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DEVELOPMENT
POLICY AND
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THE OPEN UNIVERSITY

FINANCE AND MONEY WITH UNDERDEVELOPED
BANKING

by

Laurence Harris

DPP Working Paper No. 2

**Faculty of Technology
(Third World Studies)**

The Open University

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When the West Bank and Gaza were occupied by Israel in 1967 one of the first actions of the new administration was to demolish the existing Arab financial and monetary institutions. In the West Bank, for example, the earliest Military Orders closed the 31 branches of Amman-based and other banks, imposed the authority of the Bank of Israel over all banking matters, made the Israeli shekel legal tender (jointly with the Jordanian Dinar) and imposed Israeli foreign exchange controls.⁽¹⁾ These actions to repress Arab financial institutions and to exercise Israeli authority in areas formerly controlled by the Central Bank of Jordan have had profound effects on subsequent financial and monetary conditions in the Occupied Territories and, through them, on their 'real economy' (in the sense of real saving, investment in physical capital and growth).⁽²⁾ There is, however, little systematic knowledge of what those effects on the monetary and financial system have been. In this paper I consider some aspects of them. In Section

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1, I describe the monetary and financial system that does exist; in Section 2, I outline an existing theoretical framework for analysing 'financial repression'; in Section 3, I relate the occupied territories' experience in that theoretical framework and examine the problems of money and finance in the West Bank and Gaza.

1 The Operations and Institutions of the Financial System

The Occupied Territories' financial system is built around a number of distinct institutions and agents:

- (a) Arab Money-changers have a key role for the whole system. Their operations, which are largely illegal but not generally repressed, are relevant for the internal transactions of the economies but are most significant in the relations between the Occupied Territories and other economies.
- (b) Branches of Israeli banks which are (almost) the only legal banks in the OTs.
- (c) Permitted Arab financial institutions of which the most significant is the Bank of Palestine (in Gaza).
- (d) Merchants and landowners who provide agricultural credit on an unofficial basis.
- (e) Finance emanating from Amman.

Although these institutions have distinct characteristics they are partially linked in an interdependent financial network.

This chapter describes and analyses each in turn.⁽³⁾ In this analysis, a distinction is made between monetary activities and financial

intermediation. The former involves dealing in money - foreign exchange dealing, transfer of funds, clearing of cheques etc. - whereas the latter refers to borrowing and lending. The two may overlap in practice but remain distinct in principle. In this chapter the institutions concerned with giving grants are not described except to the extent that grant finance overlaps with credit and financial intermediation.

1.1 Money-changers

Money-changers operate in every town in the Occupied Territories with, in most cases, a shop front, kiosk, or counter which carries out the most obvious part of their work, the exchanging of one currency for another. All engage in foreign exchange dealing at this level, but the most important fact is that many have also developed a wide range of banking functions. They operate as banks (or constrained or embryo banks) by taking deposits, transferring funds, clearing bills and cheques and giving loans.

There are, however, different types of money-changers. They differ according to whether they are located in the West Bank, Jerusalem or Gaza; whether they were established before 1967 or subsequently; whether they concentrate wholly on financial transactions or combine these with commodity dealing. Those which have in effect developed into banks are the largest; they were established before 1967, are based in the West Bank or Jerusalem, and generally hold only financial assets rather than non-monetary commodities. To analyse their significance I examine each aspect of their business in turn.⁽⁴⁾

1.1.1 Currency Exchange

Exchanging one currency for another is the foundation of the Money-changers' business. It has flourished particularly because they disregard all exchange controls and are therefore able to buy and sell foreign exchange to Israeli citizens, residents of the Occupied Territories, and others, all of whom have been formally constrained by Israeli or Jordanian exchange regulations to varying degrees at different times since 1967. A second reason for the money-changers' strength as foreign exchange dealers is that the high rates of inflation in Israel during the early 1980s gave rise to a situation where the shekel price of the US dollar in the money-changers' free market generally diverged significantly from the official rate and thereby attracted much foreign exchange business to them.

As far as pure currency exchange is concerned, money-changers deal principally in cash with some business, especially in tourist areas, in travellers' cheques. But because this business is linked with their wider banking role, currency exchange also involves receiving and disbursing debits (cheques and drafts) on the bank accounts of customers and money-changers in Amman.

The most substantial part of currency exchange is illegal in terms of the occupying authorities' law. Authorized money-changers in the West Bank are permitted to buy and sell the two currencies which are legal tender there, the Israeli Shekel and the Jordanian Dinar but transactions in US Dollars, which are a major element, are illegal as are transactions in other currencies. In Gaza, even the exchange of shekels for dinars is illegal for money-changers. In East Jerusalem where Israeli foreign exchange regulations are considered to apply to

the annexed city, unlike the West Bank and Gaza, there is nevertheless a position more like the West Bank regarding the ability to deal in J.Dinars because of a commitment at annexation to permit the continuation of pre 1967 activities. In fact, however, the illegal currency dealing of the money-changers is not normally prevented by the occupying authorities. But they do use the position of tolerated illegality to take action against money-changers either on an arbitrary basis or in connection with Israel's macro-economic policy. Examples of the former in recent years include the temporary arrest in Nablus of the West Bank's largest money-changer, and the confiscation of U.S. Dollars from time to time (one such incident is said to have occurred in Jerusalem in summer 1985). An example of the latter was the temporary closure of the open transactions in dollars of Jerusalem money-changers when Israel tightened its monetary policy and foreign exchange restrictions (although examples exist of transactions continuing through clandestine arrangements at that time).

Money-changers determine their own exchange rates taking into account local market conditions and current and expected conditions in the foreign exchange markets of Europe and elsewhere. The current exchange rates on the world's foreign exchange markets provide the benchmark for the money-changers' daily rates but the latter diverge from them in response to two forces: expected changes in the world's market rates and the current balance of demand and supply for individual currencies in the local market. The system by which large money-changers set prices in line with these three forces is as follows. The day's exchange rate for spot transactions on international foreign exchange markets is obtained. Because under occupation, it is impossible for money-changers (in the West Bank at least) to obtain telex facilities or high

technology links to market information services they obtain the market rate from other sources, in particular the world radio services such as the B.B.C. The rates at which they buy and sell are then set at a premium (or discount) in relation to the international market's rates to anticipate expected changes in the latter over the next one or two days for that is the length of time it usually takes the large money-changer to transfer surplus funds to (or deficits from) the international centres. Finally, the premium (or discount) is adjusted in response to any large imbalances in the local demand and supply for currencies at those international rates. A common method by which money-changers take expectations and local conditions into account is to adjust their prices in the same direction as international market prices with a lag after a change in the latter.

In setting exchange rates the large money-changers determine their own spreads as well as premiums; the relation between their spreads and international markets' spreads is determined by similar factors to the above.⁽⁵⁾ Exchange rates for particular currencies, for example, between the Israeli Shekel and the Jordanian Dinar, are determined as cross rates in relation to their individual exchange rates vis a vis the US dollar. All exchange transactions are conducted without documentation or record keeping and, in contrast with foreign exchange purchases made by Israeli bank customers, without taxation.

Exchange rates are determined in this way by a small number of large money-changers. It appears that smaller money-changers follow their rates.

1.1.2 Money Transfers

The transfer of funds between the Occupied Territories, Amman, and foreign countries is integrally linked with the money-changers' currency exchange and has been so since before the Israeli occupation.

The largest money-changers have branches in the Occupied Territories, Amman and the Gulf. (Money-changers permitted by the Jordan authorities to operate in Amman are in two categories: those which are permitted to have foreign bank accounts, and those which, without such permission, can only deal in bank notes).⁽⁶⁾ In addition, they have a network of correspondents and agents which extends at least to the international financial centres in Europe and the U.S.A. These branches, correspondents and agents are the channel for moneychangers' money transfers. The transfers they make between centres outside the Occupied Territories (from the Gulf to Amman, or from Amman to Europe for example) are carried out through normal banking mechanisms debiting and crediting the moneychangers' accounts with banks there. But net transfers between Amman and the Occupied Territories take place by carrying or smuggling cash over the bridges, the crossing points into and out of the OTs. In general, there is a net flow into the OTs from Amman because the Occupied Territories have a balance of trade surplus with the East Bank. It is estimated that US\$170 million crossed the bridges into the West Bank in the 5 months from March 1985.

Carrying or smuggling cash between the OTs and Amman is the only way in which the money-changers can carry out net transfers between those places, for the occupation itself has broken the formal channels. Since 1967 it has closed all the branches of Jordanian (and other Arab) banks

formerly operating in the OTs, there are no relations between Jordan and the Israeli banks in the OTs, and Israeli foreign exchange controls and controls on the amounts of cash that can be carried across the bridges (controls that are tightened and relaxed at different times) give currency smuggling its role as the main means of transferring net balances between Amman and the OTs.

Only net balances give rise to cash movements between Amman and the OTs; money-changers in the Occupied Territories receive both debits and credits on Amman and only have to move cash to the extent that these are unbalanced. Thus, for example, a person in the West Bank wanting to transfer money from Amman will obtain the cash from the money-changer in return for a cheque on his or her bank account in Amman. If another person deposits an equivalent amount of cash with the money-changer for transfer to his or her account in Amman no cash need cross the border. In that example the transactions may be closed by the money-changer paying the first person's cheque into his account in Amman and (by unwritten agreement with the second person) instructing his Amman branch to pay a cheque from his Amman account to the second person's account. Alternatively, the money-changer may simply give the second person the first person's cheque (originally drawn in favour of the money-changer). In that case, if the standing of the person who drew the cheque is high enough, the cheque is sometimes passed on again in settlement of another transaction and, to a limited extent, therefore circulates as money.

Transfers between the OTs and Amman are an important feature of the Occupied Territories' monetary systems since Amman is in effect, the local banking centre for the OTs.⁽⁷⁾ But to a large extent the transfers effected by the money-changers are over a much wider area and Amman is a staging post. Much money transfer business emanates from

inflows from the Gulf and elsewhere to Amman, or to the OTs via Amman, as Palestine workers employed in the Gulf and elsewhere send their earnings as remittances to their accounts in Amman or to their homes. Similarly, money-changers handle the significant outflow of funds from families in the OTs to children studying abroad. And money-changers carry out many of the transfers that arise from the Occupied Territories' imports and exports.

The money-changers' role in transferring funds depends on the existence of a high degree of trust and confidence. Agreements are oral and undocumented and, in any case, would not be legally enforceable; an individual who gives the money-changer cash for transfer to his or her bank account or to a third party can only do so on the basis of trust, and equally the money-changer accepts cheques in settlement on the basis of trust. This requirement limits the money-changers' ability to expand or match the breadth that banks have in economies with similar levels of development but different political frameworks.

1.1.3 Deposits and Loans

The money-changers' money transfer activities give rise to financial intermediation which, although limited and partial, is similar to the financial intermediation banks carry out. That is, the large money-changers take deposits (borrow) and lend.

In its most basic form money-changers acquire the use of borrowed funds simply as a result of the time lag necessarily involved in transferring funds from one centre to another. Thus, when a person in the West Bank pays cash to a money-changer for it to be transferred to the person's bank account in Amman, the money-changer has the use of that money, interest free, for the time that it takes for instructions to be given

to the money-changer's Amman office and the payment made from that office's bank account into the person's bank account.

But money-changers also attract deposits more actively, paying interest on deposits in JDs and foreign currencies with them (although some depositors place funds with money-changers without requiring interest). In the third quarter of 1985 the interest paid on short-term JD deposits was between 15 and 18 per cent per annum at a time when Amman banks were paying 8.5 per cent p.a. For short-term deposits in foreign currencies large money-changers pay interest rates above the short-term interest rates on credits in those currencies on international markets; in the third quarter of 1985 they paid 2 per cent or 3 per cent per annum more than the international rates.

These high deposit rates are determined by competition for funds between different money-changers and banks. They would not be sustainable if the borrowed funds were used for lending in the organised international markets. In fact, however, they are used for two forms of more profitable business: providing funds for the activity of money changing and money transfer itself, and lending within the occupied territories themselves. Money changing and money transfer yields profits in the form of commission (which is between 1 per cent and 1.5 per cent on large transactions in notes) and spreads. Lending yields profits in the form of interest.

Money-changers lend short term at rates of up to 3 per cent per month for merchants and small businesses.⁽⁸⁾ The loan arrangements vary but none are based on formal documentation. One type of arrangement is for a money-changer to lend money to a merchant secured only by a post-dated cheque on Amman (dated 30 days later, for example) but that small degree

of documentation is the maximum. Money-changers' lending is mainly confined to thirty-day loans, but some loans for several months are given with repayment being by instalments.

1.1.4 Evaluation of Money-changers

Since the occupying forces in 1967 closed Arab banks in the West Bank and Gaza, money-changers have carried out many of the functions of banks. The largest money-changers, established before 1967, carry out a wide range of banking functions including currency exchange, money transfers, and borrowing and lending. Because of the undocumented character of their business and its generally illegal nature in terms of the occupying power's regulations, several functions of banks have not been developed by money-changers; for example, they do not issue letters of credit or take on contingent liabilities such as guarantees (although there is at least one recent example of a money-changer being willing to guarantee a client's credit).⁽⁹⁾ But currency exchange, money transfer, and borrowing and lending are simultaneously well developed and subject to severe limits, a combination which justifies money-changers being seen as 'constrained' or 'embryo' banks.

In currency exchange, the large money-changers in the Occupied Territories are the market makers and price setters for Israeli Shekels, Jordanian Dinars and US Dollars. In money transfer they transfer funds for clients in large and small amounts between the Occupied Territories, Amman, and the Gulf States, the US, Europe and other centres. And in relation to these transactions money-changers also accept deposits and make loans extensively. Nevertheless, the conditions of occupation set severe practical limits as well as formal ones to the extent to which money-changers can develop banking functions. The absence of a legal

authority for most money-changers' operations and the fear of both money-changers and clients that documented transactions of any kind will be interrupted by the occupying authorities leads to money-changers' transactions being undocumented and based on oral agreements. That, together with the impossibility of resorting to courts for legal remedies against default, means that their business depends on a high degree of trust and personal knowledge which acts to limit it.⁽¹⁰⁾

Large money-changers do compete with each other and their exchange rates and interest rates are constrained by this competition; each compete for business throughout the Occupied Territories (sometimes using the branches of Israeli banks to transfer funds to their own account from clients based in other parts of the Occupied Territories). But, although that competition exists, each money-changer's business is constructed around a network of clients who know and trust the money-changer's business honesty. Thus, clan relationships and historical business relationships play an important role in underpinning money-changers' business and therefore limiting its expansion. These relationships are only unimportant for transactions such as over-the-counter currency exchange where little trust is involved, hence small money-changers with little historical record have been able to proliferate since 1967 by confining themselves mainly to such transactions.

The importance of trust and personal knowledge rather than legally enforceable documentation severely limits the ability of money-changers, even as embryo banks, to meet the financial needs of Palestinian development. The risk in such transactions gives rise to high risk premia on interest rates which can hinder investment in working capital and fixed capital. And in the Occupied Territories even the relatively

high interest rates on deposits with money-changers have not enabled them to attract the small savings of peasants and others outside of their established network of clan-based or other relationships of trust. Indeed, many ordinary individuals who are not engaged in trade or handling large sums are unwilling even to take the risk of entrusting funds to money-changers for the transfer of funds. Thus, money-changers, ability to mobilise domestic savings as an element in economic development is severely limited by the risky environment.

1.2 Israeli Banks

After the occupying power closed the branches of Arab banks in the West Bank and Gaza, Israeli banks opened branches in the area. In 1982 there were 27 such branches.⁽¹¹⁾ They are not widely used by the Palestinian Arab population. Palestinians would choose only to accumulate bank deposits in Jordanian Dinars (which has been the strongest currency in the Occupied Territories) but are unwilling to do so partly because of the danger that assets held in Israeli banks may be seized and partly because of the tax charges imposed on the use of such accounts.

The branches of Israeli banks do not act as financial intermediaries within the Occupied Territories, in the sense of borrowing savings (accepted deposits) and lending them to businesses and people in the West Bank and Gaza. Thus, in 1984 only 8 per cent of these branches' total assets were loans to the public and these were either to Israelis or short term credit to Palestinian merchants. Instead of the deposits with these branches being part of a process of financial intermediation within the West Bank and Gaza, the banks act as a channel to invest the funds in Israel itself: in 1984 60 per cent of these branches' assets were deposited by them in accounts in Israel (and the figure was 70 per

cent in 1980 to 1982) with a further 8 per cent held in Israeli coins and notes.⁽¹²⁾ This policy of using the Israeli bank branches to channel funds to Israel itself reinforces Palestinian Arabs' unwillingness to use them.

Although they do not carry out significant financial intermediation within the Occupied Territories, and although a significant proportion of their business is with Israelis in the Occupied Territories, the Israeli bank branches do carry out two functions in the Palestinian economy. They transfer funds and clear cheques for Palestinians whose income is paid in I.Shekels (such as Palestinians employed by Israelis); and they provide facilities for Palestinian businesses' imports and exports.

Arranging guarantees and letters of credit is an extremely valuable service to Palestinian importers and exporters over which the Israeli bank branches have a monopoly since money-changers do not have the legal standing to be recognised by foreign banks in such business. From the banks' own point of view it is a significant and profitable part of their business and its significance has increased: the balance sheet item which incorporates these contingent liabilities rose from 14 per cent of total liabilities in 1980 to 25 per cent in 1984.

Nevertheless, Palestinian merchants state strongly that the Israeli bank branches give a poor service in arranging the finance of international trade. They quote many examples including banks' failure to arrange proper documents as agreed, and delays which lead to demurrage costs. Similarly they claim that the branches of Israeli banks provide an inefficient service in operating accounts.

Although the Israeli bank branches in the OTs as a whole have a monopoly of the lucrative commission business of formal financing of Palestinian

international trade, and although each branch generally has a monopoly of bank business in its own town their profitability is not assured. In the West Bank, the Israelis claim that branches have been operating at a loss (although some of the loss is attributable to foreign exchange movements); in Gaza, the Israeli bank branch (Bank Leumi) serving the important urban centre, Khan Yunes, closed on 1st May 1985 because it was loss-making. The occupying powers have used the Israeli branches' lack of profitability as an argument against permitting Arab banks reasoning that the latter would also be unprofitable. But the Israeli branches, low profitability stems from specific factors including both their inability to attract deposits on a large scale from Arabs for the reasons mentioned, and their failure to carry out financial intermediation and make profits from loans on the public.

1.3 Permitted Arab Financial Institutions

The occupying authorities have permitted some Palestinian Arab financial institutions to operate including the Bank of Palestine Ltd., (Gaza), and an Arab insurance company (West Bank). Money-changers are also formally approved by the occupying powers but since the main part of their activities are not formally approved (and not all money changers have approval) they are treated (in Section 1.1) as quite different from permitted Arab institutions.

1.3.1 Bank of Palestine Ltd

The Bank of Palestine is an Arab owned and managed bank in Gaza.⁽¹³⁾ It was established in 1960 and began operations on 13 February 1961 with a capital of LE 500,000. It was closed by the Israeli occupying authorities in 1967 but it obtained permission to reopen for business in 1981. Negotiations to reopen the bank were unsuccessful until then, but

finally succeeded after the bank took its case to the Israeli High Court. The court rejected the objections of the occupying authority (which centred on the bank's use of the name 'Bank of Palestine') and ordered negotiations between the bank, the occupying authorities and the Bank of Israel (represented by its Examiner of Banks).

An agreement was signed in 1981 but since then it has not been implemented in full. Although the Bank of Palestine did reopen as a commercial bank in 1981 the agreement to permit operation of 'normal banking business' was abrogated even before the opening, for the authorities prohibited all foreign exchange business. Thus, all the bank's business is in Israeli Shekels, although customers' loan repayments are indexed to the US Dollar, and Egyptian currency is used as the unit of account for calculating the bank's annual balance sheet and revenue accounts. Moreover, the agreement permitted the reopening of the Gaza City headquarters and branch with a commitment to future consideration of re-opening the bank's branches in Khan Yunes and Rafah. In the event, permission has not been given for the branches, although the closure of Bank Leumi in Khan Yunes has left that town without any banking facilities and in that context, in September 1985 some citizens of that town signed a petition demanding permission to reopen the Bank of Palestine branch.

Operating under these restrictions the Bank of Palestine has remained small. Its total assets were LE 4,677,855 at the end of 1984. Its deposits and other customer accounts (LE 3,230,753) were less than three times the bank's equity in capital and reserves (LE 1,245,760).⁽¹⁴⁾ This is an extremely low ratio of deposits to capital for a commercial bank. For comparison, whereas the Bank of Palestine's ratio of deposits to capital was only 2.56, an accepted ratio in the USA is between 25 and

30.⁽¹⁵⁾ This indicates that by 1984 the Bank of Palestine had not been able to attract deposits to the extent that a commercial bank operating without the restrictions of occupation is able. Another indication of its inability to develop full banking functions is that it has not developed fully as a financial intermediary. In other words, it does not intermediate significantly between lenders and borrowers by lending a high proportion of the deposits placed with it; its outstanding loans in 1984 (LE 1,700,730) were only 36 per cent of its total assets while its cash holdings were high at 48 per cent of assets (70 per cent of deposits). More fully developed financial intermediation would lead to a proportion of those cash holdings being used for loans; for comparison; the Israeli bank, Bank Hapaolim held only 15.5 per cent of its assets in cash in 1984.⁽¹⁶⁾

One reason for both the bank's low level of deposits and its low proportion of loans is the prohibition on business in foreign exchange including Jordanian Dinars. Since the bank reopened, the high rates of inflation and devaluation of the Israeli Shekel have made it costly to hold bank accounts in shekels; since the bank can only take deposits in that currency, deposits with it are unattractive. Similarly, the restriction on foreign exchange business hinders the bank from lending to importers. And the depression of the Gazan economy under occupation restricts other lending opportunities.

The Bank of Palestine lends to industry, agriculture and other borrowers. All its lending is short term with a maximum term of 10 months and repayments by monthly instalments but the renewal of credit enables borrowers to obtain credit for periods of up to three years. The security taken for loans is three guarantees by persons (third parties) although it may require additional security loans of over US\$

50,000. Although the Bank of Israel's Supervisor of Banks advises the Bank of Palestine to take mortgages as security for a wide range of loans, the Bank of Palestine does not generally do so.

The Bank of Palestine gives loans to agriculture at an interest rate of 12 per cent per annum which is less than half the rate charged by Israeli banks. With the rate of inflation existing until mid 1985 this represented a significantly negative real rate of interest. The Bank of Palestine reasons that loans at 12 per cent are justified since the opportunity cost of these funds is only 8 per cent; the latter is the yield that could be obtained if the funds were placed in deposits at the Bank of Israel instead of being loaned.

The Bank of Palestine regards its agricultural loans as serving the development of Palestinian agriculture in Gaza⁽¹⁷⁾. Recent examples are loans to finance new agricultural ventures: a nursery and seedling producer (approximately US\$ 10,000); a rabbit farm, and sheep farms. And in 1983 the bank began to lend to citrus growers. Citrus production in Gaza has declined severely. Whereas the output through the Gaza Citrus Growers Union was 250,000 tons in the mid 1970s, it was 168,000 tons in 1980-81 and by 1983-84 it had declined to 146,000 before recovering to 161,700 in 1984-85⁽¹⁸⁾. The decline was due to many factors especially the obstacles the Israeli occupying power places in the way of exports; one factor is probably the absence of development finance for citrus growers, and the start of the Bank of Palestine's credit programme for citrus growers in 1983 was probably one contributory factor behind the recovery in 1984-85.

To summarize the Bank of Palestine's position, it operates under severe difficulties which prevent it from expanding and make it impossible for

it to develop properly either in the sphere of money dealing and money transfer or in financial intermediation (borrowing and lending). The prohibitions on foreign exchange dealing and on opening new branches (or re-opening old ones) have impaired the bank's development in each of these fields, and the obstacles the Israeli occupation has created for Gazan economic development in general have further hindered it by restricting the economic environment within which the bank works.

In addition the occupying authorities have taken direct actions to hinder the bank. For example, in July 1985, the Bank of Palestine attempted to increase (triple) its capital by selling 100,000 shares to the public. Although, according to its officials, it had complied with all the legal requirements, the military closed the bank on the day of public applications for the shares, posted soldiers at the door and erected notices warning the public not to buy shares. The authorities claimed that legal requirements had not been met, and the action had the clear but unjustified implication that Gazans should not have confidence in the bank.

1.3.2 ARAB INSURANCE

One Arab owned insurance company has been permitted to operate in the West Bank since the mid 1970s. Its principal business is general insurance, especially vehicle insurance to meet the legal requirements for vehicles, rather than life insurance. Its general insurance is secured by reinsurance in London.

Despite the low proportion of life insurance business, the company does carry out some financial intermediation by lending surplus funds. Its policy is to concentrate on short-term credit (as short as 30 days) but examples also exist of it giving medium term credit for up to three

years. Its interest rates vary from 15 per cent to 25 per cent per annum (19).

1.4 'Informal' Sources of Rural Credit

Peasants in the West Bank and Gaza have had access to short-term credit from merchants and landlords. To a very large extent this credit is organised around merchant and marketing operations. Together with any money-changers' credit to peasants these traditional sources comprise a network similar to the 'informal' or 'unorganised' credit markets that researchers have described in peasant societies throughout the world.⁽²⁰⁾ Short-term credit is connected to two uses which are distinct but sometimes overlap: seasonal credit to obtain inputs for the agricultural cycle, and consumption credit to obtain necessities in difficult times.

Merchants provide seasonal credit through a variety of relationships. Commission agents are a significant type in some areas; they are big merchants who sell the small farmers' produce on the wholesale market and take a commission as a percentage of their net sales.⁽²¹⁾ The commission agent supplies the farmer with credit in kind (seeds, seedlings, fertilizers and other inputs) and money at the start of the season as part of the arrangement under which he sells the subsequent crop for the farmer on the market. In one study of agriculture in part of the Jordan valley it was found that the commission agent's 'normal' profit came in the form of a 7 per cent deduction from the net proceeds of the farmers' crop, but it may have been increased by charging high prices for the inputs provided. (In other parts of the Jordan valley the agents' share is different). This transaction involves no separate interest charge for the credit; interest is implicitly incorporated as

one element in the total commission. However, delay in the commission agent recovering his loan leads to an explicit interest charge which may be as high as 30 per cent per annum on the loan. The arrangements between a farmer and commission agent are frequently incorporated in a written contract.

In many cases the Commission Agent is also the landlord. In other cases, absentee landlords renting to tenant farmers or to share-croppers also provide credit to these tenant farmers. (Until 1948, big landowners also accumulated large estates through lending to poor owner-cultivators to enable them to buy seeds and other inputs, taking land as collateral and obtaining ownership of the land after poor harvests led to defaults.⁽²²⁾ The present study has no information on whether land is used as collateral for rural credit in present circumstances, but the law since 1948 and the conditions of the military occupation have been against it.)

In addition to commission agents' credit to peasant farmers, a significant form of credit associated with marketing consists of seasonal loans provided by marketing co-operatives. In the West Bank 18 per cent of farmers belong to co-operatives.⁽²³⁾ The largest is the Jericho Marketing Co-operative, an organisation which has two main functions, certifying the origin of crops which are to be exported to Jordan (certifying they are not of Israeli origin) and providing seasonal credit for the production of such crops. Its funds for this credit programme come from finance provided by Jordan's central co-operative organisation: in 1984-1985 it received approximately 2 million Jordanian Dinars from this source and provided short term loans at low interest rates (interest rates as low as 3 per cent have been quoted).

The Jericho Marketing Co-operative's credit has not been sharply distinguished from grants or subsidies to its members for there has not been a strong management system of enforcing repayment in cases of default or delay.

A final element in the structure of rural credit associated with merchants and marketing consists of the village storekeepers who sell commodities for credit and give cash loans.⁽²⁴⁾ Their interest rates and conditions are not known, but in other countries such arrangements provide credit for people in great need at usurious rates.

1.5 Jordanian (East Bank) Sources of Finance

West Bank residents have access to some finance emanating from commercial banks, and official sources operating through investment banks in Amman. These reflect the historical political circumstances of the West Bank and E. Jerusalem in relation to the Hashemite Kingdom of Jordan and the Arab world's support for the policy of steadfastness in the Occupied Territories.

1.5.1 Amman Commercial Banks

Since the occupying power closed the branches of Amman banks in the Occupied Territories in 1967, the headquarters of these banks have continued to pay salaries to employees in the area.⁽²⁵⁾ The main function these employees can carry out, however, is to assist potential new customers in completing the documents and arrangements for opening accounts in East Bank branches and transmitting them. In some circumstances they also finance exports to Amman by paying the West Bank exporter locally in Jordanian Dinars and arranging for the Amman Branch to collect payment from the importer in Amman.

Nevertheless, many residents of the Occupied Territories have accounts with Amman banks on the East Bank but they have limited access to loans from this source. The Amman banks regard loans to residents of the Occupied Territories as relatively risky since they cannot be monitored easily and action to recover debts is impossible. They require a West Bank borrower to offer two or three guarantees from residents of the East Bank and that is a difficult condition for the borrower to meet, either because of lack of personal knowledge between communities on the East and West Banks or because of economic rivalry.

1.5.2 Housing Bank

The Housing Bank is a specialised Jordanian bank, established in 1974, to give construction loans to building firms and owners.⁽²⁶⁾ Its loans on the East Bank are mainly secured by mortgages. It also finances foreign trade and carries out foreign exchange dealing. The bank has a large branch network and retail deposits, including remittances from workers overseas, are its major source of funds.

On 20 September 1981 the Housing Bank and the Jordan Palestine Joint Committee signed an agreement to arrange facilities for lending to residents in the West Bank. Between September 1981 and the beginning of September 1985 the Housing Bank has arranged 2150 loans to the West Bank totalling JD 13,800,000.

The Housing Bank's loans to West Bank residents are of three types:

1. Construction Loans. These are up to a maximum of JD 7000 for a maximum period of 15 years with a 2 year period of grace before repayments start.
2. Construction Finishing Loans. These are up to a maximum of JD 3500 for 15 years.
3. Repair Loans. These are up to a maximum of JD 2000 for 20 years with a one year period of grace.

The Housing Bank is effectively acting as the administrative agent of the Jordan Palestine Joint Committee in channelling finance to the West Bank and the credit should, therefore, be regarded as an element in the policy of support for steadfastness rather than an aspect of normal, commercial financial intermediation. The finance for the Housing Bank's

loans to the West Bank is provided by Jordan's Central Bank rather than from the Housing Bank's own resources. The borrower arranges the loan through the Jordan Palestine Joint Committee which issues the authority for the Housing Bank to lend the funds. No interest is received by the Housing Bank. Although these loans are secured by guarantees from an East Bank employer or merchant the Housing Bank itself would not be willing to give credit to West Bank residents as part of its normal business as a result of the occupation. The absence of a branch network in the West Bank prevents it from having knowledge of borrowers or monitoring the credit; the occupation prevents recourse to the Jordanian legal system for contracts; and the occupying power's land appropriations prejudice the value of property as collateral.

1.5.3 Industrial Bank

The Industrial Bank was founded in 1965 and began operations in 1966 with the objective of financing industrial and tourist developments on a long term basis.⁽²⁷⁾ It also has special credit facilities for small businesses (for which the maximum size of each loan is JD 4000 and the interest is 6½ per cent per annum). It does not accept retail deposits.

At the beginning of the Israeli occupation in 1967 the Industrial Bank had approximately JD 450,000 of loans outstanding in the West Bank and nearly all that has not been repaid subsequently. In the present circumstances the IB is not willing to lend to West Bank residents as a normal part of its business because of the difficulty of appraising credit applications, monitoring credit use, and recovering debts under the occupation. However, the bank does lend money for West Bank projects, including hotel development, using funds placed with it for this purpose by the Jordanian authorities and allocating the credit in

accordance with the authorities' directions. In addition, the Industrial Bank is now to receive a European Community loan of 2 million ECUs (European Currency Units) for lending to small scale projects on the West Bank. All loan agreements with West Bank residents are secured by guarantee from persons on the East Bank.

2. Models of Financial Repression

In one sense, the Occupied Territories' experience is an extreme form of 'financial repression'. This concept has been applied by many writers to the financial systems of third world countries where the state has intervened in banking and finance to set interest rates, direct credit and regulate it in other ways. In these paragraphs I set out the basic framework of the theory that has been constructed around that concept to analyse the effects of financial repression in third world countries (the McKinnon-Shaw model).⁽²⁸⁾

The McKinnon-Shaw theory emphasises that financial intermediation can make a significant contribution to economic growth if the state permits it to operate in competitive conditions, in particular if financial intermediaries such as banks pay interest rates on deposits and charge interest on loans which reflect market conditions.⁽²⁹⁾ Third world economies are seen as having a capital shortage in the sense that there are many high yielding investment projects that entrepreneurs in agriculture, industry and other sectors wish to undertake but have been unable to because of uneven access to finance and a low level of national saving overall to generate finance. If financial intermediaries' interest rates were to reflect market conditions, this capital shortage would cause them to be high in order to attract scarce savings and lend them on to high-yielding projects, but financial

repression occurs when the state sets interest rate ceilings which frustrate this process.

The general character of financial repression, then, is that:

- (a) it restricts the growth of financial intermediaries (most significantly, banks) by preventing them from paying interest to attract increased savings into deposits;
- (b) restricting the interest rates financial intermediaries (especially banks) can charge to borrowers increases borrowers' demand for credit;
- (c) that discouragement of saving and encouragement to borrowing leads to an excess demand for credit (a reflection of capital shortage);
- (d) the state acts in this way in order to enable it to control the direction of credit, instructing the banks which sectors and firms should receive priority in the allocation of scarce credit, and providing finance for investment projects from public funds;
- (e) if the state were to lift or change its regulations, interest rates would rise which would lead to increased funds being channelled through intermediaries from savers to enterprises with investment projects and the high rates would ensure that they are directed toward high-yielding projects.

The Israeli authorities' regulation of the Arab financial system in the Occupied Territories may be considered as an extreme form of financial repression, but it does not have all the characteristics described by the general concept. Its most extreme element has been the closure of foreign Arab banks and the fact that the branches of Israeli banks and

the re-opened Bank of Palestine are (for different reasons) not able to act effectively as banks for the Arab residents. Thus, one writer notes 'the West Bank economy is virtually without a banking system' and 'this situation is almost unique'⁽³⁰⁾; and the position in Gaza is not very different. This restriction of the banks' activity is a much more extreme hindrance to financial intermediation than the limitations which the theory ascribes to interest rate controls. But, on the other hand the model's assumption that restrictions on the banking system have their counterpart in state control of investment funds is only partly true, for although the occupying authorities have administrative controls to refuse or permit any significant credits, they do not themselves disburse significant funds to finance Arab investment projects.

One of the strong implications of the financial repression concept is that markets for financial capital are highly fragmented; indeed, in McKinnon's treatment this appears almost as a central characteristic of financial repression and is paralleled by fragmentation in all aspects of the economy. Fragmentation means that credit does not flow freely through the economy, so that savings and finance in one area or sector stay within it even though higher yields may be available on investment projects in other areas.⁽³¹⁾ Fragmentation means that some borrowers have privileged access to credit while others have none and it is claimed that it exists in financially repressed third world economies because of three processes linked to the restrictions. First, the state is supposed to use its control of funds to favour particular borrowers (creating the possibility of corruption). Second, the banks (and other financial intermediaries) ration their scarce credit by favouring particular sectors, firms and individuals. And, third, the restrictions

on banking stimulate the development of informal and often illegal financial activities such as rural moneylenders which, by their nature, are local and based upon specific social groups. Fragmentation is one of the most significant aspects of the Occupied Territories' economies and particularly its financial system. In the absence of effective banking within the Arab economy or significant investment funds injected by the Israeli state, financial fragmentation originates from other sources. In the next Section I outline the causes of this fragmentation and the general relation between the financial repression model and the situation in the Occupied Territories.

Another implication of the theory of financially repressed economies is that where financial intermediation is restricted there is also a low demand for money relative to output and income or, in other words, a high velocity of money. In one version of the model this arises because the demand for money is highly elastic with respect to real rates of interest, so that if low or zero interest is paid on bank deposits (and zero interest on cash) the demand for money in those forms as an asset will also be low. Thus, interest rate restrictions on financial intermediaries reduce the demand for money since banks are the most significant forms of intermediary and the controls reduce the attractiveness of bank deposits. This effect is intensified by inflation for if nominal interest rates on money are low or zero, high rates of inflation make real interest rates negative. Its corollary is that if constraints on interest rates are lifted, the demand for bank deposits will rise and this increase in the stock of deposits means that the real stock of money increases in line with the expansion of the banks' financial intermediation.⁽³²⁾ In the Occupied Territories, too, there are grounds for thinking that there is a low demand for money and

low real stocks of money although the reasons are largely specific to the local circumstances.⁽³³⁾

3. Weaknesses in the Financial and Monetary System

The financial and monetary system of the Occupied Territories consists of a set of arrangements that have developed within the political and economic constraints of occupation. As a result they are underdeveloped compared with the financial and monetary arrangements of other poor economies, but, considering the severity of the constraints - the Israeli occupation authorities' opposition to any significant Palestinian financial and economic development - money and finance have been developed remarkably strongly in some directions. Nevertheless, the dominant aspect of the monetary and financial system is that its weaknesses are severe and make it unsuitable for the long-term development of an independent Palestinian economy. Its weaknesses also create a risk that in the near future the system will encounter severe problems even in continuing to service the Occupied Territories at the existing level. In this section, I consider the main weaknesses and relate them to the financial repression model.

3.1 Fragmentation

The dominant characteristic of the monetary and financial system is that it is accommodating. It has developed to finance the existing structure of the Palestinian economy, therefore it accommodates the patterns of trade and production that have arisen under occupation. One corollary is that unless appropriate changes are introduced the system cannot provide the financial basis for the development of an autonomous Palestinian economy. A second is that because the system is accommodating it is fragmentary in two senses.

First, it is fragmentary in the sense that the 'real economy' of Palestine is fragmented and the financial and monetary arrangements reflect this. Thus, the fragmentation of the labour force since 1967 has been centrifugal with an initially high level of net emigration of workers; the workers' remittances that resulted (accounting for an estimated 32 per cent of GNP in 1982)⁽³⁴⁾ have been a significant element in the growth of money-changers. Similarly, the obstacles to the integrated development of the domestic economies of the Occupied Territories have given rise to a high level of dependence on imports and exports and a high level of trading activity rather than productive activity; the operations of money-changers, banks and other financial agents are similarly strongly characterised by their relation to trade.

Second, it is fragmentary in the purely financial sense. That is, it is a segmented and divided system which, depending to a large extent on personal trust, is built on networks of personal relations. Currency exchange is not greatly fragmented since it requires little trust, but money transfer and borrowing and lending are, with the result that the scope for financial intermediation is limited. Thus, savings in one circle are not generally transmitted through the financial system to finance investment in another.⁽³⁵⁾

Now, the financial fragmentation is the outcome of two forces; first, it reflects and accommodates the fragmentation of the real economy and, second, it results from the specific policies of the occupation directed at repressing the Arab financial system. Both have stimulated the growth of informal monetary and financial arrangements such as those of money-changers and rural merchants (such as commission agents). In this respect, the financial fragmentation of the Occupied Territories is more complex than in the standard McKinnon-Shaw model, for in the latter the

fragmentation of the financial system is seen as the effect of specifically financial policies with a determining influence running from the financial system to the real economy: if financially repressive policies were ended, the model argues, the new cohesion of the financial system would bring cohesion to the real economy. In the West Bank and Gaza, by contrast, the restrictions on trade, production and social conditions imposed by the occupation ensure that even if Arab banking were allowed to develop, fragmentation would remain and the informal financial networks based on personal knowledge and trust would continue to have a role. (36)

Finally, in comparing the fragmentation of the financial system in the Occupied Territories with that described in the 'financial repression' model I have noted that in the former it does not originate in interest controls over local banks (for an effective banking system is prevented more directly from operating) nor from privileged access of some Palestinians to investment funds injected by the Israeli state (since such funds do not directly enter the Arab economy in any significant amounts). In the West Bank and Gaza the differential access to credit which is the mark of fragmentation relates to differential access to the networks within which money changers lend, borrow and transfer money; secondly it relates to state funds from the East Bank (both grants and the East Bank sources of credit identified above) for different social groups have different degrees of access to such funds for housing construction, seasonal agricultural credit, or industry.

3.2 Money holdings

These forms of fragmentation have the effect that the economy has had a distorted monetisation. In one sense the Palestinian economy is highly

monetised in comparison to other poor economies, for a very high degree of agricultural production is for sale rather than subsistence; a high proportion of personal income comes from working for money wages (locally, in Israel, in the East Bank, or elsewhere); and foreign trade for cash is a high proportion of economic activity. Moreover, residents of the Occupied Territories have a high degree of familiarity with dealing in different currencies (Israel, Jordanian, US) and using shekels, dinars and dollars as units of account. But this high degree of use of money is distorted in several senses. It is not generally associated with large holdings of money within the Occupied Territories; it is not associated with a high degree of financial intermediation; there is no single monetary standard.

There are no reliable estimates of the stock of money in the Occupied Territories and none can be produced without major fieldwork. But on the basis of a priori reasoning and casual evidence it is possible to reach some judgements regarding it. On balance it appears that holdings of money balances (in real terms, in terms of the goods they can buy) are lower than would be expected for another country with similar GNP.

Both demand and supply factors have to be considered in reaching this judgement, but the initial problem is to define the money supply in the circumstances of the OTs. Here, it will be defined as cash, demand deposits in banks and time deposits in banks owned by residents of the Occupied Territories. Since three main currencies are in use, the definition should include cash and deposits denominated in Israeli Shekels, Jordanian Dinars and US dollars. No firm principle can establish whether the definition should include bank deposits held in Amman, in Israel (excluding East Jerusalem) or in foreign centres elsewhere.

The most crucial determinant of money holdings in the OTs is the demand for money. Partly because there is no state authority or control bank with a monopoly of the money supply or control of it and since capital flows into and out of the OTs directly relate to cash flows the nominal stock of money in the OTs (or defined to include deposits in Amman) is generally demand determined. However, there are periods when these demand forces are thwarted by exchange controls, increased regulation of cash flows across the bridges, or other interruptions. Thus, at times there may be an excess supply of money in the OTs (or an excess demand); the central bank of Jordan believed at one time that there was a danger of an excess supply of money ('a liquidity overhang')⁽³⁷⁾ in the West Bank itself but considers that this was gradually eliminated between 1975 and 1982 by increased capital flows from the West Bank to Amman.

There are strong reasons for thinking that the demand for money, and hence the amount of money held by residents of the Occupied Territories is low compared to other economies at similar levels of development. The factors influencing the demand for bank deposits and those behind the demand for cash are best considered separately, but in each case the relevant consideration is the attractiveness of this as compared to other assets such as jewellery, land and housing and, as with all forms of money a major element in that is its liquidity. Bank deposits with Israeli banks are relatively unattractive partly because of the difficulty of operating Dinar accounts with them and the rapid depreciation of Shekel accounts until mid 1985, but mainly because of the danger that the Israeli authorities may freeze or confiscate such deposits as a political act. Bank deposits in Amman have their attractiveness reduced by the absence of a branch network giving local access to them in the Occupied Territories, by the incompleteness of

access to money-changers who can transfer funds to and from Amman, and by the risk of interruptions to cash flows across the bridges. Cash holdings of Jordanian Dinars and, to some extent, US Dollars have not suffered through depreciation but they do not yield interest, and they carry the risk of theft, loss, and deterioration, and their international acceptability (which is an important consideration if money is considered as a liquid hoard to be used if the owner is forced to become a refugee) may be regarded as less secure than other assets such as gold.

These arguments suggest that the demand for money in the Occupied Territories, and, hence, its stock is relatively low. A low level of liquid assets is also suggested by the fact that when an Israeli imposed curfew interrupts the ability of a town's population to go to their jobs or farms, sales of basic necessities such as food are immediately cut through absence of funds, and shopkeepers' credit to individuals without money quickly expands.⁽³⁸⁾

Related to distorted monetisation and low holdings of bank deposits is the fact that the institutions and agents surveyed in Section 1 provide a low degree of financial intermediation in the Occupied Territories. Financial intermediation involves agents in borrowing the savings of some sections (by accepting deposits in the case of banks) and lending these funds to borrowers.⁽³⁹⁾ The deposits taken by branches of Israeli banks are not used to a large extent for lending within the Occupied Territories. The Bank of Palestine has a low ratio of deposits to capital and low proportion of loans to total assets. The amounts involved in deposits with money-changers and their loans to borrowers is not known, but in view of the undocumented nature of transactions with money-changers, their illegality in the authorities' view, and the need

for a high degree of personal knowledge and trust, it is probable that their financial intermediation is not quantitatively great.

Other sources of credit in the Occupied Territories are not generally financed by funds the lender has borrowed. Some, such as merchants' credit to village households, or commission agents' seasonal credit to farmers are financed out of the lenders' own capital. Others, such as the credit advanced by the (Amman based) Housing Bank for house construction are financed by outside funds provided as part of the 'steadfastness' policy.

Low money holdings and low financial intermediation appear to correspond to the McKinnon-Shaw model's predictions. In that model, however, the explanation for low money holdings would lie partly in the high rates of inflation in the W.Bank and Gaza which have produced negative real returns on some money holdings. But this argument does not apply directly to the Occupied Territories because a special characteristic of their monetary system is that they have a plural monetary standard, with both Israeli Shekels and Jordanian Dinars being widely used.⁽⁴⁰⁾ In addition, US dollars circulate freely.

In part this is the effect of the occupation regulations governing legal tender for both Jordanian Dinars and Israeli Shekels are counted as legal tender in the West Bank. But the plural standard applies also in Gaza and East Jerusalem where the occupation authorities recognise only the Israeli currency as legal tender. It reflects, therefore, an unwillingness to use Israeli Shekels as the only form of money partly because it is the currency of the occupying forces and partly because of the frequent depreciation of the Israeli currency in the 1970s and 1980s. The weakness of the Shekel has led to the widespread use of US

Dollars within Israel itself; within the Occupied Territories it has led to the wide use of both Dinars and Dollars.

Israeli Shekels are used as a medium of exchange for everyday small transactions and they are received in wage payments by Arabs working within the Israeli economy. Jordanian Dinars and US dollars are regarded as stores of wealth, able to retain their value over time. They are also used as the medium of exchange in large transactions and a wide range of medium and small transactions. (For example, some olive growers in the West Bank only accept payment in Jordanian Dinars for olive oil partly because the proceeds of such sales are an important source of savings).⁽⁴¹⁾ Thus, there has been wide use of currencies with stable real values in the face of local inflation and low money holdings within the Occupied Territories, largely the result of other factors.

3.3 Absence of Central Banking

In other countries the monetary system is under a central bank or central monetary authority which is an arm of the state. Its central bank provides implicit or explicit guarantees of the system's stability through measures encompassed in the broad term 'lender of last resort'. The counterpart is that it supervises the safety of the banks' and finance houses' operations ('prudential regulation') and it regulates their effect on the economy's total money supply or credit ('monetary control'). The Occupied Territories do not have such a central authority.

The Bank of Israel exerts the authority of the central bank over the Israeli banks with branches in the Occupied Territories. It also supervises and regulates the operations of the Bank of Palestine although

it is doubtful whether it would act as lender of last resort to ensure that bank's stability. But the money changing and money transfer system in the Occupied Territories, and the major sources of credit are outside its control. The central bank of Jordan has some authority over money-changers to the extent that it is the licensing authority with power of enforcement over their Amman branches, but this has only a marginal effect, if any, on operations within the Occupied Territories. The occupation prevents the central bank of Jordan exerting any direct control, regulation or supervision of the monetary and financial affairs of the Occupied Territories.

The absence of a legitimate state with a monopoly of authority over the monetary and financial system (through its central bank of central authority) is the most fundamental obstacle to the system operating effectively. Muhammad Talat-Harb expressed very strongly the need for a central bank in furthering national economic development and national independence (in the context of Egypt in 1920): 'Each country must pursue its own financial policy, must win its economic independence and preserve it. In every country in the world, the task of directing this policy and preserving this economic independence falls to a national bank, whose privilege it is to issue banknotes and to stand above the competition between all other banks, to supervise their activities, to help them with loans when the need arises, to solve and, where possible, prevent crises. ... Such a bank is the supreme arbiter of financial credits and business confidence ... Every government takes care that no foreign hand can regulate the affairs of the national bank ...' (42)

However, the Occupied Territories do not have such a central bank.

Without a legitimate state authority and central bank acting as supervisor and lender of last resort, the financial institutions are

inherently less secure than they would otherwise be and, therefore, have difficulty in developing financial intermediation. They are relatively less attractive as repositories for savers' assets, and their willingness to lend instead of holding high cash reserves is low. Thus, even if other obstacles to the establishment of financial institutions were removed, the absence of a legitimate state with financial authority would hinder the development of financial intermediation. Moreover, a state which itself borrows from the financial system would provide it with assets (bonds, bills, or direct loans to the state) which are secure and yield a profit and the absence of this deprives the financial system of a source of security.

The absence of a state with responsibility for economic development as a whole means that the credit that is available under the present system is not directed toward areas of need identified as priorities for comprehensive development. An independent state's development plan would, by contrast, be able to guide credit to areas which are judged to have a high priority. In this respect, the implication of the 'financial repression' model that the free development of a banking system could allocate financial capital more rationally than the state is inappropriate. The scale of the economic transformation required in an independent Palestine can only be co-ordinated through development planning. The absence of a unified monetary standard for the Palestinian economy is a severe obstacle to economic development which is a direct corollary of the absence of an independent state and central bank.

First, the economy's reliance on the circulation of two or more currencies leads to a diversion of resources towards the business of money changing. Although this is carried out with a high level of

efficiency, the resources used by the money-changers themselves and by other enterprises (their customers) calculating their best monetary deals are considerable. Moreover it can encourage a business orientation which sees the possibility of making money out of money dealing as more significant than the possibility of profiting from producing and investing in production: a mentality in which knowledge of the exchange rate acquires greater significance than calculations of productivity rates.

Second, if there were a unified national currency with an independent state controlling it, that state would be able to use the 'seignorage' from it to finance development projects. That is, by issuing currency itself (or creating bank deposits by borrowing from the central bank) the state would gain command over resources for development. In making this comparison between a plural and a unified monetary standard, a single unified money would only serve development better if, unlike the Israeli Shekel, it was relatively stable.

4 Conclusion

In conclusion, the occupation of the West Bank and Gaza has affected their money and finance, key elements in the Palestinian Arab economy. For years the Israeli policy was to eradicate Arab banking. Although Israeli banks were encouraged to operate in the Occupied Territories, the policy was not wholly designed to integrate Arab financial and economic life with Israel's as a subordinate but profitable annex for it but was principally designed with a political aim to weaken and undermine independent Arab economic development. Nevertheless, Arab financial operations have survived, been transformed and developed with great strength in particular fields. However, the financial development that has occurred has been partial and distorted.

FOOTNOTES

1. Military Orders 7, 9, 21, 33, 76, 83, 93, 94, 295, 299, 823 relate most directly to the occupying power's control of finance.
2. The principal concern of this paper is the financial and monetary system and its effect on the 'real economy', but the relationship is two-way with the 'real economy' also influencing monetary and financial developments.
3. The analysis in this section is based upon interviews conducted in Jordan, the West Bank, Gaza and Jerusalem in September 1985. The fieldwork was related to a study conducted in that month under the auspices of the British Council.
4. The information on which this sections' description of money-changers is based was obtained from independent interviews with two large money-changers and one medium-sized money-changer in the West Bank and Jerusalem. It was supplemented from interviews with business people who are their customers, with Mr. M. Shukri, Deputy Governor of the central bank of Jordan, and others.
5. A money-changer believed to be the largest on the West Bank gave the following example in mid September 1985. 'If today's Dollar/Deutschmark rate in Europe is 2.84, I would deal at a \$/DM rate of 2.86 - 2.87 (a one point spread).'
6. Interview with Mr. M. Shukri, Deputy Governor of the Central Bank of Jordan.
7. Egypt has played some historic role as a local banking centre for residents at Gaza, but its significance in this respect is small compared with Amman.

8. This interest rate was noted by an industrialist who had borrowed from a large money-lender. However, the money-lender himself had said in a previous interview that his lending rates are between 1 per cent and 1½ per cent per month. It is probable that different rates are applied to different loans.
9. Interview with Mr. Wahid al-Masri; examples given of a money-changer being willing to give a guarantee from his East Bank office for a development loan from a third party.
10. For a general analysis of the limitations of financial systems based on personal trust see R.I. McKinnon, Money and Capital in Economic Development, Washington, 1973.
11. The figure of 28 branches in 1982 is quoted in Dan Zakai, Economic Development in Judea-Samaria and the Gaza District 1981-82, Bank of Israel, Jerusalem 1985, p.67. However his data appears to include the Bank of Palestine which, in the present report, is not included as an Israeli bank. Note that this total does not include the branches of Israeli banks in East Jerusalem.
12. This data is drawn from Examiner of Banks, Annual Statistics of Israeli's Banking System 1980-1984, Bank of Israel, Jerusalem, 1985, p.26.
13. The following information is based on interviews with Mr. Rushdi T. Sakallah (General Manager) and Mr. Hashem Ata Shawa (Chairman) Bank of Palestine Ltd.
14. Bank of Palestine Ltd., Balance of Sheet 31 December 1984
15. The 1984 consolidated balance sheet of the Bank Hapaolim shows a ratio of 68.8, Examiner of Banks, Annual Statistics of Israel's Banking System 1980-1984, Jerusalem, 1985, p.28.

16. ibid
17. Interview with Mr. Hashem Ata Shawa, Chairman.
18. Data supplied by Mr. Hashem Ata Shawa from the records of the Gaza Citrus Growers Union.
19. This information is based on interviews with Mr. Hadi (representing the company) and an industrialist.
20. The classic study of such 'unorganised' markets in U. Tun Wai 'Interest Rates outside the Organised Money Markets of Underdeveloped Countries', IMF Staff Papers, Vol. vi, No.1, pp.80-125.
21. The information on the role of commission agents is based on S. Tamari and R. Giacamen, Zbeidat: The Social Impact of Drip Irrigation on a Palestinian Peasant Community in the Jordan Valley. Documentation and Research Centre, Birzeit University, 1980.
22. S. Tamari, 'Building Other People's Homes', Journal of Palestine Studies, Vol.41, Autumn 1981, p.44.
23. Interview with Mr. Shehadeh Djajani.
24. S. Tamari, op. cit., p.57.
25. The information in this section is based on interviews with Mr. Kemal, General Manager of the Arab Bank, Nablus; Mr. Midhat Kanaan, General Manager of the Amman-Cairo Bank, Nablus and Mr. M. Shukri, Deputy Governor of the Central Bank of Jordan.
26. Information based on interview with Mr. Abdul Rahman Saleh, Housing Bank head office, Amman.

27. Information based on interview with M. Ziyad Annab, Industrial Bank, Amman.
Information based on discussion with Mr. Shehadeh Djajani, Community Development Fund, Jerusalem.
28. The classic statements of the theory of financial repression are R.I. McKinnon, Money and Capital in Economic Development Washington, Brookings Institute, 1973 and E.S. Shaw, Financial Deepening in Economic Development, New York, Oxford University Press, 1973. Derivative readings are collected in W.L. Coats and D.R. Khatkhate (eds) Money and Monetary Policy in Less Developed Countries, London, Pergamon Press, 1980. There are variations of detail between different formulations of the model and the outline presented here is a synthesis.
29. The general thrust of the argument is that a competitive banking system should be permitted. If, however, the banks are monopolistic or state regulated the administered interest rates should reflect market conditions by being raised to a presumed equilibrium level.
30. A.S. Mansour, 'Monetary Dualism; the case of the West Bank Under Occupation', Journal of Palestine Studies, Vol. 43, 1982, pp.103-116.
31. In McKinnon's theory, capital market fragmentation is indicated by the simultaneous existence of widely different rates of return on investment projects in different sectors. Or it would be if such returns were quantified.
32. Empirical evidence on the interest-elasticity of the demand for bank deposits is discussed Coats and Khatkhate, op.cit.

33. The growth for believing that the demand for money is low in the Occupied Territories are set out below. This conclusion differs from Mansour's assumption that the velocity of money is low in the West Bank but the difference may be attributable to the fact that Mansour is referring to an earlier period when financial conditions differed (Mansour, op.cit.).
34. D. Zakai, Economic Development in Judea-Samaria and the Gaza District, 1981-82, Bank of Israel, Jerusalem 1985, Tables II-1 and V-3.
35. See R.I. McKinnon, op.cit. for the general effects of such fragmentation.
36. In part, the fragmentation of the credit system is related to the underdeveloped state of commodity markets which gives particular agents such as commission agents monopsonistic positions which they reinforce through giving credit on a client basis.
37. Interview with Mr. Shukri, Deputy Governor of the Central Bank of Jordan.
38. Evidence that this has been the effect of curfews in Hebron is based on interviews with Mr. K. Osaily and Mr. Natshe.
39. The classic definition of financial intermediation in these terms is that of J. Gurley and E. Shaw, Money in a Theory of Finance, Brookings, Washington, 1960.
40. See A. Mansour 'Monetary Dualism', Journal of Palestine Studies, Vol.43, Spring 1982 for one perspective on this plural standard.
41. S. Tamari, 'Building Other People's Homes', Journal of Palestine Studies, Vol. 41, 1981, p.52.

42. Mohammed Talat Harb, speech at the inauguration of the Misr Bank, 7 May 1920, reprinted in English as 'An Egyptian Bank for Egyptians Only' in A. Abdel-Malek (ed) Contemporary Arab Political Thought, Zed Books, London, 1983, pp.55-57.

The Development Policy and Practice research group was set up at the Open University towards the end of 1986 to promote research on development issues. Its members have a wide range of disciplinary backgrounds (engineering, sociology, economics, education and geography). At present, research is focussed in three areas: food markets - particularly in sub-Saharan Africa and South Asia; the development of finance and banking; and links between small and large scale production.

DPP is a relatively small research group with limited funding. In order to increase our efficacy we are keen to enter into collaborative arrangements with other research groups and development agencies where appropriate. DPP will also be acting as a centre to focus the development concerns of the Open University by arranging seminars and workshops.

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