
Strategies for Achieving Financial Stability in Palestine in Light of Current Challenges: A Theoretical and Practical Analysis

ghoggal ilyes*

Laboratory of Finance, Banking,
and Business Administration,
University of Biskra Algeria

ilyes.ghoggal@univ-biskra.dz

Received:04/08/2024

Tarek Khater

University of Batna, Algeria

tarek-khater@univ-batna.dz

Accepted: 17/09/2024

Adel Zegrier

Laboratory of business management of
sustainable economic institutions,
Algeria University of El Oued

zegrier-adel@univ-eloued.dz

Published: 31/10/2024

Abstract:

The study examines Palestine's financial challenges and the critical need for stability, addressing both theoretical frameworks and practical applications. It underscores the economy's heavy reliance on foreign aid, budget deficits, and a vulnerable financial infrastructure due to political restrictions. The goal is to analyze these issues and propose recommendations aimed at enhancing financial stability. Achieving stability is crucial for fostering economic confidence, attracting foreign investments, and sustaining long-term growth. Using a descriptive-analytical approach drawing from economic reports and studies, the study identifies challenges such as public deficits, financial system weaknesses, and political constraints on economic activity. Recommendations include strengthening fiscal and monetary policies, reducing dependency on foreign aid, fortifying financial institutions, and improving public financial management to stimulate comprehensive economic development.

Keywords:Budget deficit, financial stability, foreign aid, Palestine, Political restrictions.

Jel Classification Codes:E62, G01, H84, O53, P16.

*Corresponding author.

1. Introduction:

Despite its crucial importance, achieving and maintaining financial stability remains a complex and elusive goal. This is due to the dynamic and interconnected nature of financial systems, which makes them vulnerable to various sources of instability. In this context, (Nier, 2009, pp. 36–37) emphasizes that Interdependence and fungibility are two key factors in determining the systemic risk of financial institutions. Vital institutions in the Financial Network pose a significant threat to financial stability. In addition, some institutions can be important for the functions of financial markets as a result of existing credit relations or their decisive role in the settlement of transactions, enhancing systemic risks.

Moreover, the globalization of financial markets has amplified the transmission of shocks across borders, adding other layers of complexity to the quest for stability. In order to understand financial stability, researchers have created many theoretical frameworks and models, ranging from the traditional equilibrium-based approach to dynamic theories that take into account the challenges and complexities inherent in financial systems. By exploring and testing these assumptions, scientists aim to uncover the basic mechanisms of financial stability and identify effective political interventions to maintain stability and prevent coups.

Understanding financial stability is crucial, given the profound impact of financial crises on global economies and societies. This study aims to examine the evolution of financial stability in Palestine, amidst significant economic and political challenges. These issues have notably affected the Palestinian financial system and the broader economy. The achievement of this goal passes through the answer to the following main question: **What are the main challenges facing the financial authority in Palestine in achieving financial stability? How can the internal and external factors affecting this stability be evaluated and managed effectively?**

In order to answer this question, we have put forward two hypotheses:

- Political and Economic Interplay: Financial difficulties in Palestine might be closely linked to political factors, which means effective management is crucial for achieving financial stability.
- Economic Consequences of Reliance on External Aid: Relying heavily on foreign aid could worsen financial instability. Therefore, it's important to diversify income sources and strengthen local capacities to attain financial stability.

The study employed a descriptive-analytical method, integrating data from economic reports and prior research. It aimed to comprehensively analyze financial stability challenges in Palestine by consolidating information from diverse sources, including economic indicators and scientific studies. This approach enabled a nuanced understanding of the Palestinian financial system's complexities, offering insights into factors

influencing stability and suggesting strategies for mitigation. To achieve our goals, the research paper is structured into several sections. Firstly, we define financial stability as crucial for maintaining a stable financial system, supporting economic development, and ensuring social stability. Secondly, we analyze factors influencing financial stability, including monetary and fiscal policies, alongside effective measurement indicators. Lastly, we focus on the current financial stability landscape in Palestine, highlighting challenges and proposing strategies for achieving stability in this context.

2. Definition of Financial Stability:

According to (Gadanecz & Jayaram, 2008, pp. 365–366) Financial stability is hard to pinpoint precisely; it goes beyond just market fluctuations to include smooth interactions among financial markets and institutions within legal frameworks. It involves the ability to withstand shocks and efficiently distribute savings despite disruptions in financial intermediation that impact savings allocation.

(Morgan & Pontines, 2014, p. 3) considers that there is no universally agreed definition of financial stability due to the complexity of financial systems, which encompass various institutions, products, and markets. It may be easier to describe financial instability than stability. The ECB defines financial stability as the ability of the financial system, including intermediaries and markets, to withstand shocks and minimize disruptions in financial processes, ensuring efficient allocation of savings into profitable investments.

(Chant, 2003, p. 3) Financial stability is typically defined by its absence—specifically, the presence of financial instability. Differentiating financial instability from other economic instabilities involves identifying criteria for instability within the financial sector, distinct from normal market fluctuations like price and interest rate changes. Clarifying these criteria helps distinguish between natural market shifts and signs of instability.

(Schinasi, 2004, p. 1) believes that financial stability can be defined as the ability of the financial system to: (a) facilitate the efficient allocation of economic incentives, both spatially and temporally, ensuring the effectiveness of other economic processes, such as the accumulation of wealth and economic growth, and, consequently, social prosperity; (b) assess, price, allocate and manage financial risks; and (c) maintain its ability to perform these key functions, even if it is affected by external shocks or the accumulation of imbalances, mainly through self-correction mechanisms.

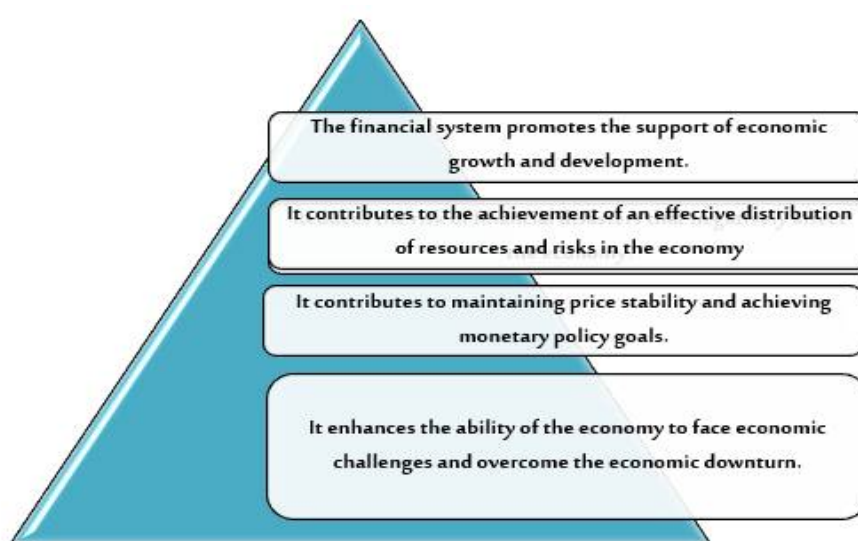
Based on the discussion, a definition of financial stability could be formulated as follows: Financial stability denotes the capacity of the financial system to endure shocks and prevent financial turmoil, thereby maintaining uninterrupted brokerage operations and enabling efficient allocation of savings into profitable investments. This involves facilitating effective economic transmission, assessing, pricing, distributing, and managing financial risks, ensuring the financial system's ability to function reliably even amidst external shocks or disruptions, supported by self-correcting mechanisms.

3. Why is Financial Stability Considered Important?

(Heinlein, 2022, p. 1) The financial system plays a crucial role in economic development by facilitating the flow of funds between savers and borrowers. Financial stability is essential to prevent economic downturns that can harm various sectors. It ensures efficient resource allocation and risk management, crucial for sustainable growth and price stability, goals central to a robust economy. Stable financial markets reduce volatility, support sound decision-making, and enhance overall efficiency in resource allocation. Strengthening banks and financial institutions fosters market reliability and supports economic resilience.

خطأ! لم يتم العثور على مصدر المرجع.

Fig N° 1: The Importance of Financial Stability



Source: Prepared by the authors based on: Heinlein, R. (2022). Significance of Financial Stability in Economy. J Stock Forex, 9(100210), 9458. <https://doi.org/10.4172/2168-9458.22.9.210.Citation>

4. Determinants of Financial Stability

The factors that may be a concern for financial stability, they are shown in خطأ! لم يتم العثور على مصدر المرجع.

a) Liquidity pressure:

refers to the lack of liquidity in financial markets, as it is difficult for companies and institutions to obtain financing to meet their daily needs or finance their investment projects. According to a study by (PricewaterhouseCoopers, 2015, p. 20) Liquidity in capital markets enhances economic growth by facilitating capital flow and efficient risk distribution, reducing issuance costs for companies. It also improves price discovery and monetary policy effectiveness, positively correlating with asset returns and stock price movements that reflect company value and liquidity risks.

b) Global impacts / crises:

refers to global economic events or conditions that may significantly affect the financial system of a particular country, such as global financial crises or global economic recession. (Žugić & Fabris, 2014, p. 33) define a financial crisis occurs when the financial system or its components, like markets, institutions, and infrastructure, face risks hindering their functions due to various factors. This jeopardizes financial stability, leading to substantial economic costs when problems in banks escalate to impact the broader economy and other financial entities. For example, presented by (McKibbin & Stoeckel, 2010, p. 1) The collapse of Lehman Brothers in September 2008 had a profound impact on global financial markets. It led to a freeze in interbank lending, prompting banks to withhold loans and increase borrowing costs sharply. Despite efforts by authorities to boost liquidity, the damage was extensive, manifesting in elevated corporate bond yields and stalled capital projects. Companies struggled with restricted trade credit, while reduced demand for investment goods and manufactured products caused a significant downturn in trade volumes.

c) Operational problems:

refers to difficulties that financial institutions may face in performing their functions effectively and smoothly, such as technology or management problems. In this framework, (Aloqab et al., 2018, p. 12) financial risks encompass intricate and uncertain positions that can result in diminished profits or losses. While "risk" and "uncertainty" are often linked, risk specifically pertains to quantifiable uncertainty. Accurate measurement and assessment of investment risks are essential for making informed decisions. Understanding the banking environment is vital in mitigating and managing these risks effectively.

d) Payment system threats:

refers to any threats facing the country's payment system, such as cyber hacking attacks or manipulation of payment processes. (Pandey & Rastogi, 2010, p. 12) The integrity of the payment system is crucial in e-commerce, with Secure Sockets Layer (SSL) and Secure Electronic Transaction (SET) protocols ensuring reliable online payments. SSL operates at the session layer, while SET functions at the application layer of network models. These protocols are vital communication tools in e-commerce, making SSL and SET among the most significant for secure electronic transactions.

e) Contagion:

This refers to financial contagion, where disturbances or crises spread from one market to another, potentially across borders, amplifying financial tensions.

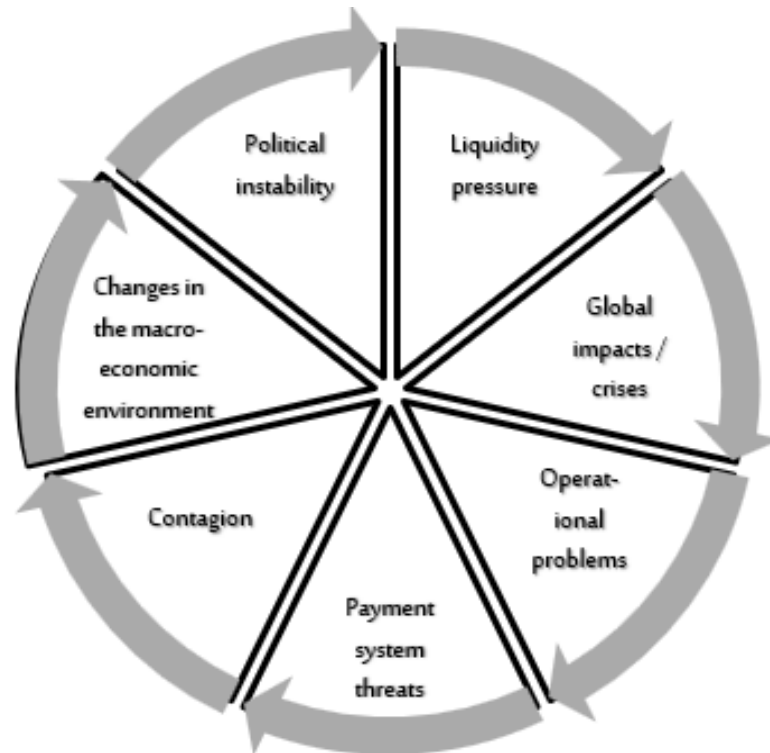
f) Changes in the macroeconomic environment:

refer to significant transformations in the economic and financial landscape, such as new technologies or legislation, which can impact how the financial system operates.

g) Political instability:

means political instability in the country, which leads to uncertainty and fluctuations in economic and financial policies, affecting confidence in the financial system.

Fig N°2: Financial Stability Determinants



Source: Žugić, R., & Fabris, N. (2014). Framework for Preserving Financial Stability in Montenegro. *Journal of Central Banking Theory and Practice*, 3. <https://doi.org/10.2478/jcbtp-2014-0003>

5. Financial Stability Index:

According to (Fell & Schinasi, 2005, p. 117) and the (Arab Monetary Fund, 2023, pp. 226–227), the importance of developing a financial stability index stems from the following:

- Finance differs from exchange, production, and resource allocation in economics.
- Finance supports economic functions, fostering development, growth, efficiency, and prosperity.
- Financial stability is a public good, crucial alongside monetary stability.
- A quantitative tool measures financial stability, guiding policies and warning risks.
- Enhancing market information transparency helps identify risks and preventive policies.
- Comparing financial sector performance across countries reveals gaps and improvements.
- Supports early warning tools, offering insights into financial system risks.
- Monitoring variables over time assesses risks and addresses potential challenges.

Thus, the most important studies that have tried to build an indicator of financial stability are presented, as shown by خطأ! لم يتم العثور على مصدر المرجع.

Table N°1: Attempts to build and develop the Financial Stability Index

Indicators Used	Study
(BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM, 2023, pp. 1–70)	<ul style="list-style-type: none"> • Valuation Pressures: High asset prices relative to fundamentals, driven by investor risk appetite, increasing the likelihood of asset price declines. • Excessive Borrowing: High debt levels in businesses and households, risking distress if incomes fall or asset values drop, leading to reduced spending and investor losses. • Financial Sector Leverage: High leverage risks financial institutions' stability, potentially leading to reduced lending and economic activity. • Funding Risks: Rapid fund withdrawals by investors, forcing institutions to sell assets quickly at low prices, leading to losses and market pressures.
(Jakubik & Slacik, 2013, p. 106)	<ul style="list-style-type: none"> • Money Market Indicators: General development, annual change, volatility, and spread between domestic and German interbank interest rates. • Foreign Exchange Market Indicators: Annual change and volatility in exchange rates. • Equity Market Indicators: Annual change and volatility in equity indices. • Bond Market Indicators: General development, ten-year government bond yield, annual change, yield volatility, and composite global EMBI indicators.
(Nelson & Perli, 2007, pp. 1–30)	<ul style="list-style-type: none"> • Interest Rate and Asset Price Metrics: Measures market liquidity and investor risk sentiment through bid-ask spreads, trading volumes, and financial options. • Financial Vulnerability Index: Estimates the likelihood of the financial system being under severe stress using various financial variables. • Mortgage Market Indicators: Monitors average duration and hedging flows of mortgage-backed securities • Institution Assessment: Evaluates the financial health of individual institutions, monitoring lending practices and market indicators like credit default swaps. • Market Spreads: Uses corporate bond spreads and credit default swaps to assess default probabilities and systemic risk.
(Geršl & Heřmánek, 2008, p. 129)	<ul style="list-style-type: none"> • Capital Adequacy: Regulatory capital ratios and non-performing loans net of provisions. • Asset Quality: Non-performing loans to total loans and sectoral distribution of loans. • Earnings and Profitability: Return on assets, return on equity, interest margin to gross income, and non-interest expenses to gross income. Liquidity: Liquid assets to total assets and to short-term liabilities. • Foreign Exchange Risk: Net open position in foreign exchange to capital.

Source: prepared by the authors

6. Achieving Financial Stability in Palestine: Challenges and Opportunities

Achieving financial stability in Palestine is crucial for economic and social development, despite challenges, opportunities exist for growth.

6.1 Analysis of the current economic situation in Palestine

According to (Palestinian Central Bureau of Statistics, 2024) the Palestinian economy in 2023 was characterized by the following. See Fig. 3:

Fig N°3: Characteristics of the Palestinian Economy in 2023



Source: Palestinian Central Bureau of Statistics. (2024). The Performance of the Palestinian Economy during 2023.

<https://www.pcbs.gov.ps/post.aspx?lang=en&ItemID=4674> (Accessed 19 May2024)

6.2 Strategies for Achieving Financial Stability in Palestine

(Palestinian Monetary Authority, 2024) Achieving financial stability in the Palestinian financial sector is a key goal of the Palestinian Monetary Authority (PMA). PMA prioritizes enhancing its capabilities to match advanced operational standards. It ensures the financial and banking sector in Palestine can handle risks affecting economic growth and performs efficiently. The financial stability group, comprising three core departments and the payment systems unit, collaborates to maintain the country's financial stability (See خطأ! لم يتم العثور على مصدر المرجع).

Fig N°4: Tasks of the Departments Supervising Financial Stability



Source: Palestinian Monetary Authority. (2024). Financial Stability.

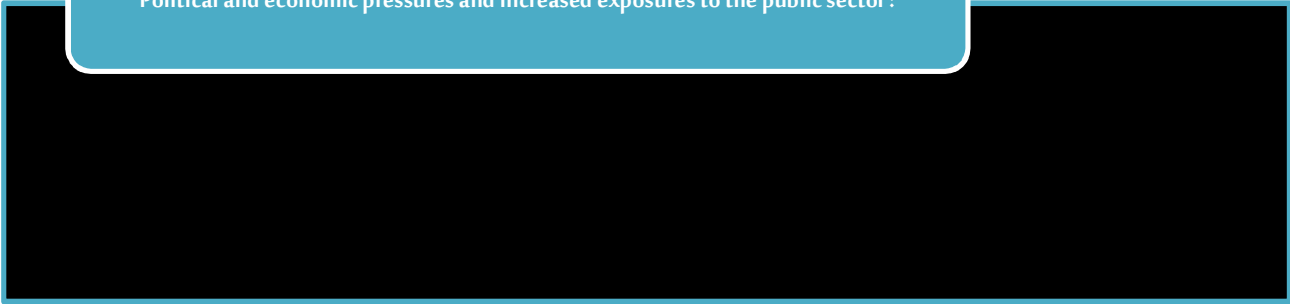
<https://www.pma.ps/en/FinancialStability> (Accessed 19 May 2024)

6.3 The Development of Financial Stability Conditions in Palestine in the Face of Challenges

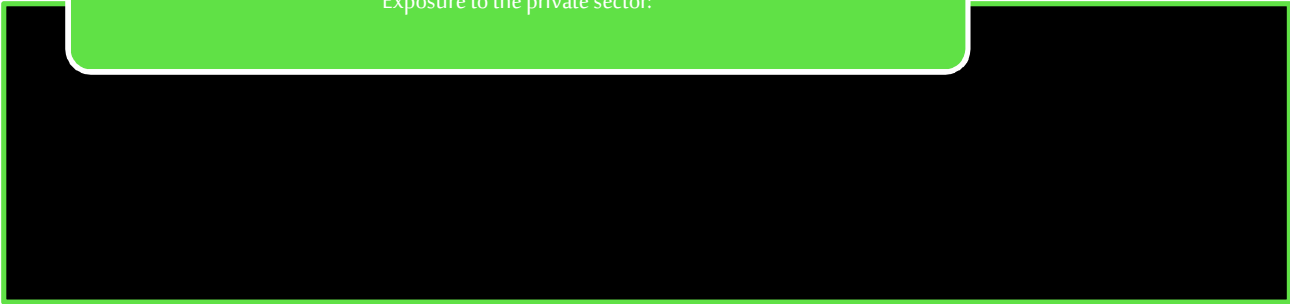
Palestine confronts financial complexities due to political strife, Zionist occupation, economic restrictions, and internal issues like inadequate infrastructure. Resolving these demands reforms to enhance financial management and bolster economic resilience. This is what (Palestine Monetary Authority (PMA), 2020, pp. 2–4) (World Bank, 2023, pp. 1–6) emphasizes (See Fig. 5 and *خطأ! لم يتم العثور على مصدر المرجع.*).

Fig N°5: Key Risks Faced by the Banking Sector in 2020

Political and economic pressures and increased exposures to the public sector :



Exposure to the private sector:



Exposure to the external sectors:



Source: prepared by the authorsBased onPalestine Monetary Authority. (2020). Financial Stability Report (FSR). PP:2-4

Fig N°6: The main challenges facing financial stability in Palestine

A Theoretical and Practical Analysis

Financial Improvements Versus Challenges: In 2022, Palestine witnessed improvements in revenue collection and expenditure control, leading to a reduction in the fiscal deficit. However, managing the financing gap and accumulating arrears remain significant challenges.



The Need for Comprehensive Reforms: Achieving financial sustainability requires coordinated efforts from the Palestinian Authority and the Zionist Entity government, along with increased support from donors. Reforms should focus on enhancing revenues, improving expenditure efficiency, and managing arrears in vital sectors.



Progress and Challenges in Managing Public Finances: despite progress in controlling spending and improving financial management, negotiations with trade unions pose challenges. Efforts are underway to eliminate the delay in financial statements and implement a liability control system.



The Critical Role of Donor Support: continued donor support is essential to the PA's financial settlement efforts. Reform measures should be gradual in order to avoid negative socio-economic impacts, focusing on transparency and attracting additional resources.



Ensuring Stability in Cross-Border Payments: Establishing stable correspondent banking relationships is crucial for maintaining stability in cross-border payments. Rising food and fuel prices emphasize the urgency of accelerating economic growth.

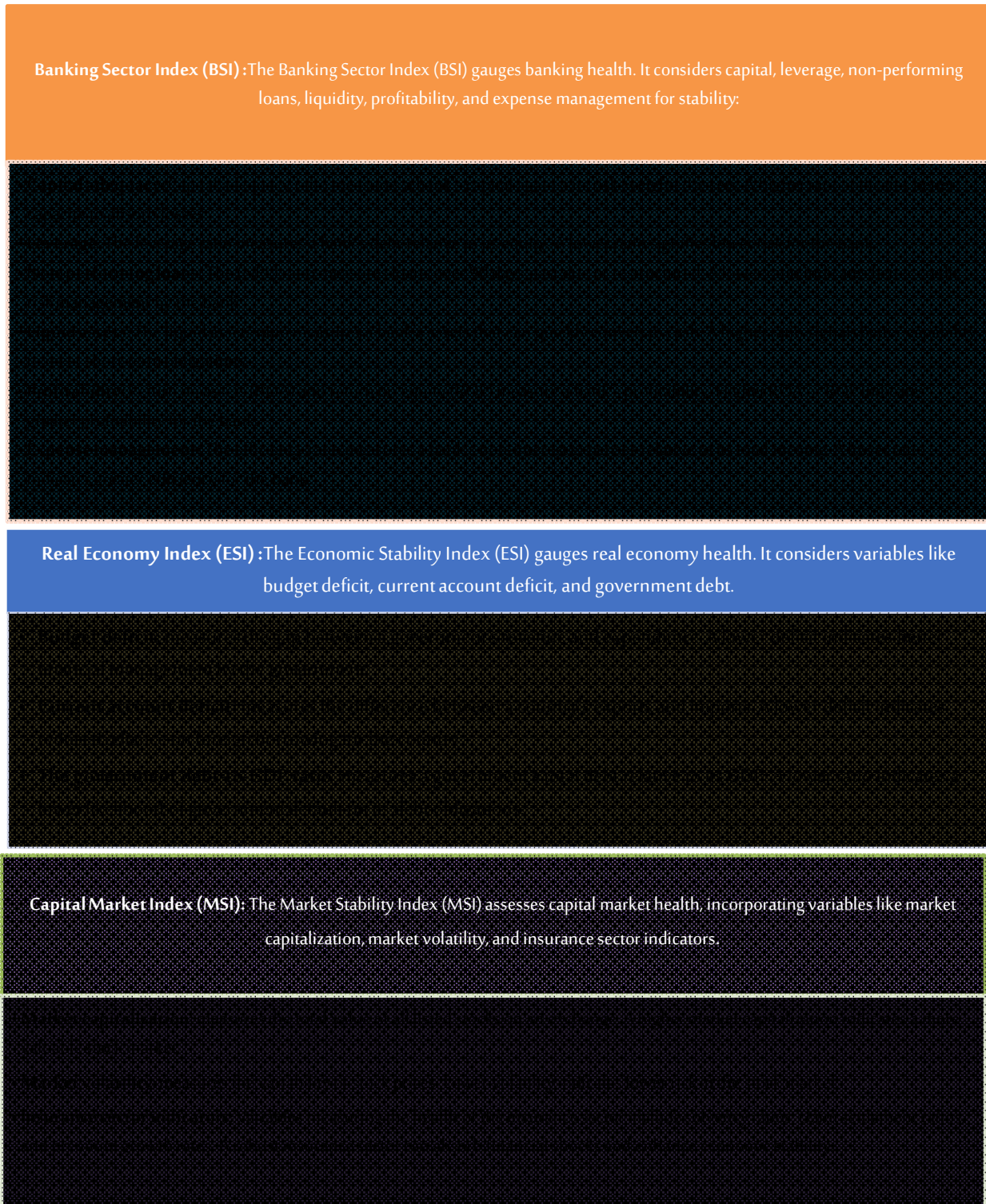


Source: prepared by the authors Based on the World Bank. (2023). World Bank Economic Monitoring Report to the Ad Hoc Liaison Committee (English). Washington, D.C.: World Bank Group. PP:1-6

<http://documents.worldbank.org/curated/en/099455304272328937/IDU00e7074dc01c850437a0b9770f1fcae9a85c8>

6.4 A Review on the Financial Stability Measurement Index in Palestine

According to (Palestinian Monetary Authority, 2020, pp. 68–73). خطأ! لم يتم العثور على مصدر المرجع. presents three indices that measure the financial stability of a country: the Banking Sector Index (BSI), the Real Economy Index (ESI), and the Capital Market Index (MSI). Each index is composed of a number of variables that have a positive or negative impact on financial stability (See Fig. 7).

Fig N°7: The Financial Stability Measurement Index in Palestine

Source: Palestinian Monetary Authority. (2020). Financial Stability, Research and Monetary Policy Department. (FSR) . P:68-73

Overall, the table suggests that the country has a relatively stable banking sector and real economy. However, the capital market is somewhat volatile. The government should take steps to reduce market volatility in order to further improve financial stability.

Table N°4: Variables Used to Calculate the Financial Stability Index in Palestine

Financial Stability Index	Indicator	Impact on Financial Stability
Bank Sector Index (Bsl)	Capital adequacy	+
	Leverage	+
	Non-performing loans-to-total loans	-
	Non-performing loans (net of provision)-to-capital	-
	Liquid assets-to-total assets	+
	Liquid assets-to-short-term liabilities	+
	Return on assets	+
	Return on equity	+
	Interest-to-total income	+
Economy Sector Index (Esl)	Non-interest expenses-to-total income	-
	Economic growth rate	+
	Inflation rate	-
	Budget deficit as a proportion of GDP	-
	Current account deficit as a proportion of GDP	-
Capital market index (Msi)	Domestic government debt as a proportion of GDP	-
	Market capitalization as a proportion of GDP	+
Insurance sector index (Ada)	Volatility of market rate of return	-
	Capital-to-total assets	+

Source: Palestinian Monetary Authority. (2019). Financial Stability, Research and Monetary Policy Department. P:71

7. Conclusions and Recommendations

Based on the analysis, Palestine has made strides in achieving financial stability, yet significant challenges persist. These challenges are heavily influenced by external political and economic factors, as well as internal structural issues. Based on these findings, the following conclusions and recommendations are proposed to enhance financial stability and economic resilience in the region:

- **Strengthening Financial Institutions:** Improve regulations, governance, and risk management.
- **Reducing Dependence on Foreign Aid:** Diversify economy, boost local industries.
- **Improving Public Financial Management:** Enhance budget planning and transparency.
- **Enhancing Monetary and Fiscal Policies:** Coordinate policies to stabilize economy.
- **Building Financial Infrastructure:** Develop robust payment and credit systems.
- **Addressing Political Risks:** Ensure stability for economic growth.
- **Promoting Financial Literacy:** Educate public on financial products and rights.
- **Strengthening Legal Frameworks:** Enforce robust laws for market stability.
- **Encouraging Foreign Investment:** Create favorable conditions for investment.
- **Regular Monitoring and Assessment:** Use indices to monitor and preempt risks.

In conclusion, achieving financial stability in Palestine requires a multifaceted approach that addresses both external and internal challenges. By implementing these recommendations, Palestine can enhance its financial stability, attract investment, and support sustainable economic growth.

8. References

1. Aloqab, A., Alobaidi, F., & Raweh, B. (2018). Operational risk management in financial institutions: An overview. *Business and Economic Research*, 8(2), 11–32.
2. Arab Monetary Fund. (2023). *Financial Stability Report in Arab Countries 2023 (In Arabic)*.
<https://www.amf.org.ae/ar/publications/tqyryr-alastqrar-almaly/tqyryr-alainstqrar-almaly-fy-aldwl-alrbytlam-2023>
3. BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM. (2023). *Financial Stability Report (Issue October)*.
<https://doi.org/10.5089/9798400249686.082>
4. Chant, J. (2003). Financial stability as a policy goal. *Essays on Financial Stability*, 95.
5. Fell, J., & Schinasi, G. (2005). *Assessing Financial Stability: Conceptual Boundaries and Challenges*. *Financial Stability Review* (Frankfurt: European Central Bank). Available via the Internet: [Http://Www. Ecb. Int/Pub/Pdf/Other/Financialstabilityreview200506en. Pdf.](http://www.ecb.int/pub/pdf/other/financialstabilityreview200506en.pdf)
6. Gadanez, B., & Jayaram, K. (2008). Measures of financial stability-a review. *Irving Fisher Committee Bulletin*, 31(1), 365–383.
7. Geršl, A., & Heřmánek, J. (2008). Indicators of financial system stability: Towards an aggregate financial stability indicator? *Prague Economic Papers*, 3, 127–142. <https://doi.org/10.18267/j.pep.325>
8. Heinlein, R. (2022). Significance of Financial Stability in Economy. *J Stock Forex*, 9(100210), 9458. <https://doi.org/10.4172/2168-9458.22.9.210.Citation>
9. Jakubik, P., & Slacik, T. (2013). Measuring financial (in) stability in emerging Europe: a new index-based approach. *Financial Stability Report*, 25, 102–117.
10. McKibbin, W. J., & Stoeckel, A. (2010). The global financial crisis: Causes and consequences. *Asian Economic Papers*, 9(1), 54–86.
11. Morgan, P., & Pontines, V. (2014). Financial stability and financial inclusion.
12. Nelson, W. R., & Perli, R. (2007). Selected indicators of financial stability. *Risk Measurement and Systemic Risk*, 4, 343–372.
13. Nier, E. W. (2009). Financial stability frameworks and the role of central banks: lessons from the crisis.
14. Palestine Monetary Authority (PMA). (2020). *Financial Stability Report (FSR)*.
15. Palestinian Central Bureau of Statistics. (2024). *The Performance of the Palestinian Economy during 2023*.
<https://www.pcbs.gov.ps/post.aspx?lang=en&ItemID=4674> (Accessed 19 May2024)
16. Palestinian Monetary Authority. (2020). *Financial Stability, Research and Monetary Policy Department*.
17. Palestinian Monetary Authority. (2024). *Financial Stability*. <https://www.pma.ps/en/FinancialStability> (Accessed 19 May2024)
18. Pandey, D., & Rastogi, A. (2010). A Critical Research on threats and security technology related to Payment System on E-commerce Network. *International Journal of Computer Applications*, 975, 8887.
19. PricewaterhouseCoopers. (2015). *Global financial markets liquidity study (Issue August)*.
<https://doi.org/https://www.pwc.com/gx/en/financial-services/publications/assets/global-financial-market-liquidity-study.pdf>
20. Schinasi, G. J. (2004). *Defining financial stability*.
21. World Bank. (2023). *World Bank Economic Monitoring Report to the Ad Hoc Liaison Committee (English)*. Washington, D.C.:World Bank Group.
<http://documents.worldbank.org/curated/en/099455304272328937/IDU00e7074dc01c850437a0b9770f1fcae9a85c8>
22. Žugić, R., & Fabris, N. (2014). Framework for Preserving Financial Stability in Montenegro. *Journal of Central Banking Theory and Practice*, 3. <https://doi.org/10.2478/jcbtp-2014-0003>