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CONTENTS

[1] The IMF provides technical services to the West Bank and Gaza, including policy advice in the macroeconomic, fiscal, and financial areas, as well as technical assistance, with a focus on tax administration, public financial management, public expenditure management, banking supervision and regulation, and statistics. See www.imf.org/wbg for previous reports.

EXCESS CASH IN THE PALESTINIAN BANKING SYSTEM

For more than a decade, commercial banks in West Bank and Gaza (WBG) have struggled to manage buildups of excess physical Israeli shekel cash. Banks elsewhere typically manage the amount and currency composition of physical cash they hold in their vaults through transactions with other commercial banks and central banks. However, citing money laundering and terrorism financing (ML/TF) concerns, the two Israeli banks that currently offer correspondent services to banks operating in WBG no longer offer them cash services. The Bank of Israel (BoI) has imposed limits on the amount of shekel coins and notes it accepts back from Palestinian banks. This has long hindered liquidity management and been a drag on the profitability of Palestinian banks, but periodic large increases in excess cash in recent years have created additional risks and raised the costs to the Palestinian banking system.

A. Excess Cash in West Bank and Gaza

1. WBG has no national currency and the New Israeli Shekel (NIS), issued by the BoI, is the main means of payment, while the Jordanian Dinar (JOD) and the U.S. Dollar (USD) are also widely used.[2] Palestinian Authority (PA) employees' wages and retirees' pensions are paid in NIS, as are goods imported from and exported to Israel. Palestinian workers in Israel are paid and remit in NIS,[3] and clearance revenue (taxes collected by Israel on behalf of the PA) is transferred by the Government of Israel (GoI) to the PA in NIS. However, real estate is normally appraised in USD, and land in JOD and USD. Private sector employees are mostly paid in USD, except bank employees who are paid in JOD.

2. Before 2009, all banks operating in WBG shipped their excess physical shekel cash to their Israeli correspondent banks to be credited to relevant banks' accounts. However, the GoI's security cabinet declared the Gaza Strip a "hostile entity" in 2007. As a result, Israeli banks severed all correspondent banking relations with banks operating in Gaza in 2009. They also terminated the cash clearing services they offered domestic Palestinian banks operating in the West Bank that year because of a perceived increase in ML/TF risks.[4] Discount Bank, the Israeli correspondent bank of foreign banks operating in the West Bank, continued to offer them cash services until May 2017.[5]

3. The BoI began servicing cash shipments from domestic Palestinian banks operating in the West Bank in 2009, when Israeli correspondent banks terminated their cash services, but

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[2] The Paris Protocol Article IV on Monetary and Financial Issues requires the NIS to serve as means of payment for all purposes in WBG, including official transactions.

[3] Most simply carry their cash wages across the border to WBG.

[4] Arab Bank, the largest bank in WBG (by assets), was found liable for TF in a case brought against it in U.S. courts and reached a settlement with the plaintiffs for an undisclosed amount in August 2015, pending the results of the bank's appeal. The verdict was overturned by the Second U.S. Circuit Court of Appeals in 2016, after more than 13 years of litigation.

[5] Israeli banks continue to offer other correspondent services such as trade finance and foreign exchange services to some Palestinian banks operating in the West Bank.

set a monthly limit on the amount of coins and notes it accepted. This NIS cash in circulation is a BoI liability and as legal tender its return should, in principle, be accepted by the BoI. The limit was however set by the BoI, in coordination with the Coordinator of Government Activities in the Territories (COGAT), because of Israeli concerns that some of the cash may be proceeds from illegal activity. It was adjusted in 2017 to include shekel cash shipments from foreign banks operating in the West Bank. While the purpose of the limit is to protect the BoI and the Israeli economy from ML/TF risks, imposing a limit on cash shipments does not address the underlying risks, which may be best tackled at the transaction level. Still, restricting cash shipments is a commonly adopted mitigating measure in jurisdictions worldwide. Nevertheless refusing to accept excess liquidity from Palestinian banks negatively affects the Palestinian banking sector and fosters greater informality and use of cash in WBG, which in turn raises ML/TF risks.

4. The excess shekel cash accumulation in the Palestinian banking system became a very tangible symptom of broader and more complex financial stability issues. As discussed above, ML/TF risks, risks to shekel correspondent banking relations and excess physical shekel cash buildups are interconnected. Severed shekel correspondent cash services and limited shipments back to the BoI motivated by the perceived increase in ML/TF risks have led to the accumulation of excess physical shekel cash.

5. This paper discusses excess physical shekel cash in WBG, focusing on the links between physical cash flows from regular economic activity—notably from cross-border flows between Israel and the West Bank, and legal Palestinian informal activity—and the inflow of excess shekel notes and coins in banks operating in the West Bank. Physical cash entry into and exit from the Gaza Strip is minimal[6] and closely supervised by COGAT, as Israel considers it a matter of national security. In general, banks operating in the West Bank and in Gaza manage shekel cash from operations in both regions separately. Electronic shekel transactions between WBG and Israel present lower ML/TF risk and are not the focus of this paper. They are cleared and settled in the Israeli MASAV automatic clearing house system through Israeli correspondent banks.[7] Therefore, throughout the remainder of this paper, "cash" refers to physical cash.

B. How Much Excess Shekel Cash Is There?

6. The Palestine Monetary Authority (PMA) defines excess shekel cash as shekel cash in banks' vaults exceeding 6 percent of short-term shekel deposits. It requires banks to hold 3 percent of their deposits in each currency at each branch, in cash in vaults, in addition to holdings of 3 percent of total deposits in each currency needed to meet daily customer cash withdrawal needs. The PMA's reserve requirement of 9 percent of deposits in all currencies must be met separately.[8]

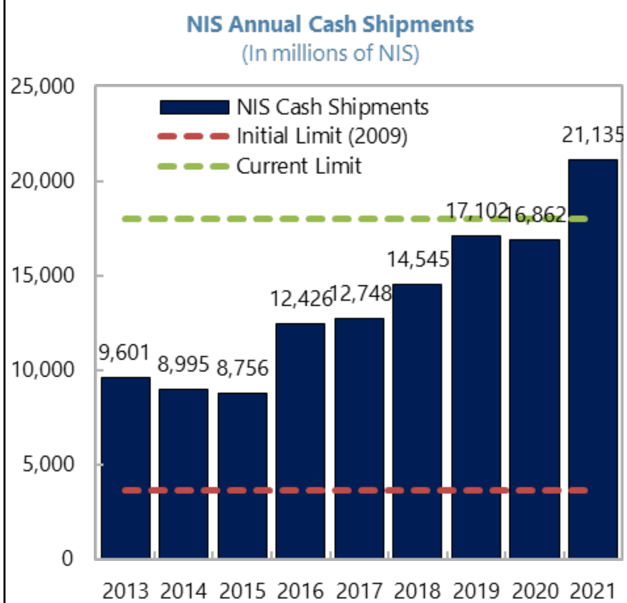
[6] One exception is NIS damaged notes that are shipped out of Gaza and replaced by equivalent amounts of NIS notes from the West Bank, with COGAT approval.

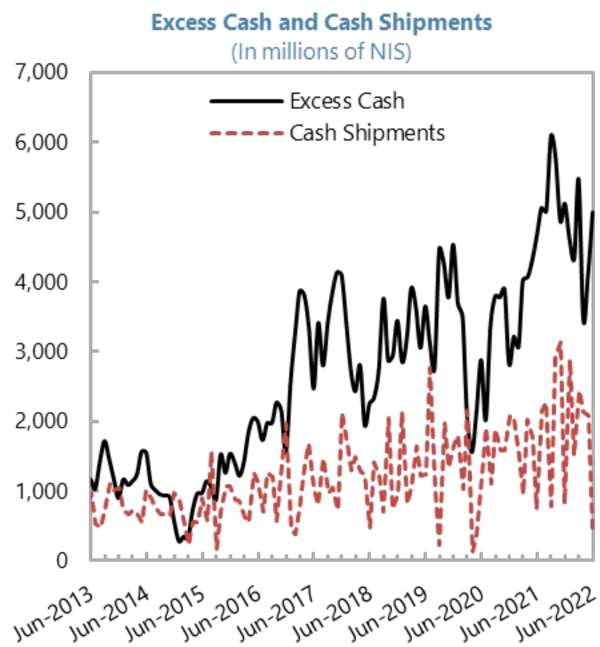
[7] Banks operating in WBG are members of the clearing house but have limited rights. They are not authorized to send direct instructions in the MASAV and must instead rely on their Israeli correspondent banks.

[8] 20 percent of these reserves are held in settlement accounts (for clearing).

7. In recent years there have been periodic large increases in excess shekel cash in the Palestinian banking system. This despite several increases in the limit of cash that can be transferred back to Israel, and ad-hoc transfers above the limits. Transfers of NIS cash from banks operating in the West Bank more than doubled over the last 8 years, rising from NIS 9.6 billion in 2013 to NIS 21.1 billion in 2021.[9] The current limit is NIS 4.5 billion per quarter (or NIS 18 billion per year), five times the initial monthly quota of NIS 300 million set in 2009. The BoI has also authorized ad-hoc additional cash transfers above the limits (including exceptional shipments of NIS 2.4 billion in 2021Q4 and NIS 2.3 billion in 2022Q1, and a planned shipment of a similar amount in 2022Q3).[10] Yet, banks held excess shekel cash of NIS 5 billion (equivalent to 7.2 percent of assets) at end-June 2022.[11] They periodically run out of vault space and refuse NIS cash deposits, as they did when their excess holdings peaked at an all-time high of NIS 6 billion in September 2021.[12]

Figure 1. Cash Shipments and Excess Cash, 2013–22





Source: Palestine Monetary Authority (PMA).

[9] PMA figures. BoI official data on transfers differ slightly.

[10] PMA figures. Exceptional shipments were of NIS 3 billion in 2021Q4 and NIS 2.5 billion in 2022Q1 according to BoI official data. The BoI has also authorized an additional exceptional shipment of NIS 2.5 billion for 2022Q3.

[11] PMA figures including excess shekel cash in both the West Bank and Gaza. West Bank-only excess shekel cash comprised NIS 4.7 billion (6.8 percent of assets) at end-June 2022. The amount of excess shekel cash varies daily. The average total 2022Q2 holdings amounted to NIS 4.2 billion (6 percent of assets). West Bank-only average 2022Q2 holdings were NIS 3.9 billion (5.5 percent of assets).

[12] The all-time high for West Bank-only excess cash was of NIS 5.6 billion, also at end-September 2021.

C. Costs to the Banking System

8. Holding excess shekel cash creates or increases six types of costs to the Palestinian banking system and lowers bank profits by about 20 percent. Nevertheless, banks remain profitable. Return on equity and assets stood at 10.4 and 1.4 percent respectively at end-June 2022.

- **The opportunity costs of holding excess cash.** Banks lose the interest that they could have earned had the equivalent (above-the-BoI-limit) shekel amount of cash been deposited in interest-bearing accounts. Cash shipments can also take weeks, prolonging the time outside these interest-bearing accounts, even for shekel cash shipped back to the BoI. The interest rate that some of the Israeli correspondent banks offer is also significantly below the BoI policy rate. In addition, the uncertainty of ad-hoc shipments above the cash transfer limit and the unpredictability of upward adjustments of the limit make it difficult for Palestinian banks to manage their operations and liquidity efficiently – presenting another indirect opportunity cost. Lastly, banks are at times somewhat reluctant to deal with potential customers from economic sectors in which transactions are largely in cash, such as gas stations, supermarkets, and restaurants that deposit large amounts of cash, foregoing opportunities to increase their portfolio and market share or even losing clients.

- **NIS borrowing and NIS-USD swap costs.** When they run low in their NIS correspondent account, banks are forced to borrow shekels from the PMA as emergency liquidity assistance, or swap JOD or USD for NIS to settle commercial transactions between their clients and Israeli merchants, while the shekel cash continues to pile up in their vaults. USD and JOD used as (borrowing or swap) collateral cannot be lent out to customers.

- **The cost of building new vaults in branches and additional transportation of the cash between branches.** The vaults of many bank branches periodically reach their maximum cash-holding capacity. Cash kept unsecured outside vaults is a security risk. New vaults need to be built. In the meantime, the excess cash is shipped to other branches where there is still space in vaults, with the shipment costs borne by the banks.

- **Security and insurance costs.** These are particularly steep. Cash insurance premiums have skyrocketed. Security and insurance costs alone comprised an estimated USD 12 million in 2021.

- **BoI-authorized private cash center administrative costs.** Since 2009 Israeli commercial banks must process their cash at an authorized private cash center before recycling it or depositing it at the BoI. Terms, conditions, and fees charged to the banks vary across cash centers. Excess cash from Palestinian banks was processed at no cost for several years. The BoI eventually requested that Palestinian banks contract an Israeli operational cash center to process the notes and coins from the West Bank. The center charged Palestinian banks an initial administrative fee of NIS 1,200 per million processed that was later raised to NIS 1,500 per million processed.

- **Time spent in intense negotiations for ad-hoc cash shipments or to raise the transfer limit.** The periodic negotiations between the BoI and the PMA for ad-hoc transfers or to raise the transfer limit and between the PMA and the Palestinian banks on the division of the quota over the banks can be resource-intensive for all parties involved.[13]

D. A Breakdown of the Sources of Excess Cash

9. To address the problem of excess shekel cash in the banking system, it is paramount to understand its sources. This requires accounting for shekel cash in circulation in the West Bank, i.e., for formal and informal cash inflows from Israel into the West Bank (and vice versa) and the rate at which this cash flows in and out of the Palestinian banking system. Changes in the level of the largely cash-based informal economic activity inside WBG (**Error! Reference source not found.**) and financial inclusion can both also weigh on shekel cash flows into the Palestinian banking system.

10. There is a significant correlation between the growth of excess cash in WBG's banking system and NIS cash in circulation. NIS cash circulating in WBG is a portion of the cash component of Israel's currency in circulation. The Israeli cash in circulation more than doubled over the past decade—the period during which excess cash pressures in WBG have become more evident. A one percent increase in NIS cash in circulation is associated with a 9 percent increase in excess cash.[14] NIS cash in circulation (on the BoI's balance sheet) grew by 32 percent during the period 2019–21 (or about 10 percent a year), as COVID stimulus was provided by the GoI and following the adoption of restrictive Israeli laws and regulations that limit cash transactions in Israel (to combat tax evasion and reduce ML/TF risks), double the annual rate at which it grew during 2016–18.[15] This as Israel's nominal GDP grew by annual averages of 4 percent and 5 percent respectively in 2016–18 and 2019–21.

NIS Cash in Circulation vs. Growth in West Bank and Gaza's Excess Cash
(In percent)

	Growth in Excess Cash in the West Bank
Percentage Change in NIS Cash in Circulation	8.788***
	(5.34)
Constant	-0.038
	(-1.73)
N	119
R^2	0.196
Adjusted R^2	0.189

t statistics in parentheses
* p<.10, ** p<.05, *** p<.01
Sources: BoI; PMA; Haver Analytics; and IMF staff calculations.

[13] The PMA negotiates with the BoI but each Palestinian domestic and foreign bank lobbies to be allocated a larger share of the quota by the PMA.

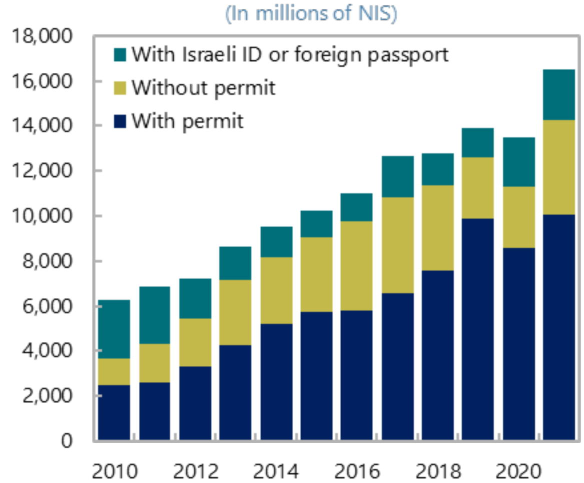
[14] Using PMA and BoI monthly data for the period January 2012-December 2021.

[15] The Locker bill that took effect in 2019 limited lawful commercial cash transactions to transactions below NIS 11,000 and prohibited cash transactions above the limit. The 2021 Economic Arrangements Law further decreased the limit to NIS 6,000 from August 2022. Similar laws were enacted in several European Union countries. For example, in Belgium, cash transactions must not exceed €3,000 and cash real estate purchases are prohibited since January 2014. Cash payments are also limited to €3,000 in Italy since January 2016. The Netherlands and Sweden do not prohibit high-value cash transactions but require additional due diligence and reporting of transactions.

Formal and Informal Cash Inflows from Israel into the West Bank

11. Palestinian workers in Israel—almost all of whom are paid in cash and carry their wages across the border to the West Bank—are the main source of shekel cash inflows. The total number of Palestinians who work in Israel and settlements rose from some 83,000 in 2010 to 153,000 in at end-2021 (145,450 on average in 2021).[16] These 145,450 Palestinians (with or without permits or other Israeli work authorization) earned an estimated NIS 17.4 billion, 95 percent of which (some NIS 16.5 billion) was paid in cash.[17] Going forward, these flows may increase as Israel made more work permits available to Palestinians from the West Bank. Likewise, planned increases in the number of Israeli work permits to Palestinians from Gaza, to bring the total number of permitted Gazan workers to 15,500, will increase cash inflows into Gaza starting in 2022. Going forward, this will require devising a Gaza-specific solution to ship excess shekel coins and notes back to Israel.

Wage Cash Flow from Israel to WBG
(In millions of NIS)



Sources: PCBS; Israel Central Bureau of Statistics; and Haver Analytics.

12. Informal trade with Israel added to net shekel cash inflows to WBG in recent years, while it used to reduce net inflows. Informal trade between WBG and Israel—all of which is assumed to be settled in cash, in shekels—generated an estimated net cash inflow into WBG of NIS 1.3 billion in 2021, compared to an outflow of NIS 5.9 billion in 2016.[18] The shift from shekel cash outflow to inflow is mostly due to lower informal imports from Israel (thanks in part to better enforcement on the Israeli side).

Informal Trade
(In millions USD unless otherwise indicated)

	2016	2017	2018	2019	2020	2021
Informal Exports	4,090.4	4,368.5	4,373.4	4,470.9	3,862.5	5,152.8
Informal Imports	5,633.1	5,243.4	5,016.8	5,027.4	3,748.3	4,735.6
Net Informal Trade	(1,542.7)	(874.9)	(643.4)	(556.5)	114.2	417.2
Net Informal Trade (in millions NIS)	**(5,924.8)**	**(3,149.3)**	**(2,310.3)**	**(1,983.6)**	**393.1**	**1,347.5**

Sources: PCBS; and IMF staff calculations.

[16] Palestinian Central Bureau of Statistics (PCBS) labor force survey data.

[17] Staff estimated Palestinian workers in Israel's wages during 2010–21 by multiplying PCBS labor force survey data on the number of permitted and unpermitted Palestinian workers by the average of i) the monthly salary of workers in Israel (including foreigners) as reported by the Israeli Central Bureau of Statistics and ii) the average wage of Palestinians working in Israel and settlements from PCBS's labor force surveys. Wage cash flows were an estimated 95 percent of total wages.

[18] Estimates derived using PCBS estimates for the share of informal imports and exports in trade with Israel and national accounts data exports and import figures.

13. Arab Israelis' and East Jerusalem residents' cash purchases in the West Bank are among these informal trade transactions that generate significant shekel cash inflows into WBG.[19] The more restrictive Israeli laws and regulations that limit cash transactions in Israel, more attractive prices (e.g., fuel subsidized at the pump at gas stations in the West Bank), the desire to support West Bank merchants, scarcity of credit cards points of sale in the West Bank, and high credit card fees for NIS transactions using Israeli bank-issued cards, all encourage Arab Israelis to shop with cash in the West Bank. Arab Israelis and East Jerusalem residents who study in the West Bank also mostly pay their university fees in cash. Surveys estimated these informal flows at NIS 3.72 billion in 2020, up from NIS 2.74 billion in 2016.[20] The sell rates for JOD are more attractive in WBG than in Israel, and fees are lower. Arab Israelis therefore prefer exchanging cash shekels for dinars in the West Bank. Jewelers take advantage of different gold value added tax regimes in Israel and WBG.[21] Arab Israelis' cash purchases of gold and real estate (particularly in Jericho and Ramallah) added an estimated NIS 1.01 billion to inflows in 2020.[22]

14. There is uncertainty around these estimates for Palestinian workers in Israel remittances and informal trade cash flows, but with potential upside and downside measurement errors. Both inflows and outflows may be underestimated. PCBS labor survey data may not reflect the true number of Palestinians working in Israel and settlements. Official figures put their total number at an estimated 145,000 in 2021, but unofficially numbers as high as 215,000 are mentioned. At the same time, shekel cash outflows may be higher than estimated as available data does not, for instance, capture all Palestinians' cash purchases in Israel.

Informal Economic Activity, Financial Inclusion and Shekel Cash Flows into the Palestinian Banking System

15. In addition to the balance of payments flows discussed above, greater financial inclusion increases shekel cash deposits and hence excess shekel in the banking sector. The PMA and banks have made progress since 2014 in promoting financial inclusion and development, through literacy and consumer protection initiatives. Less stringent requirements to open fee-free (also known as no-frills) accounts have boosted inclusion. Deposits (40 percent of which are in NIS) grew as a share of GDP from 63 percent of GDP in 2014 to 91 percent of GDP in 2021 and the share of Palestinians over 15 with a bank account rose from 24 percent in 2014 to 34 percent in 2021.[23] Financial deepening proceeded further through the adoption of e-wallets, and increased use of

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[19] These purchases (except real estate purchases) are akin to tourist expenditures that ought, in principle, to be recorded in the current account of WBG's balance of payments and are reflected in informal goods and services trade figures.

[20] Palestinian Forum for Israeli Studies (MADAR) http://library.mas.ps/records/index/1/22708

[21] Gold is considered a currency in WBG, but a good in Israel. It is therefore subject to VAT in Israel but not in WBG.

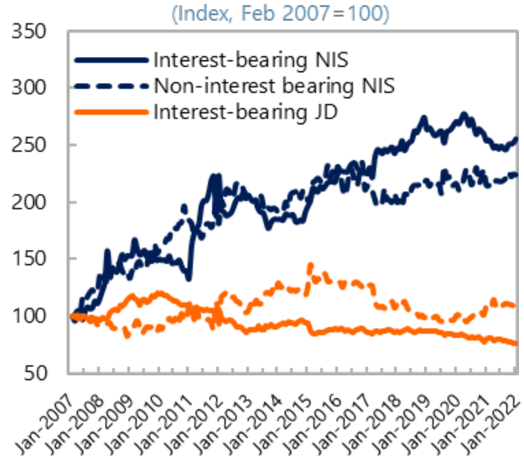
[22] Attempts to estimate these real estate purchases are relatively recent. The 2016 and 2020 Palestinian Forum for Israeli Studies' surveys included a question on real estate purchases, but their 2013 survey did not. These purchases may be a recent additional source of NIS inflows into the West Bank, or simply one that has long been ignored or reflected in other statistics.

[23] World Bank Global Findex Database.

e-payments, particularly during the pandemic. Some 2 percent of those aged 15 and over had a mobile account in 2021, a year after digital payment service providers were licensed to operate in WBG.[24] Demand deposits in NIS rose while demand deposits in JOD stagnated. Both the number and the average NIS value of deposits in accounts have grown in recent years. The number of NIS accounts increased by about 78,000 between 2020 and 2021, and the average deposit value per account rose to around NIS 13,000. There was thus an estimated additional NIS 1 billion in cash deposits in 2021 in new (basic, current, savings and deposit) accounts, up from an estimated NIS 850 million inflow in cash deposits in new accounts in 2016.

Demand Deposits by Currency and Type

(Index, Feb 2007=100)



Source: PMA.

16. A change in the size of the informal economy would also result in changes to the amount of shekel cash in the banking system. The size of WBG's informal economy is difficult to estimate, and while employment data suggest informality has decreased, other estimates based on electricity consumption suggest the opposite. Cleary informality may explain why large amounts of NIS in circulation in WBG remain outside the banking system (Box 1). Business is conducted almost exclusively in cash at gas stations, in restaurants and with electricity and fuel vendors in the West Bank.

17. Taken together, the regular BoI cash shipment limit is not commensurate to the shekel inflows into the Palestinian banking system. This has been the case from the start of the current system. The shipping quota was NIS 3.6 billion compared to an estimated inflow from Palestinian workers alone of NIS 6.3 billion in 2010. However, throughout the years, exceptional shipments above the annual limit have helped ease the problem and accommodate somewhat unpredictable inflows. For instance, in 2021, shekel inflows into the banking system are estimated as just short of NIS 20 billion, against regular shipments of NIS 16.6 billion and exceptional shipments of NIS 4.6 billion.[25] Nevertheless, these exceptional shipments remain ad hoc and unpredictable, and hence cannot be relied upon in banks' liquidity management.

Total Cash Flows

(in billions of NIS)

	2017	2018	2019	2020	2021
Palestinian workers in Israel	12.7	12.8	13.9	13.5	16.5
Informal trade	-3.1	-2.3	-2.0	0.4	1.3
Arab Israelis' real estate purchases in the West Bank 1/	1.01	1.01	1.01	1.01	1.01
Financial inclusion	0.88	0.91	0.94	0.97	1.00
Total (A)	**11.4**	**12.4**	**13.8**	**15.9**	**19.8**
Regular cash shipments (BoI limit) (B1)	**12.7**	**12.1**	**15.5**	**13.7**	**16.6**
Exceptional cash shipments (B2)	**0.0**	**2.4**	**1.6**	**3.1**	**4.6**
Total cash shipments (B) = (B1) + (B2)	12.7	14.5	17.1	16.9	21.1
(A) - (B1)	**-1.3**	**0.3**	**-1.7**	**2.1**	**3.3**
(A) - (B)	-1.3	-2.1	-3.3	-1.0	-1.3
Excess cash (PMA definition)	3.4	2.8	3.6	3.0	4.6

Sources: PMA; and IMF staff calculations.

1/ Figures also include gold purchases. There are no available estimates for real estate purchases only.

[24] World Bank Global Findex Database.

[25] PMA figures. BoI data differ slightly.

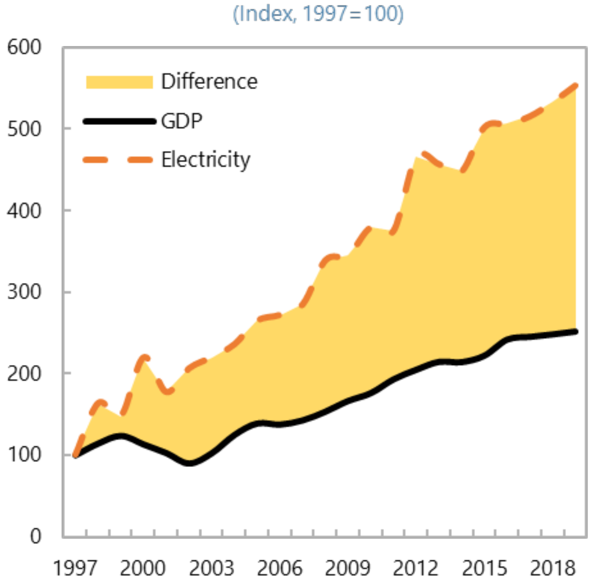
Box 1. Estimating the Size of Informal Economy

Commonly used estimates of the size of the informal Palestinian economy put it at over 50 percent of GDP:

- **Employment data.** Several studies use PCBS labor force survey (LFS) data to estimate the size of WBG's informal sector and compare informal to formal private sector employment. A 2014 study estimated informal employment as equivalent to more than a third of formal private sector employment (62,493 informal firms employing 152,262 workers in WBG, but at an average wage 27 percent lower than for workers with formal jobs).[1] According to International Labor Organization (ILO) harmonized LFS data, 51 percent of WBG's workers were informal workers in 2021, putting informal sector output at 51 percent of WBG's official GDP (down from 54 percent in 2016).

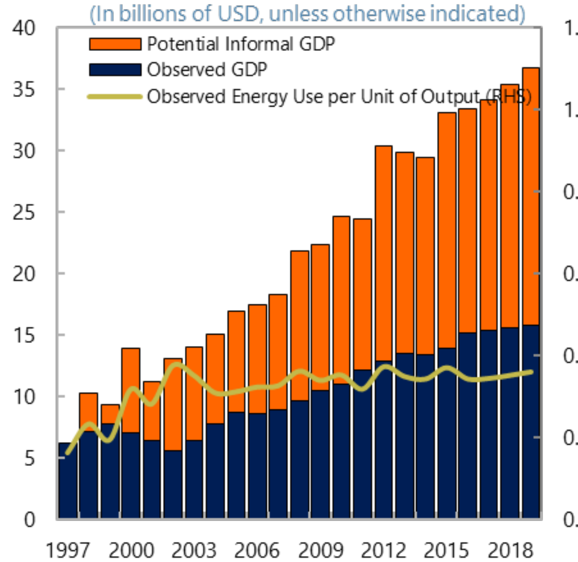
- **Electricity consumption data.** Other studies use the gap between observed output growth and electricity consumption growth as a proxy for informal activity. Assuming that electricity consumption per unit of output remained flat since 1997 (i.e., that electricity use does not become more inefficient over time), staff estimates unobserved output larger than the observed, at 57 percent of total economic activity. Assuming energy efficiency increases over time would imply even higher estimates of the size and growth of the informal sector.

Electricity Consumption vs. Real GDP Growth in WBG
(Index, 1997=100)



Sources: PCBS; and Energy Information Agency (EIA); and IMF staff calculations.

Unobserved Economic Activity Using Electricity Consumption as Proxy
(In billions of USD, unless otherwise indicated)



Sources: PCBS; EIA; and IMF staff calculations.

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[1] Belal Al-Falah, The Informal Sector in the Occupied Palestinian Territory, Palestine Economic Policy Research Institute (MAS), 2014.

[2] ILOSTAT.

18. Moreover, the estimated inflows are likely an underestimate, implying the current regular shipment quota remains below regular inflows. This as more formal Palestinian workers have recently been allowed in Israel and Israeli settlements, adding to shekel cash inflows into WBG. In addition, no changes in informal activity have been taken into account in the estimations, even as employment data suggest informality may be decreasing. Lastly, financial inclusion may be accelerating. Most importantly, the estimates of Palestinian banks' holdings of excess continue to increase, suggesting cash inflows remain above shipments.

E. Final Considerations and Recommendations

19. Palestinian banks could be allowed to deposit their excess shekels in the PMA's vault instead of holding it in each branch, but this would displace rather than solve the problem. Banks would also welcome being able to use cash in their vaults as part of the 9 percent reserve requirement. However, that would not solve WBG's excess shekel cash problem. It would instead only shift the burden of holding and transporting the cash from commercial banks to the PMA.

20. Dollarization could also, in principle, be a solution to the excess cash problem, but would be impractical given the volume of trade and other formal flows between WBG and Israel. Banks operating in WBG have USD correspondent accounts and access to USD cash services. They manage the amount of USD they keep in their vaults, through transactions with commercial banks. However, eighty percent of WBG's imports come from Israel and all government transactions are in NIS, making a shift from NIS to USD for most economic activity undesirable.

21. The GoI electronic wage payment requirement for Palestinian workers who hold permits to work in Israel could significantly contribute to the solution. This GoI initiative, which is expected to start as a pilot in the second half of 2022, if swiftly broadened to cover all Palestinian workers with working permits, is expected to help significantly alleviate banks' excess physical cash problems, as it would reduce the main source of cash inflows into WBG. Paying Palestinians electronically would also lower ML/TF and tax evasion risks, provided that effective anti-money laundering and counter financing of terrorism (AML/CFT) preventive measures, including due diligence measures, are implemented and that compliance with AML/CFT obligations is appropriately supervised. Palestinian authorities should closely coordinate with the BoI to ensure that the current cash shipment limit is not automatically reduced as workers start being paid electronically. A premature reduction would imply electronic payment of workers would not contribute to a reduction of excess cash.

22. Continued efforts to strengthen WBG's AML/CFT regime will remain crucial, while Israeli and Palestinian authorities should increase efforts to stem the flow of illicit cash into WBG. Palestinian authorities should quickly close any gaps identified in their ML/TF national risk assessments and the Middle East and North African Financial Action Task Force (MENAFATF) on-site mutual evaluation, with possible capacity development support from the Fund.[26] This may include considering future limits on large cash transactions. Israeli authorities should strive to ensure that proceeds from any illegal activity in Israel cannot be brought across the border.

23. Improved cross-border payment infrastructure and services are further important to help reduce banks' excess liquidity. Palestinian authorities' recent measures to promote digital payments as a reliable and safe alternative to cash—licensing five new financial digital payments service providers, organizing financial awareness campaigns to encourage the use of credit and debit cards and e-wallets, limiting interchange fees and reducing credit card merchant fees from 3.4 percent to 0.5 percent, lowering regulatory barriers to entry into the digital payment market, and launching a regulatory sandbox to test innovative financial solutions and technologies—are commendable. The PMA has also worked with Palestinian commercial banks to raise the share of fuel stations in the West Bank with a point-of-sale terminal to 70 percent at end-July 2022 and committed to a zero-merchant fee for 6 months, to encourage e-payments at the pump. Further measures to facilitate Arab Israelis' use of their Israeli cards, promote domestic cashless transactions and shrink the informal economy and PMA collaboration with the BoI on greater interconnection of Israeli and Palestinian payments systems will nevertheless be needed to durably reduce the flow of shekel cash.

24. Periodic discrete rule-based adjustments of the cash transfer limit according to a fixed set of metrics reflecting the sources of shekel cash and the size of the flows from each source would be advisable. Rule-based adjustments at set time intervals would make said adjustments more predictable and help facilitate banks' liquidity management. This will be all the more important going forward, now that more Israeli working permits for Palestinians have been made available, including for those living in Gaza. Nonetheless, these reviews of the limit will remain resource-intensive for both the PMA and the BoI and require constant and consistent data gathering to estimate shekel cash flows into the Palestinian banking system.

[26] The MENAFATF on-site visit was postponed due to the security environment in early August 2022.