

## 1 Palestine's economic structure and performance: introduction and overview

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### **One country – one economy, or two peoples – two economies?**

Any student of Palestine's economic history is inevitably confronted with the need to characterize the country's economy during the three decades of British rule (1919–48). At the heart of the matter lies the question whether Palestine should be viewed as a single economy or as a segmented entity, composed of two ethno-national economies, one Arab and one Jewish, coexisting under a single administrative aegis of the Mandate government.

In the uneasy history of Arab-Jewish coexistence in adversity, each of these two viewpoints had distinct and explicitly acknowledged political connotations. The "single economy" approach, adopted mainly by Arabs, was consistent with their political views and objectives, whereby Palestine was a single entity in which Jews, while entitled to individual rights, were by no means supposed to have any separate collective standing, let alone autonomy. The Jewish-Zionist position adopted the notion of a separate Jewish economy and promoted it both as a plan of action, while striving to form an autonomous body politic based on the "National Home" postulate, and as a factually justifiable distinction for reference and analysis (Metzer, 1982).

Another aspect of the debate, which has kept it alive in the scholarly literature, has to do with some methodological ambiguities as to what exactly constitutes an "economy," and what are the practical implications of that concept. These unresolved issues have led to two broadly defined schools of thought. One approach views the unified economic administration of the Mandatory government and the economic relations between Arabs and Jews as dominating attributes warranting the treatment of Palestine as a single economy. According to this school of thought, the socio-economic differences between the two peoples, while affecting the specific structure of the overall economy, are not sufficient evidence of ethno-national economic separation. The other approach regards the array of observed dissimilarities between Arabs

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and Jews as the decisive factor in modeling the country's "two-economies" fabric.<sup>1</sup>

In view of the vagueness of terms and diversity of viewpoints, it is worthwhile to delve a bit further into specifics. This is done in the following discussion, which elaborates on the conceptual and empirical parameters that ought to be considered before choosing a framework for the presentation and interpretation of facts and findings.

Conceptually, an economy could be defined as a locus of economic activities and transactions in the areas of production, distribution, or consumption, which is set apart from the rest of the "economic world" by various barriers to completely free and frictionless movement, in and out of that locus, of people, capital, or final goods and services (or of any combination of the three). These barriers may be determined by fundamentally objective factors, such as geographical conditions or the quality and cost of transport and information; they may be generated by more subjective policies and regulations; or they may simply reflect such elusive qualities as mental and social affinity to certain locations, customs, and traditions that form group self-identity and determination which may involve, among others, exclusionary attitudes toward the "other." Thus, in addition to the familiar regional, state, and national economies, one may discern distinct "economies," when appropriate, in religious, ethnic, or socio-economic terms, both within and across regions or countries.

Moreover, a given set of barriers may distinguish recognizable groups of people, specific modes of economic conduct, particular regions, or even entire countries as constituting distinct economies with respect to certain aspects of economic life, while remaining indistinguishable from a larger economic realm with respect to some other aspects. Observe, for example, a traditional rural economy in a developing country, one that is well defined by its modes of production and distribution and by its form of land tenure and utilization. The denizens of this rural economy may be indistinguishable from the urban population of the country with respect to, say, taxation or the provision of social services. Another case in point is the membership of individual nation states, with well-defined national economies, in supra-national economic structures (e.g., the EU).

Three major implications arise from these general observations. First and foremost they imply that the search for an "economy," which may by its very nature be a multi-dimensional frame of reference, cannot rely on an *a priori* definition or on a unified set of characteristics. Hence, the

<sup>1</sup> For a detailed discussion and summary of the literature dealing with the nature of Palestine's economy in the Mandate period see Owen (1982, 1988) and Kamen (1991), chap. 4.

question whether a certain community, location, or otherwise-defined locus of economic activity should be treated as a distinct economic unit is primarily a practical – even *ad hoc* – one. Its resolution hinges on the nature of the available data and on a cost-benefit-type assessment of the insights to be gained or lost by choosing a disaggregated versus a consolidated approach to the issues under consideration.

The second implication is that once an entity is deemed to be an “economy,” that title need not necessarily be considered an all-embracing concept. Therefore, in dealing with the entire scope of a community’s economic life, consideration should also be given to the possibility of its belonging to a number of “economies.”

The third implication, which follows naturally from the first two, is the clear distinction between an entity’s typical characteristics in the economic sphere, on the one hand, and the notion of its economic isolation or complete segregation from the broader economic surroundings, on the other. Note that while the former could justify the treatment of a community as a separate economy, the latter is neither required as a condition for economic segmentation, nor is it commonly observed.

Equipped with these general criteria, let us turn to the specific arena of Mandatory Palestine.

The peace agreements that ended World War I officially designated Palestine as a distinct entity, under British Mandate, in the newly emerging Middle East of the post-Ottoman era. Britain drew the final borders of the Mandate for Palestine in late 1922 (when Trans-Jordan was separated from it) and moved swiftly to consolidate the area west of the Jordan river into an administratively homogeneous unit.<sup>2</sup>

The Mandatory government provided the inhabitants of the country with an official “state” identity and citizenship, and created a unified civil administration with the following attributes: a well-defined legal structure enforced by state police and courts; a centrally designed and administered fiscal system; an integrated monetary regime, operated by the Palestine Currency Board in London; and, from 1927 on, a state currency (the Palestine pound). These institutional rules and means applied equally to all the inhabitants of the country, irrespective of ethno-national affiliation. As such, they constituted a common framework for the conduct of civil affairs, for internal economic activity and for external trade. If we add the modern transportation and communication infrastructure built and operated by the government (Reichman, 1971; Biger,

<sup>2</sup> For information and illuminating discussions of the administrative and institutional aspects of the Mandatory government see, among others, *Report* (1925); *Survey* (1946), vols. I, II; *Memorandum* (1947); Biger (1983); Makover (1988); and Reuveny (1993).

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1983; Gross, 1984b), there are grounds to argue that, besides contributing to Palestine's administrative integrity, the Mandatory government provided a solid institutional and operational foundation for the formation of a single economy (Owen, 1988).

But Britain's task as the League of Nations' Mandatory for Palestine was more complex than that. While legal and administrative equality in the treatment of the country's population was an unequivocal obligation, the Mandate carried an explicit commitment to the promotion of a Jewish National Home, as clearly embedded in its wording.<sup>3</sup>

The Mandatory shall be responsible for placing the country under such political, administrative and economic conditions as will secure the establishment of the Jewish national home, as laid down in the preamble, and the development of self-governing institutions, and also for safeguarding the civil and religious rights of all the inhabitants of Palestine, irrespective of race and religion. (Article 2)

The terms of the Mandate go into some detail in specifying the means and policies to be employed in realizing the National Home objective, laying special emphasis on the functions of an officially recognized Jewish Agency as

a public body for the purpose of advising and cooperating with the Administration of Palestine in such economic, social and other matters as may affect the establishment of the Jewish national home and the interests of the Jewish population in Palestine, and, subject always to the control of the administration, to assist and take part in the development of the country. (Article 4)

Specifically, the Mandatory was expected to cooperate with the Jewish Agency in settling immigrating Jews – whose influx was to be facilitated by the government – “on the land and waste lands not required for public purpose” (Article 6). The Mandatory administration was also advised to

arrange with the Jewish agency . . . to construct or operate, upon fair and equitable terms, any public works, services and utilities, and to develop any of the natural resources of the country, in so far as these matters are not directly undertaken by the Administration. (Article 11)

The embodiment in the Mandate of these two sets of policy guidelines, namely equal treatment of all the country's inhabitants and cooperation with the Jewish community and its representative bodies in establishing a Jewish National Home, highlighted the dual – and quite asymmetric – role that Britain had undertaken. The political impossibility of executing this double-edged policy, given the diametrically opposed objectives of the Arabs and the Jews, and the attempts made by the British government

<sup>3</sup> The text of the Mandate is reprinted in *Survey* (1946), vol. I, pp. 4–11; the following quotations are taken from there.

to modify it by distancing itself from the National Home postulate, are well-known features of the history of Mandatory Palestine, and need not be dwelt upon here.

For our purposes, however, it is important to emphasize that the distinct position of the Jewish community and its institutions, upheld by a government that was also attempting to equalize the *communal* (not merely the individual) treatment of Arabs and Jews, certainly contributed to the division of economic life along ethno-national lines (*Memorandum*, 1947; Owen, 1982; Metzger, 1982; Smith, 1993). Reference here is to the officially recognized national institutions of World Jewry (the World Zionist Organization and, from 1929 on, the Jewish Agency) and to the executive body (*va'ad leumi*) of the elected assembly (*assefat ha-nivharim*) of Palestine's "statutory Jewish community" (the *yishuv*).<sup>4</sup> Their official standing enabled these institutions to use their financial independence (secured mainly by Jewish unilateral transfers from abroad) to develop into a quasi-governmental public sector within the Jewish community, dedicated to the pursuit of the Zionist goals.

The activities of the national and communal institutions were mainly economic and socio-economic: acquisition of land, which was then turned into a publicly owned "national asset"; investment in agricultural settlements and other "nation-building" projects; and the provision of education, health, and welfare services to the Jewish community. In performing these functions, as was fully realized by the Mandatory government itself, these institutions provided the inputs needed for the development of a cohesive and self-reliant Jewish community, and consolidated its position as a viable economic entity (*Memorandum*, 1947; Gross and Metzger, 1978; and chapter 6).

The government, for its part, sought (*inter alia*) to compensate for the lack of comparably developed mechanisms in the Arab community. These considerations were particularly noticeable in the area of education, where government schools served the Arab population almost exclusively (*Survey*, 1946, vol. II, chap. XVI; Metzger, 1982; Biger, 1983). Consequently, the provision of public services, insofar as they were ethnically earmarked, added another dimension to the Arab-Jewish division and contributed to the socio-economic divergence between the two peoples (see chapter 6 for a more detailed discussion of the political economy of public economics in Mandatory Palestine).

<sup>4</sup> Note that while over 95 percent of the Jewish inhabitants of Palestine belonged to the "statutory Jewish" national community, certain separate, ultra-orthodox groups, notably "Agudat Israel," excluded themselves from the organized *yishuv* (at least partly), and were recognized by the government as a religiously distinct community (see *Survey*, 1946, vol. II, chap. XXII).

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All this leads to the conclusion that the diverse measures employed by the government in exercising its double role, and their (implicit or explicit) consequences, in no way prevents the postulate of two distinct economic entities, functioning within the unified Mandatory administration, from being a sound option for the analysis of Palestine's economic structure and development. In probing the usefulness of this option, *vis-à-vis* the "single economy" approach, let us now explore some of the institutional and socio-economic characteristics of the two communities.

On the Jewish side, the General Federation of Jewish Labor in Eretz-Israel (the *Histadrut*) emerged, in addition to the national institutions, as instrumental in shaping the autonomous structure of the *yishuv*. The *Histadrut* was founded in 1920 for the purpose of promoting the national and socio-economic objectives of the working class – which proclaimed itself the driving force of the Jewish "nation-building" endeavor – and of catering to the needs of the workers. The *Histadrut* rapidly evolved into a major multifunction organization. It incorporated 55 percent of Palestine's Jewish employees by 1923, and its membership reached a long-run stable proportion of 75 percent in 1931.<sup>5</sup> *Histadrut* members were enrolled in its centrally controlled federation of trade unions; they were provided with employment services by its labor exchanges; with health, social, and cultural services by its sick fund (*Kupat Holim*) and other institutions; and were also made owners of its conglomeration of production and marketing enterprises. In occupying such a central place in Jewish life, the *Histadrut* obviously complemented the national and communal institutions in establishing the *yishuv* as an autonomous socio-economic entity.

It should be stressed, though, that while concentrating on the promotion of the interests of Jewish labor – for instance, in struggling to achieve ethno-national segregation of employment – several attempts were made by the *Histadrut* to foster Arab-Jewish collaboration for the purpose of collective bargaining. In practice, however, these attempts were few and ineffective. Moreover, except for the single case of a common union of railroad workers (founded in 1923 and whose membership never exceeded 500), these efforts concentrated on the establishment of a "sister" Arab labor union to be federated with the *Histadrut*. Such a union – the Alliance of Palestine Workers – was indeed set up in 1932, and after all but disappearing in the turbulent years of the Arab revolt (1936–39), was reactivated during World War II, with a negligible membership of 2,500 (Horowitz and Lissak, 1978, chap. 2). In other words, by endoge-

<sup>5</sup> Employees include self-employed members of workers' cooperatives and of communal agricultural settlements – *kibbutzim* and *moshavim* (see Sussman, 1974, chap. 4).

nizing the ethno-national divide, while attempting to accommodate Arab workers, these moves could be viewed as an additional manifestation of the segregated coexistence of Arabs and Jews.

Another not unrelated aspect of the Arab-Jewish divide is revealed by the “economic destination” of the massive influx of Jewish immigrants and capital. The sizable supply of labor generated by waves of immigration over the entire period was absorbed, by and large, within the “economic boundaries” of the Jewish community. According to recently constructed estimates, about 96.5 percent of the 130,000-strong Jewish labor force in 1935 were either self-employed (including members of *kibbutzim*, *moshavim*, and workers’ cooperatives), or were employed by Jewish institutions and private employers; 3 percent were government employees; and a negligible 0.5 percent were either employed by or provided professional labor services to Arabs (Metzger and Kaplan, 1990, chap. 5). The same is true of imported Jewish capital: investments financed by these imports were confined to the Jewish economic sphere; there is no evidence of Jewish investment in Arab enterprises (or of Arab investment in Jewish projects, for that matter), or of joint ventures of any significance.

Shifting to geography, it can clearly be inferred from table 1.1 that the regional and local clustering along ethno-national lines, driven largely by the tension between Arabs and Jews, constituted another segregating factor. The Jews, led by the regional availability of land for sale and utilizing the geopolitical advantages of geographic consolidation, were building up their rapidly growing community by settling primarily in spatially contiguous areas stretching north along the coastal plain and then east through the northern valleys to the Jordan valley and north again to the eastern Galilee and the Huleh valley. The only area of major Jewish settlement lying outside this stretch was Jerusalem. Over 90 percent of the Jews in Palestine resided in only two well-defined regions: the central and northern coastal plain and Jerusalem. The Arabs, on the other hand, were concentrated in the central hilly region, with a more dispersed presence along the entire coastal plain and in the Galilee (Bachi, 1977, chap. 5).

Equally significant was the ethnic segregation between (and within) localities. Rural areas were completely segregated, since none of the villages and rural settlements had a mixed (Arab-Jewish) population. In the urban areas the picture was more complex. The share of Arab town-dwellers living in “all-Arab” towns – about 58 percent in 1922 – stabilized around 50 percent in 1931, with the rest residing in the country’s five “mixed” towns (Jerusalem, Jaffa, Haifa, Tiberias, and Safed). The proportion of the Jewish urban population living in “all-Jewish” towns had increased steeply from 22 percent in 1922 to 52 percent in 1946, along

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Table 1.1. *Regional distribution of Palestine's population (%)*

	1931		1944	
	Arabs	Jews	Arabs	Jews
coastal plain				
central and north	23.8	58.6	25.3	75.2
south	10.1	0.4	11.2	0.5
central range				
Jerusalem sub-district	11.5	31.4	12.2	18.1
others	32.2	0.1	29.0	0.0
northern valleys				
Galilee	1.3	1.6	1.6	1.7
Jordan valley	11.5	3.5	11.4	2.2
Negev	3.7	4.4	4.2	2.3
Negev	5.9	0.0	5.1	0.0
<i>all regions</i>	100.0	100.0	100.0	100.0

Sources: distribution calculations based on *Census of Palestine* (1933), vol. II, tables II, III; *Vital Statistics* (1947), tables A6, A7; Bachi (1977), tables 5.4, 5.5, and appendix 6

with a decline in the “mixed” towns’ share from 77 percent to 48 percent (*Survey*, 1946, vol. I, p. 148; *Supplement to Survey of Palestine*, 1947, pp. 12–13). It should also be noted that even in so-called “mixed” towns Arabs and Jews usually resided in separate, ethnically distinct neighborhoods.

Another characteristic is the difference in the rural-urban mix (table 1.2). Notwithstanding the significance of its town-based commerce and the rise in urbanization since the 1880s, the Arab community remained primarily a rural society. Its rural population share, while declining from its peak of 79 percent in 1880, did not shrink below 64 percent in the Mandate period, and the socio-economic organization of the typical Arab village remained largely “traditional” throughout this period. It was dominated by hierarchical lineage-descent groups (*hamulot*), and was still partly (though decreasingly so) based on communally held and periodically redistributed land (*musha'a*) within the village (Kamen, 1991; and chapter 4). The Jewish rural population share, on the other hand, although it rose from a negligible 0.7 percent in 1881, never exceeded 27 percent. Thus, despite the Zionist back-to-the-land ethos, epitomized by promoting agriculture as the focal activity of the Jewish “nation building,” the *yishuv* remained essentially an urban community.

This distinction is closely associated with the dissimilarities between the two communities in the composition of employment and production by industry. Of particular note are the differences in the labor and output



Table 1.2. *Percentage shares of rural population*

	Arabs	Jews
1880	78.6	0.7
1914	68.4	12.9
1922	70.9	18.1
1931	69.9	26.4
1946	63.9	26.4

*Sources:* Bachi (1977), tables 1.1, 1.2, A12, A13;  
McCarthy (1990), table 2.18

shares of agriculture and manufacturing. Over 50 percent of all Arab employed persons were engaged in domestic agricultural production, and no less than 30 percent of Arab product originated in agriculture, while the share of manufacturing remained less than 10 percent on both counts. The Jewish industrial structure had entirely different proportions: agricultural workers (Jews and Arabs employed by Jewish farmers) constituted less than 30 percent of total employment, and agricultural output accounted for less than 13 percent of total product. Manufacturing, which utilized between 16 and 20 percent of total labor before World War II (during the war this proportion came to exceed 30 percent), was the largest industry, output-wise, and generated about 20 percent of Jewish domestic product as early as 1922 (see chapter 5).

These dissimilarities, whose broader implications for secular growth, cyclical patterns of economic activity, and inter-communal trade are discussed below, obviously strengthen the case for the “separate economies” approach. It would therefore severely circumscribe our documentation and analysis of the economic record of Mandatory Palestine, if – besides treating such topics as the monetary apparatus, the balance-of-payments and trade policy, and the tax structure on an aggregate, country-wide basis – we failed to examine the economic life of each community separately, bearing in mind the interrelation between them.

It should be emphasized, though, as Owen (1982) has rightly pointed out, that the case for two economies should by no means be based on the assertion that economic relations between Arabs and Jews were either nonexistent or negligible. Such relations, as demonstrated below and in chapter 5, were, in fact, quite substantial, at least until the outbreak of the Arab revolt of 1936–39, and to some extent again in the course of World War II (see also Abramowitz, 1945). Furthermore, precisely the same marked dissimilarities that distinguished the two economies from one

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another were largely responsible for their different comparative advantages, and were thus instrumental in facilitating bilateral trade (see below).

Granted the appropriateness of the “two units” approach, the question is whether the ethno-nationally divided economy of Mandatory Palestine could usefully be treated within a more generalized framework. Following Sussman (1973) and Horowitz and Lissak (1978), I have argued elsewhere (Metzger, 1982; Metzger and Kaplan, 1985) that the “dual economy” notion serves this purpose well. However, since various versions of “dualism” can be found in the literature,<sup>6</sup> and since some doubt has recently been cast on the appropriateness of the concept in the context of Mandatory Palestine (Kamen, 1991, chapter 4), a clarification regarding the meaning of “economic dualism” in our particular context is called for.

Let me start by way of elimination. In applying the dual-economy approach to Mandatory Palestine I do not allude to any of the variants of (social) dualism (stemming from the work of Boeke, 1953, and widely used in the sociological literature) that characterize a dual economy as consisting of a market-oriented, modern sector functioning alongside a traditional sector that is only marginally responsive, if at all, to market signals. The concept that I refer to is a rather generalized notion of “economic dualism”: the coexistence, within some broader frame of economic reference (state, region), of two interacting economic sectors that differ from one another in level of economic development, *both* of which are “rationally” responsive, in the economic sense, to their respective environments and material opportunities and constraints.

More specifically, reference is here to economic units that differ from one another on the following Kuznetsian developmental counts: urbanization, the weight of agriculture (versus manufacturing industry) in employment and production, the institutional structure of farming and the nature of the financial markets, the extent of school enrollment, the skill composition of the labor force, and the level of income per capita (Kuznets, 1973; Chenery and Syrquin, 1975).

The less developed, or so-called (somewhat misleadingly) “traditional” sector is typified by substantial peasant-based husbandry and by other small “household” firms, all of which are often served by dated financial instruments of a personal nature. This sector is also typically distinguished by being relatively non-urbanized and under-industrialized, by poor school attendance, and by low levels of income per capita. The advanced sector (designated as “modern” in the development literature)

<sup>6</sup> See Meier (1989), chap. III, for a critical review of the literature.