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CASHLESS IN GAZA?

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SUMMARY

1.(S) Since the Hamas takeover, Israel has designated Gaza as a "hostile entity," and maintained an economic embargo against the territory. Under this designation, decisions on shekels in circulation in Gaza and the territory's economy in general are treated by the GOI as security matters, and therefore are subject to the same high level of uncertainty that the GOI uses to keep potential sources of security threat off-balance. Israeli officials have confirmed to Embassy officials on multiple occasions that they intend to keep the Gazan economy functioning at the lowest level possible consistent with avoiding a humanitarian crisis. The Palestinian Authority's request for a guaranteed "floor"

transfer rate of NIS 100 million per month will not be seriously considered by the GOI until after January 2009, when the Palestinian political situation becomes more clear. In any case, given the size of the population and economy in Gaza, GOI interlocutors find it implausible that the number of workers on the Palestinian Authority,s (PA) payroll there and the amount of money to be paid each month accurately reflect the current size of the territory,s civil service or its future government service requirements, nor do they agree with the PA's contention that these payments are buying loyalty. Furthermore, GOI officials doubt the effectiveness and authority of the Palestinian Monetary Authority (PMA) to regulate and police banks in Gaza. Israeli officials reject the PA,s argument that denying banks the liquidity to pay PA salaries in full bolsters the Hamas regime. While some acknowledge the gains to Hamas from a weakened formal banking sector in Gaza, they argue that such gains are small relative to the cost of giving Hamas greater access to shekels or the economic benefits they bring to Gazans. A USG policy that encourages the GOI to review its present policies (as requested by the Office of the Quartet Representative and the PA) while pressing the Israelis to approve as much funding each month as possible under security constraints, assisting the PA to improve its regulatory regimes and due diligence procedures, and continuing to foster direct dialogue between officials of the GOI and PA on Gaza issues in the monthly Joint Economic Commission meetings is our best bet for minimizing economic/political gains to Hamas in Gaza.

 GAZA IS A HOSTILE ENTITY

2.(C) While the GOI believes that maintaining the shekel as the currency of the Palestinian Territories is in Israel,s interests, it treats decisions regarding the amount of shekels in circulation in Gaza as a security matter. Requests by Palestinian banks to transfer shekels into Gaza are ultimately approved, partially approved, or denied by the National Security Council (NSC), an organ of the Israeli security establishment, not by the Bank of Israel (BOI). As part of their overall embargo plan against Gaza, Israeli officials have confirmed to econoffs on multiple occasions that they intend to keep the Gazan economy on the brink of collapse without quite pushing it over the edge (see reftel &D8). The PA's request to set an NIS 100 million floor on monthly transfers to Gaza is being looked at, but no action will be taken until after January 2009, when the Palestinians' political situation becomes more clear. Complicating the Gaza issue, and Palestinian banking as a whole, is Bank Hapoalim,s recent decision to terminate its correspondent banking relationship with the Palestinian

banking sector (see reftel &C8). Hapoalim remains determined to stand by its objective to sever ties on November 30, though observers have their doubts that Hapoalim will follow through on the initiative (septel).

3.(SBU) The GOI's monetary policy towards Gaza is consistent with its declaration that Gaza is a "hostile entity." Some observers have told Emboffs that political pressure arising from the issue of captured Israeli soldier, Gilad Shalit, may have influenced high-level Israeli officials to tighten their stance on monetary policy (see ref &A8). However, this has not been raised or confirmed by any high-level GOI contacts. The GOI position on cash to Gaza has remained negative since the Knesset's declaration that it was a hostile entity.

THE PAYROLL DILEMMA: WHO IS ACTUALLY RECEIVING PA PAYCHECKS
IN HAMAS-CONTROLLED GAZA?

4.(S) The PA contends that Hamas, ability to pay its workers, salaries each month combined with the inability of the PA to do so causes further deterioration in support for PA/Fatah relative to Hamas (reftel &I8). The GOI, on the other hand, believes that many of the estimated 77,000 wage earners on the PA's payroll may actually be Hamas members or affiliates. Israeli security analysts argue that a considerable portion of the civil service salaries that the PA attempts to pay each month to its Gazan employees actually find their way to Hamas or Hamas supporters (see reftel "D"). They have therefore determined that full coverage of the payroll is contrary to Israel,s security interests, even if Hamas gains some political advantage from being able to pay its salaries in full. Whether money finds its way into the territory by means of the PA payroll or the Hamas payroll, says the GOI, Hamas experiences a net increase in its funding. Israeli analysis suggests that it is best to deny the terrorist regime a larger pool of funds in Gaza, no matter the origin, preferring to minimize Hamas, ability to purchase weapons or equipment for use against Israeli civilians. Thus, they reject the PA,s argument that denying banks the liquidity to pay PA salaries in full bolsters the Hamas regime (see reftel &I8).

5.(S) Furthermore, GOI officials, while often praising the credentials of PA technocrats, doubt the effectiveness and authority of the Palestinian Monetary Authority (PMA) to regulate and police Palestinian, and especially Gazan banks. This double standard in the treatment of Gaza and the West Bank by the GOI is yet another example of how Gaza is becoming increasingly isolated from the West Bank, despite

the best efforts of the PA/Fatah to maintain unity. These issues come to the fore at the end of every month when the PA tries to make payment to its employees in Gaza.

HOW MUCH MONEY DOES GAZA ACTUALLY HAVE?

6.(S) Observers speculate as to the amount of shekels circulating in Gaza. The BOI has established a history of routinely approving all requests from the Palestinian banks to exchange spoiled shekel notes from Gaza for new notes. This is not a security issue as it does not increase the total number of shekels in circulation. In order to support a minimal level of commerce and provide for minimal necessities such as food, utilities, and medical supplies, analysts agree that there must also be a certain outflow of cash from the territory to Israel, the West Bank, or other countries. The September 11, 2008 report of the International Crisis Group Middle East Briefing estimates this outflow as 30 percent of Gaza's total shekel holdings each month. Unfortunately, since Gaza tends more and more towards a cash economy based upon movement of goods through its tunnels to the Sinai, it becomes increasingly difficult to estimate this amount with accuracy. Udi Levi (strictly protect), a high-ranking official in the Israeli security establishment, commented to Econcouns in October that at least 1.8 billion shekels are currently unaccounted for in Gaza.

WHO APPROVES THE INTRODUCTION OF NEW CASH TO GAZA?

7.(C) The NSC, an organ of the Israeli security and intelligence community, ultimately has the final say in permitting new liquidity into Gaza. When the PA or a Palestinian commercial bank ask to move shekel bank notes into Gaza, the request is usually submitted to the BOI. The BOI defers to the NSC though it may act in an advisory capacity to inform the NSC on the state of the Gazan economy or possible consequences of action or failure to act. When the NSC ultimately approves a particular amount, the IDF routinely permits the cash to enter Gaza. In determining how much new liquidity can enter Gaza at any given time, the NSC considers several factors, including the humanitarian situation in the territory. The NSC abides by the principal that Gaza should receive just enough money for the basic needs of the population but it is not interested in returning the Gazan economy to a state of normal commerce and business. The agency tries to approve a reasonable amount of new money for entry into the territory each month; however, it will not

permit any large scale transfer of assets from Ramallah-based banks to their branches in Gaza for fear of improving the purchasing power of entities wishing to harm Israel. NSC officials have been unable to advise econoffs of any particular formula used in arriving at a figure, but the fluid state of Gazan, PA, and Israeli politics make it difficult to anticipate factors that might have a bearing on the decision from month to month.

SO WHAT SHOULD THE USG DO?

8.(S) Embassy Tel Aviv has encouraged the GOI to review its policy on Gaza liquidity, as requested by the Office of the Quartet Representative and the PA. As noted above, we do not expect that review to result in any changes until the political situation between Hamas and Fatah becomes more clear, presumably after January 9, 2009. In the meantime, we believe the USG should continue to encourage the Israelis to approve as much funding as possible each month, consistent with our mutual political/security objectives in Gaza. We should continue to assist the PA to improve its regulatory regimes and due diligence. Finally, the USG should continue to promote use of the Israeli-Palestinian Joint Economic Committee as the appropriate venue for resolving Gaza liquidity issues.

Visit Embassy Tel Aviv's Classified Website:
<http://www.state.gov/p/nea/telaviv>

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