterion.

Blinder (1999) analyzes both the theory and practical aspects of central banking. In short, the case of choosing between interest rate and monetary aggregates as the policy instrument, the symbiosis is extremely strong. In case of the modern incarnation of the rules versus the discretion debate, based on time inconsistency, researcher has argued that things are simply different. The academic literature has focused on either the wrong problem or non-problem and has proposed a variety of solutions that make little sense in the real world. The choice of the zero point to define the monetary policy is still unresolved and the researcher suggested using an estimated neutral real rate of interest, which is defined as the real short rate. Indeed, it is consistent with constant inflation, as the dividing line between tight and loose monetary policy.

Amsterdam and Caprio (2011) argue on the role of the central banks in financial stability. In brief, they found that monetary and financial stability are the two sides of the same coin. Following the global financial crisis, central banks are expanding their financial stability function. With the advancement of international banking, central banks need to coordinate the financial stability internationally. The financial stability board provides coordination at the global level, and the European systemic risk board at the European level.

Blinder (2010) in his studies scrutinizes that the central bank should be the country's only lender of the last resort and its sole and independent monetary policy authority. He also presents several related job assignments to follow logical from that assertion. Most importantly, the central bank should be the systemic risk regulator because preserving financial stability is (a) closely aligned with the objectives of monetary policy, and, (b) likely to require a lender of last resort powers.

Moreno-Villalaz (1999) investigates the Panama monetary system, financial integration, interest rate, stability of the economy and real exchange rate. In brief, Panama's monetary system with full financial integration has shown remarkable economic stability. The experience of Panama supports a systemic solution over a managed solution (a central bank based system) to macroeconomic problems and implies that financial integration should occur early in the order of liberalization.

Honoban (2002) works on the reappearance of the interest in currency board and prompted reconsideration of one of the Irish experience. The researcher evaluates the institutional arrangement which underpinned the Irish pound for a half-century. In conclusion, he achieves that the regime has a credibility which led to low interest rates and a degree of price stability. It is elastic to some extent because large additional foreign reserves held by the private banking system and to the fact that Sterling did not proved as a strong currency.

Hanke and Schuler (2003) state different aspects of issuance of the new currency. As a conclusion of this study many western advisers on transition policies recommend the republics build multilateral currency arrangements similar to the European monetary union or a common currency for several or all of the republics. Other western advisers recommend that the republics peg their currencies to a strong western currency such as the Dollar or the Mark through a currency board or a central bank. To expedite their transition to market economies by using Eurodollars, the government of the republics would not have to create any new institutions. They realized they could generate maximum benefits from the use of the Euro currency markets, if they would make their currencies fully convertible, avoid all the exchange controls, permit free trade and capital investment, maintain stable domestic purchasing power for their currencies and let their exchange rate to be determined in free markets.

Moreno Villalaz (2005) directs his energy to inquest market based macroeconomic stability, capital freedom, Panama's institutional framework and dollarization. As conclusion it has been summarized that the dollarization and the financial architecture debates have been cast as debates over the exchange rate administration and the policy choice framework, strengthening international institutions and improving macroeconomic management. Modern monetary policy and government macro-management leads to policy determination instead of market determination and interest or exchange rates. It ends up as Panama’s efficient macro economy is a set of institutional arrangements that reduce the financial and banking risk.

Labid (2005) argues on the burning matter that is the issuance of the new national currency. He discusses the components and the obstacles that may arise after the issuance of the new national currency. His recommendations are advising the Palestine monetary authority to make a deep study on issuing the new national currency because of the financial conditions that Palestinian people were facing. Furthermore, when the Palestine monetary authority issues a new currency they have to make sure that they will gain the trust and the honesty in terms of the ability to keep the value of the new currency and stable the demand on it by keeping in mind that the increasing interest rate that might happen after issuing the new currency.

Al-agha (2004) in his research highlights the control of PMA on the bank sector. According to his analysis banks should provide more services to attract more investors, and assure that the PMA is independent. They should make some procedures to support the local banks, and put some rules to immerge the small and weak banks together that will lead to support the financial sector.

Mokdad, (2007) explores and represents the available alternatives for the Palestinian economy; in case PMA couldn’t issue the new national currency. The outcomes are in favor that it is better to stay with the PMA strategy in regard to issue the new national currency and the alternatives are more costly than issuing the new national currency.

Mokdad (2009) deliberates the advantages of issuing new currency and the available alternatives that fits the Palestine economy. His recommendations are to put some plans to develop Palestine economy and prepare the financial system to issue the new national currency.

Ali (2007) examines how banks deal with credit risk with the help of the Palestine monetary policy. The result of her studies show the good quality of management that can achieve the credit risk in banks and the sufficient money to face the expected losses in the portfolio in banks. Some banks succeed to handle the high percent bad debt in their portfolio and all banks' commitment to the rules that the Palestine Monetary Authority puts for banks to minimize the credit risk.

Chapter 3

MONETARY HISTORY IN PALESTINE

The Canaanites are known as the first who used the currency as a mean of the commercial exchange among the nations in the Palestine region in 4000 BC. History reveals that it was a mass of silver that was known as Alshaqla, Wazna and Shaqla that were equivalent to 11.46 grams. The New Hebrew “NIS or Shekel” are the other names of currencies which also were derived from it (Barsheed, 1930).

3.1 The Ayoubi Age (1193-1259)

Ayoubis spent most part of their era in the battle with Crusade, therefore they designed their currency in Cairo and Damascus by following the “Abbasi Model” with name and picture of Salah Eddinon on some of the currencies. Abbasi Model is basically the way Abbasis were dealing in their own perspective with this situation in their era.

This confrontation with Crusaders had led to the end of Ayoubi’s Empire. After that “Mamluks” took over the empire while Mughals were also in the race, who had already occupied Baghdad and Gaza. After Mughals’ defeat by the Muslim leader Al-Thaher Byprs, Mamluks leaders started focusing on money making by the following Ayoubi’s approach of money making (Fakhri, 1981).

3.2 The Romans Age

When the Romans took over the Palestine in 63 BC under the leadership of Bompay, each city were using their own silver and gold coined currency by decree of the emperor and the impression of the ruler was clearly visible on the currency as one side of the coin was decorated with a portrait of the ruler of that time and on the other side, it had various symbols and shapes for each city. That trend was in practice until Islamic emperors conquered the Levant region, including the Palestine (Al-abadi, 1982).

3.3 The Era of the Crusades

The Arab's Islamic currency was used in Palestine until the Crusades lived in Palestine (1099-1294). During that time the Crusaders created a currency of pounds and pennies with Arabic scribe. They called it the (Byzantine / Arab) currency. One interesting thing is that the Crusaders created fake (Fatimid / Ayyubid) pounds and pennies, which caused a rise in prices up to six times before the arrival of the Crusaders (Hitti, 1951).

3.4 The Era of Ottoman (1516-1917)

During the 1516 war, when Mamluks were defeated and Ottoman took over the rule, Sultan Suleiman decided to devise a new Ottoman currency. Picture of Ottoman sultan and some Quran verses were printed over the currency. This currency gives us a glimpse of the Islamic era. This currency was applicable in Palestine. First World War led the downfall of Ottoman Lira and French Golden Lira took its place in Palestine (Ibn Illias, 1960).

3.5 The British Mandate (1927-1947)

The Ottoman currency was still in use when the British occupied the Palestine (1917) and Turkey got defeated. The Egyptian and English currencies were also used as official currencies till January 12, 1918. When Britain created a law against dealing in the Ottoman note and gold currencies, and allowed to deal in the Egyptian coin and note currencies in Palestine, English gold pounds also became applicable in

Palestine. Moreover, people were ordered to use the Egyptian currency instead of the Ottoman currency in legal documents, declarations, and in official letters in Palestine.

In that scenario the Palestinian golden pound divided into 1000 pieces which was a medium unit. Therefore, the value of “Piaster” emerged as equal to five and ten pieces. Various other categories of NICL appeared as bronze with the value of 1 piece, 2 pieces, 5 pieces, 20 pieces and Shilling category of 50 pieces. They were actually made up of Breeza and 100 pieces of Silver.

This period (1946-1927) is considered as one of the most important stages, as the Palestine currency was undergone to different challenges, as the British mandate implemented the schemes of the Zionist movement by the orders of the high commissioner who received his instruction from the Zionist movement. In relation to currency, the British mandate’s high commissioner ordered to form a committee aimed to take charge of the currency in Palestine. This committee was consisted of four managers from foreign banks, three Arab public employees and three Jewish, elected by the Zionist movement. This act dismayed the Palestinians and caused them to reject the whole idea (Palestine Encyclopedia, 1984).

The high commissioner was rigid on his decision to implement the Zionist plans in Palestine to pave the way to build the Jewish state. Thus, in February 1927, the Palestinian currency charter was declared. The British minister of colonies declared as a new law which replaced the Egyptian currency with the Palestinian currency.

Britain implemented the “British monetary defense” law on all Palestinian money in Britain, and this money added up to 130 million confiscated Palestinian pounds, 54 million of which were in bonds, and 76 million of which were in bank accounts. All that money was confiscated in British balance, in fact, it all belonged to Palestinians (The Government of Palestine Newspaper, 1/2/1921).

3.6 The Egyptian Era (Jordanian Rule)

The state of Israel was declared in 1948. The Egyptian forces took control of the Gaza strip, and the Jordanian forces took over the West Bank. The currency used in Palestine was replaced by the Jordanian currency in the West Bank after 1950 and the Egyptian currency in Gaza Strip after 1951. It was established in Gaza Strip with the order of Lt. Gen. Hard Muhammad Najeeb, and the order number was 166 in 1951, which was declared on November 18,-1951 (Palestinian facts, the official journal of the Gaza Strip, 6/7/1951).

Chapter 4

THE MONETARY POLICY IN PALESTINE

4.1 Monetary system

A monetary system is a set of policy tools and institutions through which the Central Bank provides money and controls the money supply in an economy. Palestine monetary system is the emerging central bank of Palestine, It is located in Ramallah. It is an independent public institution responsible for the formulation and implementation of the monetary and banking policies to safeguard the banking sector and ensure the growth of the national economy in a balanced manner.

4.2 Israeli Occupation Period (1967-1993)

In war of 1967, Israel overwhelmed the West Bank and Gaza and not just this but also they stopped up all the active branches of Arab banks on immediate basis, suspended their assets and transferred into special accounts of Central Bank of Israel. Israeli authorities also disallowed to deal with foreign currencies and gold from June 3, 1997. Israeli authorities announced that the Israeli currency (Lira) was the only legal currency for circulation in Gaza Strip and West Bank (Basil, 1998).

The decision of Israel to set “Lira” as legal currency closed the doors of economic development for Palestine. It was big challenge for Palestine economy to repay the foreign currency especially when Israeli currency is nonconvertible.

Israel developed very strict laws for Palestine regarding the foreign exchange. These laws were about building the foreign currency reserve which reached to more than 19 billion dollars in 1996. They contributed to increase the capacity of the Bank of Israel which controlled the exchange rates and adopted effective monetary policy. They also provided foundation for the evaluation of Israeli currency. So, as much as these benefits formed gains for the Israeli economy, they formed losses to the Palestinian economy.

Israel imposed strict restriction on banks in case if they dealt with foreign currency. Money transaction could only be possible unless they had credit letters from Israeli bank, which increased the cost of payment settlement because they charged high benefit and it also delayed the transaction.

These awful acts affected Palestine economy negatively. The main challenge were to receive the amount of Palestine export and import in New Shekel, that means a loss for the Palestinian economy, equivalent to a difference in currency conversion rate.

Following are some facts defining how Israel ruined the stability of Palestine's economy in its ruling era:

- Absence of Central Bank of Palestine: The central bank of any country is responsible to manage the state's currency, money supply and interest rate. It is the institute who is responsible to keep the economy on right track by managing the interest rate, open market operations, capital requirements and reserve requirements.

Someone who studies finance can envision the situation of any country that skipped such institution entirely. Unluckily Palestine is one of those countries who did not have its own central bank since Israel ruled on that.

During this era, Israel prevented the bank of Jordan to manage and control the Palestine banking sector, and authorized the central bank of Israel to control the operating banks in Palestine. The absence of Palestine's own central bank produced a drastic gap in survival of the economy of Palestine, even though it affected the economy in the most terrible way.

- Absence of Palestine Currency**:** The basic role of a currency is to act as a tool or means of exchanging goods. Currency in today's market has become the strongest or the weakest constituent on which the value and stability of any economy is dependent.

  After 1950, Palestine's economy suffered from the numbers of challenges. One of those was absence of its own currency, which is the key constituent of any monetary policy. This deficiency led the Palestine economy to decline which they didn't have revenue for the monetary reserve and issuance.

- Tentative Political Situation**:** As Israel overwhelmed the Palestine, which caused unstable political situation of the region and legislation structure was also in the weakest form. Israel and Jordan used that situation for their motives and enjoyed their benefits by putting the Palestine economy on stake. The detail about Israel's negative actions upon Palestine to create tentative situation is discussed in various parts of this study.

- Scarcity of Fund: As Palestine economy was passing through number challenges, it had lost all its efficiency. There were also scarcity of resources and funds that were required to sustain and revitalize the Palestine economy.

After a deep analysis the picture can be summarized by stating that Israel took over all the matters of Palestine economy under its umbrella of central bank for the sake of creating more barriers. It restricted the Palestine economy to deal with foreign currency, which it collapsed the banking system and ultimately the financial units. The consequence cannot be limited only with this; it also smashed the long term funding operations. These sudden changes in the currency shattered all the economy.

The consistency of Palestine with use of foreign currencies, particularly NIS, was a step to let down the Palestinian economy to take in control of the Israeli policies. After the terrestrial military siege Israel Banks threatened Palestine not to deal with the Gaza Strip, which led to create monetary liquidity crisis in Gaza strip. Most of the Palestinians save their money in foreign currency which led to depleting the money that can be used for the investments in the local market.

After the agreement of Oslo Accord between Israel and Palestine in 1993, Palestine was allowed to establish national banks and Jordan banks in Palestine territory in order to create a negotiation path. Under this act, Palestine opened 22 banks with 124 branches in different cities which invaded some blood to the banking sector at that time.

4.3 The Period of the Palestinian National Authority

The Paris economic agreement brought different impact to monetary provision in its transitional period that can be summarized as follows:

4.3.1 Establishment of the Palestine Monetary Authority

Palestinian Monetary Authority established to carry out most of the traditional functions of central banks except the issuance of national currency, which must be coordinated and approved by the Central Bank of Israel. This agreement explicitly defined the role of Palestine Monetary Authority as responsible for the management of monetary policy and to act as a lender for the last financial and banking system in Palestine.

4.3.2 Moving towards the Regularization of Economy

At that time Monetary Authority was newly functional and didn't possess sufficient resources to achieve its general objectives which led to the situation of deprived Monetary Instrument, the absence of national currency and the degradation of general indicators of the national economy that could be in its stream, if monetary and fiscal policies were implemented. Due to the lack of this, Monetary Authority attempted to influence the money supply by improving the environment in where the economic units were operating. It affected the behavior of these units and the money supply, but that measure was also not enough to bring the economy on track.

Monetary Authority changed its surpluses of Israeli Shekels from the foreign currency in exchange of balance of payment, but Bank of Israel didn't exchange more than fifth of surplus achieved biannual (agreed upon) in one month. Although the Palestinian Monetary Authority was not restricted to sell foreign exchange to the Bank of Israel, even permissible to buy back what was sold (Ishtayeh, 1999).

4.3.3 Paris Economic Agreement

Monetary arrangements that were made under the Paris Economic Agreement to limit the ability of the Palestinian Monetary Authority (PMA) influenced the money supply and its ability to adopt effective monetary policies. The absence of the national currency induced the Monetary Authority to influence the monetary base and permitted to lend circulated foreign currencies to the central bank. Therefore, it was not possible because of the prolonged deficit in the balance of payments, and interest rates were also higher. That eventually could burden the public budget of the Palestinian Authority.

To manage the compulsory reserves in terms of “Dinar Jordanian currency”, the Monetary Authority forced to adopt the same proportions of the Central Bank of Jordan to avoid any circumstances that might change the ratios, whether in increase or decrease. It restricted the ability of the Palestinian Monetary Authority to use effective and appropriate monetary policy and especially in the situation when they were lacking in the monetary instrument and national currency. Monetary arrangement was also banned due to Paris Economic Agreement.

PMA tried hard to survive its economy by taking measures of discount window, open market operations and rearrangement of government deposit on small scale to make even short term changes. After that they also tried to direct the monetary system to the right path. Nevertheless, these constructive efforts were not enough to meet the huge requirements of foreign reserve due to limited sources of foreign currency and accumulated deficit in the balance of payments. The Paris Economic Convention and the monetary arrangements made Palestinian Monetary Authority (PMA) independent from the limitation and dependencies of Israeli Central Bank, that were indispensable for the survival of Palestine economy (Awartani, 1996).

4.4 Dealings with the Foreign Currencies in Palestinian Economy

In general there are three currencies applicable in Palestine: USD, NIS and Jordan Dinar. Dollar is more famous because after the Oslo agreement that was between Palestine and Israel, Palestine received all the foreign aid in Dollar currency.

The flow of foreign currency impacts on the monetary system of Palestine in various ways. Some of them are discussed as follows (Mohammad. M, 2003):

- In a scenario when Palestine was already suffering from the challenge of lacking its national currency, transactions and exchange of national currency with foreign currency helped Palestine to generate revenue by investing in global market that enabled Palestine to fill its financial deficits.
- Since the last decay Palestine is using NIS and Dinar and established Jordanian and Israeli Central Bank, which successfully generate high revenues.
- Use of various foreign currencies led Palestinians to nominate different goods. As a result, real economy changed and affected the Palestinian economy negatively.
- Dealing in foreign currency exposed the Palestine economy to Israel and Jordan policies. Thus, the inflation can be observed.
- Decline in the value of Israeli Shekel reduced the purchasing power for Palestinians. In 1988, Jordan Dinar struck out from the economy resultant and people lost their savings.
- Use of different currencies in Palestine, influenced adversely the Palestinian economy. They didn't have any choice except to use the opposite political policies.

Chapter 5

ELEMENTS OF ISSUING THE PALESTINIAN NATIONAL CURRENCY

In order to issue the new currency, Palestine Monetary Authority was required to define some basic principles that would be based on the role of economics and politics. These basics were supposed to act as stimulus to push the national currency towards the consistency and stability, because the stability value of currency is a greater challenge than its issuance.

There are seven elements that should be considered by the Palestine Monetary Authority to maintain the stability of the new Palestinian national currency. They are as follows:

5.1 Independence of the Palestinian Monetary Authority

The economy of every country is directly linked with its political stability and its major constituent that can accelerate or slow down the economic activities. Palestine economy also depends on this factor, and faces the challenges because of its fluctuating political situation. However, it’s a controllable factor that politicians may use in their favor by boosting or busting the economy before the election despite the long term consequences. The central bank also gets affected by this situation. Hence, unbiased personnel consider it as susceptible body and move violently to build as independent of all the influences. This independence does not limit the sovereignty of the operation and management. The economist agreed on the following aspects that they are essential for the real independent economy:

1. Legal Independence:

   Legal bodies have accepted the significance of the independent central bank from all over the world but in a democratic state, independent central bank must have boundaries to some extent and they are liable to consider the commands of government or legal authorities. This situation affects its sovereignty badly. Therefore, central bank should be free to take its decision regardless getting affected by the legal issues and authorities.

2. Independent to set its target:

   To work as an independent body central bank should have authority to formulate its policies, make itself a separate entity and independent target without considering any other factors. Independent target can be an inflation targeting, control of the money supply, or maintaining a fixed exchange rate.

3. Independent to execute its operations:

   The central bank should be independent to set its strategies that convert its plans into action. It should also have authority to decide the type and the time of the instrument to be used.

4. Independent in Management:

   The central bank of Palestine should authorize to run its own operations (appointing staff, setting budgets, etc.) without the excessive involvement of the government. The other forms of independence are not possible unless the central bank has a significant degree of management independence.

The ideal monetary authority for Palestine can be the one that each and every effort is for the development and stability of monetary policy by implementing the above points that ultimately strengthen the process of investment and currency value management. In this way, Central Bank cannot only deal with the amount of money in the market but also professionally supervise the banking system without being subjected to different policies. All this process can ultimately impact the Banking System of Palestine.

5.2 The Existence of a Strong and Effective Banking System

Stable financial system is the one in which financial intermediaries, markets and market infrastructure facilitate the smooth flow of funds between savers and investors, and also the path of economic activities and growth.

The existence of a stable and effective banking system in Palestine is essential before the issuance of the national currency. This requires the Palestine Monetary Authority to ensure that necessary measures are taken into account and by creating an adequate system to deal with banking risk and large capital flows. It includes the enactment of the laws, strict regulations, supervision and continuous follow-up of Public Banks by the Palestine Monetary Authority.

5.3 The Provision of a Sufficient Cash Reserve from Foreign Currency

Palestinian National Authority requires doing adequate safety measures to manage the stocks and foreign currencies in order to support the issuance of cash-plan, and to ensure its stability against any danger or potential tremors. That factor may destabilize all the processes and its value.

In this situation, Palestine Authority has to exert in a more vigilant way to deal with the other currencies. The process of motivating the country people to use local currency as the sole legal currency left adverse effects, and rather than encouraging, they become dissatisfied. It also cause resultant capital leverage and unstable national economy (Fon, 2001).

By analyzing the relationship of dependent factors and their effects on each other it can be said that the Palestine National Authority should take safety measures and careful management of stock and foreign currency to support the cash-planned and to ensure the stability and meet any challenge that might destabilize the national economy.

Whereas the Palestine authority holds limited reserve, it has to manage a sufficient level of foreign reserve from international revenues. Moreover, careful management and allotment of the budget may lead to a state where it may appear as self-sufficient authority in terms of funds. But unfortunately it does not seem feasible to talk about the ground reality and analyze these elements in a scenario where the Paris Economic Agreement is there and the economy is in feeble situation.

5.4 The Presence of a Strong Economy Which is Able to Face the Shocks and Developments

To build a sound and effective economy, there are some areas that should be look through and satisfied first. These are presented as follows:

- Strengthen the productive sector of the economy.
- Full control on the border and the barriers.
- Trade should be free from any restriction, that will increase the export ultimately, and the demand of national currency will also increase.

These steps may lead to a surplus in trade balance or at least reduce the deficit in the Palestine economy. In general, this process will end up with economic recovery and financial stability in Palestine region.

5.5 Choosing the Right Exchange Rate

There are two types of exchange rate systems; namely the fixed and free exchange rate. The implementation of the fixed rate system minimizes the inflation and fluctuations in interest rate. This system needs full support from the foreign reserves. Free exchange rate system helps the economy to find an independent monetary policy and does not bound with the restrictions required by the first system.

However, there are some reservations about the implementation of this system in Palestine because it cannot maintain the local interest rate against the international interest rate as well as it requires sufficient reserves to support the new currency. Therefore, there will be few benefits of issuing the new currency. According to the above points, Palestine should choose the fixed exchange rate system, and gradually get rid of it to achieve the free exchange rate system after completing the requisites (Fon, 2001).

5.6 Institutional Framework "Currency Board"

The institutional framework means establishing the Monetary Board that oversees the process of issuing the Palestinian currency and chooses a currency that the Palestinian currency can be linked with taking the following into account:

To set up fixed exchange rate between the currency of the state and other customary or supportive currency, automatically convertible into another currency which means the right to exchange the local currency into other currency at a fixed exchange rate as desirable.

The Currency Board should be characterized by transparency and clearance. There is a consensus that when the conditions are appropriate, it is possible through the Monetary Board (whether it is independent or follow the Monetary Authority) to oversee the issuance of Palestinian currency and connect it with a stable currency such as the dollar. However, according to the economists, in the case of countries where economy is exposed to challenges, risks and potential risks, this leads to the inability of the central bank to carry out its mission as a last lender to the banks that are facing difficulties. In this way the Central Bank’s role to provide emergency fund may also be affected. Furthest, one of the criticisms to the Currency Board is the lack of its ability to apply the monetary policy that contributes in stability of economic system, as well as its inability to response rapidly to market reserves "expansion and contraction."

It elicits the system to keep enough foreign currency through the central bank, which can be provided through the donations from abroad or national balances in foreign currencies (Fon, 2001).

As for the practical experience of this system, Jordan followed the Monetary Board System during the period (1926-1964) through linking the Jordanian Dinar with Sterling Pound which had a good impact on the monetary stability and high growth rates.

The international efforts were collected to support the monetary and economic stability in Jordan for more than one reason. However, the question that arises is that if it is possible to take the Jordanian case as a basis for comparison? In other words, is it possible to gather the Arab and international efforts to find a stable Palestinian currency and an effective national economy?

The World Bank considers this system in the Palestinian case (the system of connecting currency that will be issued in dollars or any other convertible currency). There are features that make it a convenient choice for the Palestinians. The most important things in favor of this system according to the international banks are:

- Easy management and rapid creation of this system.
- The ability of this system to create the fiscal discipline.
- Getting revenue proceeds from the issuance of the national currency.

The possibility of developing this system to a more flexible system for the development and growth of the national economy, the development of the banking system will be sound and effective (International bank, 1993).

5.7 Effective Coordination between the Fiscal Policy and the Monetary Policy

Monetary and fiscal policies are both considered as the keys of the economic components through which a country can access to the overall economic objectives into an open market. The stability of Monetary and inflation rates is essential to achieve the economic growth requirement and the equal distribution of income. Monetary and fiscal policies are responsible to administrate and manage the monetary issuance, interest rate, legal reserve ratio, open market policy, public spending, and tax and customs system. Financial and monetary decisions are directly correlated to each other and it might not be wrong to say that they are affecting each other vice versa while the other factors, which are political, economic and technical, should be available and remained same. The following are the constituents that have a vital role in the perfect blending of Monetary and Fiscal policies.

5.7.1 Public Spending Policy

Palestinian Authority might way out to cut down the public spending in order to reduce the inflation and recession, as public spending is a part of a fundamental demand. In the Palestinian case, the situation can be said to be more difficult, particularly when economic and financial decisions are imprisoned to political and social developments. Accordingly, it is necessary to follow a public spending that is generally more balanced and based on local and self-sources of income. For the sake of stability of Palestinian exchange, the Palestinian fiscal and public spending policies strive hard together and their aim is to achieve the overall balance in expected economic and social objectives and not to use monetary issuance as the only way to finance the public expenditure and developmental expenses.

5.7.2 Tax and Customs Policies

The real facts of Palestinian situation depicts that it is impossible to use the tools of tax policies and customs except for the income tax and property, because of the commitment to the Paris Agreement of economic as well as the accumulated deficit in the trade balance. Tax burdens on the Palestinian economy arrived at its best levels in the period of 1999- 1998. It was nearly about 25% of GDP, which is a very high percentage in comparison to any other situation. It cannot be added to the public expenditure fund without any negative impact on the price levels and exchange rate. Therefore, there is a difficulty in maintaining the stability of currency exchange rate, which is one of the most important targets (Alawna, 1999).

5.7.3 General Budget

General budget is one of the most important reasons affecting the stability of the exchange rate. The existence of a surplus in the budget reflects in financial procedures such as reducing tax rates and increasing spending or other which helps with the stability of the currency exchange. However, when the deficit occurs, especially the accumulated deficit, in such case, the government should make actions to reduce the deficit, which means a negative impact on the budget in the following years. This leads to the instability of the currency exchange and access to the expected economic objectives, especially if the government resorts to printing additional quantities of money.

Accordingly, it is necessary to depend on a balanced budget annually and to keep the deficit in case of necessity so that it does not exceed 3% -5% of the total budget (Makhool, 1998).

Chapter 6

IMPORTANCE AND WARNINGS OF ISSUING THE PALESTINIAN NATIONAL MONETARY

6.1 The Importance of Issuing Palestinian National Currency

As it is discussed earlier, economists believe that currency of any state represents its sovereignty and independence. Thus Palestine's national currency also has profound significance in autonomy and economic development. It also helps to achieve several economic gains such as a sound Palestine monetary system may decrease the dependency of Palestine on the Israeli economy. Therefore, the following characteristics need to be considered in regards to issue the Palestine National Currency:

- A sound monetary system impacts positively the economy and state in several aspects. An affective monetary policy may result to act as resistance against the inflation, reduce the unemployment rate, and promote the investment opportunities by reducing the business cost. It also contributes in the improvement of the financial system and enables a country to make free choice to choose and adopt the exchange rate. Economic growth and financial stability will appear as its consequences.
- Issuance of the new currency caused the failure of Palestine National Authority but also reduced the accumulated losses. On other hand. Issuance of the new currency offers numbers of benefits for the government as well; one of them is called "Seignonrage", which illustrates the profit made by a

government by issuing the currency, especially the difference between the face value of coins and their production costs. The Economic Policy Research Institute (MAS) and the World Bank estimated the losses to two percent to five percent of the total Palestinian GDP annually. The use of Israel Shekel in Palestine reduced the direct loss that is estimated about five hundred million to six hundred million dollar in a year in addition to the indirect losses which were estimated more than the direct cost.

According to the above scenario, the reason behind contracting the use of Israel Currency by Palestine National Authority, when it completely had been diffused in all economic system, is completely clear. This decision actually produced the following benefits and losses in favor of Palestine:

1. The falling in the Israel's currency can cause a rise in prices of goods, especially the imported goods from Israel that increased the burden on the final consumer of Palestine. On the other hand, Palestinian imports get affected by the exchange rate when converting NIS to other currencies to cover the imports process.
2. The falling in the Israel's currency also influenced the Banking sector of Palestine and caused numerous impacts, which include credit facilities provided by NIS. Moreover, it caused an impact on banks and disturbed their financial balance defined by NIS. In regards to this scenario, Banks started to keep their savings out of Palestine, which also damaged the economic situation of the country. In period of economic fluctuation it was trend to invest their saving in stable currency which created chaos in exchange rates market. Statistical data shows that the 90% of Palestinian nation had begun to

deposit their savings in Jordan banks. Thus, in accordance with the need of Jordan, those deposits got invested in Jordan banks rather utilizing for the development of Palestinian economy.

3. The unwilling attitude of the importers towards sustaining and increasing the import of Palestine created a situation of sky-scraping inflation and recession, same as reluctant behavior of consumers towards their national products sabotaged the economy and market activities of Palestine.
4. As Shekel (NIS) was used in all the commercial activities, it increased the cost of loans for borrowers when they lend money in Dollar and Dinar because they had to pay high value when they paid back in Dollar and Dinar.

6.2 Challenges in Issuance of the Palestinian Currency

It is a grand challenge for Palestine to issue the new currency especially in a situation when Palestinian has lost their confidence over their national currency, and this knot doesn't limit the loss of confidence in fact it was tough an obligation to restore and build their confidence again.

The most significant threats and concerns about the Palestinian Monetary are mentioned below:

- If Palestine National Authority can't manage the pressure of challenge and in excitement print excess banknotes, it will further increase the expense compare to revenue. As a result inflation may increase and further will become a reason of diminishing value and credibility of currency. The currency value is determined by its purchasing power; as much as the consumer buys goods and services by a particular unit of that currency. It is clear that it is inversely associated with the level of prices in the country. If there would be "inflation", the currency will decrease its value rather than reduction in prices of goods and services (Mohamad. N, 1999).

- Lack of confidence over new currency can crash its value. Some people also believe that the Palestinian currency probably will not gain the public acceptance because of the abiding separation between Gaza strip and West Bank. Further its inability to insure the required reserve which is necessary specification, may also lead it on to distressing situation.
- Inflation is the main concern of the Palestine economy in a circumstance when its national currency was absent and it deprived from the appropriate monetary policies. The reason behind the growing inflation is that Israel Central Bank uses its monetary policies to handle the economic situations. Hence, there is doubt to fall in inflation trap, which may lead to decrease the value of the new currency.

For the issuance of new currency in Palestine its obligated to determine the necessary elements such as a well-designed and stable economic environment. An effective Banking system and most importantly resources possess excellent skills and knowledge to maintain the progress and the stability of the economy. Those resources should also assure the requirements to retrieve the benefits from the new currency and decrease losses, threats, and cost that are directly engaged with the issuance of new currency.

Chapter 7

RECOGNIZING THE ROOT CAUSE OF IMBALANCE IN PALESTINE MONETARY POLICY

7.1 Introduction

To find the actual root of declining and the current situation of Palestine economy, deep different factors are required to be discussed. This in depth study makes it possible to formulate some hypotheses that might be the reason of the disturbance of Palestine Monetary Policy.

This chapter is designed to test those hypotheses on the basis of qualitative research which is made by careful analysis and keeping eye on every element to associate this issue.

7.2 Arguments Review

The following hypotheses are derived after a careful analysis of literature, history, facts and circumstances:

1. Paris Economic agreement is an obstacle for Palestinian authority for the issuance of new currency.
2. Palestine monetary authority is inadequate to sustain economically and to issue new Palestinian currency.
3. Palestine authority is incompetent to use fiscal and monetary policy tool because it is dependent on Israel's economy.

7.3 Argument 1

In April 1993, an agreement classifying the requisite economic activities was done by the West Bank and Gaza Strip was formed and called as "Oslo Agreement". This agreement provided a framework. According to the agreement Israel had right to empower the land, labors, cultivation system, tax policies, tourism and other industries in Palestine. This framework also authorized Israel to cover the external borders and nearby districts of Palestine under its control.

In September 2000, just after seven years of the implementation of Oslo Agreement, Israel took possession of thousands of acres land in the West Bank and Gaza Strip with intentions to expand the resolutions and build new roads by using it.

In 1994, another agreement known as **"The Paris Economic Agreement"** was made. It can be said that it was the worst agreement ever in the history of Palestine. In this agreement Palestine was totally ignored in case of its empowerment over the occupied areas. According to this agreement, Palestinians were elicited to formulate economic development strategies. Thus, Palestine had to rely on Israel in these matters.

In regards of the above factors, it can be concluded that "The Paris agreement came into existence to empower the Israel and also to impact Palestine economy but in negative manner" (International Journal of Business and Management, 2010).

7.4 Argument 2

Palestine is graced with every blessing of God, but the prolonged slavery and discrimination, fluctuating political situation and economic issues has brought their morale down. In exposure to all that challenges Palestine Authorities are still working hard to come out from this situation to prove them as an independent nation.

7.5 The Achievement for the Palestine Monetary Authority

World Bank praised the performance of Palestine Monetary Authority in such words: “ The World Bank praised in report the performance of the Palestine Monetary Authority (PMA) saying the Palestine banking sector continues to show good performance under the supervision of the PMA, which continues to strengthen its institutional capability and build the required capacity for the establishment of a Palestine Central Bank”. (Ramallah, 2012).

Palestine Monetary Authority do their best hard to sustain the economic situation of Palestine by formulating the fiscal policy, exchange rate system, budget and other economic tool very carefully to resist against the obstruct element in environment.

In the beam of this research and studies it can be concluded that Palestine Monetary Authority is adequate to carry out a smooth economy and to issue New Palestine Currency, but it depends on Israel and having number of challenges in a way of right practice.

7.6 Argument 3

Israel hooked up the West bank and Gaza Strip in “Six Days War”, and during this period, Israel military authority signed a series of military orders to imprison the residents of occupied areas. These military orders spaced out the connection between the occupied areas and the external world. This act actually turned the Israel towards raise in its supplier, in production and in other daily necessities.

In occupied areas, 90% of all the goods were imported only from Israel, although Israel was charging a huge amount of tax on commodities produced by other sources. This situation let down the Palestine trade with other countries and made Israel its sole trading partner. On the other hand, Israeli goods were trading off to the West Bank and Gaza Strip free of cost but trade from Palestine to Israel got stopped. Meanwhile, Palestine got forbidden to carry their business license for manufacturing and other business activities in the districts. Israel has also confiscated lands, settlements, and water in rural areas. Due to these all troubles created by Israel, many Palestinian started to enter in Israel for earning, and by this way Israel got the cheap labor for their production and business.

In period of 1978 to 1988, Palestinian economy faced a serious fall down. However, Israel succeeded in adjusting the economic infrastructure in the occupied areas and increased the dependency of Palestine economy on the Israel economy.

7.7 Graphical Comparison of Outcomes

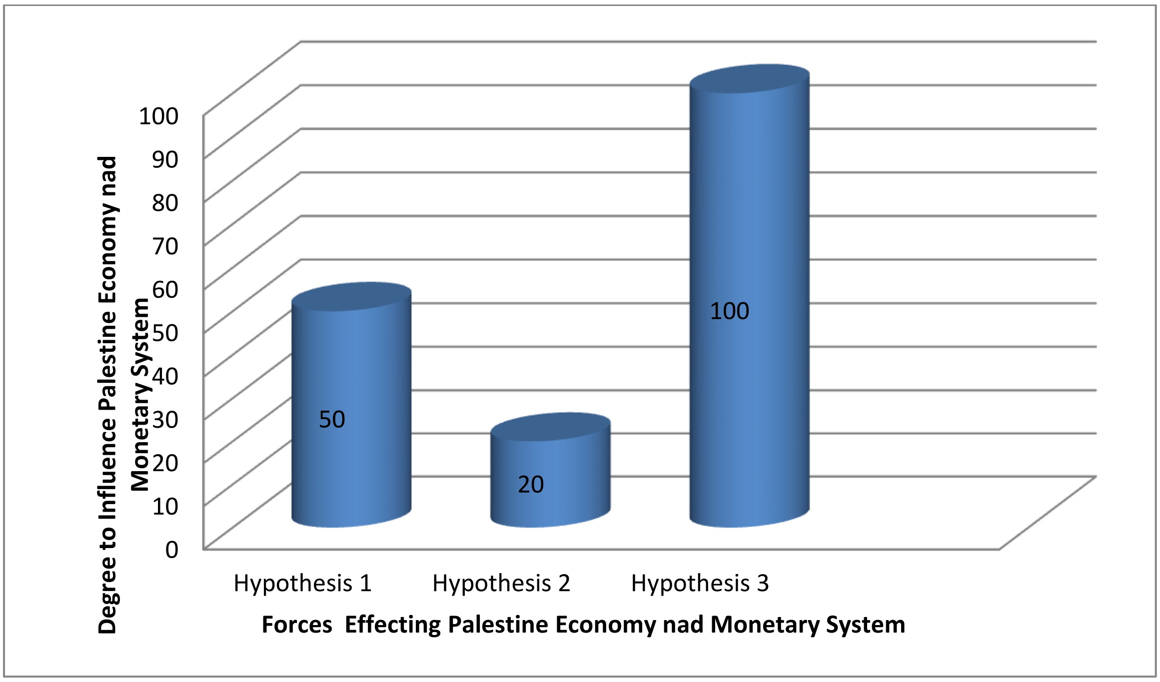

Figure 7.1: Comparative Analysis of Impact of designed Hypothesis on Palestine Economy

7.7.1 Graph Interpretation

This graph gives an apparent view to understand the major root causes of declining the economy and the monetary system of Palestine. X-axis basically represents the forces that influence the performance of Palestine economy and Y-axis rates their degree of influence.

According to the results, it can be said that Hypothesis 1 can be rated to 50 percent contributor in the current situation of Palestine Economy and Monetary System.

As Palestine is bound under number of agreements that are made to facilitate only Israel, so this leap of obstacles would be rated as 20% to Hypothesis 2. Therefore, it is not prevailing situation to judge the capability and competency of Palestine Monetary Authority.

The whole research leads to this conclusion that “The Palestinian economy is completely lying upon the Israeli economy. It’s not just their dependence on Israel economy that the sole reason of their failure, but the way they are following free-market economic policies blindly also caused hurdles such as the inappropriate investment routes, disorganized structure, serious reflux of the social funds, subject to the Israeli economy and ever more sharp polarization and corruption in the way of development of Palestinian Economy”.

Therefore, Hypothesis 3 can be rated to 100% for making intervention of Israel in Palestine Economy 100% responsible of its feeble situation of economy and monetary system.

Chapter 8

CONCLUSION AND RECOMMENDATIONS

By analyzing the history and present circumstances of economy of Palestine, it is strictly recommended to issue its own national currency for the sake of its independent identity and to sustain its economic situation. At the same time it is a huge responsibility to issue a new currency especially in a scenario when they are dealing with numerous challenges, from political instability to scarcity of reserve, dependency on Israel to Paris Economic Agreement.

The decision of issuance the new currency must be taken after investigating all the aspect and challenges and by considering the follow up of this decision. The fundamental aim behind this decision is to develop the trust and credibility over Palestine and to stable the economic condition and purchasing power of consumers. To maximize the outcomes of this decision Palestine has to move and plan carefully and, by reducing the risks and cost associated with new currency issuance they can secure their objectives.

Before jumping on the next phase to issue new currency it is essential to consider the following basic requirements:

- Establishment of a strong national economy which must be able to cope with any uncertain situation.

- Palestinian Monetary Authority’s subsequent institutional frameworks that belong to the executive branch should be independent. They must work in coordination to achieve their goals and objectives.
- Banking system must be secure and effective.
- Adequate amount of cash reserves in foreign currency should be there.
- Careful selection of appropriate exchange rate system and the institutional framework should be in favor of the privacy of the Palestinian case.
- The coordination among the Monetary Policy and Fiscal Policy must be finest to ensure the monetary stability with reference of macro-economic policy.
- Palestine has to build a friendly relationship with the central bank in Arab countries, so it may gain potential support and the local dimension of issuance of currency will lead to broad vision.
- Palestine should gradually to get rid of the Israeli economy and its interventions.
- Adopt globalization but meet the challenge only facing reality.

The issue of what can be done by the Israeli side to hinder the issuance of the Palestinian Monetary or hurt it in the future should be taken into consideration in order to flop the Palestinian economy in general and the Palestinian speculative currency after its issuance.

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