The Emergence of Israel's Security Market: A Note

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Prior to World War I, Palestine was an underdeveloped province of the Turkish Empire, with barely an elementary commercial banking system, let alone an organized long-term capital market. Only thirty years later, however, the new State of Israel was able to confront the economic challenge of statehood with the institutional framework of a formal domestic capital market already in place. This article analyzes the salient economic and social forces which led to the emergence of a viable domestic security market in Palestine during the later years of the British Mandate.

THE DOMESTIC CAPITAL MARKET IN THE 1930s

Prior to 1933, Palestine had no institutional framework for mobilizing domestic resources for financing public or private enterprise. A formal market did not exist and securities trading was almost unknown. Between 1920 and 1933 the local capital market's contribution to economic growth was practically nil.[1]

The Nazi assumption of power in Germany marks a turning point for the economic development of Palestine in general, and the security market in particular. The influx of immigrants from Germany and central Europe in the 1930s had a two-fold impact on the domestic capital market. First, many of the middle-class German settlers possessed considerable capital funds and were already accustomed to investing part of their savings in securities. Between 1933 and 1935 almost 15 thousand registered Jewish immigrants qualified as "capitalists," that is, they possessed more than £1,000 sterling.[2] Second, and perhaps more important for the long-term development of the local capital market, the German immigration provided a nucleus of bankers and brokers with considerable experience in the technical aspects of securities trading.

The period from 1933 to 1937 marks the birth of a new issues market for securities in Palestine. During these years capital was for the first time raised by public subscription in the domestic market, nine companies issuing securities to the public totaling 3.6 million Palestine pounds (see Table 1).[3]

One notable feature of these nine companies is their *public nature*. The Zionist Organization controlled five of them, the General Federation of Labor (Histadrut) controlled one, and the Zionist Organization and the Histadrut jointly controlled the two others. The only privately controlled firm that issued shares to the public during this period was an investment company established by German immigrants. The public nature of the firms is also reflected in their economic activities: with the exception of the

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[1] See Alfred Bonné, *Palestina: Land und Wirtschaft* (Leipzig, 1933).

[2] However, since such status exempted the immigrant and his family from the provisions of Palestine's Immigration Ordinance, not all of these immigrants may have been in bona fide possession of their declared capital resources. See *Palnews Economic Annual of Palestine* (Tel Aviv, 1936), p. 79.

[3] From 1928 to the end of the British Mandate in 1948, the Palestine pound was pegged to sterling at an exchange rate of one Palestine pound equals one pound sterling.

TABLE 1
NEW SECURITY ISSUES IN THE TEL AVIV CAPITAL MARKET, 1933–1937
(£P thousands)

Issuing Company	Value at Issue Price[a]
BIZUR	£P 79
General Mortgage Bank	2,454
Investment Corporation of Palestine	20
Jewish National Fund[b]	190
MEKOROTH	48
NIR	365
Palestine Agricultural Settlement Association	115
Palestine Land Development Co.	273
RASSCO	56
Total	3,600

[a] In the absence of the issue prices, nominal values are used.
[b] Issued in sterling to German immigrants. The proceeds have been converted to Palestine pounds at the official exchange rate of one pound sterling equals one Palestine pound.
Sources: Data collected from Jacob Japhet & Co. Ltd., *Palestine Securities*, Jerusalem, March 1937; and the Anglo-Palestine Bank Ltd., *Handbook of Palestinian Securities*, Tel Aviv, March 1947.

investment company, all were connected with land development, with urban or rural settlement, or with the financing of these activities.

THE ROLE OF GERMAN TRANSFERS

The sudden emergence on a relatively large scale of a domestic new issues market for securities cannot be properly interpreted without first examining the manner in which the capital resources of German immigrants were transferred to Palestine during the 1930s. When Hitler came to power in 1933, the organized persecution of the Jews in Germany led to emigration, but the refugees were not permitted to take their capital. Owing to restrictions placed by the German government on capital exports, a way had to be found to enable German Jews emigrating to Palestine to transfer their money. The resulting agreements between the Jewish Agency and the German government had far-reaching implications for Palestine's economy, and comprised the most important single factor shaping the development of the domestic security market during the 1930s.

In order to facilitate the transfer of capital from Germany, a trust company, Ha'avara Ltd. (Hebrew for "transfer"), was established in the fall of 1933. The founders' shares were held by the Anglo-Palestine Bank.[4] The company was established as a non-profit institution, and its board of directors included representatives of the Jewish Agency, the National Council, the Association of German Zionists, the Association of German Settlers in Palestine, and the Anglo-Palestine Bank. The company's objective was to "organize the export of Jewish capital from Germany and its transfer to Palestine."[5]

From November 1933 until the middle of 1939 German Jews transferred a total of 138

[4] See *Palnews Economic Annual of Palestine* (1937), p. 210. A trust company in Germany owned by APB and two German Jewish banks acted as correspondants.

[5] Quoted from *Palnews Economic Annual of Palestine* (1939), p. 169. In a somewhat broader context, the company viewed its primary objective as "promoting the immigration of German Jews," ibid., p. 170.

million Reichsmarks (RM 138 million) through Ha'avara. This amounted to about £8 million, which represents an average discount of 30 percent with respect to the official exchange rate. This "transfer loss" largely reflects German restrictions on currency transactions, as well as the expenses incurred by Ha'avara in facilitating the transfer. Over the period the transfer of cash and goods from Germany became increasingly difficult. While substantial amounts could be transferred in cash during the early years of the Hitler regime, German currency restrictions became increasingly stringent.[6] In April 1936 the German government decreed that from that date only the £1,000 ("Vorzeigegeld") necessary to secure a "capitalist visa" could be transferred in cash.[7] Additional amounts could be transferred only in the form of goods; and it is with this transfer of goods via Ha'avara that we are primarily concerned.

The transfer of goods was often extremely complex, but in general it worked as follows. A German candidate for immigration transfered his Reichsmarks to Ha'avara, which in turn deposited them in a special blocked account at the Reichsbank. These marks were then made available to Palestinian importers, who used the marks to pay for their orders of German goods. The payments in Palestine currency received by Ha'avara from these importers were then transmitted to their registered German transferors. Since German goods tended to be overpriced at the official rate of exchange, a bonus was paid to the importers in order to induce them to used the blocked marks. As a result, the German Jewish emigrant suffered a "transfer loss," that is, the effective exchange rate on such transactions was lower than the official rate.

Numerous variants existed.[8] Ha'avara sometimes obtained permission from Germany's standstill creditors to use Ha'avara marks, rather than the "Register marks" of the standstill creditors, in making remittances designed to support Jewish institutions and individuals in Germany. In this manner the foreign currency formerly remitted by relatives and friends of German Jews was made available to Jewish emigrants. Here again, the rate of exchange on these transactions was less favorable than the official rate. In addition, emigrants were also permitted to use "Ha'avara" blocked account marks in order to purchase goods intended for their personal use or for the establishment of an enterprise in Palestine. The import of such goods, however, was carefully controlled by Ha'avara, which was in contact with the Manufacturers Association in Tel Aviv. In general, this type of "self transfer" was not allowed for the purchase of goods destined for resale in Palestine.[9]

The demand for transfer through Ha'avara became so great that by the middle of 1937 a balance of RM 8 million awaiting transfer had accumulated in the special blocked account at the Reichsbank, while an additional backlog of RM 90 million (£4.5 million) had been registered with Ha'avara by German Jews planning to emigrate.[10] The latter sums were to be paid into Ha'avara's special account in the Reichsbank as soon as transfer could be arranged.

To expedite the transfer, the blocked marks could be used to purchase securities issued by Palestinian companies, which in turn used the marks to import machinery and other equipment from Germany. But since many of these securities were overpriced, they could subsequently be sold in the open market in Palestine only at a substantial loss; upon resale these losses often exceeded 30 percent of the capital value invested.[11] Combined with the exchange-rate loss suffered in acquiring the blocked marks, the

[6] During 1933/4 the Reichsbank allocated 2.3 million pounds for emigration transfers, see *Palnews Economic Annual of Palestine* (1938), p. 105.

[7] See "Ha'avara Activities," *Palestine and the Middle East* (1937), p. 407.

[8] See E. Kahn, *Der Effektenmarkt als Mittel zum Aufbau Palastinas* (Jerusalem, 1937).

[9] See "Ha'avara Activities," p. 407.

[10] Ibid.

[11] See Kahn, *Der Effektenmarkt als Mittel zum Aufbau Palastinas*, p. 52.

transfer through the purchase of securities often involved a total "transfer loss" of over 50 percent, that is, the effective exchange rate (Reichsmark to Palestine pounds) was more than double the official rate.[12]

In order to gauge the impact of these security transfers on the domestic new issue market, it is sufficient to note that, with two exceptions (Bizur and the General Mortgage Bank) all of the remaining *domestic* issues of bonds and preference shares, between 1933 and 1937, were effected through the Ha'avara system. And this holds true for 1938/9 as well. It appears highly probable that, were it not for the catastrophe which befell German Jewry in 1933, most of these issues could not have been made at all; but it is a virtual certainty that the vast majority could not have been sold without a large price discount.

The purchase of these issues by German Jewish emigrants in order to effect an immediate transfer of their capital clearly had no economic motivation in the narrow sense of the term. Confronted by the great danger involved in waiting for a "cash transfer," the purchase of these securities represented a premium, paid to expedite the capital transfer, rather than an investment as such. Perhaps the closest analogy is provided by the forced loans demanded by governments in times of economic crises. It is this *captive* nature of the market, more than anything else, which enabled Palestinian firms to raise relatively large amounts of domestic capital, and this also helps to account for the public nature of the issuing firms.

Since the German immigrant had to sell the securities in order to obtain cash, the Ha'avara transfer also created a need for a secondary market for the trading of securities. Although trading took place on a very small scale during the late 1920s, the scope of security transactions broadened substantially after 1933, as immigration from Germany accelerated. It was not until 1935, however, that steps were taken to establish a formal centralized market for securities trading. The immediate cause for establishing a formal market was the Abyssinian crisis, which led to dumping of securities by nervous investors.[13] In September of that year representatives of Palestine's leading banks met at the initiative of the Anglo-Palestine Bank to establish the Tel Aviv Securities Clearing House. In 1953, the Clearing House was reorganized as the Tel Aviv Stock Exchange.

THE IMPACT OF THE SECOND WORLD WAR

Under the impact of Great Britain's initial setbacks in the war, prices of both bonds and stocks weakened. Italy's entry into the war was marked by a general financial crisis, but security prices recovered, and during the last years of the war the trend of all securities was generally upward. This recovery reflected the buoyant economic conditions which prevailed in Palestine during those years, the sharp rise in personal incomes, and the rapid accumulation of liquid assets.[14]

[12] Ibid. Kahn gives the following example. The immigrant pays RM 20.40 for a Palestine pound rather than the official rate of RM 12.38. He then effects an immediate transfer by purchasing PASA 4 percent bonds issued for this purpose at par, which on the open market subsequently could only be sold for, say, 70 percent of par. The combined exchange rate and security transfer losses in this case mean that in effect the immigrant transfered only 42 percent of his initial capital, valued at the official exchange rate. Kahn adds that even worse examples can be found. It should be noted that two decades later the West German government paid compensation to many of these immigrants for the "transfer losses" incurred in the 1930s. (I am indebted to the late K. Klopfer for this observation.)

[13] See *Palestine Economic Review* (1945), p. 14.

[14] The economic development and structure of Palestine during the British Mandate are critically examined by N. Gross, "The Economic Policy of the Mandatory Government in Palestine," *Research in Economic History*, 9 (1984); N. Halevi, "The Economic Development of the Jewish

TABLE 2
NEW SECURITY ISSUES IN THE TEL AVIV CAPITAL MARKET, 1944–1945
(£P thousands)

Issuer	Value at Issue Price[a]
Bonds	
Palestine Government	£P 5,000
Anglo-Palestine Bank Investment Co.	200
ATID Navigation Co.	50
BIZUR	125
PASA	150
RASSCO	50
Total	5,575
Stocks	
Africa Palestine Investment Co.	50
ATA	242
KOOR	250
LODZIA	150
MEKOROTH	150
NIR	250
Palestine Central Trading Co.	150
Total	1,242
Total Securities	6,817

[a] In the absence of issue prices nominal values were used.
Sources: Complied from Anglo-Palestine Bank Ltd., *Handbook of Palestinian Securities*, Tel Aviv, March 1947; and *The Palestine Economist*, January 1946, p. 9.

The closing years of the war also witnessed the renewal of activity in the domestic new issues market (see Table 2). Two features stand out. The mandatory government first appeared as a supplier of securities to the local market. During the last two years of the war the Palestine government floated three series of bearer bonds totaling £5 million. These issues represent the first *large-scale* financing effected in the Tel Aviv market. Second, 1944/5 saw a spurt of new corporate issues. Despite the competition of government financing, a relatively large number of new issues were floated by local firms in 1944/5, after the wartime restrictions on such issues had been relaxed. One striking feature of the renewed activity was the appearance of industrial concerns in the market.[15] The country's two leading textile manufacturers, ATA and Lodzia, floated shares at this time, and Palestine's first closed-end investment company (APB Investments) also made its appearance. In general, the list of issuing companies contrasts sharply with that of the 1930s.

Several factors combined to create a favorable economic climate for the emergence of a viable domestic securities market during the closing years of the war. Palestine's industries had expanded greatly during the war in order to meet the growing demand of

Community in Palestine 1917–1947," Maurice Falk Institute for Economic Research in Israel, Discussion Paper 7914 (Nov. 1979); N. Halevi, N. Gross, E. Kleiman, and M. Sarnat, *Banker to an Emerging Nation: The History of Bank Leumi Le-Israel* (Tel Aviv, 1981); J. Metzer and O. Kaplan, "Jointly but Separately: Arab-Jewish Dualism and Economic Growth in Mandatory Palestine," this JOURNAL, 45 (June 1985); R. Nathan, O. Gass, and D. Creamer, *Palestine: Problem and Promise* (Washington DC, 1946); and R. Szereszewski, *Essay on the Structure of the Jewish Economy in Palestine and Israel* (Jerusalem, 1968).

[15] The rapid expansion of manufacturing during the war years is examined by N. Gross and J. Metzer, "Palestine in World War II: Some Economic Aspects," Maurice Falk Institute for Economic Research in Israel, Discussion Paper 8701 (Feb. 1987).

the allied forces for local goods and services.[16] This expansion resulted in rising personal incomes, the accumulation of relatively large liquid balances, and a sharp rise in prices. Finally, owing to wartime restrictions, both Palestinian firms and investors were effectively isolated from foreign capital markets.

CONCLUSION

In view of the artificiality of the domestic security market during the 1930s, the true emergence of the new issue market in Palestine should more properly be dated from the closing years of the Second World War. Although the incipient security market suffered severe setbacks during the early war years, activity was resumed in 1944 and 1945. This reflected the sharp expansion of the domestic economy in general, and of industrial output in particular, the resulting rise in personal incomes and liquidity, and the country's wartime isolation from foreign capital markets. The country's leading industrial concerns made their first appearance in the domestic security market, and the primary motivation for financing and investment decisions was now economic. It should be noted, however, that when economic forces did permit the creation of a viable domestic capital market, the Palestinian economy could call upon the institutional framework and nucleus of experienced investment brokers and securities dealers which was already in place as a result of the German immigration and the Ha'avara system of the 1930s.

[16] Ibid.