

1-1-1999

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Judy Scales-Trent

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Recommended Citation

Judy Scales-Trent, *African Women in France: Immigration, Family and Work*, 24 Brook. J. Int'l L. 705 (1999).
Available at: <https://brooklynworks.brooklaw.edu/bjil/vol24/iss3/2>

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ESSAY

AN AMERICAN BANK IN THE PALESTINIAN AUTHORITY: INVESTING IN THE PEACE

*Amir H. Khoury**

I. INTRODUCTION

The banking issues of the Palestinian Authority (PA), much like the whole Israeli-Palestinian conflict, involve legitimate conflicting interests. In this Essay, I will explore one aspect of those banking issues: the establishment of an American bank in the PA. Parts II and III of this Essay will consider the historical development of the Palestinian banking system, and the special relation with its Israeli counterpart. In Part IV, I will examine the problems facing the Palestinian banking system—specifically, the international banking aspects. Finally, I will introduce a model, in the form of an American bank branch in the PA areas, as well as the possibility of an American bank branch in Israel. This model is intended to address the pressing banking needs in the PA, while at the same time respecting Israeli concerns.

I submit that this proposed model will simplify banking operations, thus attracting more investment and trade to the area, which will lead to a more stable Palestinian economy. It is my contention that a more stable Palestinian economy will closely guard the peace.

* Amir H. Khoury, a Fullbright scholar, received an LL.M. Degree in International Business and Trade Law from Fordham University, New York City. In addition, the author is an Israeli lawyer and holds an LL.B. Degree from the Hebrew University, Jerusalem. The author wishes to express his sincere appreciation to Professor Carl Felsenfeld of Fordham Law School, and to Ms. Dorothy N. Giobbe, Editor in Chief of the *Brooklyn Journal of International Law*.

II. EVOLUTION OF THE BANKING SYSTEM THROUGH THE PEACE PROCESS

In order to comprehend the current banking system in the PA areas, it is imperative to understand the origins and dynamics that have led to the existing system. Through a historical context, we will turn our attention to the evolution of the current peace process and examine the different provisions of the agreement that helped shape the face of the Palestinian banking system.

News of the 1993 Israeli-Palestinian secret peace agreement took the Israeli and Palestinian public by surprise. Indeed, the entire international community was astonished to learn that Israel and the Palestine Liberation Organization (PLO) had conducted secret negotiations during fourteen rounds of talks spread over a short period of eight months.¹ These talks produced an accord outlining Israeli recognition of the PLO, and the transfer of authority over the Gaza Strip and the West Bank town of Jericho to the PLO in exchange for the PLO recognition of Israel.² These historic compromises were embodied in the Declaration of Principles on Interim Self Government Arrangements (DOP) of September 13, 1993.³ The DOP is the beginning of the end of decades of conflict between the Jewish and the Palestinian people.

Some commentators have attributed the DOP's success to two fundamental factors: timing and negotiation context.⁴ It is well-recognized that prior to the DOP, both sides needed to break the political status quo. Before the DOP, the Palestinian uprising (*Intifadah*) inflicted its toll on both peoples, creating urgency for a peaceful settlement, especially in the wake of rising religious radicals on both sides who threatened to further escalate the situation. Also notable is the rise of the United States as a sole superpower, and the intense efforts of the

1. See generally Katherine W. Meighan, *The Israel-PLO Declaration of Principles: Prelude to a Peace?*, 34 VA. J. INT'L L. 435 (1994) (discussing the negotiations and the implications for the peace process).

2. See Israel-P.L.O. Agreement on the Gaza Strip and the Jericho Area, May 4, 1994, Isr.-P.L.O., 33 I.L.M. 622 [hereinafter Cairo Agreement].

3. Israel-P.L.O. Declaration of Principles on Interim Self-Government Arrangements, Sept. 13, 1993, Isr.-P.L.O., 32 I.L.M. 1525. The DOP discusses the transfer of power, the Cairo Agreement and Interim Agreement implement the transfer.

4. See Meighan, *supra* note 1, at 437.

United States to help bring stability to the Middle East. These factors are not conclusive, however, other commentators have cited the Gulf War, as well as international pressure on the Palestinian and Israeli leadership to break out of the cycle of violence.⁵ Analyzing all of these different factors would no doubt fill volumes and is well beyond the scope of this Essay.

On May 4, 1994, we saw the conclusion of the first agreement envisioned by the DOP: Palestinian self-rule in the Gaza Strip and Jericho, and Israeli troop withdrawal from these areas. This agreement, known as the Cairo Agreement,⁶ granted the PA certain legislative, executive and judicial powers in the Gaza Strip and Jericho,⁷ excluding Jewish settlements and Israeli Defense Forces (IDF) facilities. For our purposes, note that the Cairo Agreement incorporates the Paris Protocol on Economic Relations of April 1994.⁸ It is within the Economic Protocol that the financial and monetary system is considered.

The second agreement dealing with early empowerment was signed at Erez on August 29, 1994.⁹ Under this agreement, the PA received powers in certain limited spheres such as: direct taxation and value added taxes (VAT), health, tourism, social welfare, education, and culture in parts of the West Bank outside the Jericho area. The third agreement, the Protocol on Further Transfer of Powers and Responsibilities, was signed in Cairo on August 27, 1995.¹⁰ In this agreement, the PA civil powers were further expanded to include labor, industry and commerce, petroleum, gas, local government, agriculture, postal services, and statistics.¹¹

5. *Id.* at 438.

6. Cairo Agreement, *supra* note 2. The Palestinian Authority, established through the Cairo Agreement, is comprised of 24 members headed by P.L.O. Chairman Yasser Arafat.

7. *Id.* For more on the Cairo Agreement, see Justus R. Weiner, *The Israel-Palestinian Peace Process: A Critical Analysis of the Cairo Agreement*, 14 WIS. INT'L L.J. 223 (1995) (book review).

8. The Protocol on Economic Relations Between the Government of the State of Israel and the P.L.O. Representing the Palestinian People was signed as a separate agreement in Paris on April 24, 1994. However, it was later attached to the Cairo Agreement as Annex IV.

9. See Agreement on Preparatory Transfer of Powers and Responsibilities, Aug. 29, 1994, Isr.-P.L.O., 34 I.L.M. 455. Erez is a border checkpoint between Israel and the Gaza Strip.

10. Protocol on Further Transfer of Powers and Responsibilities, Aug. 27, 1995, Isr.-P.L.O., 34 I.L.M. 455.

11. *Id.*

The fourth and final interim agreement, the Israel-Palestine Liberation Organization Interim Agreement on the West Bank and The Gaza Strip, was signed in Washington D.C. on September 28, 1995.¹² The preamble of the Interim Agreement reaffirms the determination of both sides to "live in peaceful coexistence, mutual dignity and security, while recognizing their mutual legitimate and political rights."¹³ In order to accomplish these ambitious goals, the Interim Agreement addresses numerous issues such as: scheduling redeployment of the IDF, establishing an elected Palestinian authority, transfer of authority, cancellations of certain provisions from the Palestinian National Charter, and economic development and cooperation.¹⁴ I will examine a few provisions of the Interim Agreement that have an impact on the Palestinian banking system, both in the geographical sense and in the sphere of competence, cooperation, and economic relations.

A. Redeployment of the IDF and the Span of PA Jurisdiction

The Palestinian banking system extends only as far as the territory under the PA rule. Thus, it is crucial to recognize these banking "borders." The first phase of the IDF redeployment in the West Bank covered six cities.¹⁵ In accordance with Article X of the Interim Agreement, this first redeployment was completed prior to the eve of the January 20, 1996 Palestinian elections. According to the Interim Agreement, the West Bank is divided into areas A, B, and C.¹⁶ Areas A and B are primarily cities and villages under PA rule.¹⁷ Area C includes Jewish Settlements, as well as IDF locations that remain under Israeli rule.¹⁸ Also included in Area C are areas under "transitional shared rule."¹⁹ The fate of the settle-

12. Israeli-Palestinian Interim Agreement on the West Bank and the Gaza Strip, Sept. 28, 1995, Isr.-P.L.O., 36 I.L.M. 551 [hereinafter Interim Agreement]. The Interim Agreement is also known as the Oslo II Agreement.

13. *Id.* at preamble.

14. *Id.*

15. *Id.* art. X. The cities covered in the IDF redeployment are: Bethlehem, Jenin, Nablus, Tulkarem, Qalqilia, and Ramallah.

16. *Id.*

17. Area A is made up of the eight Arab cities in the West Bank: Bethlehem, Hebron (El-Kalil in Arabic), Jenin, Jericho, Qalqilia, Nablus, Ramallah, and Tulkarem. Area B is made up of smaller towns and villages. *Id.*

18. Area C is made up of the portion of the West Bank controlled by Israel. *Id.*

19. Leon Harris, *The Israeli-Palestinian Interim Agreement: Economic and Tax*

ments and IDF Bases will be determined in the negotiations on permanent status of the Gaza Strip and the West Bank.²⁰ Thus, the Interim Agreement gave self-rule to most of the Palestinian population in the West Bank—however only 27% of the lands in the West Bank, and approximately 60% of the Gaza Strip were given to the PA.²¹ Nevertheless, for international banking purposes, it is clear that most Palestinian private businesses are within the 27% area controlled by the PA.

B. *Transfer of Authority*

Article I of chapter one of the Interim Agreement deals with transfer of authority from the IDF and its civil administration to the Palestinian Council.²² Accordingly, the Council enjoys executive and legislative powers within its jurisdiction. Furthermore, the Interim Agreement provides that the executive powers of the Council are vested in its Executive Committee.²³ For our purposes, the Council has the capacity to “conclude contracts”²⁴ and to sign “economic agreements” with “states or international organizations.”²⁵ Additionally, the PLO may conduct negotiations and sign agreements on behalf of the Council in issues involving regional development, and cultural, scientific, and educational agreements.²⁶ As we shall see, these Articles do not deal with the regulation of banks or of creating branch offices in the West Bank. However, these issues regarding the capacity to enter into contracts and the geographically limited jurisdiction may be contrasted with the banking authority vested in the Palestinian Monetary Authority (PMA).

Aspects, in ISRAELI BUS. L. 554 (Alon Kaplan ed., 1996).

20. See Interim Agreement, *supra* note 12, art. XI(2)(f).

21. See Mel Levine, *Palestinian Economic Progress Under the Oslo Agreements*, 19 *FORDHAM INT'L L.J.* 1393, 1395 (1996).

22. See Interim Agreement, *supra* note 12, art. I(1). Prior to elections for the Palestinian Council, its powers and responsibilities were exercised by the PA, established by the Cairo Agreement.

23. *Id.* art. V(1).

24. *Id.* art. IX(2).

25. *Id.* art. IX(5)(b)(1).

26. *Id.* art. IX(5)(b)(4).

C. *Economic Cooperation*

Special emphasis is placed upon the cooperation between Israel and the PA, with both sides committing to implement cooperation in a wide array of issues. Indeed, this cooperation extends into the banking system as well. If the peace process is to succeed, this mutual cooperation is both desirable and crucial. The cooperation in banking, particularly for conducting international banking operations, will be discussed, *infra*, in Part III. The cooperation provisions in the Interim Agreement focus on general issues, e.g., developing contacts in areas such as industry, agriculture, energy, transportation, tourism, science, culture, education, and environment.²⁷

D. *The Economic Protocol*

The Economic Protocol "established the political and procedural framework within which Israel and the PLO would work on actual economic development."²⁸ The Economic Protocol, which originally was annexed to the Cairo Agreement, was later given renewed effect by integrating it with certain modifications into the Interim Agreement through Article 24. Various economic aspects are addressed in the Economic Protocol, ranging from financial and monetary issues to movement of industrial and agricultural products, as well as other issues that may have some significance for banking in general and international banking, in particular.²⁹

1. The New Israel Shekel (NIS) remains the circulating currency in the PA. However, the Jordanian Dinar (JD) is also allowed to circulate in the West Bank. Introducing a Palestinian currency is a possibility that remains under discussion; and
2. A Joint Economic Committee (JEC) was introduced in order to oversee the implementation and trouble-shoot

27. See Harris, *supra* note 19, at 554; see also Interim Agreement, *supra* note 12, app. I.

28. David P. Fidler, *Foreign Private Investment in Palestine: An Analysis of the Law on the Encouragement of Investment in Palestine*, 19 FORDHAM INT'L L.J. 529, 536 (1995) (citing Interim Agreement, *supra* note 12, art. XXIV).

29. See Cairo Agreement, *supra* note 2, Annex IV, arts. I, II, IV-XI.

for issues related to this Agreement.³⁰ The JEC is a good idea, but its effectiveness has been doubted by some.³¹

III. BANKING IN THE PALESTINIAN AUTHORITY

A. *Banks in the PA*

The Palestinian financial sector has been "dynamic and growth-oriented," as reflected in the recent establishment of a number of new banks and investment concerns.³² For example, in 1994, the number of banking institutions operating in the PA doubled; by mid-1995 ten commercial banks operated in the area (through forty-one branches).³³ Currently, there are seventeen commercial banks with sixty-nine branches.³⁴ These banks include: ANZ Grindlays Bank, Arab Bank PLC, Bank of Jordan, Bank of Palestine, Arab Land Bank, Cairo-Amman Bank, Jordan and Gulf Bank, Commercial Bank of Palestine, National Bank of Jordan, and the Palestine Investment Bank. ANZ Grindlays Bank is the only foreign bank operating in the PA. The Arab Bank PLC is the largest bank operating in the PA and has seventeen branches worldwide, including two in New York City.³⁵

Additionally, preliminary plans have been made for opening a Palestinian Securities Exchange. It is also agreed that Israeli banks in the areas given to the PA may continue to

30. *Id.*

31. See, e.g., Jasmine Jordaan, Note, *Proposal of Dispute Resolution Mechanisms for the Israeli-Palestinian Interim Agreement: A Crucial Step for Establishing Long Term Economic Stability in Palestine and a Lasting Peace*, 23 BROOK. J. INT'L L. 555, 592-93 (1997).

32. See *Handbook on Palestinian Business*, ch. 8 ¶ 1 (visited Apr. 14, 1998) <<http://casa.mena.org/newweb/Region/palestine/handbook/chap8txt.html#A>>. The Handbook was prepared by the Small Business Support Project of the United States Agency for International Development (USAID).

33. *Id.* ¶ 1. For a brief description of the Palestinian banking system, see *Country Commercial Guide—Palestinian Authority* (visited Oct. 30, 1998) <<http://mena-peacenet.nist.gov/Palestine/chapter8.htm>>. The Guide is published by the Middle East/North African Information Exchange Network (MENA).

34. See *Investing in the PA Areas: Rules For Doing Business, Franchising Opportunities*, MIDDLE EAST EXECUTIVE REPORTS, WEST BANK AND GAZA, May 1997, at 20 [hereinafter MIDDLE EAST EXECUTIVE REPORTS].

35. *Id.* at 21. For a historical note on banking in the Palestinian areas, see Dr. Suleiman Abbadi, *Credit Facilities of Commercial Banks in Palestine* (visited Nov. 14, 1998) <<http://www.cprs-palestine.org/economy/97/banks.html>>.

operate, and a special relationship will exist between the banks operating in the PA and the banks operating in Israel. I will discuss this relationship, *infra*, Part D.

Currently, there is no Palestinian banking law, although observers anticipate one shortly.³⁶ Thus, many of the formerly-existing regulations and restrictions still apply in the PA. Accordingly, the laws of the civil administration still apply a combination of British Mandate Law and Israeli Military Orders in the Gaza Strip, and a combination of Jordanian law and Israeli military orders in the West Bank. Note that the Central Bank of Israel or the Central Bank of Jordan supervises all branches in non-autonomous areas of the West Bank.³⁷

B. Regulating Banking and Financial Issues in the PA

The Agreements pertaining to monetary and financial issues in the PA are found in Article IV of the Economic Protocol.³⁸ This article establishes the financial "hierarchy" in the PA. As we will see, U.S. international banking activities are largely affected by the location of business and by the local laws and regulations of the "host," in this case the PA. Thus, it is essential to understand the legal and financial environment of the PA in which a U.S. bank may operate.

The Economic Protocol allows for the PA to establish a monetary authority.³⁹ The PMA, headquartered in Gaza City, has the powers and responsibilities for the regulation and implementation of the monetary policies within the functions described in Article IV of the Economic Protocol.⁴⁰ The powers and responsibilities bestowed in the Protocol include the power for the PMA to act as:

The Palestinian Authority's official economic and financial advisor;

The Palestinian Authority's and the public sector entities' sole financial agent, locally and internationally . . . ;

36. See *Handbook on Palestinian Business*, *supra* note 32, ¶ 2.

37. *Id.*

38. Cairo Agreement, *supra* note 2, at 703, Annex IV, art. IV.

39. *Id.* Annex IV, art. IV(1).

40. *Id.* Annex IV, art. IV.

The foreign currency reserves (including gold) of the Palestinian Authority and all Palestinian public sector entities will be deposited solely with the PMA and managed by it;

The PMA will act as lender of last resort for the banking system in the Areas; and

The PMA will authorize foreign exchange dealers in the Areas and will exercise control (regulation and supervision) over foreign exchange transactions within the Areas and with the rest of the world.⁴¹

C. Regulating Banking Operations

The PMA has a banking supervision department, responsible for the "proper functioning, stability, solvency and liquidity of the banks operating in the Areas"⁴² (i.e., in the PA areas). The PMA is expected to act in accordance with international principles and standards, namely the Basle Committee.⁴³ Article IV(7)(c) of the Cairo Agreement is particularly relevant to our discussion, and it states, "[t]he supervision department will be charged with the general supervision of every such bank, including: the regulation of all kinds of banking activities including their foreign activities; the licensing of banks formed locally and of branches, subsidiaries, joint ventures and representative offices of foreign banks, approval of controlling shareholders, and the supervision and inspection of banks."⁴⁴ Furthermore, the PA has "the authorit[y], powers and responsibilities regarding the regulation and supervision of capital activities in the Areas, including the licensing of capital market institutions, finance companies and investment funds."⁴⁵

The provision can be viewed as covering three key issues: first, the PMA has an authority to operate independently without Bank of Israel control; second, the PA recognizes a wide

41. *Id.* Annex IV, art. IV(2)-(6).

42. *Id.* Annex IV, art. IV(7)(a).

43. *Id.* Annex IV, art. IV(7)(b).

44. *Id.* Annex IV, art. IV(7)(c).

45. *Id.* Annex IV, art. IV(18)(e).

array of foreign banking activities (namely, branches and subsidiaries); and third, the PA has a wide scope of authority and discretion. However, as we shall see, this contention is contested in view of the special relations with the Israeli banks.

D. Special Relations With the Bank of Israel and Other Israeli Banks

Because of geographic proximity, as well as dependence of the young PA banking system on its Israeli counterpart, the PA and Israel have created special banking relations with each other. It is worth examining this relationship because it may affect the branch prospects of an American bank in the PA. Prior to the *Intifadah* of 1987, twenty-eight branches of Israeli banks operated in the West Bank. By July 1995 there was only one operating branch.⁴⁶ The Economic Protocol contains special provisions and procedures for Israeli or Palestinian banks wishing to operate in each other's territory.⁴⁷ Some commentators have observed that although the Israeli banks have ceased to operate directly in the West Bank, the banks "still continue to play an active role as correspondents."⁴⁸ Indeed, according to the Economic Protocol, all banks conducting business in the PA must have an Israeli correspondent bank in order to supply customers with a wide array of services.⁴⁹

1. New Israel Shekel Transactions

In these transactions, the Israeli correspondent bank provides clearinghouse services for its Arab clients. Moreover, in practice, Arab banks also keep their NIS accounts with the Israeli banks, rather than on their own premises. It should be noted that clearinghouse services in JD are provided within the PA.⁵⁰

46. The Mercantile Discount Bank in Bethlehem is the only branch remaining in the West Bank. See *Handbook on Palestinian Business*, *supra* note 32, ¶ 8.

47. See Cairo Agreement, *supra* note 2, Annex IV, art. IV(8)(9).

48. See *Handbook on Palestinian Business*, *supra* note 32, ¶ 8.

49. *Id.* ¶ 3.

50. See Cairo Agreement, *supra* note 2, Annex IV, art. IV.

2. Foreign Currency Transactions

These transactions include purchase and sale of foreign currency against NIS, conversion of foreign currency at cross rates, outgoing and incoming transfers, deposit of checks in foreign currency, cash deposit and withdrawal, issuance of bank checks, account maintenance, and interest on deposit of funds in foreign currency.⁵¹

3. Foreign Trade Services and Transactions

This category applies to both import and export services. The former includes opening an account, collecting documents, issuing and servicing letters of credit, issuing guarantees, and other general services pertaining to imports such as: return of documents and processing protest fees. The latter includes: collecting bills of exchange and other documents, opening accounts, and advising and transferring letters of credit.⁵²

IV. PROBLEMS THAT HINDER THE EFFICIENCY OF INTERNATIONAL BANKING IN THE PA

Few observations can be made about the functioning of the international banking system in the PA. In saying "international banking," I refer to the functioning ability of banks in the PA that have a clientele conducting business abroad, and hence are in need of international banking services. My observations conclude that in order for the Palestinian banking system to function in the international arena, the procedures must be simplified, hence the need for a bank that could operate locally and satisfy both the Palestinian economic needs, as well as the requirements of the Israeli banks that are involved in the process. Next, we shall examine these observations.

A. *Operating Requirements*

Every bank operating in the PA, "regardless of country of origin," must have an Israeli correspondent bank to process NIS transactions, as well as transactions that involve funds

51. *Id.*

52. *Id.*

coming from abroad, or funds transferred abroad.⁵³ Additionally, bank branches operating in the PA are required to send a daily activity report to the Central Bank of Israel.⁵⁴ The PA-based bank will, in turn, use its foreign currency deposits abroad in order to guarantee the Israeli bank's role as correspondent.⁵⁵

This cooperation between the Israeli banks and the banks operating in the PA is a promising one, yet it poses practical problems of administration, increases expenses, and hinders fast and efficient banking because every international transaction (however minor) has to be relayed back and forth between the bank in the PA and its Israeli correspondent.

B. Branching Limitations

At this point, banks that have head offices registered with the PMA may not open a branch in Israel, or in the areas of the West Bank outside the jurisdiction of the PA. This prohibition is to insure financial security inside Israel and in the areas under Israeli control, since the banks do not have a lender of last resort.⁵⁶ According to the Economic Protocol, the PMA is expected to eventually take on this role,⁵⁷ although at present it does not have the financial power to do so.

Although the above-mentioned restriction is a logical one, the restriction nevertheless hinders the prospects of expansion of the banks into the rest of the West Bank and beyond. This inability to expand reduces the incentive to base banks in the PA, thus creating a negative signal of investment and economy in the PA.

C. Currency Restrictions

According to the Economic Protocol, branches in the West Bank are to deal exclusively in the NIS and JD. In other words, they are prohibited from opening accounts for clients in other currencies.⁵⁸ Furthermore, "if a client deposits cash on a

53. See *Handbook for Palestinian Business*, *supra* note 32, ¶ 3.

54. *Id.*

55. *Id.*

56. *Id.*

57. See *Cairo Agreement*, *supra* note 2.

58. See *Handbook for Palestinian Business*, *supra* note 32, ¶ 4.

check in foreign currency in a West Bank branch, the client can only withdraw it from that branch in JD or NIS.⁵⁹

Maintaining the dominance of the NIS and the JD in the PA necessitates this measure. Furthermore, this measure stabilizes both currencies in the PA. However, this policy may alarm investors—especially foreign investors—who may be reluctant to invest in the PA system, since it rids them of “hard currency” (i.e., U.S. dollars and leading European currencies). Similarly, exporters in the PA, who play a major role in bringing in hard currencies, may well find themselves without incentive to do so. Additionally, it is difficult to conceive of conducting efficient international banking operations under such restrictions since the hard currency is the main way to communicate financially with the West.

D. Non-Acceptance of Guarantees

It should be noted that branches in the PA are permitted to maintain foreign currency accounts “without Israeli supervision, and without the need for an Israeli correspondent bank.”⁶⁰ In practice, however, a number of banks in the PA ultimately choose to utilize an Israeli correspondent bank. It has been suggested that this is because goods that arrive in Gaza and the West Bank must still be imported through Israel. Ordinarily, Israeli businesses will not accept guarantees from Arab Banks.⁶¹ Therefore, an Israeli correspondent bank issues a guarantee.⁶²

This reluctance on the part of Israeli businesses is understandable, because the current political situation is still unclear and these businesses do not wish to find themselves disconnected from banks operating in the PA, if the political situation should take a turn for the worse. It is also true that the mistrust between the two peoples reaches into the realm of business. This grim picture leaves the banking system fragmented and unable to satisfy the needs of efficient business, and ultimately slows down trade and commerce.

59. *Id.*

60. *Id.* ¶ 5.

61. *Id.*

62. *Id.*

E. Lack of Certainty

The final problem is the lack of a standard model for the agreement between a PA bank and its Israeli correspondent. Currently, the banks negotiate an agreement which is then subject to review by the Bank of Israel.⁶³ The clients do not have a say in the transaction between a PA bank and its Israeli correspondent. Thus, a client's role is merely to inform his or her own bank as to the nature of the transaction to be made—the PA bank in turn processes this request through the Israeli correspondent.⁶⁴

This chain of negotiations that begins from the client in the PA and ends at the Bank of Israel is incompatible with the modern need for fast and efficient international banking. Continuous debate of every transaction is the complete opposite of fast-paced decisions that are crucial in the international business arena. Furthermore, the lack of standard agreements deals a fatal blow to legal certainty. International transactions are based on the assumption that each side will comply and operate within a clear framework of moving goods and monies. How can this be done when nothing is clear from the outset? How can international banking commence to serve business when every deal is in a mist of uncertainty? Indeed, the streamlined Israeli banking system plays a crucial role in the development and intermediate functioning of the young Palestinian banking system. While many of the present restrictions and procedures are necessary, due to the unclear situation, there is a need to pursue a more efficient system. If trade and banking are to guide the peace process, the banking system should be reconstructed in a manner that allows PA banks to render all services of business banking, especially international banking.

Reconstructing the PA banking system may be costly and may take some time.⁶⁵ A large part of the current problem

63. *Id.* ¶ 9.

64. *Id.* Service charges ordinarily are calculated on a percentage basis. A minimum charge is applied in each case. *Id.*

65. Many other internal elements are said to reflect on the current unsatisfactory situation with respect to banking in the PA. For a discussion of these issues, see Osama Hamed, *The Palestinian Banking System: Reality and Potential* (visited Oct. 30, 1998) <<http://www.palecon.org/masdir/notes/mas5.html>>. See also CENTER FOR PALESTINIAN RESEARCH AND STUDIES, *The Palestinian Monetary Authority and the Banking System* (visited Apr. 14, 1998)

will be solved once the PMA assumes its role as the lender of last resort. However, this solution demands considerable funds, which are lacking at the present time. As an intermediate solution, I propose that a branch of a U.S. bank in the PA will contribute to a more sound and efficient banking system in the PA. The next section will examine the procedural and substantive issues concerning such a U.S. bank.

V. AN AMERICAN BANK IN THE PA

In the current situation, where political constraints and a degree of deadlock exists, changing the procedures of international banking in the PA is a difficult task. An American bank branch in the PA may provide a solution, and it may assume the role of a bypass in this blocked artery in the heart of the international banking system in the area. First, we will examine whether it is possible for an American bank to open a branch in the PA. Second, we will examine the potential benefits for all concerned.

A. *Regulation of American Banks Opening Branches Abroad*

Section 25 of the Federal Reserve Act of 1913 (FRA) grants national banks the powers to establish foreign branches abroad and to conduct investment activities.⁶⁶ Section 9 of the FRA grants similar powers to state chartered member banks.⁶⁷ The scope of powers granted in section 25 is quite broad in that it allows U.S. foreign branches "to exercise such further powers as may be usual in connection with the transactions of the business of banking in the place where such foreign branch shall transact business."⁶⁸ Thus, in our case, section 25 allows U.S. foreign branches to engage in activities similar to other banks operating in the PA. Thus, a U.S. bank will be able to effectively compete with all other banks operating in the PA. Furthermore, section 25 allows the U.S. bank to invest directly

<<http://bertie.la.utexas.edu/research/mena/cprs/ed/bseiso/html>>.

66. See Federal Reserve Act, ch. 6, § 25, 38 Stat. 251, 273 (1913) (codified as amended at 12 U.S.C. § 601 (1994)).

67. *Id.* § 9.

68. *Id.* § 604(a).

in the foreign banks.⁶⁹ The Edge Act of 1919,⁷⁰ (enacted as section 25(a) of the FRA), further enhances the international banking powers of U.S. banks. The Act enables U.S. banks to own Edge Act corporations, so that the U.S. banks may engage in international banking activity.⁷¹

Through the Edge Act corporations, the American banks are given the opportunity to engage in a wide array of international financial activities, such as holding stock in foreign companies that are "not engaged in the general business of buying or selling goods, wares, merchandise or commodities in the United States"⁷² A relevant application of these powers is a Palestinian, Israeli or Jordanian company operating in the PA and conducting investment and trade within the Middle East or the European Community. An Edge Act corporation could hold stock in such a company. Essentially, I conclude that the Edge Act helps American banks to maintain their edge in the international banking arena.

Regulation K⁷³ of the Federal Reserve is deemed to be the "principal regulatory oversight for U.S. international banking laws."⁷⁴ Regulation K sets the powers of U.S. banking organizations operating outside the U.S.⁷⁵ This is done by implementing portions of section 25 and 25(a) of the FRA and section 4(c)(13) of the Bank Holding Company Act of 1956 (BHCA).⁷⁶ An expansion to Regulation K was adopted in a Final Rule of the Board of Governors of the Federal Reserve System on December 21, 1995.⁷⁷ The expansion made it easier for well-managed U.S. banks to invest abroad.⁷⁸ The Final Rule eliminates the \$25 million limit on general consent au-

69. *Id.* § 601.

70. *Id.* §§ 611-632.

71. *Id.*

72. *Id.* § 615(c).

73. 12 C.F.R. § 211.4 (1998).

74. Henri Moudi, *The State of U.S. Banking in the Global Arena*, 10 B.U. INT'L L.J. 255, 274 (1992).

75. 12 C.F.R. § 211 (1998).

76. Bank Holding Company Act § 4(c)(13), 12 U.S.C. § 1843(c)(13) (1995).

77. International Operations of United States Banking Organizations, 60 Fed. Reg. 67,050 (1996) (amending 12 C.F.R. § 211) [hereinafter Final Rule].

78. See generally John B. McGinty, Jr., Comment, *Development in Banking Law: 1996*, 16 ANN. REV. BANKING L. 150 (1997) (surveying international banking activities in selected countries and regions); see also *Fed Eases Regulation K Burden for Banks Investing in Foreign Countries*, 66 Banking Rep. (BNA) 9 (Jan. 8, 1996).

thority for banks to invest in non-U.S. companies.⁷⁹ In addition, the Final Rule raises the dollar amount that an Edge Act corporation is permitted to invest in a single company under general consent.⁸⁰

B. *Opening a Branch in the Palestinian Authority*

For an American bank to open a branch in the PA, it must receive the permission of both sides (i.e. the Bank of Israel and the PMA).⁸¹ Where the bank wishes to open a branch in the non-autonomous areas of the West Bank, only the permission of the Bank of Israel is required. However, most banks also request permission from the PMA, with "a view to the future political situation."⁸² Since Israel has some authority in which banks may operate in the PA, it is useful to note that Citibank has set up a representative office in Israel, which makes Citibank the first large international bank to establish operations in Israel.⁸³ This endeavor of Citibank is a vote of confidence in both the Israeli banking system and the blossoming economy. According to one commentator, "Citibank cited Israel's economic improvements, better regional stability, and more business opportunities resulting from geopolitical changes, including the peace process, as reasons for the move."⁸⁴ I conclude that Israel will not be hostile to an American bank wishing to branch in the PA. On the contrary, such a branch should be a welcome sign of economic stability in the area.

C. *The Role of an American Bank in the PA*

The involvement of the United States in Middle Eastern banking is not new. In October 1995, the United States announced an agreement to launch an international development bank to promote investment in the Middle East and North Africa.⁸⁵ This bank is expected to capitalize at about \$5 bil-

79. See Final Rule, *supra* note 77, at 67,051.

80. *Id.*

81. If the bank is a Jordanian listed bank, permission is also required from the Central Bank of Jordan. See *Handbook on Palestinian Business*, *supra* note 32, ¶ 6.

82. *Id.*

83. See Richard L. Holman, *Citibank Enters Israel*, WALL ST. J., Feb. 6, 1996, at A11.

84. McGinty, *supra* note 78, at 158.

85. See *U.S. and Other Countries Announce Start of Mideast Development*

lion, with about \$1.25 billion of paid-in capital over a five year period, with the U.S. share expected at about 10-20 percent.⁸⁶ Four regional entities—Israel, Egypt, the PA and Jordan, along with the United States and Canada—have already signed on to this project.⁸⁷ Some commentators believe that this bank would “draw on the experiences of the European Bank for Reconstruction and Development, focusing on private sector development with debt and equity financing and providing expertise for improving capital markets.”⁸⁸ Furthermore, this proposed bank will “seek out projects for assistance, in particular, that contribute to promoting regional trade and investment in such sectors as transportation and communications.”⁸⁹ Also, a variety of activities will be provided by the bank: from lending directly to public or private-sector entities at market rates, to lending through other commercial entities, as well as providing risk insurance and guarantees.⁹⁰

The role of an American bank operating in the PA may not seem to be as ambitious as the development bank, yet, as we shall see, an American bank branch in the PA has a great potential to contribute to all concerned.

D. The Palestinian Economy and the Need for Long-Term Financing

The PA consists of the Gaza Strip and areas of the West Bank,⁹¹ with a combined territory of 6,610 sq. km (2,368 square miles), and a population of 2.3 million, 65% of whom are under the age of fifteen.⁹² The PA economy is largely service-oriented with a private sector actively dominating the economy with about 85% of the Gross Domestic Product (GDP). In this respect, the PA is quite distinct in that the Palestinian Council does not have ownership of large sectors of the economy.

Bank, 12 Int'l Trade Rep. (BNA) 1823 (Oct. 11, 1995).

86. *Id.*

87. *Id.* Italy and Japan have also agreed to participate.

88. *Id.*

89. *Id.*

90. *Id.*

91. On the local level the PA is comprised of 29 municipalities and 96 village councils.

92. The Palestinian population has a natural growth rate of 3% in the West Bank and 3.3% in the Gaza Strip.

The Palestinian Gross National Product (GNP) is about U.S. \$3 billion, 20% of which is earned outside the PA.⁹³ Low-cost Palestinian labor constitutes, in Israel, the second-largest source of income for the 380,000-person Palestinian work force.⁹⁴ Because of security constraints, Israel currently allows 30,000 Palestinian workers (who are married and over the age of thirty) to work in Israel.⁹⁵ Until three years ago the Palestinian workforce constituted the bulk of the unskilled labor force in Israel, namely in building and construction. Initially, it was perceived that new enterprises in the PA would provide an alternative source of employment. However, the shortage of substantial investment and foreign aid has hampered these prospects, at least for the short term.⁹⁶ Thus, due to low-cost labor and severe unemployment it is not surprising that the purported per capita annual income of U.S. \$850 is half that of the West Bank, and roughly 5% of Israel's.⁹⁷

In contrast to this grim picture, the Palestinian economic skills have proved their success in the Arab, as well as the international economic arena. Indeed, for many years, the Palestinian skilled workforce found employment in the Gulf countries and provided a steady flow of income home.⁹⁸ In the wake of the Gulf war, this flow of income was cut short, adding to the economic decline in the West Bank and the Gaza Strip. Banks in the PA offer short-term credit, such as overdrafts, LC's, and bank guarantees. Long-term financing is not available. Average interest rates on loans in NIS are 20-25 percent, and 13 percent on loans in JD's.⁹⁹

Without any adequate (and relatively inexpensive) long-term financing, there is no incentive for the much-needed investment in infrastructure, services, trade, and tourism. An

93. See Levine, *supra* note 21, at 1395-96.

94. There is an annual increase of 10,000 to this work force.

95. This followed a series of bombings in Tel-Aviv and Jerusalem carried out by Palestinian extremists against (military and civilian) Israeli targets.

96. See Keith C. Molkner, *Legal and Structural Hurdles to Achieving Political Stability and Economic Development in the Palestinian Territories*, 19 FORDHAM INT'L L.J. 1419, 1422 (1996).

97. For an overview of the Palestinian economy between 1970-1991, see Levine, *supra* note 21, at 1396-98. See also Osama Hamed & Mark Khano, *Palestinian Banking Sector: Statistical Review* (1995) (visited Nov. 14, 1998) <<http://www.palecon.org/masdir/publications/bankingsec2.html>>.

98. See Levine, *supra* note 21, at 1396.

99. See MIDDLE EAST EXECUTIVE REPORTS, *supra* note 34, at 20.

American bank that introduces long-term financing at competitive rates may find itself in the center of a very profitable market and it would be able to fill a vacuum in the banking arena of the PA.

Many other sources of finance are provided toward investment in the PA, including international organizations and programs from Europe and the United States, and may include: Arab Development and Credit Company, Arab Technical Development Corporation, British Palestinian Partnership Scheme, European Community Investment Partners, French Import Program, U.S. AID's Loan Guarantee Program, The United Nations Relief and Works Agency (UNRWA), Income Generation Project, American Near East Refugee Aid (ANERA), and the U.S. Government's Foreign Commercial Services.¹⁰⁰ These programs are largely aimed at "micro" rather than "macro" goals, i.e., poverty alleviation, human development, environment protection. These programs serve a noble purpose, yet they do not and cannot substitute for long-term commercial loans for large-scale investment. Some business-oriented loans are offered by these programs, however, an American commercial bank offering long-term loans would only complement these efforts. In order to highlight this proposition, it is useful to examine the nature of American involvement in commercial lending in the PA.

1. American Near East Refugee Aid (ANERA)

ANERA is a non-profit organization, established in 1968. Through social and economic projects, ANERA works to reduce poverty and relieve human suffering, particularly among Palestinians and Lebanese.¹⁰¹ ANERA grants loans for farmers, fishermen, and women entrepreneurs in Gaza.¹⁰² However, the combined budget of these schemes does not exceed U.S. \$5 million and the individual loans do not exceed U.S. \$ 10,000.

100. See *Handbook on Palestinian Business*, *supra* note 32. UNRWA offers two credit programs for Gazan businesses: a revolving loan fund for small manufacturers, and a group lending program for women entrepreneurs. *Id.*

101. *Id.* ¶ 15.

102. *Id.*

2. U.S. Government's Foreign Commercial Services (FCS)

The FCS offers business and financial services, with the goal of promoting trade among American, Palestinian and Israeli businesses. The FCS does not offer financing itself, but it can direct Palestinian businesspersons to two U.S. Government finance programs.¹⁰³

The first program is the Overseas Private Investment Corporation (OPIC). A number of OPIC-sponsored trade missions have visited the PA, and have yielded new joint venture and business deals. OPIC offers medium-to-long-term financing for sound overseas projects through loan guarantees and direct loans.¹⁰⁴

The second program is the Export-Import Bank (EXIM). EXIM offers credit for machinery purchases and consumer products from the United States, at "somewhat below" market rates.¹⁰⁵ Until recently, EXIM was not open for business in the PA, although Palestinian businessmen could utilize its services through a guarantor in Jordan or Egypt where the bank does operate, or through a U.S. exporter who has an existing insurance policy with the EXIM bank. Today, EXIM has some limited programs in the PA areas.¹⁰⁶

E. Improving Efficiency of International Transactions

As discussed in Part IV, all banks and branches operating in the PA must have an Israeli correspondent bank to handle NIS transactions, and transactions involving money coming from or being transferred abroad (e.g. letters of credit). An American bank operating in the PA may be a substitute for such an inefficient practice.

An American bank, being well-connected and well-trusted by Israel, will be able to handle such transactions. Naturally, the American bank will not allow itself to be used to transfer money that might compromise Israeli national security. Thus,

103. *Id.* ¶ 28.

104. *Id.*

105. *Id.*

106. *Id.* See also MIDDLE EAST EXECUTIVE REPORTS, *supra* note 34, at 22. For more on how to finance exports, methods of payment, and project financing, see *Country Commercial Guide—Palestinian Authority*, *supra* note 33, ch. VIII.

an American bank could serve its Palestinian clientele in conducting international business transactions without the need for a "detour." In addition, a practice of reporting to the Central Bank of Israel should be introduced in order to allow for Israeli supervision of banking operations without the need for correspondent banks.

F. The Ability to Branch in the PA and in Israel

Unlike banks that have a head office registered with the PMA, an American bank will be at liberty to open branches in the PA, as well as in Israel. This mobility may well simplify the financing of commercial transactions. Consider a situation where a Palestinian or foreign manufacturer establishes a furniture assembly line in the Gaza Strip. Needless to say, due to the abundance of both skilled and low-cost labor force in Gaza, this assembly line may compete well in the European market. This manufacturer will most likely depend on the Israeli port of Haifa to import raw materials. If the American bank has branches both in Haifa and Gaza City, the procedure for payment of LCs, transfer of monies and presentation of required documents for the release of the materials from the port of Haifa may be made simpler, since the manufacturer can utilize both branches for his dealings. The same may apply in any Israeli-Palestinian Joint Venture, where the American bank with branches in both entities, would be able to provide swift transfers of money and instructions within the same bank rather than among two or more banks. Furthermore, the problems with respect to lack of lender of last resort in the PA, will most likely not worry the Israeli banking system since the American bank is well established and secure.

G. Unrestricted Currency Dealings

The restriction of dealing with only NIS and JD should not have to apply to an American bank. On the contrary, an American bank is likely to stimulate flow of "hard currency" into Israel and the PA through export and investment. Foreign currency accounts could be opened with the American bank without any hesitation. Since Israeli businesses will naturally be reluctant to accept guarantees from Arab banks, the American bank could fill this need. The Israeli banks will gladly receive such guarantees from an American bank, thus elimi-

nating the lengthier process of supplying guarantees through Israeli banks. In the prior example, the manufacturer could issue guarantees directly from the (American) bank to any Israeli business with which he or she is involved.

H. Simplifying the Decisionmaking Process

A client of the American branch will save time, reduce expenses, and increase certainty in business dealings. Since the need for an Israeli correspondent bank will no longer be necessary, the negotiating process that occurs between a branch in the PA and its Israeli correspondent bank will be evaded. Thus, a client of an American bank can merely instruct the bank, which will act accordingly without the current need to negotiate each and every deal. Informing the Israeli banking system about banking transactions affecting it, is still a very necessary and useful tool, since the ultimate goal is to enhance the cooperation between both banking systems.

VI. CONCLUSION

Efficient banking and unrestricted movement of monies is at the very essence of financial development. The current situation in the PA banking system with respect to international banking is unsatisfactory. However, the situation should be viewed in the context of the conflicting interests. While there is a need to free the Palestinian banking system, there is a corresponding need to address the Israeli financial concerns.

The role of the United States in the peace process has been invaluable, but without a stable Palestinian economy, the process may prove to be a house of cards. The well-established and experienced American banks may step in and bridge the gap, thus providing efficient and rapid banking that is the impetus of economic progress. Clearly, the banks are not philanthropic institutions. An American bank that supplies competitive financial services and provides a "smooth ride" for businesses may well profit greatly from handling the bulk of Palestinian international banking. The PA may yet prove to be the "Hong Kong" of the Middle East.

