**College of Postgraduate Studies**

# "Strategic analysis and planning of establishing an efficient Bond Market in the Palestinian Stock Exchange".

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## Declaration:

I Ismail Izat Abdallah, declare that the Submitted thesis is my original work and no part of it has been published anywhere else in the past. I take full responsibility, that if in future, the thesis is found invalid according to basic rules, the last decision will be of the Authorities concerned.

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29/04/2021.

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## Abstract:

This research has examined the four dimensions that could impact the potential and Viability of establishing an efficient bond market in the Palestinian Stock Exchange. These dimensions are financial, economic, strategic, legal, or legislative. Using SWOT (Strength, Weak, opportunity, Threat) analysis method can determine the variables that might positively or negatively impact establishing an efficient bond market—using the TOWS method. It can also extract the results that determine recommendations or conditions to establish an efficient bond market in the Palestinian Stock Exchange.

No studies addressed how the possibility and Viability of establishing the bonds market in the Palestinian Stock Exchange. Consequently, this study aims to measure an ability to develop the bond market, which contributes to serving the Palestinian economy by developing various projects or even encountering a financial crisis that harms the economy.

The research methodology builds the theoretical framework for establishing the bond market Model (BMM), with four dimensions, including financial, economic, strategy, and legal or legislation dimensions. Also, this methodology depends on conducted some interviews with some academics, business people, and significant individuals in the financial institutions.

The study's empirical results have demonstrated that the bond market model can explain the relationship between financial, economic, strategy, legal variables (independent

variables), and the potentiality to establish an efficient bond market in the Palestinian stock Exchange (dependent variable).

The research results provided an insight into those who adopted the establishment of an efficient bond market in the Palestinian Stock Exchange. In addition, the results' essence states a set of basic requirements to establish an effective bond market in the Palestine Stock Exchange.

**Keywords**: Bond, Stock Exchange, Bond Market, Financial Sector.

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# First Chapter.

## 1.1 Introduction:

Nowadays, the financial sector occupies an important position in most economies of the world. Thus the financial sector's indicators reflect the economic situation for any country due to the causal relationship between the development of the financial sector and economic growth. Therefore, the bond market is considered one of the essential pillars of a reliable financial infrastructure that characterizes several strong economies. It can offer the necessary liquidity for companies to finance the long-term projects and form an investment capital and finance the governments' projects, infrastructure, in the long run, or even settle the required obligations like a budget deficit.

Also, the bond market plays a strategic and vital role in stimulating economic growth in developed countries by attracting foreign investment and domestic capital to provide the necessary liquidity to mobilize savings and financial resources and direct them towards more productive assets and create balance in the financial sector. Thus, an economy that relies on the banking sector and the stock market without an efficient bond market will lack a valid criterion of the real interest rate, a free interest rate, and the inability to calculate the opportunity cost of invested capital. Also, the economy that lacks an efficient bond market is more vulnerable to crises because, in the banking crisis, the damage will be much more significant than if there was a bond market. As a result, the financial restructuring process will be more difficult. The Palestinian economy relies mainly on financing the banking system and the Palestinian economy, which depends on a soft and non-deep share market.

The Palestinian economy has been suffering since 1967 that was due to Israel's occupation policies, and restrictions which cause strike the fundamental elements for growing the Palestinian economy, and one of the great importance of these sectors is the financial sector that is the backbone for the Palestinian economy.

Nevertheless, the Palestinian economy has lightly evolved in the last three decades, particularly beyond signing the Oslo agreement. The Palestinian Authority has enacted some of the legislations and laws that encourage investment. Since the most prominent features in this stage are an abundance of investment opportunities that catalyze investors to exploit these opportunities, the opening of the stock exchange market in Palestine in 1997 was imprinting clearly in the Palestinian economy's development. However, the Palestinian market has lost several investment opportunities that some government or private sectors like infrastructure developments and effective programs with long-term establishing periods lack an efficient bond market in the Palestinian Stock Exchange.

As a result of the above, we must question whether the Palestinian financial sector, which relies on the banking sector and stocks market in the financing, can be a financial source to these projects that could be part of the growing economy. To have an objective answer, it must diagnose the fundamental factors that could have a different degree of influence on establishing a bond market. These factors are considered a keystone of establishing an efficient bond market in developing countries' financial sectors.

## 1.2 Study Objectives:

- The research aims to examine the effectiveness of laws and regulations in the Palestinian Stock Exchange to organize and arrange the tradings in the bond market.

- To analyze the financial sector that includes the banking sector, the stock market, and financial intermediation companies, to explore the role that they can play in enhancing the likelihood of establishing an efficient bond market.

- To measure the impact of strategic aspects on establishing an effective bond market includes institutional infrastructure, bond issuers, primary investors, and financial intermediaries, corporate governance, investment awareness ..... etc.

- To determine the extent to which the Palestinian political and economic environment enhances the likelihood of establishing an effective bond market.

- To measure the extent of the impact of fiscal and monetary policies on the likelihood of establishing an efficient bond market.

- To determine a set of fundamental variables that could influence establishing an efficient bond market.

- To conduct an objective comparison with some of the bond markets for other developed countries regarding similarities and discrepancies between key elements and conditions to establish an efficient bond market.

- To present an indicative map to be the ground to establish the bond market within certain conditions.

## 1.3 Research Importance:

There is no appearing to be cited studies empirically examined for establishing an efficient bond market in the Palestinian Stock Exchange. Consequently, this study contributes to this body of knowledge of the Palestinian financial market's potential and efficient bond markets.

Furthermore, stem the importance for the research of providing researching results that help interested researchers to deepen the investigation of these results and explore the reasons and factors that are allowing for the effectiveness of the establishment of the bond market or not.

Finally, this study provides scenarios and views simulated for reality to give decision-makers like the government, Capital Market Authority, investors, and those engaging in the economic matter a picture about potential establishing an efficient bond market in the Palestinian Stock Exchange.

## 1.4 Research Methodology:

This study uses two data collection methods: the first one depends on the primary data collection method that conducts thorough interviews with a group of experts in the financial institutions, business people, and academics, as shown in table figure (1), who have knowledge and analysis about the four dimensions (finance, economy, strategy, and laws) related to establishing Palestinian bond market. Consequently, a questionnaire with open-ended questions could be used with those concerned with establishing an efficient bond market, as shown in table figure (2). These questions can provide an in-depth understanding of correlations between establishing the bond market and independent variables and demonstrating the relationship among variables with each other.

In addition, the interviews concluded that most of the opinions and expectations of those interviewed set preconditions to the ability to establish an efficient bond market in the Palestinian Stock Exchange. Therefore, the relevant fundamental conditions are as follow:

- Provide a safe environment for investment, including appropriate economic and political conditions.
- Cooperate and have partnerships in the financial and economic aspects with foreign markets.
- Provide transparency, responsibility, and accountability in public and private institutions through implementing the governance rules.
- Disengage from the Israeli occupation financially, economically, and on the monetary level.

- Support by crucial participants such as the monetary Authority, Capital Market Authority, Palestine Stock Exchange, banks, government parties, and large-capital Palestinian companies who have the length-arm to establish an efficient bond market.

The second method uses previous studies, reports & and articles published in books, newspapers, magazines, journals, statistical data, and online portals. It can use the data available in these sources about our research area. In addition, it might benefit from interviews with experts, also preparing open-ended questions to collect data that would be necessary to extract the results and conclusions about the research problem.

**Table (1).**

**The interviewees' names who were interviewed by the researcher.**

| | Name of Interviewee | Title of Interviewee |
|---|---|---|
| **Academic Group** | | |
| Dr. Fawaz Hammad | Dr. Fawaz Hammad | Academic staff member in Arab American University, and General Director of Al-Razi Hospital |
| Dr. Monther Nejem | Dr. Monther Nejem | Academic staff member in Birzeit University- Department of Banking and Financial Sciences |
| **Businessmen Group** | | |
| Palestine Development and Investment | Mr. Amjad Hassoun | Head of Financial Department |
| Global Insurance Company | Mr. Mahmoud Sehweil | Assistant Chief Executive Officer for Financial and Administrative Affairs |
| Birzeit Pharmaceutical Company | Mr. Abdul Qader Badawi | Head of Financial Department |
| Istishari Arab Hospital | Mr. Ahmed Kawamleh | Head of Financial Department |
| **Financial Institutions Group** | | |
| Palestine Stock Exchange | ❖ Mr. ❖ Mohammed Obaid. ❖ Mr. Ahmed Al Zahra | ❖ Director of Systems, Technology and Development Department. ❖ Deputy Director of Operations |
| Palestine Capital Market Authority | Mr. Murad Jadbah | General Manager of the General Administration of Securities. |
| Palestinian Monetary Authority | Mr. Ahmed Yousef | Controller of banking remittances |
| Sahem Trading &Investment Company | Mr. Firas Salama | l Manager |
| Al Quds Bank | Mr. Mahmoud Barakat | Manger of Portfolio |

**Table (2).**

**The open-ended questions that have been posed to interviewees.**

| | |
|---|---|
| Infrastructure: | ➢ What are the Palestinian Stock Exchange and its objectives and importance?<br>➢ What are the technology systems and tools supplied by the Palestinian Stock Exchange that contribute to serving investors easily and rapidly?<br>➢ What is the role that plays of the organizational structure and the administrative responsibilities & duties for the Palestinian Stock Exchange in order to raise the competence of the performance of its functions?<br>➢ What are preconditions to financial and non-financial companies to have exercised trading of securities in the Palestine Exchange? |
| Issuers of Bonds: | ➢ What are the work nature of Palestinian companies and their value in the Palestinian market and the size of their debts?<br>➢ What are the company's financial motives (interest, maturity date, size of the financing, etc.) and administrative (procedures, conditions, and time period for obtaining financing .....) to go towards financing its activities from debt securities, instead of financing with a bank loan?<br>➢ Does the nature of projects financed by debt bonds relate to the type of financing? If the answer is yes, what is the nature of this relationship between the project and the type of financing by issuing bonds?<br>➢ What are the barriers and obstacles that prevent or limit Palestinian companies from issuing debt bonds? |
| Base Investors: | ➢ Who are the potential institutional investors in an efficient bond market in the Palestinian Stock Exchange? |

| | |
|---|---|
| | ➢ What are the investors' incentives behind buying debt securities? |
| Legal & Regulatory Framework: | ➢ What is the extent to which laws and regulations effectively regulate the trading of securities on the Palestinian Stock Exchange?<br><br>➢ What is the eligibility and merit of the bodies authorized to issue judgments and punishment against the perpetrators of financial violations in the Palestinian Stock Exchange? |
| Banking Sector & Stock Market: | ➢ What role can the banking sector and the stock market play in establishing an efficient bond market?<br><br>➢ How can the establishment of an effective bond market affect the severity of competition in the financing sector?<br><br>➢ To what extent can the existence of financial derivatives markets, government bonds, and credit rating agencies contribute to establishing an effective bond market? |
| Intermediation Companies & Investment Awareness: | ➢ What is the role of the Palestine Stock Exchange and financial intermediation companies in raising investor awareness about the securities market, especially debt Bonds?<br><br>➢ What is the relationship between the size of securities trading and the experience and skill of financial intermediation companies in managing risk and earning more profits? |
| Companies Governance: | ➢ To what extent are the rules of governance applied in public and private institutions in Palestine?<br><br>➢ How can administrative and financial practices in public and private institutions contribute to establishing an efficient bond market? |

| | |
|---|---|
| Political & Economic Conditions: | ➢ How can the Israeli occupation increase the risks that in turn create an insecure investment environment?<br>➢ How can some financial indicators in Palestine contribute to increasing the likelihood of establishing an effective bond market?<br>➢ What is the importance of issuing debt bonds in an independent local currency? |

## 1.5 Research Limitations and Obstacles:

In the path for conducting the research were some of the difficulties that encountered the researcher are as follows:

- It isn't easy to reach some of the individuals for an interview.
- The interview time is not enough to catch all data that is necessary to analyze and extract results.
- Scarce studies related to the research topic in the Palestinian context might highlight some aspects that could be useful for the research problem.
- It is how to choose the right experts or interested individuals for an interview to use information about the research problem.
- Some interviewees lack deep thinking about the research problem.

## 1.6 Research Problem:

## Fundamental Research Question:

One of the most important reasons for the economic and financial growth that has seen the world today in developed and even emerging countries is the employment of national and foreign savings for investment in infrastructure and production projects, bridging the budget deficit, or paying off the public debt. However, because of the inability of the state and companies to provide the necessary funds, it has resorted to an essential source of financing that is the bond market. Accordingly, most of the developed global markets contain the bond market, which is another source of financing and the ability to attain the financial balance of the state. Therefore, the establishment or existence of an efficient bond market requires providing certain conditions. Hence, this summoned the researcher to pose the main question is; ***what is the feasibility and Viability for establishing an efficient Bond Market in the context of the Palestine Exchange?***

In addition, the conditions that to meet in establishing an efficient bond market in the Palestinian Exchange could be by posing the sub-questions of the leading research question as in the following:

- What is the extent to which the legislative and legal environment participates in establishing a bond market in the Palestinian Stock Exchange?

- How is the Palestinian financial sector impact the ability of the establishment of the bond market?

- How do the strategic aspects contribute to the establishment of the bond market? (Institutional infrastructure, Issuers of bonds, base Investors, Financial Intermediaries, Companies governance, Investment Awareness……...).

- What is the extent to which macroeconomic and political stability contribute to success in establishing the bond market?

- How monetary and financial policies are impact the likelihood of establishing the bond market?

# Second Chapter.

## 2.1 Literature Review:

The study's central theme is to investigate Whether Establishing a bond market in the Palestinian Stock Exchange is potential and viable. This topic's importance raises an essential question about the feasibility of establishing an efficient bond market in the Palestinian Stock Exchange, whether government or corporate bonds. However, establishing the bond market depends on internal and external factors and how to exploit these factors effectively to conclude the possibility and effectiveness of establishing the bond market.

It appears that there is consensus among researchers and who have enjoyable in the financial and economic sectors that the bonds market has a practical impact on the financial sector and economic growth. Many studies have addressed the bond market's issue and its effects on specific aspects such as the financial sector, economic development, or legislation & laws. The first, (Richard Benzie, 1992). This study aimed to examine the relationship between the international and domestic bond markets, which has both competitive and complementary aspects. The researcher has described the differences between Euro-Bonds, foreign Bonds, and domestic Bonds. In addition, this study displays how the Euro-bond market is organized, and looks at the trading convention employed, and the functioning of the primary and secondary markets, and analyzes the relationship between borrower and investor. The main conclusion of the study the potential for a further diversion of business from the domestic to the international market exists mainly in Europe and in particular in the growth of a large

European bond market. (Schinasi, M. G. J., & Smith, T. T. (1998). This study aims to identify factors contributingto the development and effectiveness of public and private debt securities markets in the developed economies. One of the most important factors is minimizing the cost of government securities through tapping the pool of global capital, granting greater independence to debt management, and reforming primary and secondary market infrastructures to appeal to institutional investors. (Poterba, J. M., & Rueben, K. (1999). This study explores the link between financial institutions and borrowing costs. It collected bond market data for the 1973-95 period, a substantially longer sample than earlier studies, and one that includes the state fiscal crisis of the early 1990s.The main result is that government financial institutions affect lenders' rate yield when states enter the tax-exempt bonds market. The effects revealed by this study are of fundamental and statistical significance. On average, a state with a binding tax limit law will face borrowing a rate between 15 and 20 basis points is higher than a state without the tax limit law. (Herring, R. J., & Chatusripitak, N. (2000). This study intended to focus on the necessary measures to develop a broad, deep bond market. It addresses Thailand's case, which broadly represents the wide range of countries with highly-developed equity markets and large banking sectors, but only rudimentary bond markets. It would be by illustrating the dangers of growth without a well-functioning bond market. It also demonstrates how to implement policies to rebuild the financial sector with an expanded role for the bond market. This study has addressed the critical part of the bond market in the financial sector. (Fabella, R., & Madhur, S, (2003). The study's essence states that East Asian countries need the set of requirements to establish a domestic bond market so that these requirements differ from one country to another because each country needs different strategies s for the bond market establishment. " initiatives to develop bond

markets in East Asia should focus on (i) sustaining a stable  a macroeconomic environment with low inflation and stable interest rates, (ii) developing a healthy government bond market that would serve as a benchmark for the corporate bond market, (iii) completing the post-crisis agenda of banking sector restructuring, (iv) improving corporate governance, (v) strengthening the regulatory framework for the bond market, (vi) rationalizing tax treatment of bonds, (vii) broadening the investor base, and (viii) promoting the growth of regional bond market centers." Since there is a great difference in bond market establishment levels across countries, each country will have its mechanisms and strategies by which bond market establishment. While (Fink, G., Haiss, P. R., & Hristoforova, S. (2003), this study researches the relationship between the development of the aggregate bond markets and real GDP [(1)] in 13 highly developed economies that would be through providing empirical evidence for causality patterns supporting the supply-leading approach in the USA, U.K., Switzerland, Germany, Austria, the Netherlands, and Spain over the 1950 to 2000 period. The conclusion was that the estimated models support the supply-leading hypothesis implying that the bond market's development significantly influences real economic activity. (J Batten, P Szilagyi, 2003). This study has aimed to appear the importance of Japan's financial sector to develop its corporate bond market. The researcher has concluded the major channel to lending the borrowers is the banking system which still has dominated Japan’s financial system; consequently, the lending patterns of the past decade bearing witness to the adverse selection and moral hazard problems that may arise from a market overly reliant on banking financing. This study recommends more development of Japan's corporate by

[(1)] GDP is an abbreviation for Gross Domestic Production.

improved access and facilitates domestic and foreign capital into the Japanese bond market. (Bambang Kusmiarso, 2005). This study aims to display the current development of the bond market in selected SEACEN member countries, determines some impediments/challenges in developing the bond market, and recommends some measures to further develop the bond market. The conclusions have exposed are the common problems that hinder efforts to develop most bond markets are underdeveloped secondary markets, shallow bond markets, and a limited supply of bond issues. In countries with more advanced bond markets, they face challenges in auction schedules, hedging instruments, derivatives market, tax treatment, and the implementation of short selling for bonds. In less developed bond countries, they still face the basic problem of improving the bond market infrastructure, such as having a good database for bond market management. This study recommends developing the bond market by taking the common measures adopted that include, enhancing the legal and regulatory framework, extending benchmark and adopting auction systems, stimulating demand, improving market infrastructure, improving market liquidity, and promoting regional cooperation in developing bond markets, developing a benchmark bond, and broadening the variety of debt instruments. (Tarun Chordia, Asani Sarkar, Avanidhar Subrahmanyam.Spring (2005). This study explores, by estimating a vector autoregressive model, there is a significant correlation between stock and bond market liquidity and volatility. Forecasting to a stock and bond liquidity is by the ability to gather volatility historical information. Moreover, the study forecasts that government expenditure by the bond market funds increases bond market liquidity. Consequently, the results found a link between "macro" liquidity of money, flows, and "micro" or transaction liquidity. (Danijela Miloš Sprčić, 2007). This study has intended to examine the factors influencing

the speed of development of corporate bond markets in Croatia. A survey was carried out of a sample of Chief Financial Officers from the largest companies in Croatia to investigate the barriers that inhibiting issuing of corporate bonds. The researcher concludes that a range of macro-level, industry level, market level, and firm-level factors influence the rate at which corporate bond markets develop in Croatia. (Edwards, A. K., Harris, L. E., & Piwowar, M. S. (2007). This study analyzed average transaction costs as an indicator of trade size for each bond that traded more than nine times between January 2003 and January 2005. The study has findings that transaction costs reduce significantly with trade size. Highly rated bonds, newly issued bonds, and bonds close to maturity have lower transaction costs than other bonds. Costs are lower for bonds with transparent trade prices, and they drop when the TRACE system starts to disseminate their prices publicly. The results indicate that bond traders benefit significantly from price transparency. (Bessembinder, H., & Maxwell, W (2008). This study displays how TRACE (Trade Reporting and Compliance Engine) has affected corporate bond investors' costs to bond dealers for their transactions. The sample is a set of opinions and discussions by interviews with various finance professionals. It analyzes articles in the trade press and magazine to obtain a wide and deep view of transparency's impact on the corporate bond market. This study has a conclusion that increased transparency on the corporate bond market. will result in great reductions in the bid-ask spreads that are paying to bond dealers to conduct trades. (Adelegan, O. J., & Radzewicz-Bak, B. (2009).This study empirically analyzes the determinants of bond market development in a cross-section of 23 sub-Saharan African (SSA) countries between 1990 and 2008. The results from this study that the savings constraint is a key impediment to domestic bond market development and financial market deepening. Overall, the results show that a

confluence of factors matters for developing domestic bond markets in SSA; these include the structure of the economy, investment profile, law and order, size of the banking sector, and economic development level. Policy implications include increased efforts to strengthen the investment environment and the need for a regional approach to bond market development in SSA. (Biswanath Bhattacharyay, 2011). This study attempts to identify the determinants of bond market development in Asian economies that include the size of an economy, the stage of economic development, the openness of an economy, the size of the banking system, the exchange rate variability, and the variability of interest rate. The researcher concluded that the size of an economy has a positive relationship with government and corporate bond market development, exchange rate variability has the expected significant negative relationship with a total (government and corporate) bond issuance, the gross domestic product has a positive relationship with a total (government and corporate) bond issuance. The banking system has the expected significant negative relationship with corporate bond issuance but has a positive relationship with government bond issuance. Interest rate spread exhibits the expected negative relationship with total (government and corporate) bonds. The openness of an economy has a significant positive influence greater on corporate bonds than a government bonds. (Sunder Raghavan and Daniel Sarwono, 2012). This study intended to analyze factors that could have influenced the development of corporate bond markets in India, suggest policy reforms to enhance its development. The researchers have reached to several factors that may have impacted the development of corporate bond markets such as the banking sector, the size of the economy, openness, size of the stock market, and institutional factors like corruption. In addition, this study suggests some policy reforms to improve the corporate bond market in India which include improving the retail

investment markets, encouraging foreign participation by relaxing regulations and providing tax incentives, providing credit enhancements, and introducing new instruments such as credit default swaps and corporate repurchase agreement. (Wedyan Abdul Fattah Abdul Ghani. (2012). The researcher is interested in studying and analyzing the bond market as a promising market that helps finance the economy in general, and companies and investors in particular well as; this study considers that the bond market is less dealing than market share in terms of diversity and value. It addressed that the bond market contributes to providing finance to support economic development and improve living standards for individuals in Egypt. (Y Mu, JG Stotsky, P Phelps, 2013). This study aims to analyze a set of data on government securities and corporate bond markets in Africa. The researcher has applied an econometric model to analyze the key determinants of the African government securities market and corporate bond market. The results have exposed that the government securities market is directly linked to better institutions and interest rate volatility, and inversely related to smaller fiscal deficits, higher interest rate spreads, exchange rate volatility, and current and capital account openness. The corporate bond market is directly linked to economic size, the level of development of the economy and financial markets, better institutions, and interest rate volatility, and inversely related to higher interest rate spreads and current account openness. (JD Burger, FE Warnock, VC Warnock, 2015). This study aimed to highlight key impediments of bond market development in developing Asia. It provides a descriptive analysis of the structure of financial systems (banking systems and stock and bond markets) in emerging Asia and (for comparison) other regions. The results have exposed that historically high inflation volatility presents a serious obstacle to the bond market development. Smaller developing Asian economies could enable bond market development by pursuing creditor-friendly

policies (for example, stabilizing inflation) and protected the legal rights of borrowers. (H Smaoui, M Grandes, A Akindele, 2017). This study aims to empirically investigate the structural, financial, developmental, institutional, and macroeconomic determinants of bond market development for a sample of 22 emerging and developing countries over the period 1990–2013. The conclusions suggest that a combination of structural, financial, and institutional factors seem to exert a significant impact on bond markets. There are some factors that have positively linked to bond market development include economic size, trade openness, investment profile, GDP per Capita, bureaucratic quality, and size and concentration of the banking system. In contrast, other factors have negatively linked to bond market development such as interest rate volatility and fiscal balance. (Aman Ameenullah and Isa Mohamad Yazid and Mohamed Naim Asmadi, 2020). This study intended to investigate the macroeconomic and financial determinants that enhance the bond market development. Panel data analysis is employed to investigate the potential relationships. Results expose that the financial system and most of the macroeconomic factors are positively linked with a bond market development. However, the stage of economic development is negatively linked to bonds. Hence, policymakers need to enhance and use existing financial systems and economic variables to provide reasonable support to the development of bond markets.

The conclusion from the literature review is a consensus of most researchers on the importance of the bond market to enhance and improve the financial sector and raise the country's economic growth. In addition, some researchers have addressed some of the factors that could contribute to the development of an efficient bond market. However, a standpoint the researcher in establishing an efficient bond market depends is not only on some aspects as of the previous studies. But it must contain the whole factors that include financial, economic, political, strategic, and legal aspects. Furthermore, no study or research addressed the possibility of establishing an efficient bond market in the Palestinian Exchange Stock. Thus, this study bridges this gap by focusing on all the factors influencing potentially establishing an efficient bond market in the Palestinian Exchange Stock to include the financial, economic, strategic, political, and legal dimensions.

## 2.2 Theoretical Framework:

### 2.2.1 The importance of Financing.

The continuous and increasing attention from all world countries to enhance and persist the growing economy is an essential requirement to improve these countries' well-being. Also, achieving economic development need to implement massive and long-term projects in nature such as infrastructure, manufacturing, and agriculture projects. Consequently, one of the most critical economic development elements is the financial resource that considers the main artery to finance investment programs to accomplish economic growth. Therefore, "a well-functioning financial sector is one of the key foundations that a sustained economic development can be built" (Demirguc-Kunt, 2006).

As a result, the financial sector is considered an integral part of economic growth. It is one of the significant components that can influence economic performance, which is being through well-functions, various markets and institutions are performing in the financial sector. The efficient financial sector fosters investment by financing okay business opportunities; raising savings; monitoring managers' performance, enabling trading, hedging, managing risk, and facilitating the exchange of goods and services. These functions result in a more efficient and rapid allocation of resources by the accumulation of physical and human capital, and faster technological progress, which in

turn feed economic growth (IMF, 2003) [1]. Several studies show the relationship between financial development and economic growth where Ross Levine's study conducted empirical analyses, including firm-level studies, industry-level studies, individual country-studies. "This theory illuminates many of the channels through which the emergence of financial instruments, markets, and institutions affect -- and is affected by -- economic development" (Levine, R. 2005). The financial sector plays a vital role in inflow funds through financial institutions and markets' most influential financial instruments. The international monetary fund study described the critical role that plays as an intermediator between those investors who need to finance their investments and lenders or savers who typically supply the funds (IMF, 2004).

Despite the great benefit that could be achieving by the financial sector in getting economic growth, there are many countries, especially in the developing countries, which lack the robust financial sector, which is resulting from scarce of finance sources for these countries. This issue reflects the state's ability to encounter a deficit of budgeting, significant gaps in trade accounts, settling short-term debt with foreign currencies. Moreover, insufficient foreign exchange reserves and rare financing sources in the private sector limit the capability to expand existing projects or pick up new business opportunities that contribute to economic development.

According to the above view, one of the essential functions that the financial sector performs is money creation or necessary investment capital to meet short- or long-term obligations. Whenever there is a diversity of financing sources in the financial sector, this helps provide investors options for the duration of pay off the debt and degree of

[1] IMF : International Monetary Fund.

riskiness in investment capital. As a result, the financial sector plays a pivotal role as a sound financial intermediary between investors and savers that would reduce the costs of acquiring information about firms and managers and lower the costs of conducting transactions.

Thus, the various financing sources are one of the financial instruments that providing investment capital in the capital market." The most important long-term financing sources for corporate are equity finance and debt finance, so the first source encompasses stocks and retained earnings, and reserves. Also, the second source contains long-term banking loans and bonds." (Nasser Abdulkareem, 1998).

Accordingly, financing with debt is another side of financing. However, companies and governments mainly depend on financing their obligations, whether deficit of budgeting, infrastructure, or drop in a trade account. Subsequently, many countries, whether underdeveloped and developed, have a high percentage of debt to local production, as remarkable that some underdeveloped countries have a high debt rate to local production like Iraq, Lebanon, and Egypt. However, some developed countries like Japan, South Korea, and the United States also have approximately a high debt percentage, as shown in table figure (3). However, the difference between these countries of high percentage debt to local production is how to manage the debts effectively that increases return. Therefore, the debt instrument has been a critical pillar of financing for whole countries, whether underdeveloped, developing, or developed.

## Table (3).

## Country List Government Debt to GDP [1](%)

| Country | Last | Previous | Reference |
|---|---|---|---|
| Japan | 237 | 238 | Dec/2019 |
| United States | 107 | 106 | Dec/2019 |
| Germany | 59.8 | 61.9 | Dec/2019 |
| Italy | 135 | 135 | Dec/2019 |
| Malaysia | 51.8 | 50.7 | Dec/2018 |
| China | 50.5 | 46.8 | Dec/2018 |
| Sri Lanka | 86.8 | 83.7 | Dec/2019 |
| Malaysia | 51.8 | 50.7 | Dec/2018 |
| South Korea | 36.6 | 36.3 | Dec/2018 |
| Thailand | 41.8 | 41.2 | Dec/2018 |
| India | 69.62 | 68.3 | Dec/2019 |
| Saudi Arabia | 22.8 | 19 | Dec/2019 |
| United Arab Emirates | 18.6 | 19.7 | Dec/2018 |
| Lebanon | 151 | 149 | Dec/2018 |
| Egypt | 90 | 90.5 | Dec/2019 |
| Morocco | 66.1 | 65.2 | Dec/2019 |
| Mozambique | 109 | 113 | Dec/2019 |
| Iraq | 48.4 | 59.6 | Dec/2018 |

Source : https://tradingeconomics.com/country-list/government-debt-to-GDP [2].

[1] GDP is an abbreviation for Gross Domestic Production.
[2]GDP is an abbreviation for Gross Domestic Production.

The debt instrument plays a vital role in building the finance structure for most countries and companies. Nevertheless, many emerging or developed countries lack long-term finance that considers a vehicle to fast growth and increase productivity.

Moreover, many studies that argued about a relationship between growth, more productivity, and long-term finance availability, one of the most important studies are "Caprio, Demirgüç-Kunt" study that illustrates that long-term finance helps provide more growth and productivity for firms. On the other hand, Government subsidies do not produce the same effects. The researchers also conclude that using long-term finance in developing countries is less than in industrial countries' counterparts. That illustrates differences in macro factors, firm characteristics, financial development, and legal and institutional factors. They conclude that more long-term finance tends to be associated with growth and higher productivity (Caprio, Demirgüç-Kunt, 1998). Thus, developed countries have long-term finance to meet long-term investments, notable that bond markets are a powerful instrument for this purpose. Some of the European countries have a higher percentage in the long-term finance of bonds than banking loans, as one study showed (Fungáčová, Z., Godlewski, C. J., & Weill, L, 2015) that percentage of debt by issues bonds in the most Europe countries is higher than banking loans from 1999 up to 2012 as shown in the table figure (4).

**Table (4).**

**The number of issues, breakdown by loans and bonds, and the number of issuers by firms' Country in the sample.**

| Country | Issues | Loans | Bonds | Issuers |
|---|---|---|---|---|
| Austria | 114 | 21.93% | 78.07% | 47 |
| Belgium | 203 | 38.42% | 61.58% | 63 |
| France | 1538 | 41.09% | 58.91% | 330 |
| Germany | 148 | 39.19% | 60.81% | 33 |
| Italy | 348 | 62.64% | 37.36% | 118 |
| Netherlands | 690 | 34.35% | 65.65% | 208 |
| Norway | 232 | 56.03% | 43.97% | 93 |
| Portugal | 104 | 22.12% | 77.88% | 28 |

Source: Bank of Finland & University of Strasbourg, 2015.

Hence, as is remarkable in the above table, most European companies prefer or tend to have issuance bonds in investments in these companies instead of financing by banking loans. This indicates to existing on a strong correlation between issue bonds and growth, increase productivity.

### 2.2.2 Bond Issuance: Concept and Importance.

First of all, the concept of the bond indicates that it is a financing instrument that provides funds from lenders(investors) whether they are individuals, companies, or Pooled funds for borrowers, whether companies and governments for a specific period called a maturity, in exchange for regular interest payments own lenders (investors) or during maturity period.

The purpose of issuing bonds varies according to the issuer, whether local government, affiliation enterprises for government, or companies. As companies use bonds for financing expansion in standing projects or starting new businesses and the government's purpose of bond issuances is to finance infrastructure projects, debt repayment, and budget deficit. Also, the bond has several features that have an impact on a bond price. Furthermore, these features can form the nature of bonds in terms of determining target-groups of investors as well they help provide comprehensive a perception about a company position in terms of the solvency robust, and increase growth of a company through expansion, or set up a new business. So the bond's features are the key indicator to attract specific investors who own set characteristics. Consequently, the most important of features for bonds are the following:

- Par (face) value is the value stated on the face of the bond and is the amount that commits the issuers to repayment in the maturity time.
- Maturity Date is the date on which the bond issuer backs the face value for the bondholder.

- Coupon rate is the fixed rate of interest on the bond, which the issuer a bond pays to the bondholder.
- Yield Rate is the rate of return and depends on a bond's price in the secondary market. Yield rate can be calculated as current yield, yield to maturity date or yield to call date.
- Bond Price is a market price that is affected by market factors that can determine the price of a bond. The bid price is the seller's ability to offer the lowest amount for selling a bond, while the asking price is the buyer's ability to offer the highest amount for purchasing a bond.

- Duration risk is the risk related to changes interest rate until repayment date the bond, then a change of bond's price. The longer a bond's duration, the greater fluctuate in interest rate, and then increase exposure to changes of bond's price.
- Rating Agency has a fundamental function is to confer a rating to the bonds and the bonds' issuers, that being by the creditworthiness. As well it provides information to investors about the degree of risky of the investment.

However, these features for bonds have directly correlated with a bond itself and the issuer of a bond, they have a significant impact, and the ability to control a bond pricing and other factors have an impact of varying degrees. Furthermore, these features provide an extensive database that enables the investors to analyze and anticipate bond returns until maturity. Thus, the bond features help the investors to expect the proper decision in this process.

To needs the investors, the rating agencies provide necessary information about each bond regarding the degree of risk that is being by a rating of bonds. Thus, this rating is based on the likelihood default degree for interest and principal amount. The rating of bonds by these agencies is built on assessing the corporations' financial stability, competitive environment, business planning, and macro factors that may affect the corporation's ability to meet the obligations toward investors. The following table figure (5) is shown ranking for bonds according to the degree of risk:

**Table (5).**

**Bonds Ratings.**

| Standard & Poor's | Moody's | Grade | Meaning |
|---|---|---|---|
| AAA | Aaa | Investment | Risk is almost zero |
| AA | Aa | Investment | Low risk |
| A | A | Investment | Risk if economy declines |
| BBB | Baa | Investment | Some risk; more if economy declines |
| BB | Ba | Speculative | Risky |
| B | B | Speculative | Risky; expected to get worse |
| CCC | Caa | Speculative | Probable bankruptcy |
| CC | Ca | Speculative | Probable bankruptcy |
| C | C | Speculative | In bankruptcy or default |
| D | | Speculative | In bankruptcy or default |

Source: Personal finance Book. (2011).

As illustrated in the above table, bonds rated between AAA (Aaa) and BBB (Baa) called investment-grade bonds; they are relatively low risk and more secure for investors. While bonds rated between B.B. (Ba) or below are called speculative-grade bonds, junk bonds, or high-yield bonds, the relatively high risk carries some of the default risks.

Although speculative-grade bonds have default risk, this does not mean that companies issue all speculative-grade bonds with poor performance. Instead, bonds may be rated junk-grade bonds caused by several reasons like a robust competitive environment, intensive capital, or rising company. This makes the company has difficulty meeting its bond obligations, and thus its bonds may receive for Junk-bonds rating (Personal finance Book, 2011).

The authorized parties to issues the bonds must comply with laws and regulations of the Capital Market Authority and Securities market to be eligible to issue bonds, as well as these parties must have their solvency, competitive strength, and efficient strategies to encounter macro factors. Therefore, these parties that can issues bonds classifies as follows:

- Corporate bonds: they are issued by listed public companies that consider haven instead of seeking banking loans. Furthermore, the maturity for bonds is classified into Short-term bonds, intermediate bonds, and long-term bonds.
- Government (sovereign) bonds: the national government issues them. The bonds that the treasury of state issues for a year or less for maturity date are called "Bills"; the bonds issued for maturity date is between 1- 10 years are called "notes"; the bonds issued for maturity date for more than ten years are called "bonds."

- Municipal bonds: Some local municipalities issue municipal bonds and offer tax-free income to investors.
- Agency bonds: they are issued by local entities affiliate with the government.
- Foreign bonds mean issuing bonds by a foreign corporation in the domestic market with local currency.

The bonds are considered to be safer than other securities; as well it attracts conservative investors. However, several features and conditions characterize each bond in terms of duration, repayment provisions, type of security pledged, time of maturity, and other technical factors that provided numerous options for investors to facilitate making an investment decision. Thus, these diverse bonds create a great base of investors who have alternatives to bonds' investment decisions. Consequently, these types of bonds are as follow:

- Plain Vanilla Bonds: is a normal bond and don't contain any feature, they pay the interest regularly, and at the maturity date the face value of a bond is redeemed. Sometimes are called Straight Cash Bonds or Fixed Rate Bond.
- Zero-Coupon Bond is a type of bond that doesn't pay regular interest. Instead of that, the bond issue at a discount amount of face value, and when a maturity date, the bond has been redeemed at full face value.
- Deferred interest bond is a debt instrument that doesn't pay interest periodically. Instead of that, pays interest in full only upon maturity.
- Step-up bond is a bond that pays interest at a lower rate in the initial period after that allows for rate increases in the subsequent period.

- Floating Rate Bond is a bond that pays interest according to market conditions, doesn't pay a fixed rate.
- Inverse floater is a type of bonds in which the interest rate goes a rise when the benchmark rate goes down and vice versa.
- Participating Bond is a bond that pays a fixed interest in addition to an extra amount if the issuer the bond obtained a predetermined level of profits or incomes and may reduce if income falls below a pre-specified level.
- Income Bonds are related to one side of the Participating Bond, is paid fixed interest plus extra coupon interest if a predetermined level income is achieved.
- Payment-in-kind (PIK) is a type of bond that pays the interest in form bonds instead of cash.
- Extendable bond is a bond that has the option to extend the date of the maturity period.
- Extendable reset bond is a type of bond that allow to negotiation between the issuer and bondholder to reset the coupon rate.
- Perpetual Bond is a bond that pays interest without endless, and the bond is not redeemable.
- Convertible bond is a bond that allows the bondholder to loosen a bond into a number of common shares.
- Foreign Currency Convertible Bond is a special type of bonds that issues with a currency other than the local currency.
- Exchangeable Bonds are similar to convertible bonds but the only difference is for the bonds can convert into a number of common shares by other corporations, not a parent corporation.

- Callable Bond is a bond that the issuer can redeem it from the bondholder before the maturity date.
- Puttable Bond is a bond that allows to a bondholder selling a bond to the issuer of a predetermined price and before the maturity date.
- Bearer bond is a bond that being to the holder without record the name.

These bonds meet the great base of investors' needs and willingness to decide on investment in the bond market. Furthermore, this diversity of bonds contributes to building a deep market by adding liquidity, fueling the base investors, thus forming the debt capital. As a result, these bonds should have active trading by investors and issuers conducted across two markets. A primary market is when the corporations or governments sell the own bonds for the first time; the secondary market is that market that takes place the buying and selling process for bonds after the corporation or government has sold its first offering on the primary market.

It is worthwhile; the capital structure forms a backbone that can rely upon to finance corporations' operations. Subsequently, the importance of corporation bonds stems from the fact that they are an essential part of this structure. On the other hand, the capital structure is affected by various factors. These factors are different from one corporation to another according to a set of goals and strategies that have been put. Thus these factors are key drivers to arise the need for corporate bonds. The first factor is, what is related to business strategies which are required for implement the various investments decisions, and they are different in term of the amount of required financing and necessary period to

pay back these investments so to be borrowers able to predict the necessary required amount and period to finance these investments.

Furthermore, there are some of the theories that link finance corporations with investment decisions. This meant that the finance decision does not make due to the desire to decrease or raise its market value. Instead of that, the corporations are seeking to achieve the strategies in which attaining investing goals. One of the most theories that support this argument is "the Modigliani-Miller Theorem that is developed in the 1950s states that the market value of a company is correctly calculated as the present value of its future earnings and its underlying assets, and is independent of its capital structure" (Modigliani-Miller, 1950). Consequently, and based on the (M&M)[(1)] theory, the finance decision does not matter if the corporation is dependent on financial leverage to raise the market value or not, but it takes broadly consideration to providing the finance itself. In this case, the corporations are not primarily interested in issuing bonds as a debt instrument to finance their investments. Often, the financing decisions of emerging corporations and local government entities are not affected by its combination of capital structure.

The second factor is related to the combination of capital structure. In reality, many corporations aim to minimize the Weighted Average Cost of Capital (WACC), thus increasing the market value for assets the corporation. Thus, the financing decision is tied up with an increase to a certain level of debt capital into a limit that is not overleveraged and decreases the corporation's value. In addition, when the corporation heads for fueling the capital structure with debt as bonds issuance, it should balance the debt's tax shield

(1) (M&M) It means an acronym for theorists. They are Modigliani-Miller.

and bankruptcy and financial distress costs. As a result, corporations with an abundance of taxable income always have a high debt-equity ratio.

Consequently, the Traditional Theory is one of the essential theories exposed to utilizing a debt the combination of capital structure. "It states that when the Weighted Average Cost of Capital (WACC) is minimized, and the market value of assets is maximized, an optimal structure of capital exists." It is also seeking to minimize the Cost of Capital through an optimal combination of equity and debt capital (Robichek & Myers, 1966; Marsh, 1982). This case applies to corporations that income is taxable because the debt takes advantage of a tax shield for these corporations. In contrast, the local government entities or affiliates are non-applicable to take advantage of the tax shield because they are exempt from taxable income. Thus, making a combination capital structure focuses on issuers, corporate bonds, and government bonds.

The third factor is that the nature of the corporation working has an efficient impact on forming the capital structure. For example, an industrial corporation or infrastructure project needs more significant investment capital than a service corporation, so the investment in the industrial sector or infrastructure necessitates having a capital intensive that might exceed internal financing (Reserves, Retained Earnings). This, in turn, results in the use of debt instruments as the issuance of bonds, whether corporate bonds, to bridge the gap of financing. Moreover, corporations that do not have high profits or precisely considerable cash inflow and internal financing sources are not enough; they will face difficulties to meet their total long-term obligations or even pick up investment opportunities. Thus are forced into external financing, which most corporations tend to debt financing instead of equity financing. Based on that, numerous studies have been

discussed the preference in choosing sources of financing for companies, and the one most important is Donaldson's theory. "The essence of the theory is that a firm follows a pecking-order of preference when making decisions on sources of capital." As a result, when making decisions on capital sources, most corporations prefer primarily internal financing, whether retained earnings or reserves, to finance their obligations or investment opportunities. The second option is external financing, in which these corporations prioritize debt like bonds, banking loans. Etc. New equity is the last source for financing consideration (Donaldson, 1961).

As a conclusion of the above, these factors are considered essential determinants to use capital debt as debt bonds. Moreover, these factors are also a vital component to draw up the path in making a financing decision of the issuance of bonds. Accordingly, it has a significant role in prominent the importance of the corporate bond market.

On the other side of the bond market, the government bond market plays a significant role in the local economy, both in the short and long term. As it also has an efficient contribution of getting a robust financial sector. As several countries in the Middle East and the Third World depend fundamentally on a financial sector without a bond market, this causes a vulnerable financial sector that cannot meet the need to finance substantial extraordinary expenditure as an investment in infrastructure or even encounter major financial crises. Subsequently, the impacts caused by such crises on the local economy are generally significant, and the restructuring process is more complicated in the absence of a well-functioning bond market. Hence, it could point out a group of reasons that drive up for using the government bond markets.

The first reason for developing the government bond market is to face the deficit that most countries suffer from, caused by inflation, foreign borrowing, and exchange rate risks. As it is familiar, most countries with a bond market resort to financing the deficit by public debt if the domestic savings are high and might go beyond into foreign savings. Furthermore, the governments with a significant budget deficit and cannot financing obligations may compel to privatize some of the public sector projects. This encourages the issuance of corporate bonds that are resulting in create a stable investment environment. This allows the private sector to crowd out in the bonds issuance process, thus controlling the debt market (Adelegan, O. J., & Radzewicz-Bak, B., 2009).

The second reason is the government's ability to debt management by controlling the financial crisis to reduce the fiscal burden. Issuance of bonds is a complex process in getting the optimal combination between the cost of debt service and risks that include default, duration of redeemed, interest rate changes. This process allows for pricing the risks by conducting the trade-off between the cost of debt and risk minimization. Consequently, reducing the risks of significant changes in the interest rate or exchange rates minimizes the cost of debt. Furthermore, according to expected liquidity availability, if the bond's redemption is guaranteed, this reduces the risk and thus the lowest cost of debt service.

The third reason is to properly approach monetary policy, which has to meet short and intermediate-term obligations or pick up investments. Therefore, one of the most important goals of money management is to support the economy's growth. Anywhere, government bonds play an essential role in controlling balance money by increasing or decreasing the supply of money. As a result, if the economy has a recession, the

government needs to spend more money by repurchasing the bonds from bondholders to reach economic prosperity; this process is called "expansionary fiscal policy," which meant increasing the money supply. In contrast, When the economic prosperity and subsequent rising of price level index, the government has to control inflation by issuing the bonds, decreasing the money supply, thus reducing inflation. This process is called "contractionary fiscal policy." Moreover, several studies addressed monetary policy, and one of the remarkable theories relevant to the money supply amount is Modern Monetary Theory, the core of this theory is "say that fiscal policy is merely money that the government is spending in the economy or the money amounts that are collected." This theory also determines the money supply amount by keeping the economy at full employment and a reasonable level of inflation and not being determined by deficit levels (Warren Mosler, 1970).

The fourth reason is the government bonds market, which is the foundation that could provide the appropriate infrastructure market, which acts as a coordinating tool between counterparties together to support both financial stability and operational efficiency. Furthermore, the well-designed market infrastructure can be a source to attract primary investors, issuers, and big dealers, as well as the government bonds market is focusing on improving rules and regulations, central market infrastructure, and a dealer community. The government bonds market is considered the first step to the startup of establishing a corporate bond market.

All these fundamental reasons are significant to appear the government bonds market importance for economic growth. However, other justifications have great importance for

the government bonds market's existence. On the financial aspect, the government bond acts as benchmarking to measure corporate bonds' performance, as well the government bond has an impact on other bonds' prices. Because government bonds are risk-free investments and guaranteed by a local government, a bond's return is low. On the other hand, when the investor compares his bond with a benchmark bond, it should have the same characteristics, including maturity date, issue size, liquidity, and credit rating. However, the government bond is not only a benchmark for other bonds; instead of that, is a benchmark to a far degree for other financial assets like corporate shares, and also a benchmark closer for debt instrument like banking loans. Ultimately, the government bond is a baseline for investors to build their anticipations in short and long-term investments. In addition to that, the risk-averse investors escape into government bonds with less risk and low return.

Furthermore, some studies like Fleming, M. J. (2000), address the U.S. Treasury market's benchmark status. This study indicates when a surplus of payment balance occurred, as it is resulting in "a significant reduction in the Treasury market's size and to deterioration in the market's liquidity and efficiency." On the opposite side, the financial crisis raises investors' concerns about market performance in the future, as a result of that, where investors' concerns are caused to scramble toward buying treasury securities instead of other fixed-income, thus cause a variance of yields and thus increased the cost of borrowing other financial securities. This leads to conclude that a government bond is a safe investment in all the economic conditions.

Ultimately, investors may desire to invest in these treasury securities as a functional tool for getting all available market information or using it as hedging vehicles or monitoring

& analytical purposes; this makes them closer to benchmark bonds. Moreover, "government bonds can play a significant role in sterilizing large capital inflow. Once the interest rate is rising, that will create demand for the local currency by foreign capital, resulting in increasing inflation. In this case, central banks are facing a hard challenge in the absence of well-developed bond markets. Therefore, the sterilizing process is conducting by selling government bonds that would reduce such a risk" (Turner, P, 2002).

## 2.3 Model of Bond Market.

With the development and growth of some economies globally and diffused of globalization in most countries, this paid toward developing free-markets that induce the most prominent companies and governments to have intermediate or long-term investments. Thus, it is necessary to provide massive money from the capital markets to finance this investment addition. The bond market is one of the essential pillars of capital markets that provide financing to borrowers, so several emerging market countries worldwide are looking to establish local bond markets.

Indeed, establishing a bond market in emerging markets countries encounters many impediments, and it needs a long time to equip an efficient bond market. However, establishing a local bond market is influenced by numerous internal factors, external factors, and across among them. Also, these factors have an impact on establishing a local bond market with disparity degrees. Interestingly, several of these factors have no existence or inappropriate in emerging markets for establishing a bond market and thus need a great time to get in place. Furthermore, some of them can be under the control of the government or regulators, and others are out of control.

It is important to emphasize that an appropriate environment is a crucial foundation for establishing the bond market. There are several essential dimensions that contribute to shaping proper conditions to have a spark for establishing this market. The crucial dimensions that impact bond markets are macroeconomic, financial, legal, political, and

strategic, where these dimensions differ in degree of impact from one environment to another.

Indeed, the infrastructure is one of the significant essential factors that impact establishing a bond market. It facilitates critical functions of the market as the trading process and size, and quality that characterized it is appealing institutional investors and critical issuers to the bond market. Furthermore, growth in the economy and privatization creates considerable investment opportunities are requiring great financing that can be filling it by issuing bonds.

Having a legal framework by laws, regulations, and internationally recognized accounting standards contribute to regulated and organized transactions in the bond market and thus facilitate and quick fulfilling the processes by reducing bureaucratic procedures in place, as well these laws are also limiting of corruption and embezzlement as well as building trusts for all key market players.

Worthwhile the existence of the government bond market helps provides the necessary infrastructure for the corporate bond market and government yield curve providing a benchmark interest rate for the pricing of corporate bonds and facilitating the conduct of monetary policy. However, holding government debt constant and not raising the deficit is generally a matter for the bond market and the local financial sector. A study was conducted in 2008 by A Silvain, stating the opposite relationship between the continued raising of deficit and the bond market's development. This study's essence is that borrowing by banking sources will create inflationary pressure without other non-banking sources that would shape a deterrent to attract institutional investors and critical issuers (Silva, 2008). On another side, when increasingly borrowing by a government, that

causes crowding out for a total amount of savings. This, in turn, give rise to have an obstacle to the establishment of the bond market.

In effect, some countries have macro instability like Middle East countries, which cause sovereign risk; thus, government defaults give rise to a crisis in the banking sector on which the government relies on. As a result, the corporate bond market is considered a benefit because it was an additional choice for other financing sources. A study has been conducted by (Borensztein, E., Cowan, K., Eichengreen, B., & Panizza, U2008). The essence of the study states that financial architecture [(1)] could contribute to developing the economy, in the case of a corporate market that allows borrowers to choose between bond finance or bank finance. However, on the other hand, financial architecture plays a crucial role in providing the corporate bond market as a "spare tire" when taking place in the default of government or a crisis in the banking sector.

The main factor of establishing the corporate bond market is the firm size and market size; they are the critical determinants for establishing this market. Subsequently, if the firm value is minimal, this means the debt value would also be small. Consequently, issued bonds are a subtotal of the present value of whole debt, a subset of small total debt (Borensztein, E., Cowan, K., Eichengreen, B., & Panizza, U. 2008). The bond market is limited to large firms that can finance their investment by bonds; the small firms are not.

Also, foreign capital plays an essential role in providing the necessary financing for local corporates to implement their investments. However, the laws and regulations in place

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[(1)] financial architecture is "made a variety of reforms to try to reduce the frequency and severity of international financial crises. The reforms include steps to improve transparency, strengthen financial sectors, and involve the private sector more fully in rescue packages"Frankel, J. A. (1999). ... To be achieved should have direct interactions with international institutions such as the United Nations, the International Monetary Fund (IMF) and World Bank, and the G8/G20 processes.

could deter foreign capital from bond markets, thus filling the gap of domestic financing. The study has been conducted by (Eichengreen, B., & Luengnaruemitchai, P. 2004). The essence of this study, stating that one of the most significant obstacles is controls on account capital, and the evidence is not to participate in foreign capital as controls hinder the foreign participation in domestic bond markets and thus hinder the establishment of a domestic bond market.

In contrast, capital account liberalization is not feasible if the domestic bond market is not deep, liquid, and efficient. Hence, the developed domestic market is attracting foreign capital, but establishing a bond market has hard in the presence of the controls on capital. Therefore, the only solution is to overcome this dilemma is to boost market regulations and laws, building bond market infrastructure, and conducting other domestic preconditions to establish the local bond markets before the liberalization of the capital account.

Moreover, from the financial side, the volatility in the exchange rate is a crucial factor that reflects the domestic economy's health, given an impression for foreign investors about the accuracy and validity of future forecasting and the extent to which the exchange rate fluctuates. This gives rise to add a risk premium caused by the future uncertainties, which in turn raising costs these the debt, which leads to discourage issuers of the bonds and adversely attract foreign investors. According to a study has been conducted by (Silva, 2008). The study's core states that the stability of the exchange rate has a significant effect on the bond market. The changes in exchange rate increase uncertainties, adversely affect polarization for foreign investors, and affect the development of the benchmark yield curve. Besides, the exchange rate volatility reduces

an inflow of other foreign currency and down up or decreases of contributing the foreign capital in other financial markets like the equity market. Subsequently, this, in turn, affects liquidity in the markets.

One of the most significant difficulties in establishing the bond market is to favor the borrowers' financing by banking than to other sources; this legacy has prevailed in most lagging countries in the financial sector. The banking sector has dominant in the financial sector because it is considered an essential source for financing as well; these countries are given higher priority to the banking sector than to other financing sources. As a result, these countries will be more exposed to the financial crisis resulting from the fragility of the financial sectors depending only on the banking sectors and thus do not have other alternatives to compensate for the exacerbated financing deficit. Therefore, the reasons that are underlying a rush to banking loans are ease and expediting in obtaining a financing loan by the banking sector. In contrast, no existence for other financing sources such as the bond market, or these markets are inefficient and need a long time before getting the financing and have complex requirements.

Consequently, many studies addressed his topic one of the most important studies is for (Batten, J., & Kim, Y. H, 2001). Since the essence of the study conducted on Asian crisis countries is to state that diversification of financing sources is the better choice and thus accelerate financial sector development, in these countries, industrial financing was significantly dependent on the banking sector because financing is less expensive for abroad borrowing, resulting in significant financial risks such as bankruptcy. Short-term financing prevailed in these countries, and this financial sector was more vulnerable to financial shocks. Consequently, this study prompted the bond market's role in the financial sector as a critical financing source.

The investor base is also considered one of the most significant factors that could significantly affect establishing the bond market. "The aim of expanding the investor base is to encourage the development of investors that have different investment objectives and employ a range of investment strategies. This will enhance market liquidity by creating trading opportunities and will reduce market fluctuations by allowing bonds exhibiting different investment risks to be held by those most capable of accepting them" (Andrews, A. M., Hannah, R., & Sutton, B., 2013).

While the investor base's diversity is evidence of a mature bond market that reflects the investor's willingness to accept risk trade-offs with a return, some investors accept high risks in exchange for high returns, and others might be not. This indicates that there is a discrepancy in an investor's desire to accept risks. Consequently, the investor base's diversity needs the existence of different types of bonds rated between high and low credit quality to meet investors' desires. Furthermore, the presence of financial derivatives in the bonds market immensely contributes to increasing the liquidity and trading activity and the ability of an investor in management to his investments. Therefore, according to the diversity of investors' base, they find themselves simultaneously a buyer and seller for bonds. Most often, some financial institutes like banks, mutual funds, pension funds, and insurance companies make up the base investors. Besides, if these institutions have evolved, this results in boosting and diversity of the investors' base.

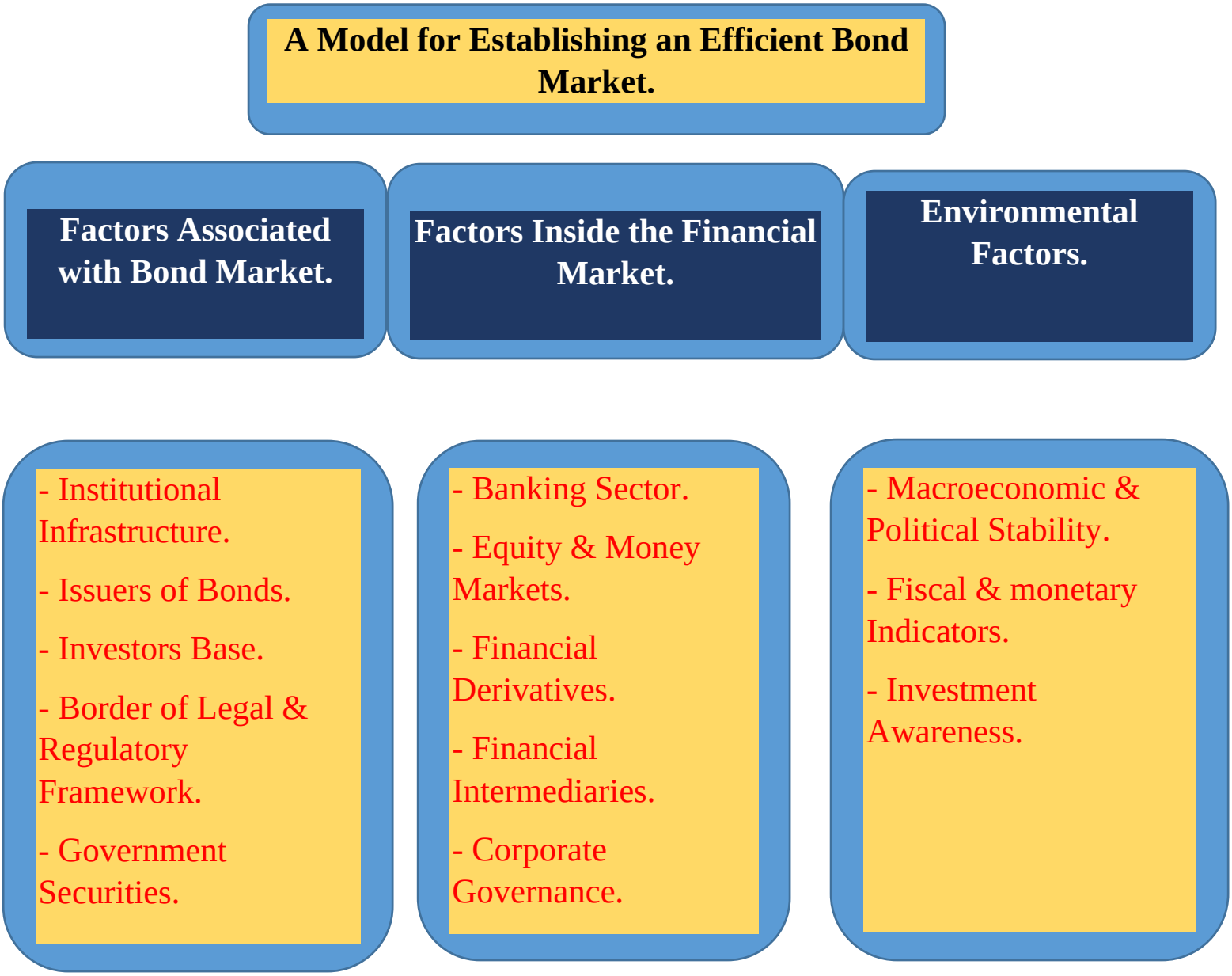
In this frame, many studies address the importance of an investor base, and one of the most important studies conducted by Andrews, Hannah, & Sutton, in 2013. This study's

essence is that there are important reasons other than promoting and awareness of the importance of the local currency bond markets. The one most critical reason to expanding the investor base is building and evolving provident, and pension funds immensely contribute to expanding the participation. Providing new pension plans and individual retirement savings plan is essential to provide income security for aging populations. Furthermore, the development of new pools of funds plays a role in creating essential investors in the local currency bond markets. Also, there have been many initiatives that could give rise to expanding the base of foreign and domestic investors. Some of these initiatives are "the legal and regulatory framework for non-bank financial institutions, particularly insurance companies and pension plans, Adopting the prudent-person investment rule for insurance companies and pension plans. Also, a movement to complete (or at least partial) funding of pension plans rather than relying on the pay-as-you-go approach creates additional domestic capital pools. The legal and regulatory framework for mutual funds should also be put in place, reduce or eliminate withholding taxes, reduce or eliminate foreign exchange restrictions, streamline or eliminate foreign exchange administration requirements, and enable bond transactions to be settled through Euroclear. "In addition to that, there are also other initiatives in this study that might be doing expanding the investors' base (Andrews, A. M., Hannah, R., & Sutton, B., 2013).

Eventually, the researcher has concluded that numerous crucial factors and determinants play an essential role in establishing a domestic bond market. These factors could be classified into four dimensions: macroeconomic, financial, legal, and strategic. Furthermore, it could divide these factors into internal and external and others. Thus, the

model building for all factors that influence establishing an efficient domestic bond market would be as follows in diagram No 1.

**Diagram (1).**



# Third Chapter.

## 3. The Landscape of Financing in Palestine.

This chapter aims to give an overall idea about the development and expansion of financing sources that include the Banking sector and the financial securities market in the Palestinian financial sector in meanwhile last decades. This chapter also presents the figures and percentages that illustrate evolving financing sources and significant accumulative capabilities that have been acquired in these financial institutes despite restrictions and imposed siege by the Israeli occupation.

## 3.1 Overview.

- **Palestinian Banking Sector.**

Over the past decades, the Palestinian territories have seen instability in the security and political levels, which led to the deterioration and collapse of the Palestinian economy and made it subordinate to external parties, whether the Jordan and Egypt state beyond 1948 or Israeli occupation beyond 1967. As a result, it has adversely impacted the Palestinian financial sectors, especially the banking sector. Furthermore, the restrictions and obstacles imposed by the Israeli occupation, whether by dominance on trade borders with neighboring countries, isolating Palestinian areas for each other, or control economic resources over the past decades, have had a significant reverse impact on economic development and thus impaired and distorted the activity and capabilities of the financial sector.

Since the Israeli occupation in 1948, both the West and Gaza areas were subordinate to Jordan and Egypt on political and military levels. Meantime, Jordan and Egypt have been substituted the Palestinian currency with their currency. Furthermore, in the early 1950s, eight banks with thirty-two branches in the West Bank and six banks with seven branches in Gaza were Palestine Bank, Arab Bank, Alexandria Bank, and the nation's bank (2000, Mass Institute). When the Israeli army occupied the Palestinian land of 1967, the Israeli's laws and procedures prevailed in these areas. It did not last long until the Israeli occupation issued Military Order No. 7, which states to close all working banks in West Bank and Gaza and seize banks' balances to benefit for investing purposes, instead of using it in the Palestinian economy. Under other Israeli military orders, the Israeli currency was adopted in the Palestinian trading and allowed the opening of new Israeli bank branches in the west bank and Gaza strip areas, which reached their number into thirty-nine branches. This situation continues until the explosion of the first intifada in 1987, the Israelis banks were forced to close all West Bank branches, and challenging security conditions were imposed on Gaza. As a result, in the early 1990s, there was an increase in the number of foreign and domestic banks working in the Palestinian territories caused by predicting the economy's growth (Mass, 2014).

Since the signature of the Oslo agreement in 1993, as well through the economic Paris agreement, the authority of Palestinian become able to establish the Palestinian Monetary Authority, which is eligible to exercise several tasks the most important are supervising and controlling the banking system and preserving a certain balance of foreign currencies. The Palestinian currency-issuing has also been postponed until the final solution agreement that deprived them of being the lenders of last resort during the

transition phase. The first years after the Oslo agreement have an increased number of banks, whether they were previously closed and rework or establishing new banks, as shown in table figure (6). Whatever foreign or domestic capital attracted to investing in the banking sector was caused by forecasted prosperity by investors in the Palestinian economy in this period (Nasser Abdulkareem, 1998). In this period, the number of banks reached eight domestic and ten foreign banks, as the bank branches were spread over all areas in West Bank and Gaza that number were 226 branches.

**Table (6).**

**Institutions of the Palestinian banking sector as of the end of 2019.**

| Domestic Banks | The year of commencement or resumption of the bank's work. |
|---|---|
| Bank of Palestine | 1960 |
| Palestine Investment Bank | 1995 |
| Quds Bank | 1995 |
| Arab Islamic Bank | 1996 |
| Palestine Islamic Bank | 1997 |
| The national bank | 2006 |
| Safa Bank | 2016 |
| Foreign Banks | |
| Cairo Amman Bank | 1986 |
| Arab Bank | 1994 |
| Bank of Jordan | 1994 |
| Egyptian Arab Land Bank | 1994 |
| Jordan Commercial Bank | 1994 |
| Jordan Ahli Bank | 1995 |
| Housing Bank for Trade & Finance | 1995 |

Source: Palestinian Monetary Authority, Annual Report, 2019.

## ➢ Palestine Securities Market.

Palestine Securities Exchange is one of the most important financing sources that attract domestic and foreign savings for massive and long-time projects like productivity or infrastructure projects. Also, Palestine Securities Exchange was established in 1995 as a private company at the initiative of PADICO [(1)] Holding. After that, the Palestinian

[(1)] Palestine Development and Investment Company.

Authority has been undertaken to establish and sign to operate the securities market in 1996. Indeed, the actual activity of the Palestine Securities Exchange commenced in Nablus city in February 1997. Since the time, there were achievements and evolving during subsequent years regarding regulations and laws and the technology systems in place in the modern financial markets in the world. The securities market also had modern electronic systems for control, trading, settlement, and transfer of securities. Also, securities market management has a technical team with skills acquired by training courses and workshops held by international financial enterprises. Furthermore, the most prominent achievements that have been achieved were to developed six corporations of financial intermediary that contribute to facilitating trading of investors base, as well the number of listed corporations through the first years was reached into 26 corporations in 2000. Moreover, the Palestinian exchange's performance was notably rising within the first three years of establishment.

"As it has been Issuing securities law no. "12" in 2004 and capital market authority law no "13" of the same year. The securities market had also been under control by the Ministry of Palestinian Finance even in 2005. Then, the Palestinian Capital Market Authority has been established and received the tasks to become the regulator, supervisor, and monitor of the capital market in Palestine. Since that time, the Securities Control Department, as one of the authority's departments, has started its work regulating, controlling, and supervising the securities sector through its various departments. A set of decisions and circulars have been issued that regulate the securities sector's work in the field of issuance, disclosure, control, licenses, and determining trading commissions. As

the Palestinian securities sector consists of several bodies involved in the securities market as the following:

- Palestine Exchange and Centre of Depository and settlement.
- Public-shareholding companies.
- Securities companies' members of the Palestine Exchange.
- Financial professionals.
- Investment funds.

During the year 2013, the General Directorate of Securities achieved a series of achievements, which were culminated when PCMA[(1)] was admitted as an ordinary member in the International Organization for Securities Commissions (IOSCO)[(2)], in addition to the accession of the State of Palestine, represented by PCMA, as a signatory of MMOU[(3)]" (Palestine Capital Market Authority, 2019).

As related to disclosure is the electronic disclosure system, which is specialized in disclosing the financial and non-financial data of listed companies. As would be mandatory disclosure according to the following sectors:

- Banking & financial services sector.
- Service sector.
- Industry sector.
- Investment sector.
- Insurance sector.

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(1) Palestine Capital Market Authority
(2) International Organization for Securities Commissions
(3) Multilateral Memorandum of Understanding

## ➢ Microfinance Sector in Palestine

Microfinance mainly refers to micro-credit and is a small part of loans presented to people with little or no income. Besides, microfinance includes the full provision of training and support for development programs and usually with little collateral, so there is a high repayment rate.

The microfinance enterprises in Palestine commenced their work during the 1990s. The most prominent of these enterprises, FATEN enterprise that began as a program by Save the Children (1995), Vitas (previously CHF-Reyada) by CHF International (1995), and Asala by Oxfam-Quebec (1997), and other microfinance enterprises, as shown in the table figure (7). They are mainly classified into non-profits enterprises that aim to contribute to the process of economic development. These enterprises also worked as vehicles to fill the gap for financial services by providing Credit, mainly since the number of working banks was small during that period.

During the past years, the microfinance sector lacks the laws and regulation which organizes works these enterprises, where non-government organizations for MFIs have followed the Law on NGOs and were overseen by the Ministry of Interior. On the other hand, domestic enterprises, either profit or non-profit, have followed and registered to the Ministry of National economy's law until 2011. After that, the PMA was controlling through overseeing and monitoring the microfinance sector, and the credit enterprises were applying for a license with the PMA.

As the microfinance sector has seen significant evolution by the end of 2000, the sector served 15,000 clients with a total portfolio of almost $16 million. After that, primarily

when the Israeli army had conducted military operations in Palestinian territories in 2002, it reduced the number of clients and portfolio worth for the microfinance sector. However, by the end of 2002, the microfinance sector had recuperated, reaching about 27,000 clients and a $37 million portfolio. As the years go by, especially the end of 2010, the portfolio worth its microfinance sector was approximately $60 million across a total of 60 branches. This is evidence of the remarkable development of performance for the microfinance sector.

**Table (7).**

**Microfinance Enterprises in Palestine.**

| Institution Name | Established Year |
|---|---|
| American Near East Refugee Aid | 1968 |
| Palestinian Agricultural Relief Committees | 1983 |
| Young Women Christian Association | 1985 |
| The Palestinian Academic Society for the Study of International Affairs | 1987 |
| Arab Center for Agricultural Development | 1988 |
| UNRWA Microfinance and Micro-Enterprise Department | 1991 |
| Global Communities, Partners for Good | 1994 |
| Palestine for Credit and development | 1995 |
| Ryada for Lending and Financial services | 1995 |
| Palestinian Development Fund | 1996 |
| Palestinian Development Fund | 1996 |
| Asala by Oxfam-Quebec | 1997 |

International Bank Group, 2017

## 3.2 Status Quo for Financing Sources in Palestine.

### ➢ Palestinian Banking Sector.

The Palestinian Banking sector has seen significantly evolving since 1994, especially in the last few years, which explained the increase in bank branches in both West Bank and Gaza from 237 in 2013 to 370 branches in 2019. This is an indication of an increase in the banking operations caused by expanding the client base. Moreover, a declining number of clients for each branch from 18,926 in 2013 to 13,619 in 2019 (Source, Association of Banks in Palestine) this evidence of fierce competition among banks in providing their banking services for clients. Also, the Palestinian banking sector's total deposits reached 8,306million dollars at the end of 2013, as shown in table figure (8). On the other hand, the deposits amounted to 2019 approximately 13,384 million dollars. Hence, it is notable, and there is rising in the depositary percentage of almost 60%, which indicates increases in savings size resulting from the people's desire to invest in the banking sector, which is considered a haven in the awareness of the Palestinian investor.

Regarding credit facilities in both public and private sectors, at the end of 2013, they were 4,480 million dollars, while they reached at the end of 2019 into 9,039 million dollars. The increase in the size of facilities granted to clients is evidence that needs financing to meet the purposes of investment and consumption programs for both public and private borrowers. Moreover, it was essential to note an increasing percentage of credit facilities for deposits from 54% in 2013 to 68% in 2019. Thus, the banking sector recorded a growth rate of the total percentage of credit facilities for deposits during the last six years, amounting to about 14%. Thus, it could be the conclusion; there is an

increase in the pace of finance by banking sectors resulting from severe competitiveness to finance programs that own for both the public and private sectors. That helps the banks do their essential function as a financial intermediary among savers (lenders) and investors (borrowers).

The most recent financial data is showing at the end of 2019 that the total asset of the Palestinian banking sector reached 16,994 million dollars with a growth percentage of 9.8% with comparison 2018. A significant rising in the banking sector's assets percentage reached 47.7% during the six last years, indicating increasing productivity in both short and long-term assets caused by an expansion of the banking operations.

Indicate the data of the Palestinian Monetary Authority as shown in diagram No (2). The banking sector is consistently profitable, and these profits steadily increase, especially in the last four years, as profits are rising from 132 million dollars in 2015 to approximately 175 in 2018. This indicates that the banking sector is appealing to invest by those who desire to use their funds in profitable projects. Despite the political and economic impediments imposed by the Israeli occupation, the banking sector attained significant profits and had great prosperity over the past years. By expanding investors base and building new branches to facilitate providing banking services to investors in Palestinian territories. As the Palestinian local and foreign banks have succeeded in bearing the test in place by the Palestinian Monetary Authority every three months or semi-annually, the test's nature was based on the Palestinian territories' economic and political conditions.

Moreover, the Palestinian Monetary Authority has given significant attention to restructuring the banking sector by encouraging fragile banks on merging for purposes of improving the competitiveness across Palestinian banks, as well as strengthening and

immunized the banking sector against risks and financial crises by raising the minimum paid-capital to 75 million dollars in November 2014. In the same context, the Palestinian Monetary Authority has issued a code of ethics and best practices for governance of the banks in Palestine, corresponding to Basel Committee Standards for Banking Supervision. Besides, it has issued a guide manual about money laundering to identify the negative impacts of money laundering and its effect on the national economy.

Despite the difficulties and impediments are facing the Palestinian banking system resulting from the deterioration of economic and political situations because of restrictions, closures, and the blockade imposed by the Israeli occupation that affects the whole financial sector. However, during the previous years, the Palestinian Banking Sector has achievements in various fields related to its work and tasks. It has also made a remarkable qualitative leaping by building the regulations and law frameworks that organize the banks' work and contribute to building the institutional system and restructuring the banking sector, which results in an increase in ability competitiveness among banks. Moreover, the banking sector's sophisticated indexes in annual reports issued by the Palestinian Monetary Authority are evident in the Banking sector's prosperity and development.

## Table (8).

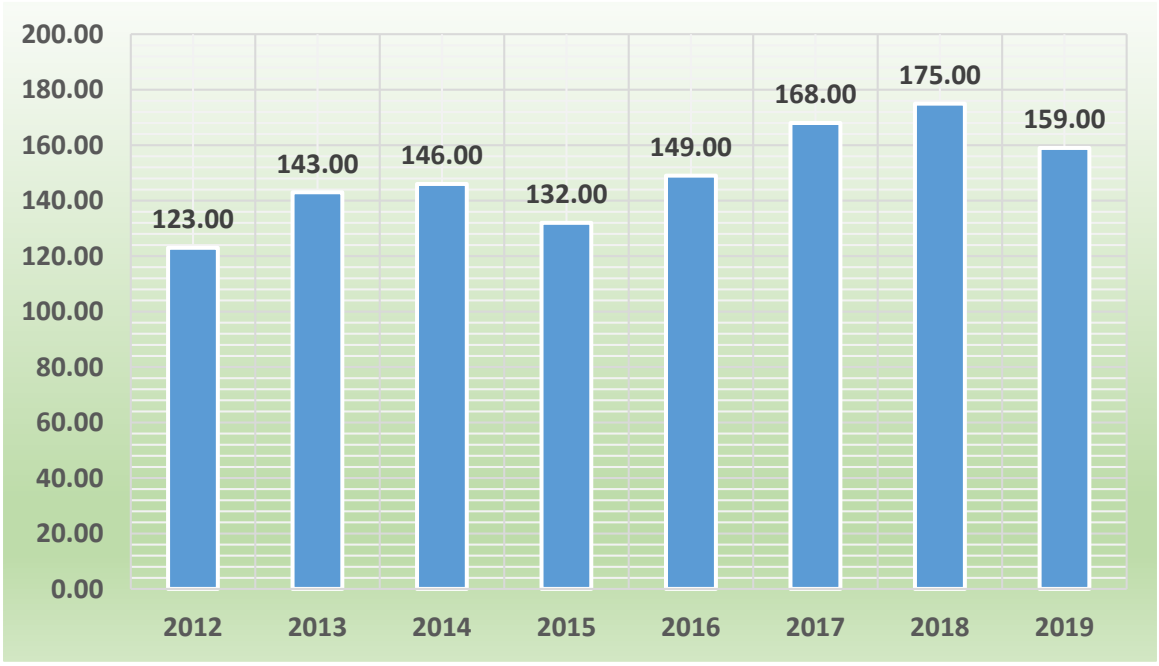
## Growth of Palestinian banking sector performance from 2013 up to 2019.

| Description | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 |
|---|---|---|---|---|---|---|---|
| **Total Assets (Million $)** | 10,783 | 11,416 | 12,271 | 13,695 | 15,376 | 15,477 | 16,994 |
| **Annual growth rate for Assets** | 0% | 5.87% | 7.48% | 11.61% | 12.27% | 0.66% | 9.80% |
| **Deposits** | 8,306 | 8,935 | 9,654 | 10,595 | 11,982 | 12,227 | 13,384 |
| **Net direct credit facilities** | 4,480 | 4,895 | 5,824 | 6,865 | 8,025 | 8,437 | 9,039 |
| **Rate of loans granted / Deposits** | 54% | 55% | 60% | 65% | 67% | 69% | 68% |

Source: Association of Banks in Palestine, 2019.

## Diagram (2).

## Net Profits for Banks (Million Dollars).




Source: Association of Banks in Palestine, 2019.

Indeed, one of the most critical roles that the Palestinian banking sector can play is to provide credit facilities to the private sector, particularly contributing to the development of the Palestinian economy by increasing the gross domestic product. However, there is a more minor increase in the percentage of Gross Domestic Production compared to the increase in the percentage of credit facilities, as the percentage in 2010 was about 21%, in 2015 about 31%, in 2019 reached 44%, as shown in diagram No (3). Thus, this percentage increase reflects the slowdown in the growth of the Palestinian economy. Nevertheless, it is notable how strong the relationship is between Gross Domestic Production and credit facilities granted by the banking sector. This index indicates the extent to which correlation and relationship depth between banking credit and growth in the Palestinian economy could explain the growing direction to both variables during the period (2010 - 2018).

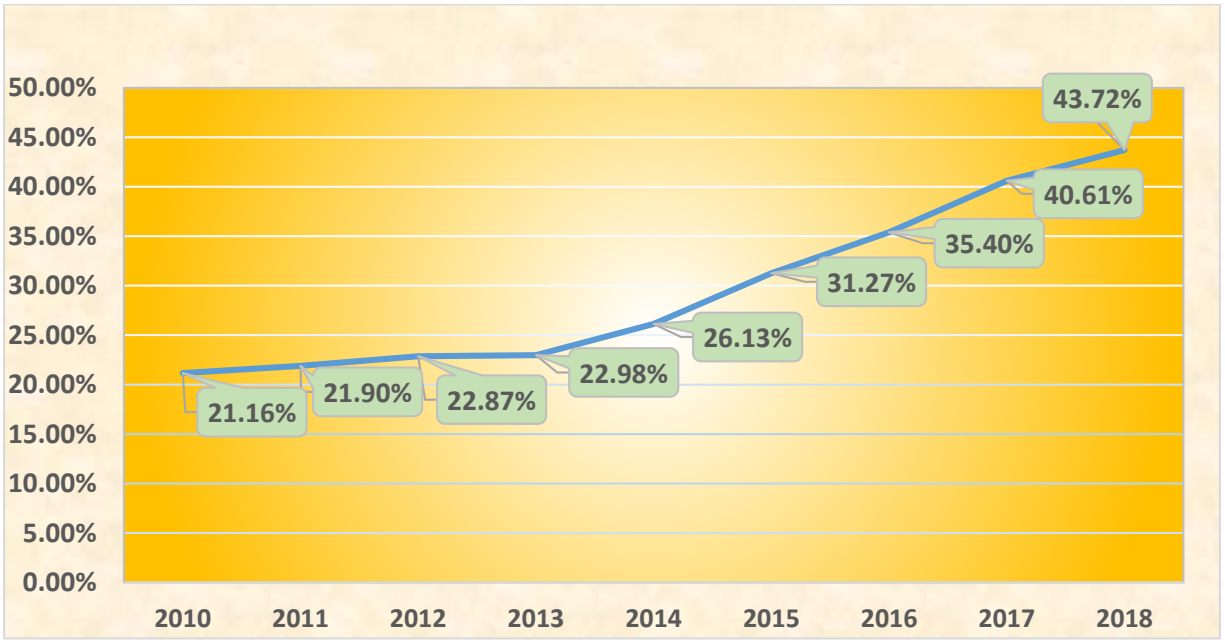
Also, the measure of the percentage of local bank assets to GDP [(1)] is one of the most important measures to determine the size of the domestic economy. This percentage measures the extent that correlates the banking sector with the local economy of the state. Also, many countries have seen differences in the percentage of local bank assets to GDP, whether these states are developed or not. If this percentage is high in the developed states, this might mean implementing the policies of economic and investment expansion in the normal state. On the other side, it reflects a deficit in the budget in developing states and vice versa. In the Palestinian case, despite the increase in the gross domestic product in the last years from 9,682 in 2010 up to approximately 16,277 million dollars, there was an increase in the percentage of local bank assets to the GDP from

[(1)] GDP is an abbreviation for Gross Domestic Production.

approximately 49% in 2010 to 71% in 2018 as shown in diagram No (4). This is evidence of an increase in government borrowing from Palestinian banks. Consequently, the banking sector is the primary fuel for the Palestinian economy, whether a deficit of a balance of payment as the Palestinian government case is or to implement investment or financial programs to attain economic growth.

**Diagram (3).**

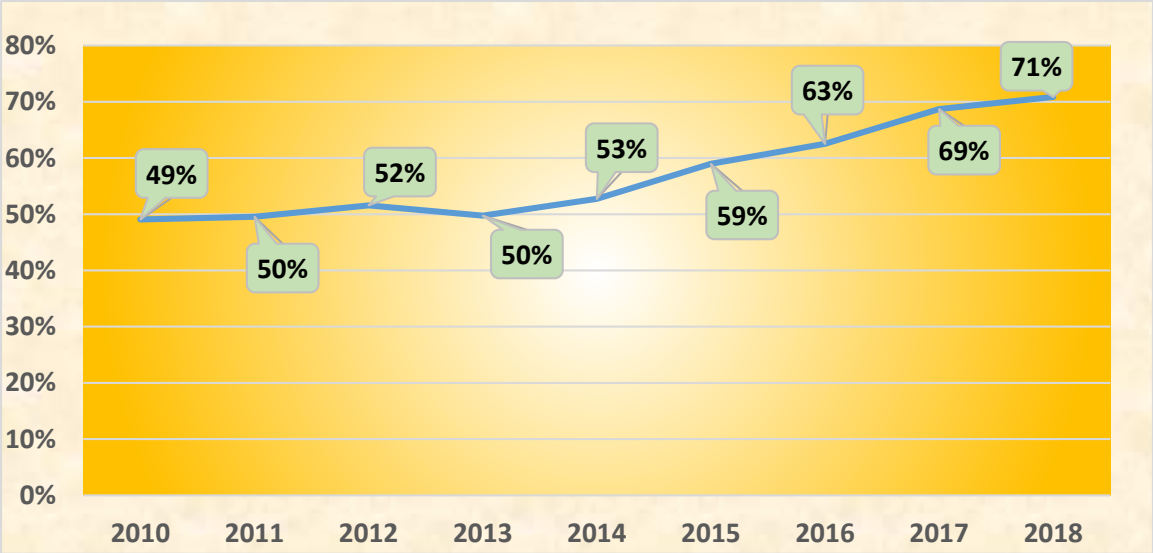
**Index of Credit Facilities for Private Sector to General Domestic Production.**




Source: Palestinian Monetary Authority, 2019.

**Diagram (4).**

**Index of Gross Domestic Banking Assets to General Domestic Production.**




Source: Palestinian Monetary Authority, 2019.

Ultimately, and despite the Palestinian banking system's progress that has been achieved over the past two decades, there are shortcomings in the performance of its primary function of financial intermediation between savers and investors. This is due to several reasons, the most important of which is first; the problematic political situations that caused imposing the restrictions and blockades on Palestinian territories by the Israeli occupation and isolate the Palestinian areas from each other, as well as the piracy of the Israeli occupation for natural and economic resources, as well as controlling the trading borders with neighboring states. Consequently, this gave rise to distortions in the structure of the Palestinian economy. Such a matter is demonstrated by the gap between the gross domestic product and total expenditures. As a result, state instability and high investment risks prevail, which negatively affects banking sector activity. The second reason is the absence of the national currency, thus the absence of a lender of last resort. In return, this influences the Palestinian Monetary Authority's ability to manage the

policy monetary and thus controlling inflation or economic recession. Finally, one of the most important implications is the inability to lend the banks to encountering a liquidity crisis. Therefore, the Palestinian Monetary Authority enacted some laws to commit the banks to have their reserves that amounted equal to paid-in-capital and raise their capital into 75 million dollars to offset the lack of liquidity. This, in turn, gives rise to a conservative principle against the investment risks affecting the banking sector's role as a financial mediation among savers (lenders) and investors (borrowers).

The third reason is the blemish of credit structure for the banking sector regarding loan types, loan duration, and the sectors that loans are serving (Abdulkareem, 1998). The banking sector's granted loans do not include all loan applicants, like a student loan, huge project loans, etc. Moreover, the banking sector guarantees loans that feature in terms of duration with short and medium-term loans. In contrast, they do not grant long-term loans because of investment risks and lack of trust in economic and political situations. Moreover, concerning sectors that have received most credit facilities in the last decade by the Palestinian banking sector are real estate and constructions, local and foreign trade finance, and consumption projects that do not essentially increase productivity and thus do not boost sustainable development of the economy. As Observable by table figure (9), the real estate and construction sector commenced with almost a percentage of total credit facilities of 16% in 2010, rising to 23%, and the consumption sector is significantly increasing by 15%, which reached 23%, in 2019.

In contrast, the mining and manufacturing sector started per se with a small size of total credit facilities where its percentage from all sectors was 12.6%, in 2010, even has down to 6.4%, in 2019. Compared with Jordan, find that the credit percentage for the industry

and mining sector is higher, reaching approximately 13.8%. This is an indication that there is a considerable disparity of size of the loans provided to various sectors, and that a result from going investors towards short or medium-term projects and which are attained fast profits. This orientation for investors is aligned with the banking sector's goals.

The conclusion that the Palestinian banking sector operates with the conservative principle to prevent losses and avoid investment risks. Thus the role played by Palestinian banks is limited to maximize the profit in the short-term and increasing their assets, which corresponds with the agency problem in which the executive managers work of their interest. Consequently, the Palestinian banks own their particular agenda in which keeps away from any future vision or national responsibility in leading the Palestinian economy.

**Table (9).**

**The sector lending percentage from banking facilities for all sectors from 2010 up to 20s19.**

| Sector | 2010 | 2011 | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | 2019/Jordan |
|---|---|---|---|---|---|---|---|---|---|---|---|
| Real estate and constructions | 16.2% | 16.8% | 21.1% | 20.9% | 21.6% | 21.8% | 22.3% | 21.2% | 22.6% | 22.9% | 26.3% |
| Local and foreign trade finance | 19.1% | 20.0% | 18.0% | 19.7% | 20.4% | 21.6% | 20.2% | 21.5% | 22.1% | 20.5% | 16% |
| Consumptions | 8.0% | 14.8% | 21.4% | 22.7% | 22.2% | 22.1% | 23.2% | 21.1% | 19.3% | 23.3% | - |
| Mining and manufacturing | 12.6% | 12.4% | 6.2% | 7.2% | 7.0% | 6.1% | 5.5% | 6.1% | 6.2% | 6.4% | 13.8% |

Source: The Central Bank of Jordan, Palestinian Monetary Authority, 2019.

- **Palestinian Securities Market.**

Over the last fifteen years, the Palestinian securities market has been provided with electronic systems for trading, control, settlement, and transfer of securities to ensure speed and accuracy for the completion of buying and selling operations, and the safety of dealing with the securities whether the volume of their transactions or their relationship with the listed companies, which provides all investors with equal opportunities for profit and risk. Therefore, the securities Palestinian Market became one of the essential sophisticated markets of the regional level.

However, the Palestinian Capital Market Authority reports indicate that The trading value is steadily declining, where it has recorded 1,185 million dollars in 2008. After that, it declined up to 273 million dollars in 2019, as shown in diagram No (5). This trading value is considered low compared with emerging markets such as Jordan and Singapore that recorded their trading value during 2019, almost 1,585.4 and 26,417 million dollars. That points out the impairment and retreat of investing in securities (stocks) by listed Palestinian companies resulting from less demand on securities, giving rise to illiquidity in the securities markets. Also, despite that, these reports indicate that the listed companies' market capitalization had increased from 2008 until it reaches approximately 3,757 million dollars in 2019, as shown in diagram No (5). However, the percentage of market capitalization to GDP declined to more than 50%, as shown in diagram No (6), this evidence that the Palestinian securities market is not a significant impact on the domestic economy. On another side, the market capitalization to GDP in other states like Jordan and Singapore is a high ratio in 2019, 50%, 187%, respectively. That means the

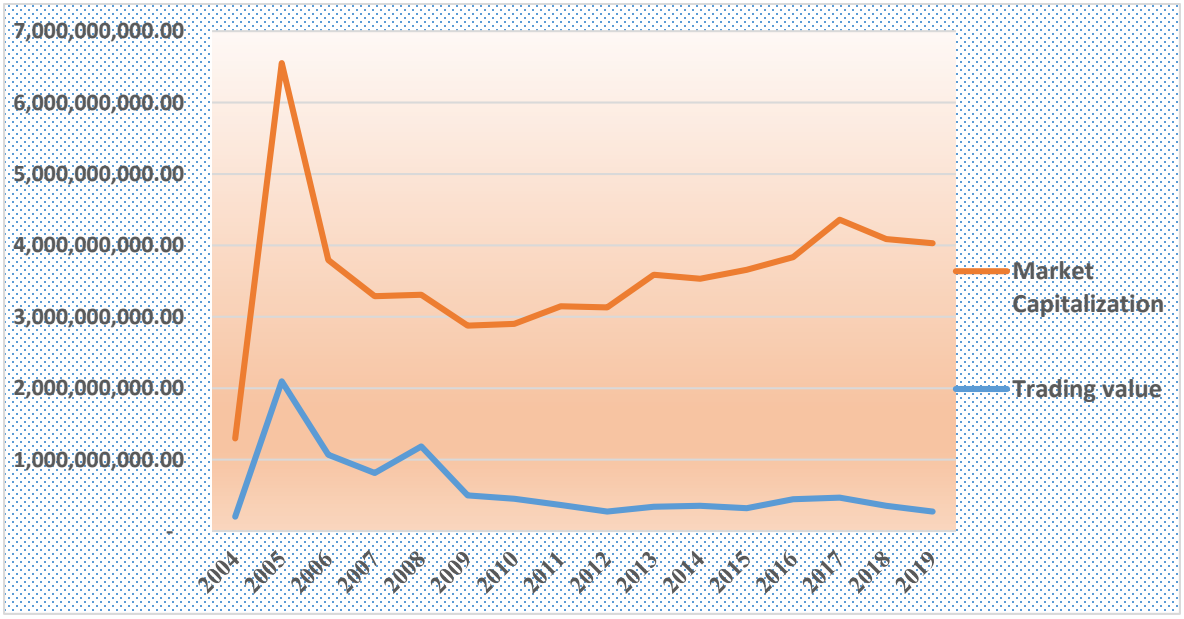
securities market in these states has an essential role in developing their economy. On the contrary, the Palestinian securities market does not have a significant impact on the economy.

Also, since established, the Palestinian financial intermediaries' firms have not been evolving, which is apparent in the size of their assets and profits that were not rising, and they have fluctuated within a specific range, as shown in table figure (10). As well the number of these brokerage firms is constant and almost not changed last during the years. This evidence that Palestinian financial brokerage firms do not have a significant role in activating the securities market and make it more efficient through providing a substantial investing base that contains accurate and correct information that impacts securities in the financial markets. On another side, the Palestinian financial markets do not have liquidity, depth, and efficiency and lack a commitment to regulations and laws, especially disclosure of information. All these reasons, contributes to creating the impediments and restrictions in performance the prime function for brokerage firms as a channel to conduct deals between saver and investor and thus slow or stall the growth of Palestinian financial brokerage firms.

**Diagram (5).**

**Trading value and Market**

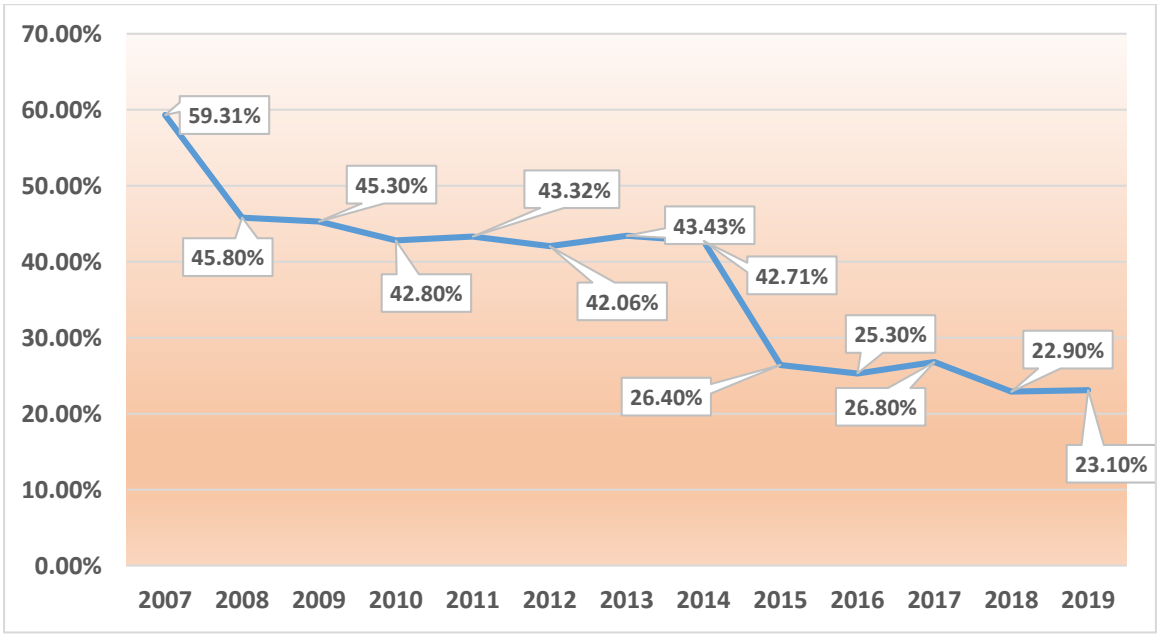
**Capitalization for the Palestinian securities market from 2004 up to 2019.**




Source: Palestine Capital Market Authority, 2019.

**Diagram (6).**

**Market Capitalization as a percentage of gross Domestic Production from 2007 up to 2019.**




Source: Palestine Capital Market Authority, 2019.

**Table (10).**

**Palestinian Brokerage Firms Key Indicators.**

| Year | Number of Member Firms | Total Assets | Net Profit (losses) |
|---|---|---|---|
| 2006 | 7 | 57,367,437.00 | 3,961,799.00 |
| 2007 | 9 | 74,832,950.00 | 7,913,889.00 |
| 2008 | 9 | 70,770,896.00 | 323,241.00 |
| 2009 | 9 | 58,094,919.00 | 884,898.00 |
| 2010 | 10 | 62,354,464.00 | (1,084,073.00) |
| 2011 | 10 | 51,677,235.00 | (2,575,257.00) |
| 2012 | 8 | 52,923,838.00 | (1,384,435.00) |
| 2013 | 8 | 56,200,040.00 | (979,412.00) |
| 2014 | 8 | 50,839,871.00 | 1,190,735.00 |
| 2015 | 8 | 57,674,799.00 | (2,761,152.00) |
| 2016 | 8 | 47,334,688.00 | 1,814,550.00 |
| 2017 | 8 | 49,287,840.00 | 1,182,597.00 |
| 2018 | 8 | 52,483,020.00 | (395,512.00) |
| 2019 | 8 | 54,268,227.00 | 838,670.00 |

Source: Palestine Capital Market Authority, 2019.

## ➢ Microfinance Sector in Palestine.

Over the last few years, the microfinance sector has seen significant growth, where the number of specialized lending enterprises licensed raising during the year 2019 to eight enterprises. This was clear through the number of branches in the Gaza strip and west bank that increased from 64 in 2015 up to 100 branches in 2019.

On the side of financial developments, the Specialized Lending sector's assets have remarkable growth as its total assets were 216.5 million in 2016 until growing up to reach 326.2 million in 2019, as shown in the table figure (11). The lending portfolio of lending enterprises' size increased by 92% in 2019, compared with its lending portfolio in 2015. A lending portfolio still forms an essential component of lending enterprises' assets that have acquired approximately 80.4 % of its total assets. On the other hand, the return on assets increased in 2019 up to 2.05, compared to a few previous years. This reflects the efficient utilization of the assets (Palestinian Monetary Authority).

Also, the income to total assets ratio is another financial index that indicates the extent to which the lending enterprises' assets contribute to raising GDP, which means the role importance of these enterprises in enhancing economic development through financial depth. As is shown in table figure (11), the financial depth ratio in the last years is rising from 1.07 in 2015 up to 1.91 in 2019. This evidence for improving the role of these enterprises supports economic growth.

When comparison the Palestinian microfinance sector to peers Arab neighboring countries, reached an average lending portfolio for these enterprises in the last four years,

approximately 220 million dollars, while the average for Jordan and Egypt was almost 340 and 900 million dollars, respectively as it is notable that the lending portfolio in Palestine has a relatively small size compared to Jordan and Egypt. Also, the lending portfolio's growth rate is instability as is in Jordan and Egypt, as shown in diagram No (7). This indicates that these enterprises' financing sources are unstable, or the different segments are not targeted by financing enterprises, with the fact that the lending portfolio balance is small compared to neighboring countries. Nevertheless, the financing offered relative to population was 52.72 dollars per capita in 2019, more extensive than Jordan's and Egypt's same ratio. It was 35.98 and 16.58 dollars respectively, as shown in table figure (12). This most significant ratio indicates that there is a considerable financing ability or finances the broader segments. This, in turn, contributes to increasing profits and growth, thus evolving and expanding the microfinance sector. On the contrary, both Jordan and Egypt have no sufficient financing balances to encompass the various segments.

Despite the remarkable progress in the microfinance sector over the last years, this type of financing is specialized only for the short and medium-term, which does not match the significant financing needs for investment projects long-term. Therefore, the microfinance sector serves small businesses and could not be a vehicle to bridge the gap of long-term financing (Palestinian Monetary Authority).

**Table (11).**

**The most important indicators for the microfinance sector.**

| Description | 2015 | 2016 | 2017 | 2018 | 2019 |
|---|---|---|---|---|---|
| No. lending enterprises | 6 | 6 | 6 | 6 | 8 |
| Branches | 64 | 82 | 84 | 81 | 100 |
| Loans Portfolio (Million) | 136.7 | 199.4 | 215 | 205.7 | 262.5 |
| Assets (Million). | - | 216.5 | 234.5 | 216.6 | 326.2 |
| Income/ Assets | 1.23 | 1.97 | 1.39 | 1.22 | 2.05 |
| Assets/ GDP (Percentage) | 1.07 | 1.41 | 1.45 | 1.33 | 1.91 |

Source: Palestinian Monetary Authority, 2019.

**Table (12).**

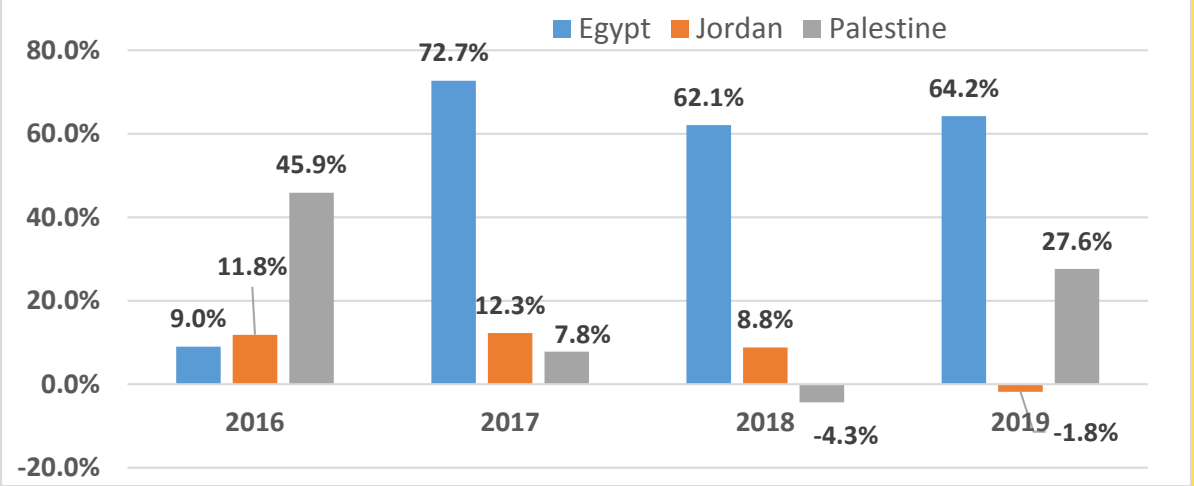
**The lending amount of the microfinance sector.**

| Description | Egypt | Jordan | Palestine |
|---|---|---|---|
| Population | 98,400,000.00 | 9,956,000.00 | 4,980,000.00 |
| Lending Portfolio ($) | 1,631,214,953.27 | 358,256,338.03 | 262,500,000.00 |
| Lending Per Capita ($) | 16.58 | 35.98 | 52.72 |

Source: Egyptian Microfinance Federation/ Jordan Microfinance Network/ Palestinian Monetary Authority, 2019.

**Diagram (7).**

**Comparison of the percentage of growth of the Palestinian specialized lending portfolio with neighboring countries.**




Source: Egyptian Microfinance Federation/ Jordan Microfinance Network/ Palestinian Monetary Authority, 2019.

- **Financial Leasing Sector.**

Finance leasing is considered one of the essential modern financing ways that finance consumption and productivity projects as other financing tools. Furthermore, the most crucial financial lease feature is to avoid bureaucracy and demanding requirements for getting a loan. Additionally, it made the idea of financing comfortable and more encouraging. In the Palestinian matter, the finance lease was defined according to Decree-Law No. (6) Of 2014 as "It is the activity practiced by a lessor that grants him the right to possess and use the leased property to the lessee for a specified period in exchange for the lease payments."

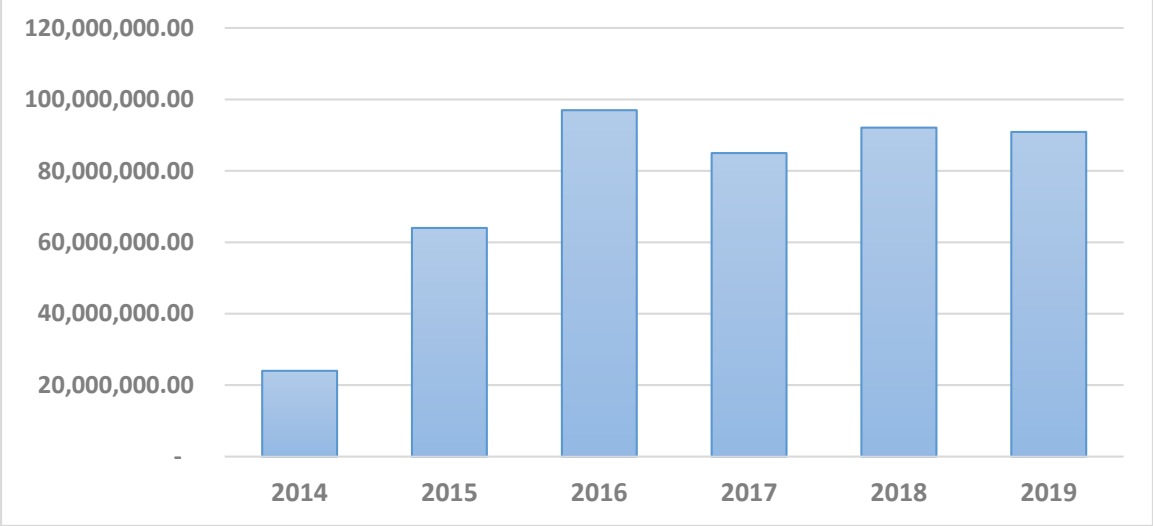
The financial leasing sector has recently arisen, and has been no regulations and laws that organize this sector's activities until issued decree-law no. (6). in 2014, which arrange and organize activities financial leasing sector within the legal framework. The financial leasing sector is also subordinated to the Palestinian capital market authority in terms of commitment of the circulars and instructions and overseen and surveillance of this sector processes.

As a reality, the financial leasing sector has been significant growth over the last years, as shown in diagram No (8), especially in 2016, as it reached the value of contracts investing to 97 million dollars, which is the value higher among all years. This indicates that the portfolio of financial leasing reached the saturation stage of the financial leasing market. The value of contracts investing declined in subsequent years that are stabilized among 85 and 90 million dollars. Moreover, vehicle financing constitutes the most considerable portion of the financial leasing portfolio, as it recorded nearly 84% of total

lending in 2019. This is one of the most important reasons to curb the growth of the financial leasing sector. Furthermore, this sector depends mainly on short-term financing, which does not meet the needs of long-term investments.

**Diagram (8).**

**Evolution of the total investment for financial leasing contracts 2014-2019.**




Source: Palestinian Capital Market Authority.

## ➢ Financial Mortgage Sector.

Definition of mortgage according to bank rate company [1] is "a loan from a bank or other financial institution that helps a borrower purchase a home. The collateral for the mortgage is the home itself, meaning that if the borrower does not make monthly payments to the lender and defaults on loan, the bank can sell the home and recoup its money".

The mortgage sector in Palestine consists of two companies, "Palestine Mortgage Finance Company," established in 1997, and its subsidiary company is "The Palestinian Mortgage Finance Company." As they are primarily working in the secondary market as a provider to many programs like:

- Financing the purchase of new housing units.

- Financing the construction of new housing units.

- Refinance existing home loans.

- Financing the finishing of housing units.

- Financing the addition of housing parts to the existing units.

Also, Decree-law no (3) was issued granting a license to property appraisers in 2012. Those who will act as a guideline in estimating the property's value in a specific region, thus mitigating the risks associated with the financing process and achieving stability in

[1] Bank rate, LLC is a consumer financial services company based in New York City. Bankrate.com, perhaps its best-known brand, is a personal finance website. As of November 8, 2017, it became a subsidiary of Red Ventures Inc.

the mortgage financing market. Nevertheless, the finance mortgage sector lacks the legal environment that regulates and arranges the mortgage market business and reduces financial default risks. Furthermore, the problem of land registration forms a barrier to the evolution of the mortgage sector, "because loans are granted only to lands and houses that have a registration in the Land Registry Department (Tabu), and therefore the Palestinian Authority has a significant shortage in land registration. Thus, this creates an aversion to investors from the mortgage market due to a lack of liquidity, financial depth, and regulatory efficiency.

Thus, because of impaired financial performance, lack of legal environment, and land registration problem, Palestine's mortgage market is encountering. Furthermore, the role the Palestinian banks are playing to finance Real estate lending operations instead of the mortgage sector and the inability to fully refinancing by the mortgage sector results in a lack of sufficient liquidity to cover these loans. Consequently, all that would delay or not achieve the mortgage market's desired growth and prosperity.

Ultimately, for purpose evaluation, the Palestinian financial sector has various sources of financing. Nevertheless, the banking sector dominates the most significant portion of the financing process, as the ratio of lending to banks is 78% of total lending in 2019, as shown in the down table figure (13), in addition to the lack of an efficient bond market. Consequently, this indicates the weak performance of the Palestine financial sector and more vulnerable in financial crisis.

**Table (13).**

**Size of lending for Palestine financing sector in 2019.**

| Type of Sector | Total of Lending ($Million). | % of Lending |
|---|---|---|
| Banking Sector | 14,921.00 | 78.4% |
| Stock Market | 3,757.00 | 19.7% |
| Microfinance Sector | 263.00 | 1.4% |
| Financial Leasing | 85.00 | 0.4% |

Source: Palestinian Capital Market Authority.

# Fourth Chapter.

## 4.1 Conditions for Establishing an Efficient Bond Market.

### 4.1.1 Factors Associated with Bond Market.

- **Institutional Infrastructure:**

Developed global bond markets that are working according to high professional criteria have a well-institutional infrastructure that comprises an electronic fixture and modern technology systems. In turn, this facilitates and rapid market operations and provides vital information and essential reports that interest relevant parties and reduce the risks that result from unintentional errors or fraud operations. Consequently, these markets are the focus of domestic or foreign investors' interests.

The critical technological equipment and systems that shape the evolved bond market are as follows:

- Competitive Auction system is the process in which several primary buyers present competitive bids and sellers submit competitive offers at the same time, then occurred matching between bids and offers, after that the deals are implemented. This auction system is implemented without the need for issues certificates through underwriting by banks and brokerage houses. On the contrary,

transferred ownership of securities between buyers and sellers is recorded electronically (book-entry [1]).

- Clearing system is all necessary activities and procedures among buyers and sellers that preceding transfer ownership for securities to buyers and funds to the seller, and in this stage transacting parties being ready to reconcile an order.
- Securities Settlement Systems (SSS) is the process that conducts transferred the securities by book-entry according to procedures and instructions in place. Additionally, this transfer of securities being with payment or without. When the transfer entails payment, it must provide a system of delivery versus payment (DVP).
- Payment Systems (PSS) is a paying a funds way that is made among dealers in financial transactions in exchange for transfer ownership of securities to counterparty according to instructions and procedures in a timely.
- Central Securities Depositories (CSD) is a financial organization that specializes in keeping securities, such as banks. Ownership of these securities can be physical certificates or electronically saved in their own accounts.
- A central counterparty (CCPs) is acts as an intermediary between the buyer and seller that means they buy to the seller and sell to buyer in a market.
- Trade Repositories is the organization or company that has a right by licensing to keep the records of financial transaction data.

[1] Book entry is a process in which made transferred electronically for securities ownership without the need to physically transferred.

- Over-the-Counter Market Trading System is a decentralized market in which trade dealers directly securities without needing a central exchange or brokers and these transactions are electronically conducted.

In essence, credit rating agencies are considered an essential pillar to infrastructure in the debt markets, especially bond markets. These agencies play a pivotal role in rating a debt issuer or specific debt issue in terms of credit risk that represent the ability and willingness of an issuer, such as a corporation or state or city government, to meet its financial obligations in full on time. There are several rating agencies, including global agencies such as Standard & Poor's and Moody agencies and some of the agencies that specialize in a geographical region or industry.

In reality, these agencies do not guarantee the probability that particular issuers or particular debt issues will not default. Instead of that, the rating agencies express views and opinions about an issuer's creditworthiness or a specific debt issue with varying degrees. For instance, some of the issuers are rated according to Standard & Poor's credit rating with the symbol "AAA," which is called "investment-grade." This means a bond has well-ability to repayment the interest and principal amount. On the other hand, other issuers are rated with the symbol "BBB," which is called "Speculative-grade," where the issuer currently can repay interest and principal amount, but there are significant doubts about repayment.

In considering, the rating agencies are an efficient and reliable measure of relative credit risk, which is an incentive to raise more trust the investors of a bond market, thus

facilitating the bonds' purchasing process. Furthermore, rating creditworthiness may be used as a benchmark device by the market participants to matching the rating relative credit risks for certain issuers with other issuers' credit risks. Thus these comparatives help market participants to make the best investment decisions and managing their portfolios.

One of the essential elements of the infrastructure for the global bond market is a financial reports system and essential data for PEX that is relevant, reliable, and timely. Furthermore, the borrowers' financial reports and disclosures are crucial to deciding by potential investors. There are real examples that the higher the quality of the disclosure practices, the lower the actual cost of the debt.

The provision of a group of professionals of the securities market is a critical ingredient of the bond market's infrastructure, contributing to financial data closer to accuracy and independence. Indeed, professional financial analysts work according to the procedures and policies of the financial markets. This, in turn, would enhance the financial reporting system through the accurate evaluation of firms.

- **Issuers of Bonds.**

The bonds issuer is one of the most critical bond market players; the issuer could be a company, financial enterprise, or government entity. Moreover, long-term investments like infrastructure projects, productivity, and agriculture projects adopted by issuers must have economic benefits, whether at the public or private sector level. Consequently, economic growth is one condition that stimulates investors to finance long-term

investments by issuing bonds. In this case, issuers are looking to invest in safe markets that stabilize the political, economic, and financial sides thus the issuers being able to draw policies and long-term goals to their business. Therefore, macro stability is one of the key components to attract domestic and foreign investors who contribute to financing long-term investments to which issuers are looking. On the other hand, the foreign issuers contribute significantly to creating a risk-free rate, a theoretical existence that assists for calculation purposes to bonds with risk and volatility. They also seek the introduction of global standards and find out the best practices for the bond market.

The issuer's present firm value reflects the size of total debt; thus, if the issuer's firm value is small, then the present value of total debt should not be greater than the firm value, which means the total debt is also tiny. Consequently, bonds outstanding would be a tiny part of the present value of total debt, which is a small size. As may say here, that the issuer firm that is a small value is one the most reasons are underlying the small corporate bond market size. As well as the debt size of a firm plays a significant role in determining the cost of capital at the time of issuance of the bonds, where if the firm debt is considerable, the capital cost is higher, and vice versa. As a result, the lower the firms' obligations, the greater the investor confidence in repayment of the debt service and principal, and thus the cost of capital becomes lower, which facilitates building an efficient bond market.

Issuers have ratings to their financial obligations by credit rating agencies specializing in evaluating creditworthiness for an issuer. Typically, ratings are expressed as letter grades that range, for example, from 'AAA' to 'D' to inform the agencies report of the extent to which the issuer may default. Consequently, these ratings per se create a diversity of

credit quality for issuers. Thus, that allows raising consciousness and opportunity for a potential investor of a trade-off between various bonds according to their credit risk appetite. Consequently, issuers' creditworthiness reflects the extent to which their business grows in terms of profits and liquidity together in order to pay the total financial obligation when maturity. Therefore, creditworthiness is the more relevant factor in determining the size of issuance and maturity date for the issuer.

Moreover, the catalytic role played by the Capital Market Authority to shorten the required time of the procedures and facilitate the conditions to obtain a license in order to issue bonds, as well as reduced listing costs and registration fees, is a factor crucial to attract domestic and foreign issuers.

- **Investors Base.**

In the beginning, it is recognized that investors are one of the critical components of the bond market. Thus, investors' role is essential in establishing the bond market, whether on the individual or institutional level investors, whereby purchasing and selling various bonds and making portfolios more attractive for investors, thus creating the market's effectiveness and efficiency.

Indeed, individual investors do not have the majority of bond ownership in most global markets; on the contrary, institutional investors have the most considerable portion in bonds and can determine the size of demand and the price of bonds. Consequently, institutional investors are the key players in most global markets to whom the issuers of bonds are targeted. In mature bond markets, the institutional investors’ base for bond

markets is composited of diversified groups of investors like banks, mutual funds, and contractual savings institutions such as pension funds and insurance companies providing the investor base for the bond market. As the diversity of these financial institutions varies from market to other since some of the mature bond markets have the full diversity of these financial institutions, and other emerging or developed markets have some of them according to each market strategy. Additionally, the various investors' goals and using different strategies create well-diversity in the investor's base. This would lead to a variation in investment risk appetite among investors, which, in turn, increased securities trading. This will enhance market liquidity by creating trading opportunities and will reduce market fluctuations by allowing bonds exhibiting different investment risks to be available for investors.

In most global bond markets, institutional investors play the essential role of developed or expanded the bond market. Hence, there are several types of institutional investors; the most influential investors are typically banks, the largest investors in the domestic bond market. The banks could hold bonds for many purposes, including liquidity, especially because loans are illiquid investments, as well as the banks could hold government bonds due to a lack of quality borrowers, or hold bonds to manage the fluctuations interest rate, or to meet the regulatory reserve, or hold bonds for other reasons. Also, other essential investors, pension funds, whether at the public or private level, provide retirement for workers, which, in turn, create long-term obligations for the fund. Thus, investment in the domestic bond market is necessary to meet these financial obligations. Furthermore, insurance companies seek to provide financial protection for property, such as cars, homes, and also life insurance for individuals. This also requires investing in the bonds,

whether short or long-term, according to the desired objectives and used strategies for each insurance company.

Some of the bond markets lack sufficient local savings; thus, it needs to raise additional local investments or attract foreign investments to raise the market's liquidity. There are some of the significant factors that contribute to attracting foreign investors. These include factors related to macroeconomic like prospective growth, free capital mobility, high levels of market liquidity, an absence of taxes on investment income, factors related to political stability, factors related to regulations and laws governing the investment activities of participants of the market, and factors related to corporate governance that aims to achieve transparency and justice, consequently, all these factors, to some degree contribute to creating a kind of trust for foreign investors of the domestic bond market.

- **Legal & Regulatory Framework.**

In most financial markets, it is valuable for the legal, regulatory, and supervisory framework to regulate and organize the investing activities in the Financial market. The legal and regulatory framework provides financial protection for investors from fraud and counterfeit. This requires placing a set of rules and standards and foster governance at the public and private levels. This would ensure the minimum transparency and justice for required managerial and financial reports for the market participants.

In reality, conflicts of interest for participants in the financial markets pay off some of them to commit a financial crime or even dominance by a party or group on financial

markets by legal deception. Consequently, there is a need to protect the participants, especially the investors in the financial market, by regulated financial activities.

Several reasons would effectively outlaw unacceptable behavior, including misinformation that can lead to making an adverse decision. First, by their very nature, the markets' financial services need to provide precise and timely information to protect investors and assist them in making an informed decision. The Principal-Agent problem is a conflict of interest between shareholders (principal) and the board (agent). This would result from providing asymmetric information between them. Consequently, as the principal-agent problem generally results in agents acting in their interests, these agency costs would be raising financing costs, thus reducing shareholders' profits.

Moreover, the lack of market integrity is unacceptable behavior. It includes the inability of consumer protection, that is, no ability for everyone to access the financial markets, mistrust by participants in the market, insufficient information to make the best decision, and unfair pricing of financial transactions. This would result in creating incompetence in the financial market.

The importance stems from the regulations and laws of the financial market in that they play a decisive role in regulating and monitoring the financial markets. It inhibits information asymmetry, fights fraud acts and counterfeit in the market, and raises confidence in the market participants. Consequently, investors' confidence and investment in the market have never been made without a robust legal and regulatory framework to promote the financial market's effectiveness and efficiency.

- **Government Securities Market.**

Effective government bond markets play a pivotal role in being the concrete base for developing a robust corporate bond market. Moreover, as that diversity of government bonds in terms of maturity date and subsequently diverse interest rate, regular issuances of bonds significantly contribute to providing proper evaluation and benchmark pricing for corporate bonds and facilitating pricing of the risk-free rate.

Also, a government bond market provides the financing to a fiscal deficit that resulted from a gap between revenues and expenditures. However, the continuing fiscal deficit leads to instability of the economic status and then inhibiting establishing the bond market or even demolishing the existing bond market. Moreover, government bonds sometimes are using for purposes of investing projects or extraordinary expenditures as well as considered as a control and monitoring tool for the monetary policies, that is by infusion of funds in case of an economic recession that means purchasing the bonds(resell), or withdrawal of fund in case of inflation by repurchasing the bonds (sell).

On the other hand, government borrowing by issuing bonds will crowd out the corporate bond market for investors' funds, which undermines the idea of establishing a corporate bond market or even resulting in lagged the current bonds market. For this reason, care should, however, be exercised in a realizing balance between government borrowing and the development and prosperity of a corporate bond market.

### 4.1.2 Factors Inside the Financial Sector.

- **Banks Sector.**

In most industrial countries, the robust banking sector plays a crucial role in establishing and growing the bond market through the catalytic role of acting as issuer, investor, and intermediary. As a result, banks could act as an issuer of bonds when needing capital adequacy or meet statutory liquidity requirements; as well they act as an investor when forecasting the high yield of bonds. Besides, banks in underdeveloped or emerging markets are the best financial institutions that play a role as bond market intermediaries or investors.

On the other hand, Banks could significantly inhibit establishing or growing the bond markets significantly in countries with underdeveloped or emerging financial sectors. These financial sectors with an extensive banking system encounter several troubles by their very nature, including the bank's control of credit decisions such as lending amount, repayment conditions, and credit interest rate. Banks also lack assessment of the credit risks considered a concern source for investors as is in place in the bond market. Also, the banks might act as investors to buy and hold bonds to lag the development of the bond market.

The extensive banking system captures most of the domestic savings, and therefore the banks have substantial deposits that, in turn, would be resulting in a low return on capital investments and on equity due to the interest paid. As a result, they will get rid of them

through easy lending to non-matching banking regulations borrowers, which could be the reason to prevent the development or establishment of the bond market.

In most countries, financial sectors that rely heavily on the banking sector for lending processes face many dangers, such as capital favoritism, lack of accounting and regulatory transparency, and control of the banks over investment decisions. Furthermore, it is natural that the larger the banking system, the more defects and faults in the banking system's organizational and supervisory Structure. All this may cause explode a financial crisis, and thus an economic downturn.

- **Equity & Money Markets.**

The equity and money markets play a severe role in supporting establishing a bond market. By the way, these markets and their instruments could enhance capital markets culture in terms of disclosure experience, transparency, and accountability. These markets can also provide intermediaries the experience and skills in dealing with securities, which, in turn, facilitate their function as bond markets. Furthermore, it is natural for these markets to play a central role in forming investors' consciousness about what and how the investment in securities is. Finally, as it seems, the importance of equity and money markets provides the benchmarking of pricing for bonds in terms of credit risk, liquidity, and maturity.

As a base general, bond and stock prices are in contrast to each other. When the economy is booming, the firms have more profits, subsequently increasing demand for purchase stocks, which raises the stock price. In contrast, demand for bonds reduced, and as of

result, their prices are falling. On the contrary, if the economy is in a slowdown, firms' profits are fall, and demand for purchase stocks and their prices is down. Consequently, the investor is moving towards fixed-income bonds and to which are less risky than others. However, there are exceptional conditions. When there are times a significant economic boom, it would be too much money or liquidity in the market, giving rise to equity and bond markets. On the contrary, when there is a severe economic downturn, all markets suffer from a downfall like economic status in the COVID-19 pandemic.

Ultimately, the bond market is a vehicle complementary to other capital markets to attain economic prosperity. Also, it contributes to creating a competitive environment in capital markets that, in turn, prevents complete dominance by the equity and money markets on capital markets and intends to reach the fair pricing of securities.

- **Financial Derivatives.**

They are the financial instruments that investors protect the underlying financial assets against some of the risks by hedging to fluctuations in exchange and interest rates, equity and commodity, and creditworthiness. Further, speculators could be using those derivatives to earn profits by anticipating a fall in the price of underlying financial assets. Therefore, these derivatives play a significant role in developing capital markets by transferring underlying asset risks to other parties who can manage risks. Derivatives transactions are usually among a wide range of parties, including commercial and investment banks, portfolio managers, insurance companies, and other non-financial firms.

## ➢ Financial Intermediaries.

A financial intermediary is an institution that acts as a bridge that transfers the money from lenders (savers) to borrowers (issuers) in exchange for economic benefit. Financial intermediaries are also an essential pillar of financial markets to facilitate and rapidly financial activities between savers and borrowers. Thus they are considered a significant reason for the success of the bond market. Several types of financial intermediaries present financial services to different lenders and borrowers, as shown in table figure (14).

The success factors that enhance a financial intermediary's vital role in making sufficient profits for intermediaries are the spread between financing costs and lending revenue. Considerable size for both issuers and investors reduces running costs through economies of scale and reduces default risks by spreading their risk by lending to several people rather than only one individual. There is an increasing need for investors for the required skills in which financial Intermediaries can find an efficient and beneficial way to trade their assets. Besides, the presence of financial derivatives helps intermediaries hedge for their positions.

Moreover, acquisition and evaluation of firms' information and monitoring performance are high-cost for individuals and non-specialized firms; thus, this makes intermediaries pivotal to evaluate and monitor the financial assets in the financial, especially bond markets. Likewise, the essential role of intermediaries in the bond market is to reduce asymmetric information and reduce the costs of researching potential investments, exerting corporate control, managing risk, and mobilizing savings. In addition, financial intermediaries' presence contributes to creating a diversity of financial assets that help

provide liquidity when needs without forced to liquidate long-term financial assets. Therefore, in this way, financial intermediaries help to enhance more investment in financial assets.

**Table (14).**

**Entities of financial intermediaries.**

| | | | |
|---|---|---|---|
| **Banks** | **Stock Exchanges** | **Financial Advisers or Brokers** | **Investment Bankers** |
| **Credit Unions** | **Financial Intermediaries** | | **Escrow Companies** |
| **Non-Banking Finance Companies** | **Mutual Fund Companies** | **Insurance Companies** | **Pension Funds** |

Source: January 2008, Zagreb International Review of Economics and Business 11(1):97-109.

- **Corporate Governance.**

The increase in the emergence of corruption and fraud cases on the administrative and financial sides in the whole world led to the emergence of major financial crises. This prompted the concerned parties to establish governance, which aims to achieve discipline, transparency, justice, and good governance in the enterprise.

The World Bank defines governance as "how power is exercised in the management of a country's economic and social resources for development. Governance has been defined as the rules of the political system to solve conflicts between actors and adopt decisions (legality)". In addition, "IFC defined corporate governance as the structures and processes by which companies are directed and controlled." Also, according to the definition, the OECD is "the exercise of political, economic, and administrative authority necessary to manage a nation's affairs.

The governance is a system that encompasses rules, regulations, and laws which determine the relationship between enterprise administration on the one hand and shareholders, stakeholders, or parties related to the company such as "securities holders, workers, creditors, citizens on the other hand."

Legislations and regulations are considered essential components of state and firm governance that organize and determine the relationship between relevant parties in firms and the state. Wherever these laws, which are correlated with governance, like investment law, corporate law, accounting and auditing standards, tax law, and others, the stakeholders related to firms or states obtain their full rights. The stakeholders include

shareholders, directors and executives, employees, lenders, banks, and other stakeholders such as government departments, investors, and others.

The importance of governance appears in controlling and developing enterprises of the private and public sectors through imposed regulations and laws. Also, it limits exploiting the authority through permissions delegation and acquired privileges like an agency problem that the executive's board utilizes their authorities to serve their interests.

Additionally, the effective utilization of accounting systems and internal control achieves the highest possible transparency and disclosure in financial reports. The governance also contributes to combating financial and administrative corruption for companies and provides an appropriate environment for control by ensuring compliance with laws, standards, and regulations.

Indeed, governance aims to foster trust in the firms and the economy to prevent capital flight abroad and attract foreign and domestic investments. Furthermore, enhance the competitiveness of the private sector by providing a healthy environment from regulations and laws that arrange the relationship between parties. Moreover, the government does increase financing opportunities, lower the cost of investment, stabilize the capital market, lower the degree of risk, and improve the quality of commodity or service production and then increase its competitiveness and integration in the global markets. Finally, governance also contributes to achieving a balance between social and economic goals by reducing the gap of return between societal and individual and reducing poverty, promoting human rights, establishing justice rules, and continuing the work of companies.

The principles evaluate and monitor corporate governance through the systems, laws, and regulations on which it is based. These principles are brief, understandable, and accessible; they also focus on public shareholding companies, whether financial or non-financial. In addition, the principles enhance the role of employees and other stakeholders in the long-term success and improvement of the company's performance, thus achieving broader economic goals. Therefore, the essential principles of corporate governance according to G20 [(1)]/OECD [(2)] are as follows:

- "*Ensuring the basis for an effective corporate governance framework*: should promote transparent and fair markets and the efficient allocation of resources. It should be consistent with the rule of law and support effective supervision and enforcement.
- *The rights and equitable treatment of shareholders*: should protect and facilitate the exercise of shareholders' rights and ensure the equitable treatment of all shareholders, including minority and foreign shareholders. All shareholders should have the opportunity to obtain effective redress for violation of their rights.
- *Institutional investors, stock markets, and other intermediaries*: should provide sound incentives throughout the investment chain and provide for stock markets to function in a way that contributes to good corporate governance.
- *The role of stakeholders in corporate governance*: should recognize the rights of stakeholders established by law or through mutual agreements and encourage

[(1)] The Group of Twenty (G20) is the premier international forum for global economic cooperation. G20 members account for 85 percent of the world economy, 75 percent of global trade, and two-thirds of the world's population, including more than half of the world's poor.
[(2)] OECD is The Organization for Economic Co-operation and Development.

active co-operation between corporations and stakeholders in creating wealth, jobs, and the sustainability of financially sound enterprises.

- *Disclosure and transparency*: should ensure that timely and accurate disclosure is made on all material matters regarding the corporation, including the financial situation, performance, ownership, and governance of the company.
- *The responsibilities of the board*: should ensure the strategic guidance of the company, the effective monitoring of management by the board, and the board's accountability to the company and the shareholders."

### 4.1.3 Environmental Factors.

- **Macroeconomic & Political Stability.**

As a rule, the political and economic status significantly influences the capital markets, especially the bond market. This is because the political environment plays an essential role in establishing or supporting the bond market by existence a robust democratic system, limit in bureaucratic procedures, fighting corruption, a rational and justice governing regime, and not having abroad threats. All this contributes to providing an adequate political situation that creates an atmosphere of confidence and credibility in the regulations and laws in place, thus raising a desire by investors to commence with their investments in a liberalized way and without restrictions.

As a result of political stability, the macroeconomic necessarily would be stable. After that, investors are looking to a growth predictable in the future, both economy and financial markets. Further, in economic growth, the firm's creditworthiness is increased, and systematic risks reduce the default risk. All this contributes to prompt the firms to issuance bonds. On the other side, under the stability of the economic environment that are represented by low inflation and stable interest rates, both individuals and institutional investors will have a spur to invest in long-term financial securities rather than shorter maturities such as bank deposits and government treasury bills, thus contributing of establishing or developing the bond market.

Most countries with a stable economic environment are more efficient and able to establish or develop the bond market. Meanwhile, in countries where the macroeconomic

environment is unstable, it needs government supports heavily in one form or another. The cost of issuing bonds would be higher than in countries in which the economy is stable. Ultimately, it could say, one of the essential ingredients for the establishment or development of a bond market efficient is a stable and predictable macroeconomic environment.

- **Fiscal & Monetary Indicators.**

Interestingly, the relationship between monetary, financial sectors and bond markets are interactional with each other. For example, the financial and monetary sectors are the leading incubator for establishing or developing the bond market. That means the financial sector environment could be a catalytic vehicle to attract bond issuers, investors, and other market participants. Nevertheless, on the other side, the bond market also plays an essential role in the efficiency and effectiveness of monetary management and the financial sector's stability.

There are a set of significant financial and monetary determinants and indicators that might adversely impact the economic environment that could contribute to establish an efficient bond market and the most important of these financial indicators are:

- High Inflation and volatility resulting from the supply of money, budget deficits, and currency depreciation requires government intervention by shrinking market liquidity. However, on the other side, reduced inflation intentionally leads to raising the volatility of market rates that, in turn, create expectations of high inflationary rates that form fears for the investor to decide for long-term investment. Thus, these uncertainties affect investors' demand for the bond

market; therefore, the investors tend to invest in short-term securities like commercial papers and treasury bills. Furthermore, inflation high and market volatility affect foreign capital inflows to investing in the domestic bond market.

- Also, continuing large fiscal deficits for the government give rise to more borrowing that raising the cost of lending, thereby Inflationary incident pressure which prevents of stall development of the bond market, as well as high borrowing by the government, will result in the crowd out domestic savings for the private sector. Thus, this will adversely affect the establishment or development of the bond market.

- Taxation is an essential ingredient that has a two-edged sword impact on establishing or developing a bond market. Anywhere, some governments with nascent bond markets impose on high bond taxes, stamps, and fees usually that are disappointed for establishing an efficient bond market for both the supply (issuers) and the demand (investors) sides. Therefore, public or private issuers would choose financing sources other than bonds, and investors also would choose to invest in securities other than bonds. Nevertheless, on the other side, some of the bond markets that are free for registration fees and stamp duty and also exempted from income tax are in the way to establish an efficient bond market.

## ➢ Investment Awareness.

Investor awareness is the intangible and psychological element that plays a fundamental role in forming the investor's behavior, which is reflected in the raising or reducing their wealth within different economic conditions. Therefore, the investor's perceived background from family individuals and communities significantly influences investor behavior. Thus, this could explain the investor's behavior in a particular country to the appetite for risky investments for more profits. On the contrary, some investors in other countries who risk-averse will wait a long time to earn the same profits. Interestingly, the investment decision is an individual decision, but in general, an investor always tends to pursue investors' collective behavior, whether in short or long-term investments, so the prevailing culture is a significant determinant of investor behavior.

## 4.2 Evaluation for Establishing an Efficient Bond Market in the Palestinian Exchange.

### 4.2.1 Factors Associated with Bond Market.

- **Institutional Infrastructure:**

Since its establishment, the Palestinian exchange has exerted great efforts to pursue developments and significant infrastructure changes for regional and global securities markets as it was always seeking to follow and catch modern systems of technology. The most important sides that characterized the Palestinian securities market in the region are the following:

- PEX [(1)] presents an Initial Public Offering (IPO) System that being conducted by IPO electronic application.
- PEX provision electronic services that including balance user inquiry, add new user, update user information.
- PEX offers several trading services and sources of much information such as reports and statistics in which investors could be able to make the best decision.
- PEX has signed an agreement with the Palestinian Monetary Authority on 13/02/2013 under which the cash settlement the clearing and settlement process that is resulting from trading for securities firms for conducted in PEX, through the system (BURAQ) at the PMA.

[(1)] PEX: Palestine exchange.

PEX has signed several strategic partnership agreements that include memorandums and memberships with financial market institutions internationally and regionally, such as the Union of Arab Stock Exchanges, Federation of Euro-Asian Stock Exchanges- FEAS, Arab Monetary Fund.... etc. That would be a guide to attaining prosperity and growth for the PEX by pursuing the developments and changes in technology systems in regional and global exchanges.

Based on the conviction that adherence to good governance rules and standards contributes mainly to creating sustainable value and preserving the interests of others. PEX has good governance, which provides; an institutional structure, a proper legal environment to practice market activities according to global financial market criteria. As well as providing administrative and financial regularly reports characterized integrity and transparency for stakeholders. Further, organizational Structure is one of the most requirements of good governance that contributes to establishing effective administration to manage and control activities of the market.

Further, the Palestine exchange has organizational Structure is one of the most requirements of good governance that contribute to establishing effective administration able to manage and control activities of the market, where this Structure including three central departments are; information technology department, which is primarily responsible for providing websites and e-application for users in the PEX such as E-trade and E-IPO...etc.

As well the operations department is responsible for following and surveillance the trading process under criteria and regulations in place of PEX [1].Notably, this department's primary goal is to ensure investors' rights, listing firms, and relevant others in the PEX.

The ultimate department is support services that contain two Departments: Financial & Administrative affairs and Public Relations & investor education. The last department is responsible for communicating with investors on all issues of concern to them. An investor communication policy is adopted to ensure that all investors obtain information about the performance of the PEX in a consistent way and also inform the current and potential investors with their rights and duties towards dealing with securities as well as financial & administrative affairs are responsible for the technical and administrative supervision of the various departments and follow-up of their work and activities. Participation in setting plans and policies and joint work and coordination with departments regarding activities, events, programs, and projects related to the exchange. Implement approved financial and administrative policies, systems, and procedures in order to reach overall goals for the PEX [2].

The PEX is one of the most developed Arab stock exchanges. It was the first fully automated exchange and pursued modern systems and advanced technology to provide more rapid and accurate electronic services to market participants and provide data and reports characterized by transparency and integrity to help investors make decisions. Consequently, the PEX has an adequate foundation for modern technology systems and

[1] PEX: Palestine exchange.
[2] Interview with the vice of the operations Manager in Palestine Exchange.

good governance at regional and global levels that spur regulators to establish an efficient bond market.

Concerning credit rating agencies have no existence in the PEX, which is, in turn, creates ambiguity around the creditworthiness of issuers of a bond. Therefore, the lack of rating credit risk for bonds hinders an investor's ability to make the proper investment decision. Thus this would result in reducing the likelihood of establishing an efficient bond market in the Palestine exchange.

The Palestinian Capital Market Authority provided licenses for specialized financial certificates to professionals working in the Palestinian Stock Exchange in cooperation with the Institute for Investment Securities, shown in table figure (15). Other laws and regulations conditions for granting a license to the Palestinian exchange professionals, such as a financial broker, a financial advisor, and an investment advisor. The financial certificates program related to the exchange is an essential ingredient in raising the capabilities of stock market professionals, which is by providing advice on issuing securities, preparing and issuing reports, conducting research and feasibility related to issuing securities, and several other essential tasks. This would aim to develop and improve the efficiency of securities and financial intermediation services.

**Table (15).**
**Certificates for Professionals the Palestinian Exchange.**

| Mandatory Certificate | Optional Certificate |
|---|---|
| International Introduction for Securities and Investments | Islamic Finance Qualification |
| Palestine Securities Sector – Rules and Regulations | Operational Risk |
| Securities | Risk in Financial Services |
| International Certificate in Wealth and Investment Management | Global Financial Compliance |

Source: Palestinian Capital Market Authority

- **Issuers of Bonds.**

The Palestinian economy is considered underdeveloped like other third-world economies, as it suffers from many economic and financial troubles and a decrease in the gross national product. Accordingly, the Palestinian investment environment lacks large, long-term projects such as infrastructure projects that include a network of roads, airports, industrial cities and a lack of productive projects that include productive and agricultural projects that need considerable financing. Consequently, it can say, the Palestinian economy is a consumption economy that significantly relies on imports, which are reached approximately 5,776 million dollars in comparison with exports of 1,068 million dollars in 2019 [(1)]. This variance is especially prominent due to the impairment of productive projects that could support Palestinian exports. That resulted from a deficiency in the government's catalytic role through a lack of good governance. It does not provide necessary investment prerequisites, thus providing an appropriate environment for investment and the absence of economic and fiscal stability due to

[(1)] Palestinian Central Bureau of Statistics.

complicated political conditions resulting from Israeli occupation. Therefore, this leads to reduced investment opportunities for investors in the Palestinian economic environment that lacks productive projects. Thus, the expected slowdown or stalled Palestinian economy growth discourages investors from investing in long-term projects that need long-term finance through debt bonds.

The number of companies listed on the Palestinian Exchange is 48 companies, and these companies represent the largest segment in the public shareholding companies' value, as their value is approximately$ 3.1 billion[(1)]. These listed companies are divided into five sectors: the banking sector, Industrial sector, insurance sector, investment sector, and service sector. On the other hand, the degree of risk to default on the debt for these Palestinian companies owes and the size of their debt financing the company's assets is explained by important financial ratios: the debts to assets ratio and financial leverage to a company. As is illustrated in table figure (16), these ratios vary from one sector to another. As is notable, the average debt to assets ratio and financial leverage for both the banking and insurance sectors are 90%, 10.54, and 71%, 3.6 respectively, higher than in other sectors. This is natural in the banking sector because the essential product that banks sell is debt, so it is logical that they have more of that debt in hand than usual in other segments, in addition to having more liquidity in the bank sector more than in other segments. Consequently, issuing bonds by banks would raise the liquidity and thus may increase the cost resulting from the mismanagement for investing these funds, whether due to a lack of an effective strategic plan to manage an investment portfolio, absence of some of the financial markets like the derivatives market, as well as imposed restrictions

[(1)]Palestinian Central Bureau of Statistics.

by Palestine Monetary Authority to investing abroad. Therefore, the bank might play another essential role as an investor or financial intermediary in the bond market [(1)].

The insurance sector has a high leverage ratio and low liquidity ratio to cover current liabilities; this indicates a high risk of default. Consequently, this creates fear and averse for both investors and lenders toward the insurance sector's creditworthiness. On the contrary, the Industrial, services, and investment sectors have lower debt to assets ratio and financial leverage than the banking and insurance sectors. Therefore, they can act as issuers of the bonds in the primary market because mostly, they have high liquidity ratios and lower debt ratios, which indicate a lower risk of default on the debt. Thus the less fixed interest costs the company will be required to pay. As well as both investors and lenders would have a spur to invest in these sectors.

In reality, it could be said, the financial Structure for most of the listed Palestinian companies is to reflect somewhat the low degree of risks of default. This, in turn, allows for these Palestinian listed companies to issue debt bonds for financing purposes.

It is very natural; the entrance to the stock exchange in general and the Palestinian stock exchange require specific procedures and conditions and costs such as listing and membership fees and others. Accordingly, when the procedures and conditions are more flexible, and rapidly, membership, trading fees, and other subscriptions are less expensive, more companies are listed on the stock exchange. The Palestinian Stock Exchange provides multiple services to market participants at affordable prices compared to Arab stock exchanges such as the Jordan Stock Exchange and Dubai. Simple examples

[(1)] Interview with Portfolio manager of al Quds Bank.

include membership fees for financial companies and fees for providing real-time data on the Palestinian Stock Exchange, which are $ 3,000 and $ 1,800 respectively, as illustrated in table figure (17), which are less expensive than on the Jordan Stock Exchange and Dubai. The company's listing fees are $ 23,000, which is less than the Jordan Stock Exchange that reached $ 44,250. Also, the taken period for responding to the request to list the company on the Palestinian Stock Exchange is up to 15 days, while it takes 30 days on the Dubai Stock Exchange. Moreover, the Palestinian Stock Exchange provides a large base of more advanced services to the participants; it could be more competitive with some advanced Arab stock exchanges such as the Dubai Stock Exchange. Therefore, the Palestine Exchange has an attractive environment that spurs Palestinian companies to issue debt bonds [(1)].

Interestingly, during the last decade, some Palestinian listed companies issued the debt bonds, as shown in table figure (18), and therefore the volume of financing by bonds constituted 1.2% of the listed companies' total debt. However, this experiment was random by the companies and did not organize and supported a comprehensive strategic plan that could create an efficient bond market.

[(1)] The Palestine Exchange, The Jordan Exchange, The Dubai Exchange.

**Table (16).**

**Statement of Financial Ratios for Palestinian Business Sectors in 2019.**

| Ratio | Bank | Industry | Insurance | Investment | Services |
|---|---|---|---|---|---|
| *Average of Debt/Assets*[1] | *90%* | *31%* | *71%* | *38%* | *53%* |
| *Average of Financial Leverage*[2] | *10.54* | *1.54* | *3.60* | *1.76* | *2.45* |
| *Average of liquidity Ratio*[3] | *N/A* | *2.92* | *0.8* | *1.21* | *2.23* |

Source: Palestine Stock Exchange.

**Table (17).**

**Comparison of the duration and cost of entering the Palestinian Stock Exchange with other regional stock exchanges.**

| Exchange Name | Listing Fees for Capitalization (100,000,000) | Intermediary Fees | Approval period by exchange (days) | Real-Time Data | Family Transfer for Securities |
|---|---|---|---|---|---|
| Exchange Palestine | $ 23,000.00 | $ 3,000.00 | 15 | $ 1,800.00 | $ 1.50 |
| Exchange Jordan | $ 44,250.00 | $ 285,000.00 | N/A | $ 8,570.00 | N/A |
| Exchange United Arab Emirates | $ 8,707.00 | $ 40,816.33 | 30 | $27,000.00 | $ 6.80 |

Source: Palestine, Jordan, and Dubai Stock Exchange.

[1] Average of Debt/Assets is means total liabilities divided by total assets.
[2] Average of Financial Leverage is meant to total assets divided by the total equity.
[3] Average liquidity Ratio is meant to divide the company's current assets by its current liabilities.

**Table (18).**

**Issuance Bonds By Palestinian Companies**

| Company Name | # of Bonds | Bond Price | Total Value | Issuance Date | Repayment Date |
|---|---|---|---|---|---|
| Palestine Development and Investment (PADICO) | 8500 | $ 10,000.00 | $ 85,000,000.00 | 2011 | 2016 |
| Arab Palestinian Investment (APIC) | 2000 | $ 10,000.00 | $ 20,000,000.00 | 2012 | 2017 |
| Palestine Mortgage & Housing | 250 | $100,000.00 | $ 25,000,000.00 | 2014 | 2015 |
| Palestine Commercial Bank | 10000 | $ 1,000.00 | $ 10,000,000.00 | 2014 | 2019 |
| Palestine Development and Investment (PADICO) | 240 | $500,000.00 | $ 120,000,000.00 | 2016 | 2020 |
| Arab Palestinian Investment (APIC) | 3500 | $ 10,000.00 | $ 35,000,000.00 | 2017 | 2022 |
| Palestine Development and Investment (PADICO) | 7500 | $ 9,900.00 | $ 74,250,000.00 | 2020 | 2025 |

Source: Interview with General Manager of Palestine Capital Market Authority.

- **Investors Base.**

The bond market's investment base in the Palestine Exchange mainly consists of institutional investors as other global bond markets. This is due to several reasons, the most important of which is their takeover of most of the national savings, the lack of a law regulating the issuance of bonds to the public, in addition to the high cost of public issuance. Consequently, institutional investors are considered an essential component to establishing an efficient bond market [(1)].

The investment base in companies listed on the exchange, as shown in diagram No. (9), shows the total long and short-term investment assets in the banking sector in Palestine is

[(1)] Interview With Director of Financial Department in the Palestine and Development Investment company.

estimated at $ 17 billion, which is greater than the total investment assets of other sectors. In addition to the nature of the banking assets characterized by high liquidity makes them the enormous potential investor in the bond market. Thus, the banks play a crucial role in establishing an efficient bond market.

Also, that non-bank financial institutions can play an additional role in investing in the bond market, mainly since these institutions have seen remarkable evolving, that is by increasing their assets up to 50.6%, compared to 2018, to reach $ 326.2 million, as well that the percentage of lending take over 70% of its assets. This means that most of its investment is concentrated in financing activities, which raises the probability of investing these institutions in the bond market.

For several reasons, the investment in the bond market could be attractive for the banking sector and non-bank financial institutions, and among these most important reasons are:

- They are contracting with one party thus saving time and possibly cost.
- Raise the rate of funds turnover (lending) and thus earned more profits.
- They are reducing the cost of funds (deposits) for banks.
- The ability to manage the investment portfolio by meeting long-term obligations.

On the other side, some of the Monetary Authority's laws and regulations on banks and non-bank financial institutions to meet credit risks, such as reserves, specific financial ratios, make them more restrictive in the financing activities. Thus, this probably creates an impediment to investing in the bond market. Also, the high risk of investment of the bond market resulting from limited lending parties rather than lending to a large number

of borrowers and the depreciation of profits resulting from interest low might discourage the banks from buying debt bonds.

Moreover, the insurance sector is considered one of the most critical sectors in the Palestinian market that can fundamentally establish an affective bond market as the nature of insurance companies' work enables them to insure on debt bonds, in particular, if these bonds are secured by a specific asset owned by the issuer. Consequently, this stimulates insurance companies to insure those bonds and make more profits. On the other hand, it aims to raise people's confidence in investing in asset-backed bonds [(1)].

The Palestine Telecommunications Company and the Palestine Investment Fund are two of the largest companies with investment assets in the Palestinian market. It also achieved growth in these investment assets (2015-2019) by 18% and 25% [(2)], respectively. This investment expansion indicates the profits attained for these companies and the desire to re-invest to earn more profits. As a result, the profits generated by these companies' investment assets have conferred it the financial ability to re-invest. For example; The Palestinian Investment Fund has invested in securities with a value of 123,385 million dollars in 2017, and also, the Palestine Telecommunications Company has invested in intangible assets amounting to $209,104 million in 2016. Subsequently [(3)], this is an indication that these companies have the financial strength and the ability to be potential fundamental investors in the bond market.

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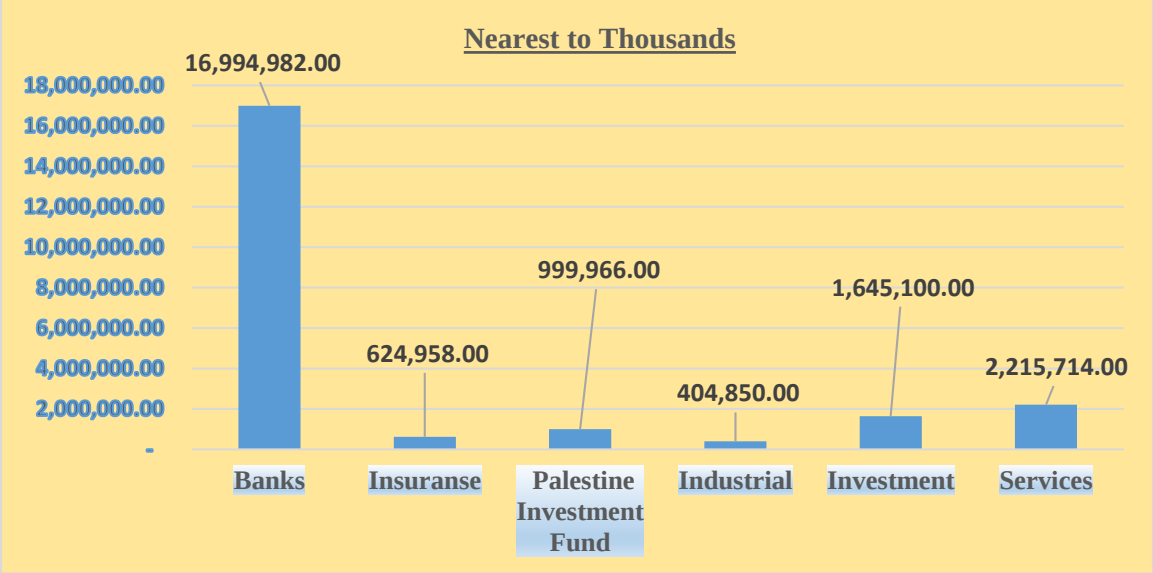
[(1)] Interview with the vice of financial & managerial affairs for insurance Global Company's executive manager.
[(2)] These percentages were calculated by the financial statements published on the website of these companies.
[(3)] financial statements published on the website of these companies.

In the end, other listed and unlisted companies and individuals and foreign investors could constitute a considerable investment base alongside the institutional companies. Thus this is raising the probability of establishing an efficient bond market.

**Diagram (9).**

**Total assets of companies listed on the Palestinian Exchange for the year 2019.**



## ➢ Legal & Regulatory Framework.

According to securities fundamental law No. (12) of 2004, which the Palestinian Authority has adopted and rules and systems related to the Palestine exchange, that activities and relationships between participation parties in the Palestine exchange are governed and organized under these regulations and laws. Further, the Palestine stock exchange regulations and laws have seen changes and developed according to developments at the regional and global levels during subsequent years, enhancing transparency and governance principles and protecting participants' rights in the Palestine exchange. Therefore, Palestine exchange criteria become more keeping up with regional and global stock exchanges, which classify the Palestine stock exchanges in the most critical global financial indicators such as "Frontier Market." Moreover, it might make it an attractive environment for investors as a stand-alone country with both MSCI and S&P indices. Consequently, the most critical systems that organize the Palestine stock exchange are the following:

### ❖ Listing System.

A listing system is considered a contract between public shareholding companies and the Palestine exchange to organize and arrange issuance and trading the securities for investors. The system defines the conditions for the listed process and transfers between the primary and secondary markets and clarifies conditions for listing the foreign companies that require other additional conditions. Also, it imposes on listed companies to follow the laws and rules of the Palestine exchange and the instructions of the Capital Market Authority, which include disclosing all data before and during the listing process and paying fees related to the listing. Ultimately, the listed system indicates the cases in

which the Palestine exchange can impose penalties on the source, such as suspending or even canceling the listing or imposing a fine.

- **Trading System.**

The trading system handles and organizes the buying and selling operations and the transfer of securities either individually by websites or financial intermediation firms. Also, it provides all the data for all trading, deposit, and transfer operations of the dealers in the Palestinian Stock Exchange, which allows the investor to make the appropriate investment decision. Moreover, the trading system provides oversight over deposits and transfers and monitoring trading in terms of prices, volumes, and times of trading operations to ensure that dealers adhere to the laws and regulations in place in the Palestinian exchange.

- **Membership System.**

This system handles company membership applicants in two stages, the first stage includes the conditions for initial membership approval, and the second stage includes the requirements after the initial approval of the membership.

The first stage requires that the company the applicant for membership has approval from the Capital Market Authority, and the company is to be established and registered in Palestine. The company also defines the significant activities in its internal system and its memorandum of association, which will form its significant activity on the Palestinian exchange. On the other side, the company's minimum capital is $ 2 million in buying and selling securities listed on the Palestine exchange and $ 4 million in the case of engaging in other activities such as under-writing and selling new securities and managing

investment portfolios. The membership system has the right at any time to amend the initial conditions for obtaining membership.

After the initial approval of membership, the second stage requires obtaining a license from the Capital Market Authority and opening an account in the settlement bank. Also, the membership system requires a company in the case of the desire to practice buying and selling securities listed on the Palestinian exchange. It must have been deposited for insurance that could be established by the exchange with an approximate value of $ 2.14 million or a guarantee letter by a specific bank to guarantee the clearance of its daily trading transactions. Also, it requires a company to deposit for settlement operations guarantee funds when such funds are set up or in the form of a guarantee letter with a sum of $ 4.28 million in order to cover any liabilities of the member company towards exchange other member companies or clients [(1)].

In actuality, the financial requirements for membership trading on the Palestinian Exchange are high compared to other stock exchanges. Where the minimum capital of the company in both the Dubai Stock Exchange and Singapore is 816 and 752 thousand U.S. dollars, while in Palestine, the exchange is 2 million USD dollars [(2)], and the amount of insurance on trading and to ensure the company's financial obligations in the Palestinian Stock exchange are higher than in the Dubai Stock Exchange and Singapore. This forms a financial impediment to issuers of debt securities.

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[(1)] The Palestine Exchange.
[(2)] The Palestine Exchange, The Singapore Exchange, The Dubai Exchange.

- **Governance System.**

Interestingly, during the last ten years, there has been a growing interest in Governance in Palestine, especially after the Code of Corporate Governance Rules in Palestine in 2009. This is due to its importance in raising the degree of competitiveness among companies, enhancing the investment environment, and reducing the risks. Thus, this increases transparency and integrity and promoting the best business practices. As a result, the Palestine exchange prepared its corporate governance guide to be the best reference for the listed companies to follow.

The governance guide aims to define criteria for appointing a member and chairman of the board of directors of the exchange and contribute to identifying the rights and responsibilities of the board of directors. The governance guide also contributes to improving the administrative and financial oversight over the exchange's operations through committees authorized by the Board of Directors. The governance guide also guarantees the shareholders' rights in non-discrimination of treatment and provides all data without concealing sensitive information that could have influenced investing decisions for shareholders. Finally, the governance guide also secures effective communication with shareholders and facilitates connection channels with shareholders about all issues that are gripping them.

One of the essential principles of corporate governance is the disclosure of its financial statements under international financial reporting standards and the annual managerial report, in addition to the disclosure of the social responsibility policy. Moreover, preserving information confidential except when disclosure is authorized or legally

required and refrains from using confidential information for unethical or illegal advantage.

- **The System of Violations, Investigation, and Punishment.**

This system is a complementary tool to the previous systems that is meaning this system would be encountered violations by any one of the participants in the Palestine Exchange, such as deceiving or concealing information, disclosing confidential information, or having some practices or activities that would affect the regular activity of the exchange. For compliance with the law by market participants, the exchange has the authority to conduct an investigation when any violation occurs. Then the perpetrator is referred to the Capital Market Authority with a report by Palestine exchange recommend the necessary disciplinary or punishments be taken. Consequently, the Capital Market Authority forms an investigation committee from the Authority's Director-General, the Director of Legal Affairs, and the Director of Complaints, who are entitled to investigate with the perpetrator of the violation, and it also has the authority of the judicial police if the perpetrator abstains from any legal action or requirement.

Further, among the most essential penalties that are punishable by law in a case occurring the violating the law, regulations, or systems are a fine not exceeding one hundred thousand (100,000) Jordanian dinars or its equivalent, or imprisonment for a period not exceeding one year or with both of these penalties. Also, one of the forms of punishment is compensation for losses incurred by others.

Further, the Palestine exchange has recognized appropriate procedures to Issuing and Offering Securities (stocks and debt bonds) for Public Subscription that as following [(1)]:

1- An underwriter or a management agent submits the licensing application along with the prospectus to the Capital Market Authority. The prospectus includes full disclosure of the data and information required to enable the investor to make the appropriate investment decision.

2- The issuer must inform the Authority of any changes occurring related to its information as stated in the prospectus without delay before or after the prospectus has been approved.

3- The prospectus would be valid thirty days after the date of its submission to the Authority unless the Authority decides during that period that the prospectus is approved, rejected, or suspended.

4- After the Authority approves the application for licensing and the prospectus, and before completion of the subscription the securities. The Authority has the right to request an amendment for licensing or the prospectus from the issuer to change the submitted data, and also the need for investors to be informed of this change.

(1) Interview with General Manager of the General Administration of Securities.

5- Final approval of the license application. However, the Authority has the right to suspend the subscription process, if any incorrect data or deception in the submitted materials is discovered that could harm the investor. Subsequently, if the issuer's outstanding problems are not resolved, then the authority has the right to cancel the license granted.

## ➢ Government Securities.

There are no government bonds in Palestine, which reduces the probability of building an efficient bond market. However, the importance of government bonds stems from the state's ability to finance its budget deficit and contribute to public debt's well-management. Also, governments bonds help manage liquidity in case of inflation or economic recession, and it provides a benchmark for pricing other financial instruments, thus reducing the financial risks of the Palestinian exchange.

### 4.2.2 Factors Inside in the Financial Sector.

- **Banking Sector.**

During the past decades, the banking sector in Palestine played an essential role in both financial and economic sides. This role is appeared in providing credit facilities "liquidity" to both Palestinian public and private sectors. The Palestinian government sector always resorted to banks to finance the fiscal deficit, and this is clear through the financial crises that the government has seen in the last years, especially in 2019, 2020. Where reached a total value of banking loans for the Palestinian government until mid-2020, approximately $ 1.74 billion formed almost half of the public debt. Also, credit facilities' value to the private sector reached approximately 7,850 billion U.S. dollars for the same period. In addition, the total value for the clients' deposits and equity of the banking sector in December 2019 amounted to approximately $ 16.4 billion, while debt capital and equity for the companies listed on the Palestine exchange for the same period amounted nearly to about $ 2.6 billion [(1)]. As a result of the above, this implies that the banking sector constitutes the primary fuel in the financial sector for financing the Palestinian economy. Consequently, the banking sector owns a sizeable financial legacy that makes it a key participant in financial and economic decisions, and thus it plays a crucial role in the decision to establish an efficient bond market.

In fact, during the last years, the Palestinian banking sector has made significant profits due to the banking sector's monopoly in general for financing services in the Palestine financial sector. Therefore, the banks operating in Palestine are usually like other banks

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[(1)] Palestine Aliqtisadi Magazine, Issue December 2020.
Palestinian Central Bureau of Statistics.

are seeking to attain growth or even constancy in profits. Thus, the interesting question is, what if the banking sector desires to establish an efficient bond market by acting as an investor, financial intermediary, or issuer of debt bonds. Consequently, the results of each role that the Palestinian banking sector may play can be reviewed as a following:

- *The Issuer of bonds:* In this case, the bank will pay interest on the issued bonds, which are usually less than the bank interest; this is because bonds are more secure to be repayment than banking deposits. Notwithstanding that would attain more earnings for issuer's bank result of reducing the cost of bond interest. However, in exchange, that is going against the investors' desire to earn more profits quickly, which does not attain by buying the bonds. Also, the purchased debt bonds would not find a secondary market for trading. This will push the investors to go toward banking deposits rather than purchasing the debt bonds. On the other hand, the issuance of the bonds by banks will be raising the liquidity and thus might increase costs due to an inability to properly re-investing the bonds' funds.

- *Investors:* Because the bank is a significant player in the Palestinian financial sector, it is assumed that they are the most likely investors to buy bonds. However, buying bonds at low interest would lose potential profits for the bank, deposited or lending by high interest, thus earning more profits. Conversely, Palestinian banks

may see the bonds as loan substitutes to buy and hold, not portfolio products. This prevents the bond market from growing.

- *Financial Intermediary*: If the Palestinian banks have the desire to play an intermediary financial role in order to have earned more profits by issuance commissions of the bonds, in exchange, they will lose the profits the funds for buyers of debt bonds, which could be using it with lending. This could prompt these banks to create impediments to establish an efficient bond market.

Ultimately, the Palestinian banking sector has a competitive advantage in the financial sector. Hence, they always seek to achieve more profits in the short term, in line with executives' goals in the banking sector to reach the required bonus without considering the strategy of long-term investment that includes buying debt bonds, which can attain significant yields. Notwithstanding, some countries like India have new regulations requiring banks to meet new asset-liability management guidelines that will encourage banks to manage their portfolios to contribute to market activity. Consequently, it is difficult for the Palestinian banking sector to be a participant or even support establishing an efficient bond market [(1)].

- **Equity & Money Markets.**

The evolution of the Palestinian Exchange infrastructure in terms of modern applications and systems and the electronic services provided, in addition to the updated regulations

[(1)] Interview with vice Portfolio Manager for Palestine Islamic Bank

and laws according to international standards, all significantly contribute to facilitating and rapidly establishing the bond market and with the cost low.

Furthermore, the existence of an equity market in Palestine is an essential matter for bond market development. It implies that the government has a "capital markets culture" with supporting institutions, issuers with disclosure experience, and investors with some understanding of what it means to invest in debt bonds. Equity markets can provide short-term pricing benchmarks and offer dealers a less risky trading experience. Moreover, companies listed on the Palestinian exchange may significantly establish an efficient bond market as an investor, issuer of bonds, or financial intermediary. Especially that the market value of these companies is greater than 3 billion U.S. dollars [(1)], this may be an indication of the possibility of investing in the bond market.

- **Financial Derivatives.**

The Palestinian exchange does not have any financial derivatives, which could establish an effective secondary bond market in which the bonds and other financial instruments are traded. In addition to that, financial derivatives allow investors to manage the risks of their investment portfolios and provide the necessary liquidity. Thus, the absence of financial derivatives raises the risks of investing in financial securities in general, resulting in more averse for Palestinian investors to buy the debt bonds in particular.

[(1)]The Palestine Exchange.

## ➢ Financial Intermediaries.

Palestinian financial intermediation companies began their financial activities since the establishment of the exchange in 1997. According to last years, the Intermediary firms achieved significant profits in 2006 and 2007, and the profits reached approximately 4 and 8 million U.S. dollars respectively. Beyond 2007, that industry was exposed to turmoil in their profits. In 2019, the Intermediary firms made profits of approximately 839 thousand U.S. dollars while the trading value for the same year was approximately 274 million U.S. dollars [(1)].

The Palestine Exchange Compared to other Arab exchanges, it can be observable that the trading value for each of the Jordan and Dubai exchanges are 1,585 and 11,266 million U.S. dollars in 2019 [(2)], respectively. These values are multiplier the value of trading in Palestine exchange, which amounted to the same year 274 million dollars as shown in the table figure (19). This considerable trading value, especially on the Dubai exchange, reflects a significant stock exchange financial activity that intermediary firms are carried out. This is an indication for these companies to have the ability and experience in managing securities in terms of rapidly obtaining sensitive information, monitoring and evaluating companies' financial performance, and skilled in managing securities risks. On the other side, the small value of trading size in the Palestinian exchange has resulted in the brokerage firms' small financial activity size, which is somewhat indicative of less experience and skills required in managing securities.

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[(1)] The Palestine Exchange.
[(2)] The Dubai and Jordanian Exchange, and Palestine Exchange.

The market share of intermediary firms on the Dubai Exchange is higher than those in Jordan and Palestine, as shown in the table figure (19). This indicates that these companies have an excellent opportunity to present quality financial services, make economies of scale, and earn more profits. Also, the rationale volume of intermediary firms and the considerable market share in Dubai exchange creates a stable competitive environment between intermediary firms and thus achieves progress and quality in managing securities. On the contrary, intermediary firms in Palestine have a small market share that could expose them to losses or even prevent growth and progress in the securities management process.

**Table (19).**
**Statistics for Financial Intermediary Firms in 2019.**

| Exchange Name | Number of Intermediary Firms | Value of Trading (Million Dollar) | market share for each firm from the trading value. (Million Dollar) |
|---|---|---|---|
| Exchange Palestine | 8 | $ 274.00 | $ 34.25 |
| Exchange Jordan | 54 | $ 1,585.00 | $ 29.35 |
| Exchange United Arab Emirates | 32 | $ 11,266.00 | $ 352.06 |

Source : The Dubai and Jordanian Exchange, and Palestine Exchange

- **Corporate Governance.**

With the rising global interest in the concept of governance, the private sector in Palestine had commenced considering the importance of the Code of Governance Rules for Public Shareholding Companies and Financial Institutions in terms of organizing the relationship between shareholders and stakeholders and creating a status of balance between the Board of Directors and the Executive Management. As a result, in 2009, a group of representatives for legal and financial supervisory bodies, institutions, and others, drafted a code of corporate governance rules that are consistent with the principles of governance at the regional and international levels and also in line with the laws, legislation, and conditions in Palestine, as well as taking into account the Palestinian corporate law.

The Corporate Governance Code also applies to public shareholding companies and local and foreign financial institutions and is under the Capital Market Authority and the Palestinian Monetary Authority's supervision and control. However, the commitment to implement governance rules in Palestinian companies and institutions faces several barriers, including financial and administrative corruption, favoritism, the agency problem, and conflicts of interest. All of this contributes significantly to undermining the exerting of governance rules seeking to guarantees investors' rights, enhancing transparency ad disclosures on information, and attaining justice without discrimination between Individuals, firms, and government bodies.

In reality, there several of the essential features of violating the rules of Governance in Palestine that are the domination of the family or personality relationships in management the companies and institutions, also increasing financial disputes between

the parties, most notably returned checks, which constituted approximately 10.16% of the total clearing checks in 2019, which were in the State of Jordan for the same year, approximately 3.9%. Besides, the lack of a Palestinian market to a healthy competitive environment, and consequently the market's monopoly by some dominant companies, duplication or plurality of jobs title for the same individual, or non-rotation of the job title for a long time. As well as falsification or concealment of sensitive information might negatively influence decision-makers. Furthermore, violating the rules of governance making a big gap between senior management and other departments in individual decisions and also in preparing plans and goals for the department or company [(1)].

Ultimately, all these indicators are evidence that the governance rules in Palestine are mainly non-applicability, and it is a written material in the publications of companies and institutions. Hence, this creates uncertainties between the public and companies, and institutions. As a result, the investors would aversion to investing in debt securities' purchases due to less confidence in those companies.

[(1)] Interview with an academic at Birzeit University.

### 4.2.3 Environmental Factors.

- **Macroeconomic & Political Stability.**

The tyrannical military policies and measures by the Israeli colonial of the Palestinian territories over the past decades have created a state of political and economic instability in Palestine. These Israeli measures include invading and blockading Palestinian areas; also, military barriers between cities make movement difficult for people and goods and confiscate the Palestinian resources such as water wells and agricultural land. In addition to controlling border crossings with neighboring states and controlling clearance funds and other Israeli measures. As a result, the United Nations Trade and Development report revealed that the Palestinian economy's losses due to the Israeli occupation between (2000 -2017) are estimated at 47.7 billion dollars. Also, the Israeli economic policy has always hindered the Palestinian's endeavors from developing the productive Structure of the Palestinian economy and also has fought the Palestinian products by preventing exports, competitive prices, and confiscating goods, in addition to facilitating the access of Israeli products to the Palestinian market without restrictions. All this aim of making the Palestinian economy subordinated to the Israeli economy thus became the Israeli economy is the largest exporter for Palestinian markets, with an estimated more than $ 3 billion in 2019 [(1)].

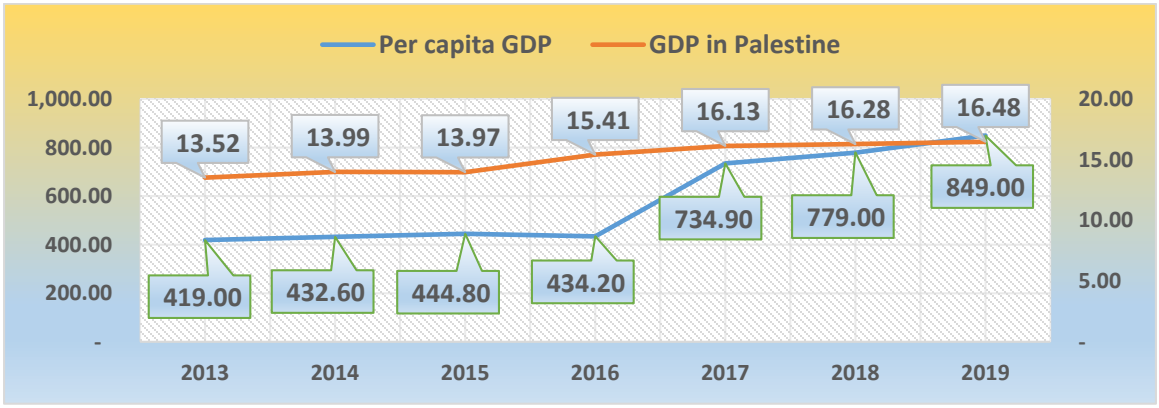
In reality, some Palestinian economy indicators have been improved in recent years, as shown in diagram No. (10). Where the gross domestic product during the previous four

[(1)] The Palestinian Ministry of Economy.

years has been growing even reached 16.48 billion dollars in 2019, and the per capita Gross Domestic Production for the same year also raising to 849 dollars[1]. Despite the improvement in Palestinian per capita income, there remains a fear of the consequences of the arbitrary policies and measures by Israel that adversely affect the Palestinian economy. Consequently, the Palestinian environment for investment is insecure for local or foreign investors. Hence, it can be said that the state of political and economic instability in Palestine creates uncertainty and raises the level of investment risks. Thus, it would be difficult to establish an efficient bond market in the Palestine Exchange [2].

**Diagram (10).**

**Some of the economic indexes for Palestine's economy.**




Source: World Bank, and Palestinian Central Bureau of Statistics.

[1] Palestinian Central Bureau of Statistics.
[2] Interview with financial manager for PADICO

## ➢ Fiscal & monetary indicators.

❖ High Inflation & Volatility. In the last years, the inflation rate in Palestine has seen a good improvement compared with other regional countries. This is due to several reasons; the most important is the low volatility in the trading currency exchange rate (shekel) and the severity of competition in the small Palestinian market. As shown in table figure (20), it is noticeable that the inflation rate in Palestine in 2018 was (0.20), lower than in Jordan, Saudi Arabia, and Singapore, and also the average rate of inflation in Palestine is 1, lower than both Jordan and Saudi Arabia. Also, the level of fluctuation (standard deviation) for inflation in Palestine is .96, and it is lower than that of Jordan, Saudi Arabia, and Singapore. Consequently, the indexes of both the average and the fluctuation of the inflation rate in Palestine infer the ability of ascertained expectations to long-term future rates, which causes a higher preference in investing in long-term debt bonds.

**Table (20).**

**Inflation Indexes for Some Regional Countries.**

| Country | 2012 | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 | Average | Standard Deviation (2012-2019) |
|---|---|---|---|---|---|---|---|---|---|---|
| Palestine | 2.78 | 1.72 | 1.73 | 1.43 | (0.22) | 0.20 | (0.20) | 1.60 | 1.00 | 0.96 |
| Jordan | 4.61 | 6.14 | 3.45 | 2.17 | 1.36 | 1.68 | 1.71 | 1.67 | 2.53 | 1.56 |
| Singapore | 4.58 | 2.36 | 1.03 | (0.52) | (0.53) | 0.58 | 0.44 | 0.57 | 0.95 | 1.49 |
| Sudia Arabia | 2.87 | 3.53 | 2.24 | 1.20 | 2.07 | (0.84) | 2.46 | (2.09) | 1.27 | 1.71 |

Source: The World Bank.

- It is continuing large fiscal deficits. Since the Oslo agreements in 1994, successive Palestinian governments have used foreign grants and tax levies to cover public expenditures throughout many years. However, in recent years, the Palestinian government has fundamentally relied on tax revenues that have a higher percentage, as it reached 86.5% of the total revenues in 2019. As notable in table figure (21). In general, the government public revenues in most years are sufficient to cover the public expenditures, and also the public debt is roughly constant and did not rise significantly, except for the fiscal deficit that occurred in 2019, as a result of piracy by the Israeli occupation for the Palestine government funds, and thus forcing them borrowing from banks and raising the public debt to $ 2,795 million. Besides, it observable in table figure (22) that the debt-to-GDP ratio in Palestine is the lowest compared to other countries such as Jordan, Malaysia, and Saudi Arabia. Consequently, it can be said that there is some stability in the financial situation of the Palestinian government, therefore, low risks from increased borrowing as a result of a continuing budget deficit. This gives a preliminary indication for foreign and local investors of the low level of default, increasing the probability issue government debt bonds.

## Table (21).

## Financial Position for Palestinian Authority (2012-2019).

**(Million Dollar)**

| Description | 2012 (Million Dollar) | 2013 | 2014 | 2015 | 2016 | 2017 | 2018 | 2019 |
|---|---|---|---|---|---|---|---|---|
| Total net public revenue and grants. | 3,172.20 | 3,678.00 | 4,021.60 | 3,685.19 | 4,316.09 | 4,374.21 | 4,127.94 | 3,759.50 |
| Total public expenditures | 3,258.10 | 3,419.10 | 3,606.90 | 3,597.22 | 3,874.04 | 4,044.82 | 3,944.26 | 3,840.14 |
| **Balance Net** | **(85.90)** | **258.90** | **414.70** | **87.97** | **442.05** | **329.39** | **183.68** | **(80.64)** |
| **Total public debt** | **2,482.60** | **2,376.20** | **2,216.80** | **2,537.20** | **2,483.80** | **2,543.10** | **2,369.60** | **2,795.00** |

Source: Palestinian Monetary Authority.

## Table (22).

## Debt to Gross Domestic Product Ratio.

| Countries | 2018 | 2019 |
|---|---|---|
| Palestine | 15% | 18% |
| Jordan | 76% | 79% |
| Saudi Arabia | 19% | 23% |
| United Arab Emirates | 21% | 27% |
| Malaysia | 56% | 57% |

Source : Statista

- Taxation & Local Currency. According to article no (7) Of the Palestinian Income Tax Law no (17) of 2004. Capital gains of selling securities, but this not being regularly made, are exempt from income tax. However, this means that the profits of regular securities trading by financial companies or investors and the periodic interest of debt bonds are income taxable. Therefore, this will lead to lower bond returns and thus discourage the investors from purchasing debt securities.

Ultimately, over decades, the virtual trading currency for Palestinian people is the Israeli shekel; therefore, the Palestinian government does not have a national currency that can implement specific monetary policies to achieve economic development goals. Consequently, the Palestinian monetary policies are dependent on the monetary and economic goals of the Israeli occupation, which will inevitably be against the Palestinian economy's agenda. Other currencies, such as the Jordanian dinar and the U.S. dollar, could be dealt with. Thus the absence of a national currency prevents the Palestinian government from making the necessary monetary measures to handle some essential monetary and economic issues such as a limit of a high rate of inflation, pumping cash liquidity in the case of an economic depression, financing the public budget deficit and other economic and financial problems. Moreover, one of the most essential financial tools to implement monetary policies is long and short-term debt securities, which control the amount of money offered through purchasing or repurchasing debt bonds. Consequently, this implies the importance of the independent national currency to establish an efficient bond market.

- **Investment Awareness.**

Since the establishment of the Palestinian Exchange, it has worked continuously to deploy and deepen awareness and familiarity with the concept, methods, and mechanisms of investing in securities and the nature of the Palestinian exchange and its fundamental functions.

Due to the evolving in the securities markets on regional and international levels and the emergence of the significant role of investment awareness, the Palestinian Exchange has established the Department of Public Relations and Investment Awareness, of which emerged the investment awareness program that aims to enhance and improve the perception of the Palestine Exchange at the local and international levels. It is also seeking to inform the current and potential investors of their rights and duties towards dealing with securities in addition to providing the necessary knowledge and information about securities to enhance the skills for investors and specialists for evaluating investment opportunities and thus the ability to make the proper investment decision. The awareness program also aims to cooperate and communicate with financial firms and the Capital Market Authority to boost investment awareness and enhance continuous communication with investors abroad, whether they are Palestinians or foreign investors.

In the same context, the Palestinian Exchange has always sought to achieve investment awareness through specific tools. For example, but not limited to; Issuing booklets and brochures to raise awareness about investing in securities, reading financial statements for listed companies, holding seminars, workshops, and training courses to introduce the market mechanisms. Furthermore, on the role of the financial intermediary in the market, risk management, and internal control, in addition to visits to universities and companies

to introduce the Palestinian Exchange, as well as strengthening the relationship with academic bodies through various activities such as the Investor Research Competition or provide scholarship to researchers. Also, media tools channels, such as radio and television, in addition to the website of the Palestine Exchange, provide all the information and knowledge needed by investors, researchers, and others. Consequently, all of these tools may create or increase awareness of investment in securities for the Palestinian community.

On the other hand, there is a decrease in the number of investors in securities, as shown in table figure (23). The percentage of investors' number to the population is about 0.07% in 2019, which is considered a tiny percentage compared to other countries, such as Saudi Arabia and the UAE, whose percentage reaches 13.91% and 9.91%, respectively. This due to several factors, the most important of which is the level of per capita income and companies, the degree of education for company owners or decision-makers, the presence of investment opportunities, the profitability of companies listed on the stock exchange, the financial awareness of individuals and companies, also the spread of some rumors and stories about failed experiences for investing in securities, in addition to religious beliefs that classify investment in securities as invalid from a religious point of view. Consequently, all these factors contribute significantly to the formation of investment awareness in society [(1)].

[(1)] Interview with the vice of the operations Manager in Palestine Exchange.

**Table (23).**

**Percentage investors number to the population in 2019.**

| Country | Palestine | Egypt | Saudi Arabia | Emirates |
|---|---|---|---|---|
| Percentage investors number to the population[(1)] | 0.07% | 0.03% | 13.91% | 9.91% |

Source: Data Common, Saudi Arabia, Egypt, and the Arab Emirates markets.

[(1)]The calculation is the number of investors divide by population.

# Fifth Chapter.

## 5.1 Results of Research.

According to the SWOT analysis, the researcher arrives at the analysis results that affect the feasibility of establishing an efficient bond market in the Palestinian Stock Exchange. Therefore, the results of the study are as follows:

**Strengths.**

- The study revealed that the Palestinian Stock Exchange infrastructure is one of the most evolving regional stock exchanges. It has modern electronic services and systems and is committed to acceptable governance standards consistent with global standards. In addition to flexibility and ease in the procedures and conditions for membership and listing. Moreover, the exchange has a legal and regulatory framework that governs and regulates its functioning and enhances transparency and integrity.

- The formation of some companies' financial structures in the industrial, service, and investment sectors are characterized by a low degree of debt financing, which gives these companies the advantage to issue debt bonds.

- The initial availability of institutional investors, such as banks with significant savings and high liquidity, confer the financial ability to invest in the bond market.

- The Palestinian public debt to Gross Domestic Product ratio is very low compared with other countries, which means a low degree of default risk would increase investors' trust toward the bond market.

**Weaknesses.**

- The lack of legal specialists and courts specialized in resolving violations, financial disputes related to the Palestine exchange transactions, particularly in the bond market.

- The absence of government bonds and financial derivatives prevents providing a benchmark for fair pricing, managing risks, and providing liquidity to the bond market.

- The absence of credit agencies that could classify each of the debt bonds creditworthiness and the bond's issuer to support the diversified investors to make the appropriate investment decision.

- The impairment of the activity for financial intermediation companies resulting from the decrease in trading volume in the exchange leads to a weakness in the expertise and skills in managing securities, which would reduce confidence in investors. Also, requirements for membership trading on the Palestinian Exchange are high.

**Opportunities.**

- The distorted Palestinian economy lacks long-term productive projects and infrastructure that require long-term financing. If there is the appropriate environment to undertake these projects, there would be the need to establish an efficient bond market to bridge the long-term financing gap.

- In general, the financial stability resulting from the absence of a deficit in the budget and the stability of both public debt and the inflation rate over the recent years, exception corona periods, leads to a lower level of financial risk. This, in turn, creates somewhat of investor confidence in the Palestinian market and may increase the likelihood of establishing an efficient bond market.

- The stock market participant's experience will have a significant role in overcoming obstacles and reducing the risks, thus shortening the way to establish an efficient bond market.

**Threats.**

- Competition and severe reluctance from the banks operating in Palestine whose stakeholders will exert political and financial pressure could impede establishing an efficient bond market.

- Political and economic instability raises the degree of the risk, which creates an aversion to investing in the bond market and thus reduces the probability of establishing an efficient bond market.

- Lack of necessary financial and monetary tools, such as the national currency, and the ability to reduce taxes outside the Paris economic agreement. These tools have an essential role in providing the appropriate economic and financial environment to establish an efficient bond market.

- The small size of companies and the monopoly of the market by some companies, thus the unfair distribution of income, reduce the possibility of establishing an efficient bond market.

- Distortion and lack of financial awareness for companies and individuals of what the Palestinian Exchange is and its objectives, results, and the mechanism of investing in securities. This would create fears to investing in the bond market.

- Despite adopting the charter of governance rules for Palestinian companies and institutions, there are some deficiencies and an inability to implement the governance rules. This is due to financial and administrative corruption, bribery, and the personality relationships and family-style is dominating the decisions for officials.

## 5.2 Recommendations of Research.

Based on the results of the data analysis, the researcher extraction with several recommendations using the TOWS analysis tool that could support the likelihood of establishing an efficient bond market in the Palestine Exchange:

- Serious endeavors to reformulate or modify all or part of the Paris economic agreement with the Israeli occupation must be looked at in cooperation with international parties in order to restore some of the Palestinian rights such as guaranteeing the right to export Palestinian goods, international monitoring of commercial crossings, collection of clearance funds by international parties, and compensation for financial losses caused by the Israeli occupation, etc. This is to ensure a safe economic environment in Palestine.

- Enhancing the role of governance to management structures in public and private institutions by adding and amending some of the legislation and regulations in economic, financial, and administrative issues, reforming the judiciary, and strengthening executive bodies' role for the law. All this contributes to enhancing the governance rules for bond market participants such as bond issuers and financial intermediaries' firms.

- The commitment of the responsible authorities to promote the securities markets and the bond market in particular by completing some crucial matters, as follows:

- ❖ Establishing the courts specialized in financial disputes in the securities market.
- ❖ Add some legislations and laws related to the securities market and the bond market in particular, such as laws related to offering debt bonds for purchasing by the public, laws on trading financial derivatives.
- ❖ Establishing local credit agencies and attracting international credit rating agencies attract investment in the bond market.

- ➢ Pursuing appropriate economic and financial policies aimed for achieving economic development; for example, promoting and supporting investment in productive projects, finding external markets to Palestinian products, reducing public sector expenditures, exempting or reducing income tax on debt bonds, and issuing debt bonds in currencies other than the shekel, such as the dollar and dinar.

- ➢ The commitment by the Palestinian government to support the establishment of an efficient bond market through several aspects, including:

  - ❖ Government guarantees a certain percentage of the issued debt bonds.
  - ❖ Issuing government bonds for pricing and liquidity purposes.
  - ❖ Committing some large-capital financial and non-financial institutions to purchase debt bonds as a compulsory reserve.
  - ❖ Amending the investment and corporate laws to stimulate investment in the bond market.

- ❖ Mitigation of some conditions for entering the bond market, such as listing fees as well as membership requirements related to capital and guarantee deposit.

- Changing and deepening the financial awareness of Palestinian individuals and companies about the securities markets, especially the bond market, which is through media such as television, radio, and social media, as well as by holding workshops and seminars that contribute to forming the appropriate awareness in order to stimulate investment in the bond market.

- Attracting foreign investors to the bond market, particularly Palestinian businesspeople abroad. That is by conferring them some of the Palestinian government's privileges, which includes ensuring do not default of debt bonds, treating them as a local investor, and legal and financial commitment toward them.
- Enhancing financial intermediation companies' role by developing expertise and risk management and investment portfolios through holding workshops and conferences in cooperation with the Capital Market Authority and the Palestinian Exchange. In addition to making partnerships and cooperation with international financial intermediation companies that contribute to raising the capabilities and capabilities for local financial intermediation companies, raising the quality level for the financial services in the Palestinian Exchange and the bond market in particular.

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## ملخص:

تناول هذا البحث الأبعاد الأربعة التي يمكن أن تؤثر على إمكانية وجدوى إنشاء سوق سندات فعال في البورصة الفلسطينية. هذه الأبعاد هي مالية, اقتصادية , استراتيجية وقانونية. باستخدام طريقة تحليل نقاط (القوة والضعف والفرصة والتهديد) يمكن أن تحدد المتغيرات التي قد تؤثر إيجابًا أو سلبًا على إنشاء سوق سندات فعال. كما يمكنه استخلاص النتائج التي تحدد التوصيات أو الشروط لإنشاء سوق سندات فعال في البورصة الفلسطينية.

لم تتناول أي دراسه إمكانية واستمرارية إنشاء سوق السندات في البورصة الفلسطينية. بالتالي ، تهدف هذه الدراسة إلى قياس القدرة على تطوير سوق السندات بما يساهم في خدمة الاقتصاد الفلسطيني من خلال تطوير مشاريع مختلفة أو حتى مواجهة أزمة مالية تضر بالاقتصاد الوطني.

كما تبني منهجية البحث الإطار النظري لتأسيس نموذج سوق السندات بأربعة أبعاد تشمل الأبعاد المالية ,الاقتصادية ,الاستراتيجية والقانونية. وتعتمد هذه المنهجية أيضًا على إجراء بعض المقابلات مع بعض الأكاديميين ورجال الأعمال وكبار الشخصيات في المؤسسات المالية.

أظهرت النتائج التجريبية للدراسة أن نموذج سوق السندات يمكن أن يفسر العلاقة بين المتغيرات المالية والاقتصادية والاستراتيجية والقانونية (المتغيرات المستقلة) ، وإمكانية إنشاء سوق سندات فعال في البورصة الفلسطينية (متغير تابع).

قدمت نتائج البحث نظرة ثاقبة لأولئك الذين تبنوا إنشاء سوق سندات فعال في البورصة الفلسطينية. بالإضافة إلى ذلك ، ينص جوهر نتائج الدراسة على مجموعة من المتطلبات الأساسية لإنشاء سوق سندات فعال في البورصة الفلسطينية.

الكلمات المفتاحية: السندات ، البورصة ، سوق السندات ، القطاع المالي.