Assessing Israel’s Trade With Its Arab Neighbours
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The paper we publish today shows what the future promise is of the Middle East. Where peace is in place, economies prosper. Where it isn’t, huge potential is being held back. This paper offers an overview of the long-term development of trade between Israel and Arab partners where a peace agreement is already in place: the Palestinian Authority, Jordan and Egypt. In the coming weeks, we will also publish our detailed analysis of these relationships.

There is significant untapped potential for Israeli-Arab trade and economic cooperation. This paper provides a basis for a deeper and wider examination of measures, projects and initiatives that could unleash this potential.

What our research shows is that while Israel’s trade with Middle Eastern markets is already quite considerable, there is still significant, untapped potential for Israeli-Arab trade and economic cooperation. It also highlights how peace agreements have helped economic development—not only by opening up new trade routes but also because the sides enjoyed significant dividends from the agreements, as funds that would have gone on defence could be invested elsewhere. The peace agreements with Israel enabled Jordan and Egypt to access significant international aid, as well as preferential trade arrangements with the United States. The research offers a glimpse of what cooperation could mean for this region—in technology, culture and trade, as well as further prospects for economic development.
While Israel and the Palestinian Authority have close trading links, this research further highlights the growing dependence of the Palestinian economy on Israel in recent years. In 2016, Israel was the source of some 60 per cent of Palestinian recorded imports of goods and the destination of 85 per cent of Palestinian recorded exports of goods. If unrecorded trade is taken into consideration, Israel's total share grows to two-thirds of imports of goods and more than 90 per cent of exports of goods. Moreover, the number of Palestinian labourers employed in Israel increased significantly from 40,000 in 2002 to 130,000 in 2016. To support a future independent and economically viable state, the Palestinian economy must be allowed to grow and develop beyond Israel.

Without a final status agreement with the Palestinians, Israel's overall security-related costs will remain at a relatively high level of close to 15 per cent of GDP. Resolution of the Palestinian conflict could cut these costs, possibly by as much as half. The economic cost for the Palestinians of the continuing conflict with Israel is enormous—and we are now at the end of three lost decades of economic growth since the First Intifada.

It is, however, interesting to see beginnings of trade between Israel and Gulf countries. According to our analysis of figures, Israeli exports to the Gulf Cooperation Council (GCC) bloc is around $1 billion. All Israeli exports to the GCC market are currently indirect, through third countries; sometimes channelled through Jordan or Turkey, but mostly via European and other non-MENA countries. Trade is growing, but to truly tap into the major potential of these markets, we will need a regional approach to the peace process, one that puts the Palestinian issue on a path to resolution. There is enormous potential if political constraints on exports to the much larger GCC and other main Arab markets can be removed.

This region is undergoing huge transition, where the ultimate goal should be open, rule-based economies and religious tolerance. Within this wider regional context, Israel's capabilities and economic strengths should allow it to play a much more central role in regional economic cooperation. If political barriers can be removed, Israel's contribution to the Middle East would be of critical importance, providing viable solutions to some of the overwhelming
challenges of the region, including in the areas of water, energy and sustainable industrial development.

But in order to move forward on this, the Palestinian issue must be addressed. What we need is to capitalise on the changing regional dynamics to advance the two-state solution. The economics and trade can be building blocks, or act as an anchor to help hold the process in place.

However, none of the above means that economics can replace politics. Without political progress any economic advance is always at risk of going backwards. The case for the two-state solution is often discredited today. But it remains the only realistic prospect of enduring peace. The Arab Peace Initiative shows the regional commitment to peace. And despite the current deadlock, both Israeli and Palestinian leaderships know roughly what the final status solution looks like and how with a more productive political context it could be achieved. Especially with the situation in Gaza so dire, every effort must be made to put a viable peace process back on track. Without it, the opportunities described here will not materialise.
UNTAPPED POTENTIAL

Israel has signed bilateral trade agreements with three of its immediate neighbours: the Palestinian Authority (PA), Egypt and Jordan. This paper takes a detailed look at these relationships and the economic potential that can be tapped by further developing Israeli-Arab trade and economic relations.

This paper and forthcoming in-depth studies examine the long-term development of trade in goods and services, both in the immediate context of Israel’s and the Arab partners’ trade relations with other partners and in the wider context of their long-term economic interests.¹ There is significant untapped potential for Israeli-Arab trade and economic cooperation, and this paper provides a basis for a deeper and wider examination of measures, projects and initiatives that could unleash this potential.

The Israeli-Palestinian trade relationship is extensive, despite the ongoing political conflict. By streamlining their trade and economic relations and cooperating in trading with Arab and other markets, Israel and the PA could unleash latent economic potential that would have a significant impact on both their economies.

The Israeli-Egyptian and Israeli-Jordanian peace agreements, meanwhile, have had major impacts on the three countries’ economies that are not fully reflected in bilateral trade figures between these partners. In fact, the relatively modest trade record is only a fraction of the economic potential that can be tapped by further developing Israeli-Arab trade and economic relations.

¹ This paper uses data from various sources and with different definitions. Usually, Israeli data are used in sections that examine the Israeli perspective, Palestinian data for the Palestinian perspective, and Jordanian and Egyptian data for those countries’ perspectives. For certain analyses, the paper uses international sources. Although in most cases all data sources show similar trends and magnitudes for the same data series, the figures for specific years and flows vary as a result of differences in definitions, gaps in collection, and recording of trade and other data. In certain cases, where trade data reflect partial registration of trade flows, the paper uses the more complete balance of payments where available, and trade data where there is no other source. For example, for overall Israeli-Palestinian trade in goods and services, the paper uses balance-of-payment figures, but for more specific analyses of Palestinian trade flows, registered trade data are the only available source.
In a wider regional context, Israel’s capabilities and economic strengths should allow it to play a much more central role in regional economic cooperation. If political barriers can be removed, Israel’s contribution to the Middle East would be of critical importance, providing viable solutions to some of the overwhelming challenges of the region, including in the areas of water, energy and sustainable industrial development.
Israel's trade with Middle Eastern markets is much larger than many imagine. Middle Eastern and North African (MENA) markets, including Turkey for the purposes of this paper, accounted for 10 per cent of total Israeli exports of goods in 2016, as large as total Israeli exports of goods to all African and non-EU European countries (including Russia) and the Americas (except the United States) combined.\(^2\)

Total Israeli exports of goods and services to MENA markets in 2016 are estimated at about $7 billion, and total Israeli imports from Middle Eastern markets in 2016 are estimated at a roughly similar magnitude (see figures 1 and 2).\(^3\) MENA markets accounted for 7 per cent of overall Israeli exports of goods and services, and MENA’s share of total Israeli imports was similar: both exports and imports of goods and services totalled close to $100 billion in 2016.


\(^3\) Estimates are as per the definitions used in Israeli balance-of-payments statistics. Trade in goods includes diamonds. Additionally, trade with the PA is included in the balance-of-payment figures. Trade in services includes workers’ remittances and compensation. Income from interest and other payments are excluded. Indirect exports and imports to the GCC and other Arab countries were estimated by the author.
Figure 1: Israeli Imports From MENA Markets, 2016

TRADE IN GOODS

The PA was the largest market for Israeli exports of goods to the MENA region in 2016, and the fourth-largest single export market globally (see figure 3). Turkey was the second-largest Israeli export market in MENA, while the Gulf Cooperation Council (GCC) bloc came third, at around $1 billion. Exports to Jordan and Egypt were of minor importance: combined, the two countries accounted for barely 0.2 per cent of total Israeli exports of goods in 2016.  

Figure 2: Israeli Exports to MENA Markets, 2016

This paper includes labour exports (workers’ remittances and compensation) as part of Israel’s import figures from the PA, and as part of Egypt’s and Jordan’s figures of exports of services. Although workers’ remittances and compensation are technically registered differently in the balance of payments, this paper includes them as part of exports of services (as a separate item) because of their critical importance as a balancing export item for all three of these countries. The term “non-factor services” is used where needed to differentiate between exports of regular services (tourism, transport and so on) and export of labour, which is the export of factor services (shorthand for “production factor services”).
All Israeli exports to the GCC market are indirect, through third countries, and are recorded in Israeli official external-trade statistics as exports to these third countries. Some Israeli exports to the GCC are channelled through Jordan or Turkey, but most go via various European and other non-MENA countries. Analysis of available data indicates that the volume of Israeli indirect exports to the GCC bloc is close to $1 billion a year.

Israeli imports of goods from the MENA are less significant, amounting to $4 billion in 2016 (see figure 4)—just 6 per cent of total Israeli imports of goods, which came to $64 billion.
Many Israeli imports of goods from the GCC are registered as imports from Jordan, while some come through other third countries and are recorded in official external-trade statistics as imports from these countries. Based on analysis of partial and indicative data, the volume of Israeli indirect imports from the GCC bloc can be estimated at $500 million a year, including some $250 million registered in Israeli statistics as imports from Jordan. Imports of goods from Jordan (minus indirect imports from the GCC) and from Egypt were less than $100 million each in 2016.

**TRADE IN SERVICES**

Israeli exports of services to MENA countries are relatively small, while imports of services are significantly larger, mainly reflecting the large import of labour services from the PA, registered in the balance of payments as workers’ remittances and workers’
compensation. Total exports of services to MENA markets are estimated at around $1 billion in 2016, less than 3 per cent of total Israeli exports of services, which amounted to $40 billion. Service exports to the PA were close to $600 million, while most of the rest were service exports to Turkey. Exports of services to Jordan are estimated at less than $50 million, and exports of services to Egypt were negligible.

Israeli imports of services from MENA markets were almost three times higher than exports, amounting to close to $3 billion, or more than 10 per cent of total Israeli imports of services. Non-factor service imports from the PA—services such as transport, tourism, information technology and communications—were close to $450 million, while workers’ remittances and workers’ compensation were as high as $1.9 billion. Service imports from Turkey, Jordan and Egypt are roughly estimated at an additional $500 million.

DEFENCE COSTS

Despite the modest amounts of trade in goods and services, the greatest benefit for Israel from its peace treaties with Egypt and Jordan has been the dramatic decline in defence costs. Resolution of the Palestinian conflict could cut these costs further, possibly by half.

Israel’s defence costs grew to about 20 per cent of gross domestic product (GDP) following the 1967 war—and jumped as high as 30 per cent of GDP after the 1973 war. As a result of the 1979 peace treaty with Egypt, Israel’s defence costs fell gradually to below 10 per cent of GDP by the mid-1990s. That dramatic decrease was a major factor in enabling the stabilisation of the Israeli economy in the second half of the 1980s and its impressive performance since the 1990s. The peace treaty with Jordan, which was signed in 1994, added another pillar of strategic stability, enabling Israel to keep defence costs at a low level of below 10 per

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cent of GDP, reducing it further to around 6–7 per cent of GDP since the late 2000s.

The ongoing conflict with the Palestinians, however, along with other unsolved conflicts, keeps overall Israeli security-related costs at a relatively high level of close to 15 per cent of GDP. That figure includes direct defence costs and other conflict-related costs such as securing Israeli settlements in the West Bank.

Analysis of Israeli-Jordanian and Israeli-Egyptian trade indicates significant untapped potential. Qualifying Industrial Zones (QIZ) are free-trade areas established in Jordan and Egypt in collaboration with Israel to take advantage of free-trade agreements between the US and Israel. Such agreements point to the potential of special trilateral arrangements—in this case, with the United States. Comparison of Jordan’s and Egypt’s large volumes of trade with other partners, and analysis of the composition of that trade, reveals clear additional trade potential for Israel—especially in advanced products, where Israel has a significant comparative advantage, but also in tourism and other areas. The large volumes of Israeli exports to the Palestinian and Turkish markets, which are open to Israeli exporters, provide another insight into the potential for Israeli exporters, if political constraints on exports to the much larger GCC and other main Arab markets can be removed.

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6 Ibid.
THE PALESTINIANS

The economic cost for the Palestinians of the continuing conflict with Israel has been enormous. The Palestinian economy is now at the end of three lost decades of economic growth since the First Intifada. In-depth studies indicate lost Palestinian GDP growth over the two last decades to be equal to one-half of potential GDP growth under non-conflict conditions. The greatly imbalanced trade relations between the PA and Israel are part of that bigger picture.

The large size of Israeli exports to the Palestinian market is mirrored in Israel’s overwhelming role in the foreign trade of the small Palestinian economy. In 2016, Israel was the source of about 60 per cent of Palestinian recorded imports of goods and the destination of 85 per cent of Palestinian recorded exports of goods. If unrecorded trade is taken into consideration, Israel’s total share grows to two-thirds of imports of goods and more than 90 per cent of exports of goods (see figure 5).

Israel’s central role as a trading partner of the PA is demonstrated by comparison with other trading partners. All Arab countries combined accounted for 6 per cent of Palestinian exports of goods in 2016, against the Israeli share of 92 per cent. All other world markets combined made up 2 per cent of Palestinian exports of goods.  

Despite some growth in Palestinian exports to Israel and a notable decline in Palestinian imports from Israel in recent years, registered exports of goods to Israel are still one-quarter of imports from Israel to the PA. That imbalance is reflected in a huge deficit of close to $2.5 billion in Palestinian trade with Israel. However, as a result of a fast increase in Palestinian workers’ remittances from Israel in recent years, most of this large trade deficit is covered by an almost equal surplus in the Palestinian labour-export balance.

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with Israel. The overall balance of Palestinian-Israeli trade in goods and services narrowed to $500 million in 2016.

The structural imbalance of Palestinian external accounts has largely shifted to the PA’s trade with non-Israeli markets. Although exports to these markets have shown fast growth over the 2010s in comparison with the 2000s, their absolute volume has remained low. The trade deficit between total Palestinian exports and imports of goods to all markets was close to $4.5 billion in 2016, as large as one-third of Palestinian GDP, which was $13.5 billion.9

The fast increase in Palestinian exports of labour services to Israel is probably the most important development for the Palestinian economy in recent years. As the number of Palestinian workers in Israel (including in Israeli settlements) grew between 2002 and 2017, workers’ compensation rose accordingly (see table 6).

Table 6: Number of Palestinian Workers in Israel and Workers’ Compensation, 2002–2017

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<tr>
<td>Number of Palestinian workers in Israel (including in Israeli settlements)</td>
<td>40,000–50,000</td>
<td>70,000–80,000</td>
<td>120,000–130,000</td>
</tr>
<tr>
<td>Workers’ compensation per year</td>
<td>$100–200 million</td>
<td>$400–500 million</td>
<td>$1.9 billion (2016 only)</td>
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Source: Palestinian Central Bureau of Statistics

The large increase in the number of Palestinians employed in Israel has been a vital stabilising factor in the West Bank. This increase has neutralised many of the negative effects of the political stalemate, such as the significant drop in investments in the productive sectors of the economy, and other negative political developments.

Against the background of the present gloomy situation of the Palestinian economy, the potential for trade-driven economic growth and fast creation of employment opportunities is probably greater for the PA than for Israel, Jordan or Egypt.  

10 The difference between Palestinian statistics and Israeli figures mirrors mainly unrecorded trade, which is not amended in Israeli figures.
For Jordan, the 1994 peace treaty with Israel is one of the pillars of the kingdom’s geostrategic and political stability, and had several important direct economic contributions. Following the signing of the peace agreement, Jordan enjoyed preferential trade relations with the United States, which extended the US-Israel free-trade agreement to cover the qualified industrial zone in Jordan. Jordan later signed its own free-trade agreement with the United States, which probably would not have been possible without the peace process and agreement with Israel.

Jordan also benefited from increased aid from the United States Agency for International Development, the EU and Japan to support the peace process. Geostrategic stability, in turn, is the base on which Jordan’s economic strategy has been built since the early 1990s.

Before signing the peace treaty, the United States initiated a series of foreign debt relief and restructuring arrangements, and Jordan began receiving considerable US economic assistance on an annual basis, along with substantial military assistance. Another benefit with even greater importance in the long run was the trilateral Jordanian-Israeli-US QIZ agreement. This accord and the peace treaty paved the way to a series of international trade agreements, which placed Jordan on the path of accelerated export-driven economic growth that lasted for most of the first half of the 2000s.

These positive trends were halted at the end of the 2000s, when there were once again risks linked to water shortages, unemployment, and other economic and social challenges for the kingdom. To deal with these risks, Jordan must develop new growth engines. Enhancing trade and economic cooperation with Israel could play a critical role in generating new, powerful growth engines for Jordan—potentially even more powerful than those seen at the beginning of this century.

Israel’s current share of Jordan's foreign trade is almost negligible. Jordan's imports of goods from Israel has declined in recent years and was as low as $30 million in 2016, according to Jordanian external-trade statistics. At this low figure, it accounted
for 0.2 per cent of total Jordanian imports of goods. Imports of services from Israel are also insignificant (see figure 7).\textsuperscript{11}

\textbf{Figure 7: Jordan’s Trade With Israel, 2016}

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\includegraphics[width=0.8\textwidth]{figure7.png}
\caption{Jordan’s Trade With Israel, 2016}
\end{figure}

Israel’s share of Jordan’s exports is higher, though still of minor importance. Jordan’s exports of goods to Israel, at $114 million in 2016, made up 1.5 per cent of total Jordanian exports of goods. However, most of the registered exports to Israel are re-exports from GCC countries. Domestic Jordanian exports amounted to only $69 million, or 1 per cent of Jordan’s exports of goods.\textsuperscript{12}

\textsuperscript{11} Figure 7 is based on Jordanian external-trade statistics. There are some differences with Israeli external-trade statistics figures that reflect differences in definitions and registration methods. Nevertheless, the magnitudes are similar. Jordan’s imports of goods were $30 million in 2016 according to Jordanian figures and $49 million according to Israeli figures.

\textsuperscript{12} In addition to the $45 million registered in Jordanian trade statistics as re-exports to Israel, about $200 million pass from the GCC countries to Israel through Jordanian free zone areas, in which goods enter and are re-exported without the intervention of customs authorities. An additional $200–250
Israel’s share of Jordanian re-exports—goods imported to Jordan and re-exported to third countries—is considerably larger, at 3.5 per cent of registered re-exports, or $45 million out of $1.4 billion. Moreover, Israeli statistics indicate that approximately an additional $200 million worth of goods are imported to Israel from the GCC countries, in transit via Jordan.\textsuperscript{13}

Jordanian-Israeli trade in services is insignificant as well. In all, Israel’s share of total Jordanian exports of goods and services is slightly more than 1 per cent, and its share of Jordan’s imports is as low as 0.3 per cent.\textsuperscript{14}

\textsuperscript{13} Author’s calculations. The difference between Israeli import figures and Jordanian exports figures reflects goods shipped from the GCC countries in transit via Jordan without entering Jordan’s customs area.

\textsuperscript{14} Figures of trade in goods with Israel are taken from external-trade statistics, while total Jordanian trade data are from balance-of-payment statistics. Import figures in the balance-of-payment statistics do not include freight and insurance costs or custom duties. These figures are lower than external-trade database figures, which do include freight and insurance costs. The freight and insurance costs are included in the non-factor services account of the balance of payment (and hence must be deducted from the goods import figures to avoid double counting these costs). Israeli trade statistics show slightly different figures, reflecting minor differences in definitions and registration methods, but the magnitudes are the same. Figures of trade in services with Israel are the author’s estimates.
The stabilising effects of the 1979 Israeli-Egyptian peace treaty on the Egyptian economy have been even more important than in the Jordanian case.

The end of war with Israel secured key branches of the Egyptian economy, which had been severely affected by the conflict with Israel: most importantly, the oil sector (and later also the gas sector), the Suez Canal and tourism. Additionally, the peace treaty with Israel enabled Egypt to receive large amounts of external aid from the United States, other Western countries and international organisations such as the International Monetary Fund, and made Egypt a safe market for large-scale foreign private investment. Since the 1980s, these have been the main sources that finance Egypt’s imports and other foreign-exchange expenses.

The sensitivity of the Egyptian economy to stable relations with Israel is expected to reach an even higher level in the next decade, given the centrality of the Suez Canal area and East Mediterranean gas fields in Egypt’s economic development strategy. That is in addition to new vulnerabilities and challenges that Egypt is going to face in the coming decade—most importantly, water challenges.

Detailed analysis of Israeli-Egyptian trade shows that although the past trade record is disappointing, the untapped potential is very large. The important achievements of the Israeli-Egyptian QIZ agreement, which led to a significant rise in Israeli-Egyptian cooperation in exports of textiles to the US market, indicate promising prospects for new arrangements modelled on the QIZ that will provide trade incentives to cooperation in wider range of fields, such as chemical industries, plastics, construction materials food products and more. Other areas of especially large potential include:

- natural gas, with cooperation in the development and export of gas from the East Mediterranean;
- tourism, with cooperation in the Sinai, Eilat, Aqaba and Saudi Neom areas;
- transport and logistics, with coordinated development of two planned land bridges and railway networks from the Gulf to the
East Mediterranean, through Jordan to Haifa and through south Sinai to Port Said;

- water and agriculture, where Israeli know-how may be of critical importance for Egypt considering the overwhelming challenges it is expected to face in these spheres in the coming decade; and
- renewable energy.

Israel’s share of Egypt’s foreign trade is even smaller than its share of Jordan’s foreign trade. Egypt’s imports of goods from Israel, at $40 million, were only 0.1 per cent of total Egyptian imports of goods in 2016. Israel’s share of Egypt’s total imports of goods and services was negligible too, at just 0.1 per cent (see figure 8).\(^\text{15}\)

*Figure 8: Egypt’s Trade With Israel, 2016*

Israel’s share of Egypt’s exports was slightly higher, but still insignificant. Exports of goods to Israel, at $51 million, were 0.2 per

\(^\text{15}\) That is expected to change as of 2019–2020, when Egyptian imports of gas from Israel are expected to start.
cent of total Egyptian exports of goods in 2016, while Israel’s share of total Egyptian exports of goods and services is estimated at 0.3 per cent.¹⁶

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¹⁶ Figures as per the Egyptian balance-of-payment and trade statistics. Israeli trade statistics show slightly higher figures, reflecting minor differences in definitions and registration methods, but the magnitudes remain similarly insignificant. Figures of trade in services with Israel are the author’s estimates. Total Egyptian export and import figures are for the 2016–2017 Egyptian financial year (Central Bank of Egypt). Egyptian-Israeli trade in goods figures are for the 2016 calendar year (WITS database).
TAPPING THE POTENTIAL

From the Israeli perspective, this research indicates that under normal trading conditions, exports to and through Jordan, Egypt and the PA can become a major growth engine for the Israeli economy. Because Israel is an immediate neighbour to Jordan, is a major supplier of gas to it and has a comparative advantage in high-end technological products, Israeli exports of goods to Jordan could reach around $2 billion a year—40 times the 2016–2017 level. Potential exports to Egypt are estimated at even more, through gas and other products and services.

The potential for indirect exports to the large GCC markets and Iraq, through Jordan, is much higher. Given the size of these markets, even if Israel’s potential share of them is conservatively estimated at just 2–3 per cent of their total imports of goods and services under normal trading conditions, that would amount to $15–25 billion.

Israeli cooperation with the PA and Jordan on tourism would triple Israel’s income from this field. All in all, the untapped potential of Israeli exports of goods and services to and through Jordan, Egypt and the PA (and in cooperation with them) is estimated at $30–35 billion a year. That is about one-third of the total annual volume of Israeli exports of goods and services in 2016–2017.

Based on the analysis and insights in this paper, Israel, the Arab parties and their international partners should develop a set of action plans for such coordinated activities. That can start in the fields with the most promising prospects, such as gas and related activities, upgraded models of QIZ-like special-status industrial zones in key locations, and tourism.

Israel and its neighbours and partners should also develop action plans for cooperation in relation to certain high-priority challenges in Jordan, Egypt and the PA where Israeli involvement can be most helpful and can show fast and visible results. That can start with new, creative solutions to water and energy challenges in certain areas in Jordan (the northern provinces and the Jordan valley), in Gaza and elsewhere.
Another sphere where Israel and its neighbours and partners should devise coordinated action plans is Israeli-Palestinian and Israeli-Jordanian cooperation for exports to the GCC and other Arab markets, and to European markets. That can start with cooperation in export-oriented agriculture, based on positive past experiences and good prospects for fast and visible results.
There is significant untapped potential for Israeli-Arab trade and economic cooperation. This paper provides a basis for a deeper and wider examination of measures, projects and initiatives that could unleash this potential.