Iqtisadi
Middle East Economy

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Vol. 11, No. 3, May 27, 2021

The UAE and Israel: Developing Relations and the Challenge Ahead

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In April 2021, the Israeli firm Delek Drilling announced plans to sell its 22 percent direct stake in the Tamar gas field to investors led by the Abu Dhabi based state-owned Mubadala Petroleum for $1.1 billion. The Tamar field has an estimated 297 billion cubic meters (bcm) of reserves. This would be by far the largest commercial deal yet between Israel and the UAE. Mubadala Petroleum is a wholly owned subsidiary of Abu Dhabi state investor, Mubadala Investment Company. Its plans to move into Israel's upstream gas sector have the backing of the UAE and Israeli governments.

In March 2021, the UAE announced the establishment of a $10 billion fund to invest in energy and other strategic sectors of the Israeli economy. According to the official statement, the UAE will invest in and with Israel in sectors including energy, manufacturing, water, space, healthcare, and agro-tech. The investment fund will support development initiatives to promote regional economic cooperation between the two countries. Funding will come from government and private sector institutions and the Delek deal is part of this framework.[1]

Under the terms of the non-binding memorandum of understanding, the $1.1bn transaction also includes Delek's 22 percent stake in the small, undeveloped Dalit gas field. Delek has said that the parties aim to finalize the agreement by the end of May 2021. Tamar is Israel's second biggest gas field after Leviathan (643 bcm). Both fields are operated by US energy giant, Chevron.

Since August 2020, when Israel and the UAE agreed to establish diplomatic relations, commercial ties between the two countries have rapidly expanded. This is best exemplified in the energy sector, where for many years foreign firms were reluctant to engage with Israel for fear of losing access to key Middle East oil markets.

In October 2020, an agreement between Israeli state firm, Europe-Asia Pipeline Company (EAPC) and the newly formed UAE-Israeli Med-Red Land Bridge (MRLB) was announced. This joint venture panned to use the EAPC midstream infrastructure to transfer crude and oil products between the Red Sea and Mediterranean. The aim is to use the land bridge to save time, fuel charges and the costs of using the Suez Canal. The deal could be worth $700-800 million annually within a few years and operations may start in 2021.[2] Environmentalists have warned that the oil pipeline deal threatens unique Red Sea coral reefs and could lead to "ecological disaster."[3]

In January 2021, Mubadala's renewables subsidiary, Masdar, announced a strategic partnership with EdF Renewables Israel to promote renewable energy in Israel. Commercial ties are increasing, and Israel plans to launch its next East Mediterranean Gas upstream round of bids soon, offering further possible opportunities for Mubadala. Even if the Abu Dhabi state firm does not participate, its willingness to enter Israel's upstream market should greatly reduce any political concerns the other international oil companies may have over bidding. Delek's sale of its Tamar stake fulfills its obligation to sell the stake by December 2021 as the result of deal with the Israeli anti-trust authority that enabled it and partner Noble Energy (now owned by Chevron) to retain their dominant stakes in the Leviathan field.

At the end of April 2021, it seemed that the Abraham Accords had loosened some of the geopolitical knots that limited the development of East Med gas reserves.[4] On May 12 however, Reuters reported that as a result of the conflict between the Hamas in Gaza and Israel, the Israeli energy ministry ordered Chevron to shut down the Tamar natural gas platform.[5]

While these risks were taken into account when Mubadala bought into Tamar – the field had been closed down in 2019, during a previous round of fighting between the Hamas in Gaza and Israel – the security of East Mediterranean gas will have to be reassessed and its development may slow.

It was initially thought that the deal with Mubadala would encourage other international companies to invest in Israel's gas-fields. Hints that the dispute with Lebanon over the maritime demarcation line between the two countries may be solved have also been encouraging but the conflict between the Hamas in Gaza and Israel may have the opposite effect.

Israeli-UAE relations are also developing outside the gas sector. Official figures issued in Dubai show that in the five months September 2020-January 2021, the Emirates exported $164 million worth of goods to Israel. These mainly consisted of lubricants, perfumes, engine spare parts, smart phones and diamonds. It imported $88 million worth of goods, mainly mechanical, electronic and computer equipment, diamonds, fruit and vegetables. In addition, there was $26 million in transit trade.[6]

Israeli figures for merchandise trade with the UAE as a whole showed rapid growth between the first quarter of 2020 and that of 2021. In the first three months of 2020, Israel exported goods worth $13.7 million to the UAE, while in the same period of 2021, they were $33.2 million. Imports rose from $15.8 million to $103 million.[7]

While the growth of merchandise trade has been considerable, that in services has been larger. This is because Israel's leading growth sector is hi-tech services, including computer services, fin-tech, bio-tech, health care water-tech and agricultural product development. These are among the sectors that the UAE is interested in as it tries to diversify its economy and cope with climate change.

What is the potential for trade between the two countries? The literature exploring this has developed during the last thirty years and is based on the idea of revealed comparative advantage (RCA).[8] RCA suggests that trade between countries is governed by their relative differences in productivity. Although such productivity differences are difficult to observe, an RCA measure can be calculated using trade data to "reveal" such differences. While it can be used to provide a general indication and first approximation of a country's competitive export strengths, it should be noted that national measures which affect competitiveness such as tariffs, non-tariff measures, subsidies and others are not taken into account in the calculation of the RCA.

In recent years with the development of hi-tech services that are not affected by distance, the potential for trade between Israel and the Gulf has grown. A simple way to identify mutual trade opportunities is to examine which main product categories the imports and exports of the UAE and Israel complement each other. When a product is in the top export list of the exporting country and in the top import list of the potential trade partner, the potential for trade large.

Much international trade occurs between countries producing similar goods. The UAE and Israel both import as well as export large volumes of non-oil product categories, such as telecommunication equipment, automatic data processing machines, aircraft and associated equipment and diamonds. While this means they are potential competitors in these areas, there will still be opportunities for trade, either to match product demand and supply within specific segments of those broad product categories or for reexport in case of the UAE.

In other product categories, the UAE and Israel are natural trade partners. The UAE is a large importer of medical technology, electrical machinery and equipment, measuring, analyzing and control equipment and food, all items that rank high among Israel's exports. Israel imports motor vehicles and ships, products that the UAE's re-exports.

The revealed comparative advantage (RCA) compares the country's export share of a product to the share of the same product in global exports. An RCA greater (or smaller) than 1 indicates a comparative advantage (or disadvantage) over other countries for a particular product category. The UAE has an RCA greater than 1 in perfumery, plastics, aluminum and cement and other construction materials. The UAE has advantages in infrastructural development. Also, the construction materials category includes ceramics of which the UAE is a major exporter. Israel has a strong comparative advantage in arms and ammunition, medical electro-diagnostic devices, chemical products and hi-tech services.

Comparative advantages are dynamic: they develop over time and one source of development is international trade and investment. This has been especially true for hi-tech, as Israel is well-known as one of the world's high-tech producers. About one-third of its exports are high-tech and this share reaches nearly 50 percent when resource-based exports are excluded. The technology mismatch with the UAE is a potential source of cooperation. While the UAE sells largely low and medium-tech and resource-based manufactures, it is gradually trading-up, buying more high-tech items from around the world. Its share of high-tech import products has increased from below 15 percent to almost 20 percent in the last decade. This coincides with the UAE's drive to diversify its economy. FinTech start-ups, for example, are welcomed in UAE's free zones and the UAE is heavily investing in its space program. Israeli companies are strong in those fields and through either trade or investment the UAE could benefit from Israeli expertise in healthcare and agro-tech.[9]

Trade and investment take place within a political as well as an economic context. The conclusion of Mubadala's investment in Tamar will be an indication that the Israel-UAE agreement has overcome its first major challenge, the war in Gaza. Its cancellation would, among other things be a victory for Hamas and Iran.

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