Measuring the Economic Performance of Islamic Banks in Palestine.

Ahmad Asad Ibrahim Mahmoud & Radiah Abdul Kader
Faculty of Economics and Administration, University of Malaya Kuala Lumpur Malaysia

This study attempts to measure the economic performance of the Islamic banks in Palestine during 1996-2004. Several financial ratios will be used to identify the economic importance of the Islamic banks, and the level of participation in achieving the developmental goals of the national economy. Data were gathered from all Islamic banks in Palestine which include three full-fledged Islamic banks and the Islamic branch of one conventional bank.

1. Introduction

The historic success of obtaining Palestinian self-rule over parts of the West Bank and Gaza Strip in 1994 followed by the landmark formation of the Palestinian National Authority (PNA) and the establishment of the Palestine Monetary Authority (PMA) in 1994 brought about a revival of the Palestinian banking sector. Evidently, since the Israeli occupation in 1967, all banks in Palestine have been replaced by Israeli-managed banks, except for the Bank of Palestine in Gaza and a single branch of the Cairo-Amman Bank, which, after a long closure, were allowed to reopen their businesses in 1981 and 1986 respectively.

The Paris Economic Agreement with Israel in 1994 had empowered the PMA to issue licenses for new banks to operate in Palestine. This had precipitated the establishment of several commercial banks. Many old banks were also permitted to reopen their branches. By the end of 1999, there were 22 banks in Palestine which comprised 9 national banks and 13 foreign banks (Jordanian and Egyptian banks). It was also during this period that Islamic banking began in Palestine. The first Islamic banks were set up in 1995 namely the Arab Islamic Bank (a national bank) and Cairo-Amman Bank for Islamic Transaction (a Jordanian bank). Later, two more national Islamic banks were set up namely the Palestinian Islamic Bank in 1997 and the Al-Aqsa Islamic bank in 1998.

Islamic banks in Palestine offer almost all traditional financial services that commercial banks normally offer but tailored based on *Shariah* principles. Current and saving deposits are mobilized based on *wadiah* principle whilst investment deposits are mobilized through *mudarabah* contracts. Credit facilities are mainly in the form of *murabaha* contracts while investments are mostly in securities.

2. The Study

This study attempts to measure the economic performance of the Islamic banks in Palestine during 1996-2004. Several financial ratios will be used to identify the economic importance of the Islamic banks, and the level of participation in achieving the developmental goals of the national economy. Data were gathered from all Islamic banks in Palestine which include three full-fledged Islamic banks and the Islamic branch of one conventional bank.

Financial ratio analysis is often used to measure the overall financial soundness of a bank and the quality of its management. The advantage of this method is that it removes the disparities in sizes between banking firms and brings them at par (Abdus Samad, 2004). The use of ratio measures is not a new method. O'Connor (1973) and Libby (1975) had used this method in the early 1970s. Since then, it has been used in many studies such as by Chen and Shimerdo (1981), Ross (1991), Sabi (1996), Hempel and Simonson (1998). The evaluation of Islamic bank performance using financial ratios includes that by Samad (1999), Iqbal (2001), Samad (2004) and Radiah and Husna (2005).

Financial ratios can also be used to evaluate and measure the economic role of banking firms. Two important studies in Arabic used these ratios to achieve this goal. The first study is entitled "Evaluating the economic role of Islamic banks" by Group of Economic Experts (1997) , while the second study is entitled "The Role of Islamic banks between Theory and Practice" by Abu Zaid (1997). Our study will use the same ratio measures that were used by the two above-mentioned studies.

This financial ratios employed in this study comprise the following;

(i) Shareholders' Fund Ratio. This ratio also known as the *capital to asset ratio* measures the percentage of the bank's capital (shareholders' equity) to total assets held by the bank. It is an indication of the bank's capital adequacy and solvency. It shows the level of capital held by the bank to cushion against the risks of unexpected loss of its total assets. The higher the capital asset ratio, the less risky and the more solvent is the bank. Theoretically, Islamic banks are expected to maintain a higher level of shareholders' fund ratio due to the fact that Islamic bank assets in the form of profit and loss sharing investments and financing are exposed to higher risk of loss compared to conventional bank assets generated under the predetermined interest rate system. Hence in order to reduce the risk level the ratio of shareholders fund in Islamic banks should be higher than that of conventional banks.

(ii) Capital Utilization Ratio or Deployment Ratio. This ratio measures how best a bank is using its resources (Iqbal, 2001). Measuring this ratio is vital because one of the most important goals of Islamic banks is to encourage investment that will increase the investment capacity of the society, so that the gross national product can be increased as well. This ratio can be measured by comparing total investments to total equity or financing to total deposits (or total liablilities). The higher these two ratios are, the higher is the resource utilization of the bank. Just like the shareholders' fund, Islamic banks have a high risk exposure due the nature of their financing and investments. As such, the capital utilization ratio should also be higher in Islamic banks compared with conventional banks. The use of this ratio will give an indication about the investment policy of a bank whether it is expansionist in nature or self-contained.

(iii) Profitability Ratio. This ratio is measured by comparing the bank's net profits to its total assets, and its net profits to equity. The higher these two ratios are, the higher is the profitability of the Islamic banks. The issue of profitability is of utmost importance for Islamic banks. This is because Islamic banks try to create profits for both its investment depositors, and shareholders, whereas conventional banks try to increase the profit of the shareholders only. The reason for this difference is the fact that depositors of Islamic banks are similar to the shareholders because they are involved in the investments of the bank and bear losses just like the shareholders do in conventional banks. In contrast, depositors of conventional banks receive specific interest rates on their deposits, and so they are more like lenders and will not be affected by any loss suffered by the conventional bank.

(iv) Deposit Ratio. Savings can be one of the economic variables that can affect the level of economic activity. Since Islamic banks are one of the financial institutions that mobilize savings from surplus units based on the principle of profit and loss sharing; and channel the savings to deficit units as investments it is important to measure the investments efficiency ratio of Islamic banks. This can be done by comparing the ratio of investment deposits in Islamic banks to their total deposits.

(v) Ratio of external investment to the total investment and the *ratio of domestic investment to the total investment.* The higher the ratio of domestic investment to the total investment the higher is the contribution of the Islamic banks to generate gross domestic product of the economy. On the other hand, a high ratio of external investment to total investment indicates that more financial resources are being channelled externally than to the economic sectors of the domestic economy.

Islamic banks can play a very important role in the economy through their investment activities. This is because the investments of the Islamic banks are investments in the real sectors of the economy which give returns in the form of profits. For instance an Islamic bank can utilize its available financial resources in establishing domestic investment projects either by doing it alone or participating with others. This will increase the share of the society in terms of capital returns which will in turn improve the gross domestic product.

(vi) Statutory reserve ratio. For banks, liquidity management involves the estimation of the demand for funds by the public and the provision of sufficient reserves to meet these needs .It is the function of liquidity management to estimate the size of demand for funds and fulfil the demand in a manner consistent with the maximization of shareholders' wealth. A bank must always be in a position to fulfil the demands of its depositors. Hence it is required to hold in reserve that amount of cash necessary to satisfy the demand of depositors. If a bank does not maintain sufficient liquid assets to meet such demand requirements, it is likely to have liquidity problems. Accordingly, banks are required to monitor liquidity by maintaining a certain level of statutory reserve ratios in two ways namely the supplementary reserve ratio and the cash reserve ratio. Both ratios are imposed to ensure bank's liquidity so that every bank is ready to meet its obligations to its customers whenever they wish to withdraw their money. The ratios are also monetary policy instruments that will enable the central bank to control the volume of credit offered by every bank and consequently restrict the ability of money creation for every bank. By doing so, the central bank will be able to protect the economy against inflation.

The supplementary reserve ratio can be measured by comparing the percentage of bank reserves to total customer deposits. According to the regulations of the PMA this ratio cannot be less than 25% of the total customer deposits. As for the cash reserve ratio it can be measured by comparing the percentage of bank reserves to deposits and notes. According to the regulations of the PMA this ratio cannot be less than 5% of the total deposits and notes held in the bank.

3. Results of the Study

3.1 Shareholders' fund ratio

A high shareholders' fund ratio indicates lower solvency risks and this would allow the bank more flexibility to invest in long-term investment projects such as infrastructure projects. A high ratio between shareholders' fund and total deposits will also increase depositors' confidence. This will attract more deposits which mean the more resources can be channelled by the Islamic bank to the various economic sectors (Palestinian Monetary Authority, 2004).

Table 1 shows that the percentage of shareholders funds to the total assets in the Palestinian Islamic banks is 17.3 per cent, while the ratio for conventional banks is 9.6 per cent for the conventional banks. Both percentages are higher than the capital adequacy requirement of 8 per cent under the Basle Accord 1988. This indicates that banks in Palestine are financially sound. The higher ratio for Islamic banks seems to reflect the higher risk faced by the Islamic bank asset portfolio as mentioned earlier.

Table 1: Shareholders' Fund Ratio(The mean ratio for 1996-2004)

Shareholders' Fund Ratio	Islamic Banks (%)	Conventional banks (%)
Shareholders' funds/Total assets	17.03	9.6
Shareholders' funds/Total deposits	19.32	13.0

Source: Palestinian Monetary Authority Annual Report 2004

The above statistics reveal that the role of shareholders funds in financing the investment and development activities though higher than conventional banks is still relatively marginal. Thereby, Islamic banks should further increase the percentage of ownership rights/capital. From the accounting perspective, this will enable them to maximize their relative portion in the long-term financial resources, and eventually accentuate the development role of Islamic banks. The long term financial resources are highly required because the nature of development projects, be it agricultural or industrial projects, normally necessitate long-term investments. Such projects require high costs in order to conduct feasibility studies, establish the basic infrastructure for each project, which in turn may require the import of certain critical equipment prior to the start of production. Moreover, the process of production itself must undergo thorough testing, and the workforce must undergo rigorous training as well. Therefore, it is vital for the Islamic banks to acquire long-term financial resources (in the form of shareholders' funds) if they seek to realize their ambitious socio-economic objectives.

Table 1 also shows that the percentage of the shareholders funds to the total deposit has reached 19.3 per cent, which implies that external sources (deposits) represent the higher source of funds for the various activities of the banks. As financial intermediaries, the banks tend to concentrate more on investment activities and give less emphasis on the ownership of primary and secondary equipment. This also means that the type of investment activity for those banks will depend on the nature of the available deposits. It follows that the ability of the Islamic banks to put in place a long-term investment strategy will depend on the structure of the available deposits. This, in turn, requires specific data about the percentage of long-term deposits to the total percentage of the available deposits, which will be further discussed in the forthcoming sections under the classification of deposits.

3.2. Capital Utilization Ratio/Deployment Ratio

As more deposits are utilized compared to total deposits; this indicates that the Islamic bank is playing a bigger role in the developmental sector. (Group of Economic Experts 1997). Table 2 shows that the deployment ratio for Islamic banks is 43.4 per cent which is far below that achieved by the conventional bank. The deployment ratio of the conventional bank is 95 per cent**.** The reason for such a high percentage for the conventional banks is the fact that conventional banks have simpler procedures for their lending activities. They rely primarily on the business of receiving deposits and lending on fixed interest which bear less risks. Moreover, they have a bigger share of the deposits in the Palestinian financial system. Because of these factors, the conventional banks seem to be a very good job in utilizing their resources, thus outperforming the Islamic banks.

Table 2: Deployment Ratio (the mean ratio for 1996-2004)

Deployment Ratio	Islamic Banks (%)	Conventional banks (%)
Total employments to total equity	43.4	95
Total Financing to total liabilities	36.9	41.7

Source: Palestinian Monetary Authority Annual Report 2004

The financing to total liabilities of 36.9% for Islamic banks (see Table 2) further confirms the low rate of deposit utilization in Islamic banks. This also implies a situation of excess liquidity which has been taken as a sign of the inefficiency of Islamic banks. Many Muslim economists[1] believe that most Islamic banks have not been able to utilize their accumulated resources in the most beneficial way. In fact, this phenomenon is attributed to many causes, some of which are as follows;

1. Lack of experience and ability to direct resources to investment channels
2. When the Islamic banks were established many people prefer to put their deposits in Islamic banks rather than in conventional banks. This led to huge deposits in the Islamic banks without a proper policy of investment (Yusree, 1995)
3. The rising level of short-term deposits led to the banks investing in short-term contracts that, in turn, led to excess liquidity.

If we look closely at the methods of fund utilization by the Islamic banks, as shown in Table 3, it is evident that 78% of total financing were based on trade-based *murabaha*, contract, while direct investment constituted only 11.1%, and profit and loss sharing namely *musharaka* and *mudaraba* constituted only 8 per cent and 2 per cent respectively.

[1] From those economists: 1- Jamal Alddeen Ateyah in his book (Islamic Banking, 1985 pp 99-100).
2- Adnan Alhedee in his book (The relationship between Islamic banks and central banks, 1984 p.20).

Table 3: Fund Utilization of the Palestinian Islamic Banks (the mean for 1996-2004)

Methods of Investment	Percentage
Mudaraba	2.5
Murabaha	78
Musharaka	8
Direct investment	11.1

Source: Palestinian Monetary Authority Annual Report 2004

Looking analytically at the above-illustrated statistics, the most important obstacles facing Islamic banks when implementing the most suitable investment methods- especially the methods of *Mudarabah* and *Musharaka* (partnership) are the nature of customers' behavior and the inadequate administration system of monitoring investment activities as described below:

1. The nature of customers' tendencies. Customers are more inclined and more familiar with conventional banking which prevented them from relying on the method of mudarabah especially when we take into consideration that their tendencies were not compatible with the established customs of the Islamic banks.

2. The Islamic banks do not have the required conducive investment climate, which is suitable for the nature of the above methods of investment

4. As a result, the Islamic banks were left with no choice but to rely on the method of Murabaha which does not contribute to the creation of job opportunities which is Islamic banks can accomplish if profit sharing investment methods were adopted. (Yusree, 1995)

The Islamic banks also offer financing in the form of indirect facilities such as letters of credit and guarantees. No doubt, by these methods of financing, Islamic banks play a positive role in funding the external trade and development sectors.

3.3. Profitability Ratio

Islamic banks should have a future long-term plan to generate greater profits. This plan will lead to elevating the gross domestic product and developing society. Realizing the objective of making greater profits is a legitimate step as long as they are based on the Shariah principles and teachings.

If we look at the level of profitability of the Islamic banks in Palestine as shown by Table 4 we will find that the Islamic banks have modest earnings compared to conventional banks. The return on assets and return on equity for the Islamic banks are 1.9 per cent and 13.2 per cent respectively. The possible reasons for this lower earnings are:

a. These banks were established only recently which implies a high cost of operation.
b. Most of the Islamic bank investments have been invested externally (as we shall see later) and are characterized by low returns.

c. Islamic banks suffer from a lack of diversity in their investment portfolios because they mostly focus on al-*murabaha.*
d. Some Islamic banks have been engaged in non-profitable projects, which naturally affect their balance sheet. The output and the rate of growth of assets were even negative.
e. Islamic banks try to create profits for both depositors, and shareholders, whereas conventional banks try to increase the profit of the shareholders only. This means that the Islamic banks are under more pressure to gain more profits from its investments.

Table 4: Profitability Ratios(the mean ratio for 1996-2004)

Profitability Ratios	Islamic Banks (%)	Conventional banks (%)
Return on assets	1.9	2.0
Return on equity	13.2	20.0

Source: Palestinian Monetary Authority Annual Report 2004

3.4. Deposit Ratio

The volume of total deposits indicates and measures the ability of the Islamic banks to mobilize their economic resources. It also indicates the level of interest and confidence among the depositors in the Islamic banking system.

Table 5 provides an unequivocal indication that the share of the Islamic banks in the total deposits of the banking system is relatively satisfactory, especially if we take into consideration the recentness of its establishment less than one decade ago. Thus, Islamic banks in Palestine have succeeded in attracting considerable volume of customer deposits which is something that the Islamic banks in the Gulf countries have managed to do as well (Alsultan, 2005).

Table 5: Deposit Ratios (the mean ratio for 1996-2004)

Deposit Ratios	Islamic Banks (%)	Conventional banks (%)
Deposits /total deposits of the banking system	6.6	93.8
Investment (term) deposits/total deposits of the banking system	38.9	43.9

Source: Palestinian Monetary Authority Annual Report 2004

This gives the impression that the level of public confidence in the Islamic banking system is beneath the desired level. As such, the development responsibilities of the Islamic banks in the economic and social sectors need to be thoroughly refined. It is important to note that the public apathy in the Islamic banking system could be due to the fading religious awareness of the populace (Da'as, 2002).

As shown in Table 5 investment deposits represented 38.9 per cent of total deposits of the banking system in Palestine. No doubt, the rising level of investment deposits to the total deposits is a positive signal because the investment activities depend on the size of deposits. This will enable the banks to fund their projects although the nature and quality of these projects will depend on the nature and characteristics of the deposit and maturity duration of redemption for business ventures.

3.5. External Investment Ratio

In order to encourage banks operating in Palestine to increase the percentage of the internal investment of their own financial resources, and decrease the percentage of their external investment, the Palestinian Monetary Authority issued a guideline that required all the Islamic banks to specify the percentage of their external investment (Palestinian Monetary Authority Report, 2004).

Table 6 shows that external investments of Islamic banks in Palestine have reached 65.1 %.This indicates the big size of external investments, which gives a negative signal unless the external investment constitutes investments in Islamic investment institutions. This is to prevent Islamic financial sources from falling into the hands of foreign investors and speculators, who will exploit the resources for their own benefits, or even against the interests of Muslim nations.

Table 6: External and Internal Investment Ratios(the mean ratio for 1996-2004)

Ratios	Islamic Banks (%)	Conventional banks (%)
Percentage of external credit facilities	65.1	95.0
Percentage of internal investments facilities	34.4	4.4

Source: Palestinian Monetary Authority Annual Report 2004

If we compare the external investments of the Islamic banks in the neighboring countries, we will find that the external investment of Faisal Egyptian Bank reached 40% of the total investment processes in year 1983-1984 (Yusree, 1995)

External investments have some risks for the following reasons:

a. If Islamic investment institutions do not manage the external investments, they risk incurring heavy losses. These resources may fall into foreign hands, who may abuse and exploit them in a manner that may be against the tools approved by Islamic Shariah (Shehadah, 1998)
b. If an Islamic financial institution decided to invest its financial resources, it has to take into consideration the feasibility of the investment in terms of the percentage of returns and the developmental benefits of these investments.

Regarding the percentage of returns experience shows that external investment can bring high percentage of profits compared with internal investment. However, experience has also shown that sometimes external investments may suffer great losses due to reckless speculation as in the case of the international gold market (Yusree, 1995). As for the developmental benefits of external investments, it can be said that even if the expected percentage of profits is relatively high and guaranteed it will not compensate the cost of the lost opportunity of investing internally. This is because investing the financial resources internally will generate profit for the domestic economy and that internal profit will generate another one creating what can be called a multiplying effect. While, external investment will only generate one round of profit. Therefore, it is vital for the Islamic banks to persuade the Palestinian businessmen living abroad to invest their external financial resources internally.

Another issue is the depositing of money by the Islamic banks in external conventional banks for investment purposes. This act will also not benefit any party as the invested financial resources will be invested using the methods of investment applied by the conventional banks, which are based on the system of usury. (Jaber, 2000).

3.6. Internal investment Ratio

Internal investment facilities can be one of the most important factors that can contribute to the reconstruction and developmental process if they were given based on sound economic principles, which can be done by relying on the consultative board of the bank in directing its financial performance.

Table 6 shows that the total internal investments of Islamic banks in Palestine have reached 34.4% of its total investments, whereas internal investments of conventional banks constituted only 4.4% of its total investment. Even though this percentage is a positive indicator for the Islamic banks, some researchers still feel that this percentage is not adequate and that it can be improved tremendously if not for the following obstacles: Investors do not possess adequate property that can be used as collateral security for loans they request from the Islamic banks. In order to know the reason behind such a situation it is vital to briefly mention the types of properties that exist in Palestine, and which types can be used as a collateral security for loans. In general there are three types of properties in Palestine namely;

1. Properties that are registered in the department of land registry
2. Properties that are registered in the financial department and not the department of land registry.
3. Properties that are owned by the government

Islamic banks only accept the first type of properties as collateral security for loans. This means that the land must be registered in the department of land registry in order for it to be used as a collateral security for loans. However, since nearly 70% of the West Bank properties and 50% of the Gaza properties are not registered in the department of land registry, investors face great difficulties in finding lands that can be used as a collateral security for the loans they need.

b) Banking law does not allow the mortgage of industrial equipments. In normal circumstances a bank will buy the equipments for the investor and transfer its ownership rights to him, thereby allowing him to use it, and at the same time the same equipments will be mortgaged by the bank until the investor pays its full price. The lack of such an arrangement will directly affect the industrial sector, which is one of the important sectors of internal investments (Alhaj, 2002).

c) Islamic banks are hampered by the complex legal processes and the lack of a unified modern collateral lending law that protects the Islamic bank and makes it possible to foreclose on collateral security in the event of default on a loan given to an investor.

d) The lack of a suitable investment environment. By this the researcher means the lack of the vital factors that encourage the investors to invest in the country. These factors are economic, social, cultural, religious, and judicial. In addition to that are factors of security and stability. The lack of such factors is attributed to the attempts of the occupation authorities to integrate the economies of the West Bank, and the Gaza Strip into its own economy.

e) Lack of laws that are designed especially for Islamic banks, which means that the monetary authority will treat Islamic banks in the same way it treats commercial banks. Currently, there is no law that forces the customer of the Islamic bank to pay his/her instalments if he/she does not fulfil the conditions of paying them. This has forced the Islamic banks to abstain from funding long-term projects (Da'as, 2002).

In light of the above, the Islamic banks should strongly consider merging with each other so as to increase their financial capital and to be in a better financial position to compete with the conventional banks in the developmental sector, through the enhancement of the internal investment facilities in Palestine. Moreover, the merging banks will be able to benefit from the latest technological innovation, provide better services at lower cost, and withstand growing foreign competition in the domestic market.

3.7. Statutory Reserve Ratios

The data in Table 7 shows the percentage of supplementary and cash reserve ratios for both the Islamic and conventional banks. Both types of banks have abided by the regulations of the Palestinian Monetary Authority in regards to the cash reserve ratio (CRR), where they kept in reserve 8.4 per cent and 6.5 per cent of its total deposits and notes respectively. As for the supplementary reserve ratio (SRR) both Islamic and conventional banks kept 70 per cent and 73 per cent of its total customers' deposits as supplementary reserves respectively. This percentage is far higher than the required percentage of 25 per cent.

Table 7: Statutory Reserve Ratios (the mean ratio for 1996-2004)

Ratios	Islamic Banks (%)	Conventional banks (%)
Supplementary Reserve Ratio	70.0	73.0
Cash Reserve Ratio	8.4	6.5

Source: Palestinian Monetary Authority Annual Report 2004

The implementation of these two liquidity requirements proves that the Palestinian Monetary Authority applies the same policies to both Islamic and conventional banks. These policies that have been imposed on conventional banks are not suitable to the nature, rules and regulations of the Islamic banks. This has put the Islamic banks at a disadvantage because the currency liquidity policies imposed by the Palestinian Monetary Authority is compatible with the methodology and tools of the conventional banks, which allowed them to achieve their developmental objectives (Sarker, 1997).
The nature of business conducted by the Islamic banks is different from its conventional counterpart (as mentioned before). Therefore, the methodology and tools which Islamic banks use to achieve the targets of the liquidity policies required by the Palestinian Monetary Authority should be different from those used by the conventional banks. Thus, the policy of the central regulatory authority has become an impediment to the activities of the Islamic banks. It has had also some negative impact on the business of the Islamic banks and they have not been able to realize their developmental objectives.

To shed more light on the negative effects of the liquidity requirements imposed by the Palestinian Monetary Authority on the economic performance of the Islamic banks we can notice that many tools used by the Palestinian Monetary Authority for banks to maintain the required ratio of liquidity cannot be used by the Islamic banks due to the presence of interest in such instruments, which include among others the financial bonds. Hence, the Islamic banks are forced to rely on liquid currency to meet the ratio requirements set by the Palestinian Monetary Authority, and if we add to this problem the fact that the Palestinian Monetary Authority imposes stiff restrictions on the investment of the Islamic banks, it will result in over liquidity in Islamic banks, which will consequently result in less profits (Dawabah, 2005 & Rachid, 1990).

In addition, the implementation of the same statutory requirements on the investment deposits of the Islamic bank will also restrict and limit its ability to fully invest its resources, especially in long-term investment fields. Thus, Islamic banks will not be able to achieve their developmental and economic goals. (Sarker 1997, Al rabeeah, 1992).

In order to overcome the above-mentioned negative effects the researcher recommends that the Palestinian Monetary Authority should follow the example of Malaysia[2] whereby Islamic banks can maintain the required liquidity ratio in the form of government Islamic bonds so as to make sure that the reserves will not be idle and will be utilized effectively. Moreover, the assets used by the Palestinian Monetary Authority in determining the required reserve ratio should take into consideration the nature of the financial assets that are available to the Islamic banks, the nature of

[2] The first attempt to overcome the liquidity problem facing Islamic banks was undertaken by Bank Negara Malaysia in July 1983 ,after the first Islamic bank in Malaysia began operations ,as it was realized that Bank Islam Malaysia could not hold government securities or treasury bills that paid interest. Therefore, non –interest –bearing paper was issued, namely, government investment issues. which represented beneficial loans (qard hassan) to the government. There was no pre-determined rate of interest on these securities, rather the rate of return would be declared by the government at its absolute discretion. For more details see (Nathif J .Adam and Abdulkader Thomas. Islamic Bonds :Your Guide to Issuing and Structuring and Investing in Sukuk.2004)

liquid assets that can be utilized by the Islamic banks such as investment funds, and securities, and the nature of its investment deposits. By doing that the Islamic banks will not be forced to use vital amounts of its liquid currency to meet the requirements of the Palestinian Monetary Authority, and will instead use it to conduct long-term investments, which will help it achieve its developmental and economic goals.

4.Conclusion

In summary this study concludes that Islamic banking in Palestine has succeeded in executing its role in mobilizing deposits according to the Shariah. We can clearly see that the share of the Islamic banks in the total deposits of the banking system is relatively encouraging especially if we take into consideration the recentness of their establishment less than one decade ago. On the other hand, the Islamic banks have yet to succeed in utilizing these deposits. As shown by the financing to total deposit ratio the percentage of capital utilization by Islamic banks in Palestine has been relatively low compared with that of the conventional banks. It is also found that majority of these deposits were invested outside of Palestine. Because of legal impediments and political instability, internal investment is limited which implies the small contribution of the Islamic banks in financing the reconstruction and development of the Palestinian economy. Islamic banks in Palestine also experience excess liquidity. Taking into account of its infant status, the problems faced by the Palestinian Islamic banking sector in fund utilization is not surprising. Islamic banks in other countries are also facing similar problems. Hence, it is reassuring to know that research and development are going on in the Islamic banking services industry to find solutions to these problems through product innovation and financial engineering.

References

Abbadi 2004**,** *Islamic Banking: An International Per*spective, University Putra Malaysia.

Abdus Samad 2004, Performance of Interest-free Islamic Banks vis-a-vis Interest-based Conventional Banks of Bahrain, *IIUM Journal of Economics And Management*, Volume 12 Number 2.

Abdus Samad (1999), "Comparative Efficiency of the Islamic Bank vis-à-vis Conventional Banks in Malaysia", *IIUM Journal of Economics and Management*, 7 (1).

Abu Zaid. 1997 .*The Role Of Islamic Banks Between Theory And Practice*. Cairo: The International Institute of Islamic Thought.

Alhaj, Tariq and Idaas, Ghassan, (2003) Musahamat al masaref al eslamiah fe al nnashat al masrifi al eslami al filesteene, Mujult An najah, Nublus, Palestine, Mujald 17, No. 2, 2003Al rabeeah, Suad. 1992. *Tahwel al masraf al rabawe ela masrif islamee, manshoorat markz al maktootat we torath*, Kuwait

W. Al Sultan and other (2005) Finance Analysis of performance of Islamic Banks In GCC Countries. Journal of Islamic Banking and Finance, Vol. 22, April-June 2005, No. 2.

Chen, K.H., and Thomas Shimerda. 1981. An Empirical Analysis of Useful Financial Ratios. *Financial Management* 10, no. 1

Da'as, Ghassan,and Alhaj, Tariq 2003. Musahamat al masaref al eslamiah fe al nnashat al masrifi al eslami al filesteene, Mujult An najah, Nublus, Palestine, Mujald 17, No. 2, 2003.

Dawabah ,ashraf 2005,alalakah bayn albonook aleslameyah wal albank almarkazee,islam on line ,sho"oon ektesadeyah

Group of Economic Experts 1997. *The Economic Role Of Islamic Banks*. Cairo: The International Institute of Islamic Thought.

Hempel, George H., and Donald G. Simonson 1998.. *Bank Management*. New York: John Wiley and Sons, Inc.

Iqbal, M (2001), Islamic and Conventional Banking in the Nineties: A Comparative Study, *Islamic Economic Studies* (Jeddah: Islamic Development Bank), 8(2).

Jaber, Hisham 2001. Islamic Banking in Palestine Challenge and Prospects, *An Najah Univ. Journa*l. Res (H. Sej. Vol. 17 (1).

Libby, Robert. 1975. Accounting Ratios and the Prediction of Failure: Some Behavioral Evidence. *Journal of Accounting Research*, Spring 150-161.

Nathif J .Adam and Abdulkader Thomas. 2004. *Islamic Bonds :Your Guide to Issuing and Structuring and Investing in Sukuk*

O'Connor, Melvin C. 1973. On the Usefulness of Financial Ratios to Investors in Common Stock. *The Accounting Review*, April.

Rachid Ali Mohamad, The role of Islamic banks in economic and social development with particular reference to the Sudanese experience, Giasogow Collage 1990Radiah Abdul Kader and Husna Hashim 2005. Islamic Banking in Malaysia An Evaluation of Performance, *Economic Kaleidoscope* Su-Fei Yap et al (ed), University of Malaya Press Kuala Lumpur, pg 99-122

Ross, Peter S. 1991. *Commercial Bank Managem*ent. Boston: Irwin.

Sabi, Manijeh. 1996) Comparative Analysis of Foreign and Domestic Bank Operation in Hungary. *Journal of Comparative E*conomics 22, no. 2.

Sarker, Abdul Awwal 1997 Regulation of Islamic Banking in Bangladesh, *International Journal of Islamic Financial Services*, Vol. 2. No. 1.

Shehadah, Mosa 1998. *Dawr al bonook al eslamiah fe felesteen fe daw'a al tajrubah al ordiniah, al motamar al masrefee al awal*, mas, Ramullah, Palestine.

Yusree, Abdurrahman 1995. Albonook Alelameyah Wa Dawroha Fe Atannmeyah. Abank Aleslamee Letannmeyah , Jeddah.