Iqtisadi

Middle East Economy

Tel Aviv University — The Moshe Dayan Center for Middle Eastern and African Studies

Editors: Paul Rivlin and Yitzhak Gal, Assistant Editor: Tal Fuchs **Vol.1 Edition no. 1 May 2011**

Table of contents:

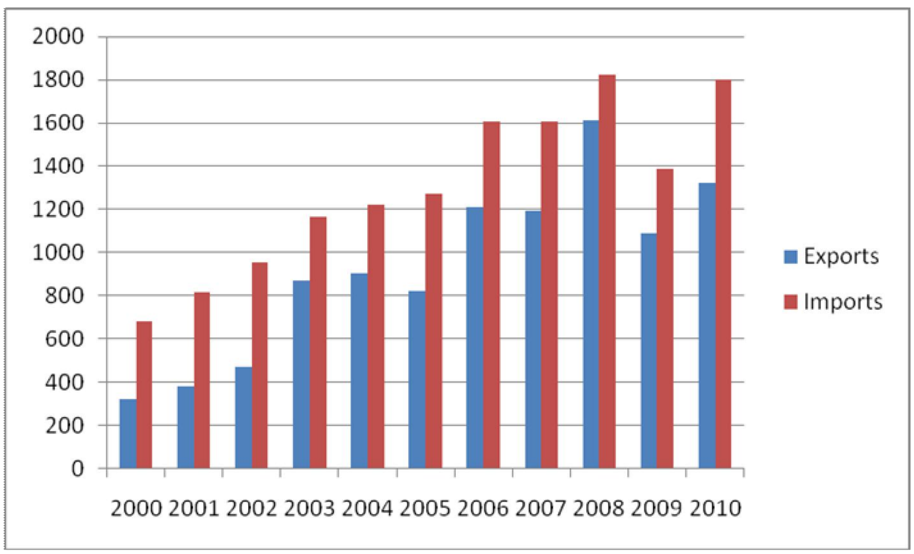
Israel's Trade Relations with Turkey: An Update

Paul Rivlin

In recent years Israel's political relations with Turkey have deteriorated sharply. How has this affected trade between the two countries? The development of imports and exports of goods is shown in Table 1 below.

Table 1

Israeli trade with Turkey (goods)



The table shows the rapid rate at which trade developed between 2000 and 2010, with Israeli exports to Turkey quadrupling and imports from Turkey increasing by a factor of 2.6. The figures for 2009 show a fall in exports and imports as a result of the international finance crisis that affected international trade worldwide. (In 2009, the volume of international trade fell by 12 percent and, in 2010, it recovered with a growth of 14.5 percent.) In 2010, Israeli exports to Turkey were 22 percent higher than in 2009 but were 18 percent below their 2008 peak. Imports from Turkey recovered, almost reaching their 2008 peak. Figures for the first quarter of 2011 are also encouraging. Israeli exports to Turkey were 14 percent above their first quarter 2010 level and imports were 36 percent higher. A word of caution is, however, necessary: trade deals take time to negotiate and implement. Thus, the effect of the worsening political environment may yet show on trade figures. Despite the political environment, it should also be noted that Israeli official trade data does not include military exports that remain significant, but which are not expected to maintain this status in the near future.

In 2010, 48 percent of Israeli exports to Turkey were chemicals; 16 percent were plastics; 12 percent were metals; eight percent were machinery and electrical equipment; and three percent was optical, photographic and measuring equipment. Israeli imports from Turkey were dominated by machinery, vehicle and electrical equipment (32 percent); stone and metals (32 percent) minerals, chemicals and plastics (15 percent); textiles (10 percent) and foodstuffs and animals (six percent).

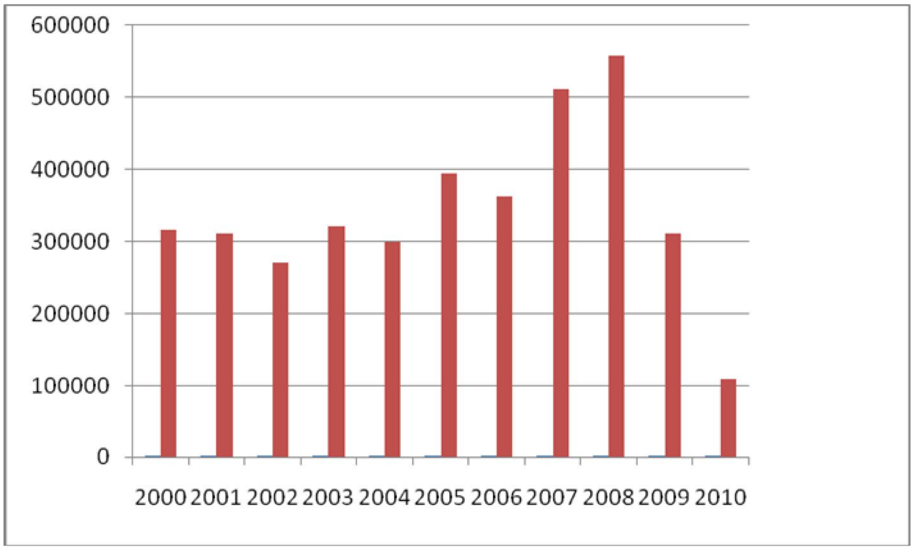
Israeli exports to Turkey are dominated by products for industry, agriculture and services such as software and irrigation equipment. These products are far from the public eye and those who wish to boycott Israeli goods in Turkish supermarkets will find little to protest about. The business community, which profits from Israeli technology and other products, has indicated that it wants to avoid the politicization of trade. Turkish products in Israel are more visible to the public, but there again, there is little evidence of a boycott. It is still the competitiveness of products that determines if they are sold.

One of the factors that will influence future trade volumes is the level of investment by Israeli companies in Turkey and Turkish companies in Israel. This may have been affected by the international financial crisis and by the political relations between the two countries. However, given the timescale of investment projects, it is too early to determine whether it has been affected.

Tourism is much more sensitive to political changes and is much quicker to respond. This is shown in Table 2 which shows the number of Israelis who visited Turkey.

Table 2

Israeli tourists visiting Turkey



The table shows very strong growth from 2005 until 2009 and a rapid fall since then. The figures for 2010 are the lowest for over a decade. In 2000, Israelis accounted for three percent of the tourists who visited Turkey; in 2010 they accounted for 0.4 percent. The number of Turks visiting Israel has always been small. In so far as tourism has been negatively affected by politics, an improvement in relations is likely to bring about a recovery in the number of Israelis visiting Turkey.

The Economic Causes and Consequences of the Uprising in Egypt

Paul Rivlin

For the new military rulers, the pressures to change economic policies and to improve conditions in the labor market are immense. Achieving this, while retaining the confidence of the international financial community will not be easy.

The average Egyptian subsists on a very low wage and, as a result, many of those who are employed live in poverty. The distribution of income is very unequal and 40 percent of the population (over 30 million people) has an income of $2/day or less. Some 30 million Egyptians are illiterate. In 2008, the minimum wage was set at $70/month. In October 2010, an Egyptian administrative court upheld an earlier verdict that forced an unwilling government to set the official monthly minimum wage at 1,200 pounds ($207) for public and private sector employees, most of whom earn between 200 and 500 pounds, much less than the minimum wage rate. Although in recent years the economy has grown by about five percent a year, employment growth has been limited. Furthermore, the pattern of employment growth has been problematic. Between 1997 and 2005, employment increased by 4.3 million, under half a million a year. Of these: 2.5 million were in services; one million in agriculture; 700,000 in construction, but only 85,000 in manufacturing industry. This is the sector that, more than any other, competes or should compete in international markets. It is the sector that has been at the forefront of China's growth and the huge reduction in poverty that has occurred there and elsewhere in East and Southeast Asia.

One year ago, the IMF issued forecasts for the balance of payments for the fiscal year 2010-2011, ending in June 2011. It forecast a trade deficit of $30.5 billion and a current account deficit of $5.5 billion. The difference between the two was largely made up of revenues from services but the collapse of tourism means that the current account deficit will be larger. Tourism revenues were forecast at $14.2 billion and the government has said that Egypt has lost up to $1 billion/month. Remittances of Egyptian workers abroad were forecast at $7.5 billion. As result of the conflict in Libya, tens of thousands of Egyptian workers have fled home. According to the United Nations, about 1.5 million Egyptians worked in Libya, and sent at least $250 million in remittances home, every year. The ability of the Egyptian economy to employ these workers was very limited and that was why they went abroad to work. Its ability to absorb them now is even more limited. Foreign investment, forecast at $9.2 billion, is now expected to be much lower. These inflows, together with sales of oil and gas were the main sources of revenue and covered much of the huge import bill. That is why Egypt is asking for aid, including US debt-forgiveness of $3.6 billion.

One of the main reasons for Egypt's socio-economic problems is its reliance on rental incomes that are largely determined by foreign demand rather than on domestic production. The balance of payments is funded by inflows of remittances of Egyptian emigrants, revenues from tourism, Suez Canal tolls, oil and gas exports and foreign aid. Although exports of manufactured goods have increased, they play a much smaller role than in countries that have successfully industrialized. Rental incomes depend as much on what happens abroad as what happens at home and this means that the economy is exposed to the whims of international trends. While this applies to manufactured exports as well, domestically determined competitiveness plays a greater role there.

As a result, the benefits of growth have been smaller than in other countries. One consequence is that 87 percent of Egyptian households have an annual income of less than $1,000, while three percent have a yearly income above $2,000. This compares with 50 percent of Chinese households who have an income of less than $1000; and 19 percent who have over $2,000; and 66 percent of Indian households with incomes below $1,000 and 12 percent with more than $2,000.

Not only is unemployment understated, but so is the inflation rate. In 2010, the inflation rate was 12 percent, but food prices rose by 20 percent. As food accounts for 40 percent of the average Egyptian's expenditure, sensitivity to food price inflation was something that contributed heavily to unrest in Egypt. In April 2011, food price inflation has been estimated at an annual rate of 50 percent.

The finance minister has sharply revised forecasts for economic growth in the fiscal year to mid-2011 to 2.5 percent. Earlier forecasts have been cut from six to four percent. He said Egypt would try to secure aid from the United States and the Gulf Arab states, and he indicated that some immediate measures would be introduced to increase new employment, including infrastructure projects. In an attempt to restrain the rise in prices, subsidies have been increased and this has pushed up government spending and the budget deficit. Estimates of the budget deficit have increased from 7.9 percent to 12 percent in fiscal 2011-2012. The International Monetary Fund lowered its estimate of Egypt’s economic growth in 2011 from five percent to one percent, and Moody’s Investor Services downgraded the Egyptian government bond rating from Ba3 to Ba2.

The Egyptian pound has come under pressure, repeatedly, forcing the Central Bank to step in at least once to support the currency. That pressure has reflected negatively on the country, adding to the unease that also led to Egypt's sovereign rating taking a hit, and the ratings of several major banks were also affected. The foreign reserves dropped to $30.1 billion in March, a 10 percent fall on the previous month. The fall was linked to the Central Bank's intervention to support the Egyptian pound and in foreign capital inflows. The stock market, shuttered for nearly two months, reopened on March 23, and has been seesawing between gains and losses, with institutional investors and foreigners behind much of the selling that has battered company share prices.

The government faces huge challenges. An official indication of the damage is reflected in the fact that the government created an $850 million fund to compensate people for property damaged during the protests. It needs to generate employment for millions of unemployed and semi-employed workers; and this requires large-scale investments. Such a program requires billions of dollars of investment and organization, neither of which the government has. One source of revenue would be a more equitable and effective tax system, but this may discourage the private sector that needs all the encouragement it can get. Taxing private monopolies that flourished under Mubarek as a result of personal connections with the leadership would be popular with the public and the military, but whether this can be organized remains to be seen.

Government plans include a focus on infrastructure construction, business development and “mega national projects” to spur growth and create jobs. One of these projects is to create an economic corridor that would move nine million people to the western part of the country creating an economic area similar to Hong Kong. The “Desert Development Corridor” plan includes the construction of an eight-lane superhighway, a railway, a water pipeline, and a power line. The goal of the plan - at an estimated cost of $24 billion - is to improve the water supply and open new land for agriculture, urban development, and tourism.

Will the regime be able to deal with rampant corruption and cronyism that have resulted in the loss of billions of pounds in tax revenues? Will it be able to control monopolies owned by those who were close to the former leadership? Will it be able to improve the infrastructure: there is a huge housing shortage with millions, living in substandard accommodation including graveyards? Will it be able to improve literacy among the 34 percent of the adult population who cannot read and write? Will it be able to change the pattern of growth so as to create more jobs in sectors that are internationally competitive? These are complex and interrelated issues. The Egyptian economy progressed under Mubarek, but gaps widened and political repression was the order of the day. It was the combination of these factors that led to the explosion, but Egypt remains under army rule, and it is the armed forces who will determine the future. Political stability is a pre-condition for economic development. Egypt will have no alternative but to import capital to help fund investment, but only time will tell if it can offer investors an attractive environment, and whether it will be able to use that investment for the benefit of a wider section of the population than in the past.

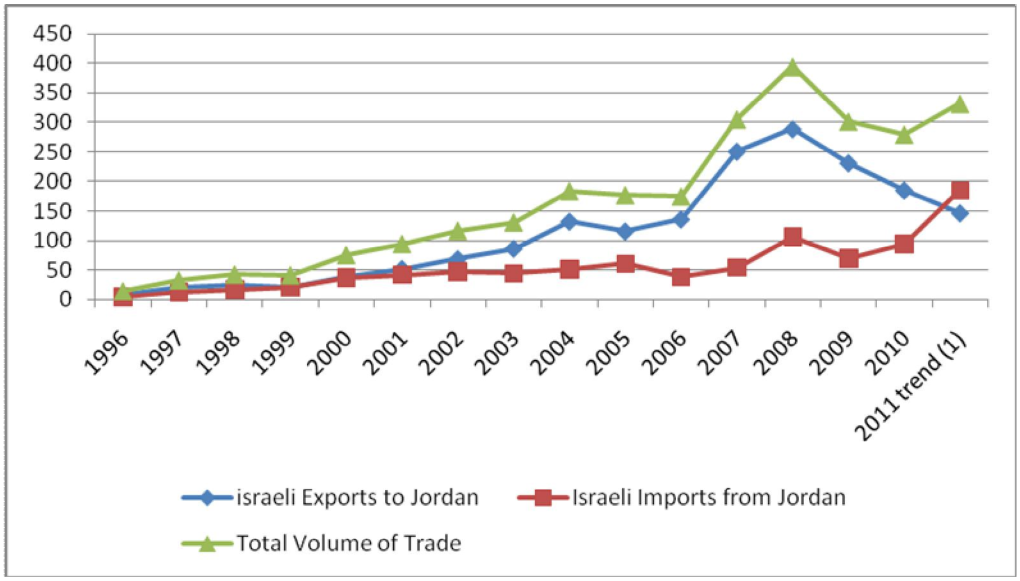
New Trends in Israel's Trade with Jordan

Yitzhak Gal

Israel's exports to Jordan increased continuously from the mid-1990s until 2008, while Jordan's exports to Israel failed to grow. Since then the pattern reversed: Israel's exports to Jordan have declined while Jordanian exports to Israel have shot up. This has provided the basis for future growth of trade in both directions, assuming political developments permit.

Trade between Israel and Jordan began in the mid-1990s following the signing of the peace treaty between the two countries in 1994. In the second half of the 1990s, the volume of trade in goods was around $40 million a year. Then, it increased ten-fold, reaching $400 million in 2008. This was mainly the result of an increase in Israeli exports to Jordan, from $25 million a year on average in the second half of the 1990s to nearly $300 million in 2008. Jordanian exports to Israel increased very slowly: from $15 million a year in the second half of the 1990s, to $40-50 million a year in the early 2000s. There was little growth in following years, and, in 2007, the volume of Jordanian exports was similar to the level seven years earlier. (See Chart 1)

Chart 1: Israeli - Jordanian Trade 1996 - 2011 ($ millions)



Note Projection for 2011, assuming annual year to year growth similar to January-March growth rate compared to the same period in 2010.
Source: Israel, Central Bureau of Statistics

In 2009 there was a change. The volume of two-way trade fell to $300 million in 2009 and 2010, as a result of an annual fall of 20 percent of Israeli exports to Jordan. Figures for the first quarter of 2011 show an additional fall of 20 percent in Israeli exports to Jordan over the first quarter of 2010. Israeli imports from Jordan have, however, increased. In 2008 they doubled to $100 million and, after a decline in 2009, they recovered in 2010, almost reaching their 2008 level. In the first quarter of 2011 they were twice the level a year earlier and if this is maintained throughout the year, Jordan's exports to Israel will, for the first time, exceed it imports from it.

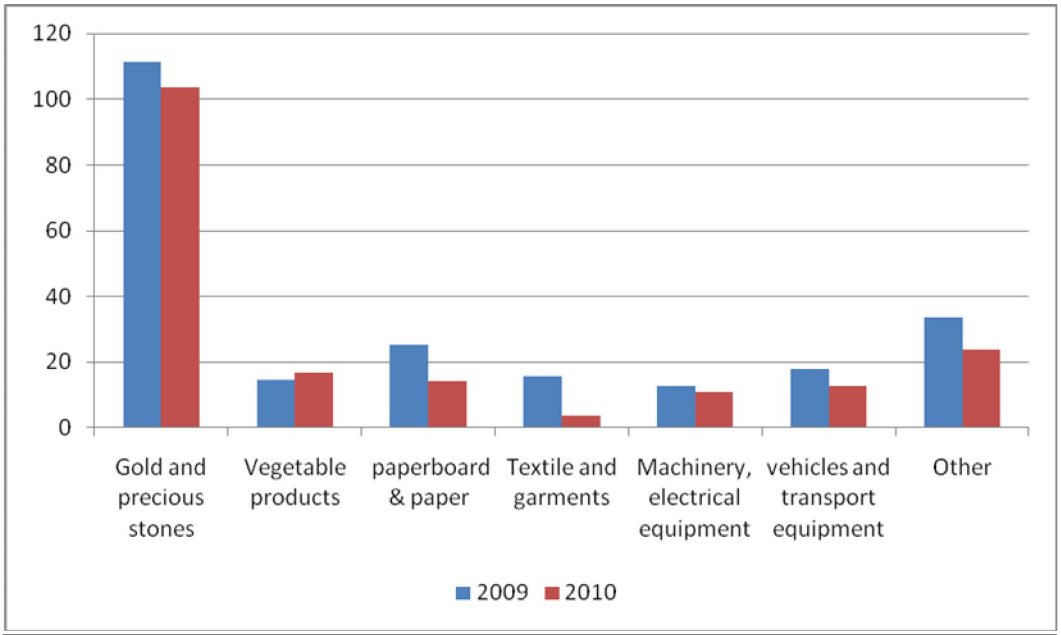
The growth of Jordanian exports to Israel is explained by changes in its composition. Until around 2005, the Qualified Industrial Zones (QIZ) Agreement was the main factor driving trade. Under this trilateral US-Jordan-Israel agreement, Jordanian exports to the United States from QIZs in Jordan were given exemptions from customs duties and quotas, provided they used a specified percentage of Israeli inputs in their production. This led to a rapid growth of clothing exports from Jordan to the United States that reached $1 billion in 2004 and $1.3 billion in 2006. This, in turn, resulted in the rapid growth of Israeli exports to Jordan: in 2003-2004, up to 90 percent of the trade between Israel and Jordan was based on cooperation relating to clothing production in the QIZ, or other shipments of inputs, semi-finished, and finished products between Israeli and Jordanian factories.

In the mid-2000s, there was a major change. In 2005, a Free Trade Agreement (FTA) which had been signed in the early 2000s between Jordan and the United States, and was implemented in stages, was applied to the textile and clothing sector. This, together with other developments in the international textile market, enabled Jordan to sell textiles and clothing in the United States with customs duties and quota exemptions using the FTA instead of the QIZ Agreement. Israeli suppliers therefore lost the advantage that the QIZ Agreement afforded them. Despite this, Israeli exports to Jordan increased in 2007-2008 after a slight decline in 2005-2006, reflecting the combined effect of the following factors:

- Israeli suppliers managed to compete with other suppliers of inputs to the Jordanian textile and clothing industry. Israel and Jordan agreed to simplify the bureaucracy that had limited trade under the QIZ. This made it worthwhile for some Jordanian companies to continue operating within the QIZ framework. Since 2008, however, Israeli exports have fallen significantly.
- Trade between the two countries has become more broadly based, sectorally. In 2004, the bilateral Israeli-Jordanian Trade Agreement was upgraded. Israel and Jordan reduced the customs duties on a wide range of products and by 2010 they were largely abolished. In 2005, an agreement was also signed between Israel, Jordan and the European Union that encouraged joint production, for sale to the latter, of a wide range of goods, including textile and clothing.

Since 2009, Israeli exports of inputs to the Jordanian clothing industry have fallen sharply and they now account for less than 10 percent of sales to Jordan. The share of other exports have increased, including raw materials for the jewelry and silver industries, paper and packaging products, fertilizers, paints, chemicals, plastics, machinery and vehicles. Despite this, in 2009-2010 the volume of nearly all sectors of Israeli exports to Jordan fell. (See Chart 2)

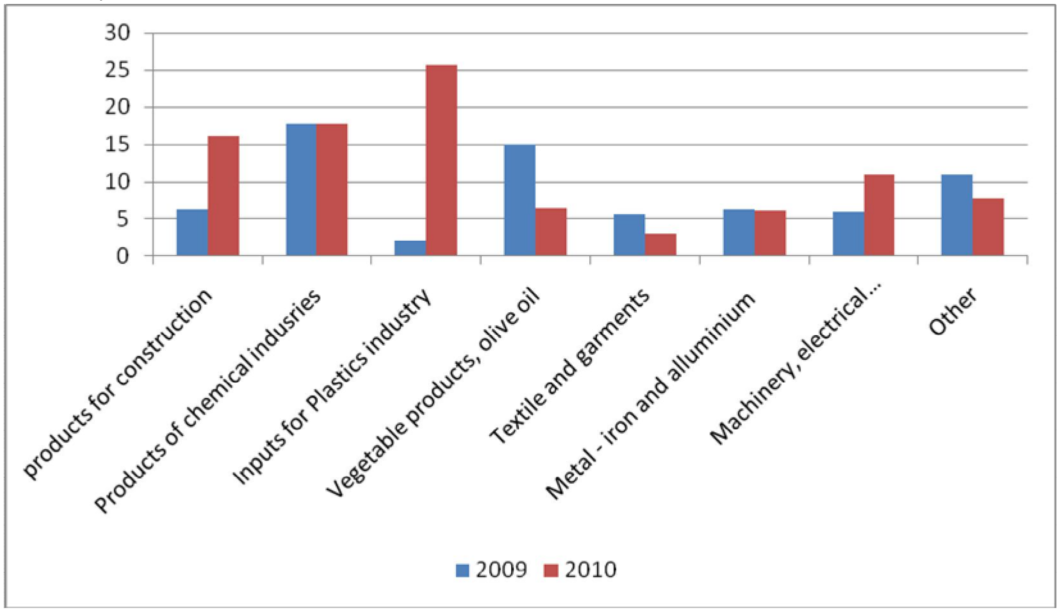
Chart 2: Israeli Exports to Jordan by Major Commodity Groups 2009-2010 ($ millions)



Source: Israel, Central Bureau of Statistics

Jordanian exports to Israel, of clothing related products, fell as well. Other goods, such as vegetables and olive oil increased, as did building materials, chemicals, inputs for the chemical and plastics industries, iron, steel and aluminum, and even mechanical and electric equipment. (See Chart 3)

Chart 3: Israeli Imports from Jordan by Major Commodity Groups 2009-2010 ($ millions)



Source: Israel, Central Bureau of Statistics

The widening of trade to a larger number of sectors is an indication of the potential for future trade that is not currently being realized because of political and security-related constraints on both sides. These have translated into business and marketing problems, limiting sales in each country.

To illustrate, it is important to mention that it is almost impossible to export finished products to Jordan for the consumer market. This is due to the hostile attitude of the clientele, in general, and the fear of marketing chains from public opinion, which opposes economic relations with Israel. Therefore, Jordanian imports from Israel focus primarily on semi-final products and inputs used in industrial production processes, agriculture and so on. This marketing obstacle is not the only one. Trade in semi-final products and inputs encounters many other political barriers as well.

The share of Jordan in total Israeli exports is very small: less than 0.5 percent. This is not the result of the small size of the Jordanian market or its limited ability to absorb Israeli goods. In fact, Jordanian imports grew rapidly in the last decade from less than $5 billion in 2000 to over $15 billion in 2010. Despite Israel's proximity to

Jordan, and the agreements between the two countries, other countries have done much better than Israel in the Jordanian market. Turkey's exports to Jordan, for example, are three times higher than Israel's.

Israel's share in Jordan’s exports is equally small. Israel accounts for only 1.5 percent of Jordan's exports, and imports from Jordan account for a negligible 0.25 percent of Israel's imports. This contrasts with Jordan's exports to its other neighbors, which do not suffer political constraints. In 2010, Jordan's exports to Iraq were ten times its exports to Israel; its exports to Saudi Arabia were eight times as large; and even its exports to Syria (which is a small economy) were three times the volume sold to Israel.

A short analysis of the chemicals and plastics sectors would help to illustrate the un-materialized potential of Israeli-Jordanian trade. Chemicals and plastics are among the leading industrial sectors in both countries. The overall volume of Jordanian foreign trade in these two areas is close to $5 billion a year. Jordan's export markets and supply sources in these areas include dozens of countries. The trade volume with leading export and import partners is at hundreds of millions of USD/year with each of these trade partners. This trade includes import and export of a wide-range of finished products, intermediate semi-finished products, and inputs.

Despite the outstanding advantages of mutual trade for both Israel and Jordan in these fields, compared to Jordan’s other trading partners, the Jordanian trade with Israel in these areas is negligible: less than 50 million dollars in 2010, about one percent of total Jordanian trade in these areas.

Along with the unachieved potential in Israel-Jordan bilateral trade, there is another area with even greater potential: regional transit trade (meaning the export of goods from one country to another via a third country). Jordan is a classic transit country: it is the land-bridge for Iraq (Aqaba serves as a major port for Iraq). It also serves as a transit route for trade between the Gulf and Lebanon and Syria, and between the Gulf and Turkey and Southeast Europe.

The route from Jordan through the Israeli-Jordanian border crossing at Bet She'an to the Port of Haifa is the shortest route for Jordanian trade with Europe and the United States; and agreements signed since 1994 provide the basis for using it. Here again, political and bureaucratic factors have prevented this potential from being realized. Few of Jordan's imports from those regions (which account for one third of its imports) are brought via Haifa. Jordan's exports to the West, which used the port at Haifa in the early 2000s, now travel mainly through Aqaba.

Jordan is the best route for Israeli exports to the Gulf and Iraq. The total imports of those countries (including the free trade areas in the Gulf) are valued at about $400 billion a year, and the potential for Israeli exports to these markets has been estimated at $5 billion. Despite the fact that Israel cannot trade openly with those countries, it exports some $500 million a year to these places. The gap between these figures reflects the political obstacles on Israeli exports to these markets, which are even higher than the obstacles on the export to the Jordanian market.

In conclusion, despite political constraints, developments since 2000 suggest that the Israel-Jordan trade has the potential for growth and diversification. Trade data in the coming months of 2011 will provide indications for future trends of Israeli-Jordanian trade, as well as the implications of the Arab Spring shock waves, on trade and economic relations between Israel and Jordan.