

## **Will regulatory instructions to increase capital base in banks add value to the national economy?**

Regulations by the PMA to raise capital base of banks operating in Palestine aims at increasing capital adequacy so that banks are able to face the competitive environment of regional and international markets and to keep pace with global developments in the banking sector. In the absence of interested investors, the increase in capital will most likely be derived from mergers.

Many questions are raised on the subject of mergers and its impact on the Palestinian economy, banks' performance, size of the lending portfolio and level of competition. Some international studies have indicated that as merged banks become larger they reduce the volume of lending to small businesses whereas small banks are more inclined to increase the volume of lending to small businesses. This may not be entirely true for the Palestinian economy which is less competitive but it must be considered.

In an ideal world, banks may benefit from mergers as they can further develop banking services and increase the volume of lending to revive the economy while creating more competition in the market. If the merged banks benefit from this process efficiently, that will lead to increase branch network which will make banks closer to more customers. With this structure in place, lending to SME customers will increase as further penetration to the SME market is more possible.

On the other side, it should be noted that there are many negative aspects resulting from mergers and raising capital which must be considered: it is difficult to integrate cultures and styles of work for different types of banks and this will result in termination of some jobs. Less banks will increase the possibility of monopoly and result in concentration of power within few entities. The smaller banks will exit from the market due to lack of investment feasibility. Therefore, it is very important to study in-depth all aspects of raising capital.

The rules of free market maintaining competitive environment must be implemented in order to avoid negative consequences. This may be done by applying solid governance principles. But still the main question is "Will this strategic change in the banking industry add value to the national economy or will it have a negative effect?" It may be worthwhile to reconsider the new regulations in order to better understand the consequences of this step.

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