

ECONOMIC COOPERATION IN THE MIDDLE EAST

edited by
Gideon Fishelson

Westview Special Studies
on the Middle East

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Gideon Fishelson

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Preface

This book contains the proceedings of the Armand Hammer Conference on Economic Cooperation in the Middle East that was held at Tel Aviv University on June 1–3, 1986. The conference was held under the auspices of the Armand Hammer Fund for Economic Cooperation in the Middle East Under Peace.

The objective of the Hammer Fund is to foster economic cooperation between Israel and her neighbors. Multinational economic relations can offer effective leverage in the political negotiations towards peace and — once it is attained — they can reinforce the countries concerned to become partners in prosperity. To this end the Fund seeks to identify areas of mutual economic interest and recommend specific joint economic projects.

The success of the conference was due first and foremost to the contribution made by all participants, and to the valuable cooperation and advice of the members of the academic committee: Professors Seev Hirsch, Baruch Raz, Gideon Fishelson, and the academic coordinator Dr. Leonardo Leiderman; the advisors, Professors Itamar Rabinowitz and Assaf Razin; and to the administrative staff, Yoram Shamir, Gerda Kessler, Esther Landau, Lionel Pyetan and particularly to Ruth Kimmell.

Professor Haim Ben-Shahar
Head, Steering Committee

Editor's Remarks

The editorial board of the Proceedings of the Armand Hammer Conference on Economic Cooperation in the Middle East is proud to present this collection of studies presented at the conference.

This conference was the first in which politicians, academicians, policymakers and business entrepreneurs discussed the opportunities as well as the risks, benefits, and economic costs that peace offers and involves.

Although the framework for the conference was the Middle East, contributors also consider experience from other tense parts of the world, which face similar problems. Such experience can provide examples and guidelines for possible benefits that peace in the Middle East might open up.

The conference took place at Tel Aviv University, which provided an academic atmosphere and helped attract top quality lectures and interested participants.

In light of the diverse economic aspects of the peace process, the conference was divided into 7 sessions, each dealing with a fairly homogeneous topic. This volume contains revised versions of the papers presented at the conference sessions and reflects discussions of each study and its ramifications as well as additional ideas that came forth.

The editorial board would like to thank all those that contributed to the success of the conference. Their effort was rewarded and will be further recognized and appreciated in the future.

The volume opens with an overview of the research effort encouraged and financed by the Armand Hammer Fund for Economic Cooperation in the Middle East. The overview is written by Professor Ben Shahrar, who initiated the research at Tel Aviv University.

The following collection of studies is divided into four sections:

The first section deals with the pre-peace era, which is typified by the military buildup and its corresponding heavy economic costs (Sheffer, Kanovsky) and by occupier-occupied relations (Kleiman, Tuma).

The second section focuses on solutions to conflicts (Intriligator and Brito), methods to achieve their resolution such as sanctions (Schott), and risks of cooperation (McGuire).

The third section examines economic integration in the Middle East, its implications and possible costs. It also explores means of financing economic integration projects and the experience of other regions (Starr, Gafny, Blejer, Concheiro, Nilsson, Hindley).

The fourth section analyzes the consequences of peace and economic cooperation in the Middle East (Hirsch, Meital, Kally, Raz, Ajami, Fishelson).

This division is meant to help guide the reader through the studies without implying anything about the relative significance of any specific section. The collection is a unified self-contained package, in which each study supports and is supported by the others. The editors feel it is the most comprehensive representation of current economic thinking on the issue of peacemaking that is now available.

The main idea that continually surfaced and that sums up the findings of the conference is that political and economic relations and agreements are strongly interrelated and must move forward simultaneously. One strengthens and reinforces the other and it is unlikely that either can stand alone.

*Professor Gideon Fishelson
Scientific Coordinator of the "Economic
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Introduction

Economic Cooperation in the Middle East: From Dream to Reality

Opening Address*

Professor Haim Ben-Shahar

Lasting peace among nations is characterized by a broadly based network of relations among them, of which economic relations are a most important and definitive dimension. This is particularly true among neighboring countries. After the signing of the peace agreements by the nations of Europe at the end of the Second World War, economic relations began to develop, and within 12 years these led to the establishment, in 1957, of the European Economic Community, which included such previously long-term enemies as France and West Germany. Today the notion of an economically divided Europe is unthinkable. We believe that this example is applicable to the Middle East, once there is a breakthrough in negotiations towards peace.

*Delivered in the presence of His Excellency, the President of the State of Israel, Mr. Chaim Herzog; the Minister for Economic Affairs, Mr. Gad Ya'acobi; the Chairman of the Board of Governors of Tel Aviv University, Sir Leslie Porter; the President of Tel Aviv University, Professor Moshe Many and many other honored guests.

The purpose of this address is to present the Hammer Project on Economic Cooperation in the Middle East under peace, its roots, its history, its development, and the main findings of the research activities carried out within its framework.

■ The Background

The question may well be asked—why research the economics of peacemaking?

Until the visit of President Sadat to Jerusalem in 1977, the Israeli public did not believe in the reality of peace in our time. The main items on the national agenda, as expressed in both government policy and public opinion, were ensuring the very survival of the State, economic growth and accelerated population growth through immigration. There were other priorities, too, such as raising the educational level, cultural enrichment, and social and ethnic integration, and indeed, important advances were made in these areas.

However, one subject, planning and preparation for peace, was excluded from the agenda of priorities. There was, of course, a genuine desire for peace, but a belief in the possibility of its ever coming about in our time was lacking. The immediate needs of survival exhausted all existing resources, economic and social, as well as intellectual and psychological, leaving no room for contemplating and planning for the seemingly unrealistic notion of peace.

As long ago as the mid-1970s, we at Tel Aviv University believed it to be our national duty as scholars whose institution was supported by the public, to contribute to vital national concerns, which were within the realm of our competence in research, analysis and planning. Among the many and varied areas of our activities were, for example, the establishment of the Jaffee Center for Strategic Studies, which is concerned with strategic issues impinging upon the very existence of the State, and the Sapir Center for Development, which deals with issues of internal policy, particularly its economic and social dimensions.

Along with these, we decided to establish a framework for planning for peace. It was clear that the subject of peace was not receiving the attention it deserved, not, as already noted, for lack of a desire for peace, but because there were always more apparently urgent and immediately relevant needs. We felt we were well equipped to contribute to the advancement of this neglected, seemingly “abstract” process of thinking about and planning for peace. These efforts and activities require little in the way of money but much in the way of strongly motivated, dedicated and experienced researchers.

In 1976, while serving as President of Tel Aviv University, I broached the subject with several international personalities, requesting their help. Among those responding positively were David Rockefeller, the Chairman of the Board of Chase Manhattan, and William Simon, then U.S. Secretary of the Treasury. Together we drew up plans for the establishment of a center for research on international economic cooperation, the central concern of which was to be the Middle East. Then, in November, 1977, President Sadat made his historic peacemaking initiative.

The very real prospects for achieving a peace agreement with Egypt proved to us that we had been right in our insistence on the immediate necessity of planning for peace, and it was only a pity that we had not started even earlier.

Following President Sadat's visit to Jerusalem, we worked, together with David Rockefeller, on modifying our previous proposals, this time for joint economic research with an Egyptian university. David Rockefeller presented the proposals to President Sadat early in 1978, but by then the peace negotiations between the Egyptian and Israeli governments had already reached the state of crisis that was to continue until the Camp David meeting of September 1978, and the issue of joint research was left pending.

In view of the circumstances, we made a decision in the early months of 1978 that, whatever the Egyptian stand on joint research, we would go ahead independently, offering to join up with them at any time they saw fit. It was this decision that led us to Dr. Armand Hammer, Chairman of Occidental Petroleum.

Dr. Hammer has always seen the development of economic relations as an instrument for promoting peace. In 1978, we presented our plans to him and requested his support. This was two months prior to the signing of the Camp David accords, a time of crisis in the negotiations with Egypt. Without hesitation, Dr. Hammer agreed to lend us his support, even though the prospects for peace at that time appeared slim indeed. He gave generously of his own resources, recruited additional resources from among his friends, and gave the prestige of his name to the project. It may be safely said that without Dr. Hammer, his personality and drive, the project would never have come about.

In 1981 we embarked systematically upon our research projects, the main findings of which will be presented at this conference.

■ Principles Underlying Our Research

Economic factors play a decisive role in international relations, serving very often as a pretext for going to war and as a reason for peaceful alliances.

In the last decade the importance of oil and its crucial effect upon international relations have been only too well demonstrated. While the Israeli-Arab conflict is not over economic issues, they are expected, nevertheless, to play an important role, in the following respects.

1. Economic factors are likely to constitute an obstacle in political relations. For instance, the shortage of water in Israel, the Gaza Strip and the West Bank may well further aggravate the political conflict.

2. Economic factors may serve as compensation for political concessions, as, for instance, in the negotiations on the territory of Taba.

3. Most importantly, any peace agreement remains merely a piece of paper until it is reinforced by the development of a substantial and broad-ranging system of relations between the signatories. Cultural relations and joint sporting activities are both important but economic relations create a lasting interest in peace and therefore are still more important.

It is essential, furthermore, to plan the economic relations in a way which will bring about the desired results and avoid the undesirable, while taking into account a complex range of considerations:

a. The economic benefits must be shared equally between the sides. Moreover, for each side there must be a substantial level of benefit that justifies cooperation. Costs of dissociation, which increase the interest of all sides in peace, are also involved.

b. Care must be taken not to create one-way dependence in areas of vital interests. This will only deter the potentially dependent side from entering into the relationship and tempt the other side to exert pressure to obtain undue benefits.

c. The areas of cooperation must be chosen from among those which will cause a minimum of friction between the parties. This means that the projects must be of a type which benefit both sides equally rather than helping one side at the expense of the other.

d. The psychological aspect, too, must not be ignored. The subjects chosen must be such that each side feels its contribution is positive and made without loss of dignity. For instance, plans based on the Israeli brain and Arab brawn, though they may be economically worthwhile for all concerned, must be approached with hesitation, because they are psychologically problematic. Therefore, planning must be very cautious. Not all subjects that meet the economic criteria should be recommended.

Another guiding principle which directed our work was that the scope of research topics should be fundamental, thorough and long-term, and not subject to the vagaries of the political pendulum, of which there have been many.

We have gone ahead steadily with our work, without letting it be affected by the highly variable political situation, and are now prepared to place our proposals at the disposal of policymakers in Israel, in other countries of the

Middle East, and in friendly nations seeking to help in mediating the peace process in our region. Our work contains no classified material pertaining to security and is available to the public at large.

It is our aim to be prepared for the eventual arrival of suitable conditions for the implementation of one or another of our programs. Each of these could be implemented at the appropriate time, like contingency plans at a military headquarters.

■ The Potential for Economic Development in the Middle East

Peace may provide the momentum for economic development in the Middle East. The potential for such development lies in the area's natural resources and plentiful manpower. Manpower is not confined to Israel — one and a half million Egyptian teachers, engineers, scientists and managers are presently employed in the Gulf states, and numerous Palestinians are studying at universities in neighboring Arab countries. Potential markets exist and both foreign and local capital are available.

International corporations perceive the potential of the Middle East for large-scale economic and commercial growth and development. At present, however, they are deterred from embarking upon concrete ventures by political uncertainty and military risks.

We have investigated the potential for growth and development under conditions of peace and cooperation and have made a number of interesting estimates of growth which would be possible if there was peace. Within ten years of peace, the GNP of Israel could be about 22 percent higher than in the absence of peace. Had the peace process begun in 1982 with accelerated economic growth accompanying it, by 1992 Israel's GNP could have been \$8.4 billion larger than is forecast with the continuation of existing conditions. Similar developments could have taken place in the Arab states bordering upon Israel: Egypt, Syria, Jordan and Lebanon. Had peaceful relations been established in 1982, the total GNP of these four countries could have been 24 percent, or \$20 billion, higher after ten years. The standard of living and per capita consumption, and, of course, levels of investment would also have risen by similar percentages. (See Table 1.)

Accelerated growth under conditions of peace is due to the following factors:

*Defense expenditures would be lower, releasing more resources for investment and growth. Manpower employed by the military establishment, too, would be released for productive employment. This latter factor is particularly important for Israel, where military reserves duty obligations are particularly heavy.

Table 1
Supplemental Economic Growth Under Conditions of Peace

	Israel		Neighboring Arab Countries	
	\$billion	%	\$billion	%
GNP	8.4	22	20.0	24
Private consumption	3.5	18	9.2	15
Investments	4.3	55	11.7	52

* Under conditions of peace, more foreign capital for investment would be attracted to the region so the cost of capital would be reduced.

* Development of intraregional trade would increase economic efficiency and create additional sources of employment and opportunities for growth.

* Cooperation in economic projects, particularly in the development of the region's infrastructure, would also contribute to economic growth.

All these factors would contribute to an improvement in education levels achieved, in professional expertise, and in productivity.

■ Economic Development Plans

The work of the research program is conducted within the framework of the Interdisciplinary Center for Technological Analysis and Forecasting at Tel Aviv University by a team of researchers in the areas of economics, engineering, geography, statistics and other relevant disciplines.¹

The following is a brief survey of the main research projects and their findings.

Water

The region suffers from an imbalance of water resources, shortages being particularly acute in the Gaza Strip and the West Bank, as well as in Israel. The water resources of the Gaza Strip and the West Bank today are only 250 million cubic meters per year, while demand is expected to increase to 600 million cubic meters within the next 15 years. At the same time, water surpluses from the Nile in Egypt and the Litani River in Lebanon flow unused into the Mediterranean and most of the winter floods of the Yarmouk River in Jordan are lost by evaporation after they flow into the Dead Sea. Jordan's agriculture is being retarded by the inadequacy of her water supplies.

Israel already utilizes all her available resources of surface and subterranean water, including the share of the Jordan River's headwaters allocated to her under the Johnston Plan of the 1950s. Israel, therefore, has no water resources available for diversion to the West Bank and Gaza Strip, and is, in fact, herself in need of additional water for which she is prepared to pay a high price, in view of the economic benefits associated with it. A regional water plan need not await the achievement of peace. To the contrary, its preparation, before a comprehensive peace settlement is attained, could help to clarify objectives to be aimed for in achieving peace.

Egypt has drawn up plans to convey one billion cubic meters of Nile water per year by canal to the Sinai Peninsula. This project could be extended to make it possible to purchase 350 million cubic meters for use in the Gaza Strip and the West Bank and 250 million cubic meters for use in Israel.

A regional water plan would provide the possibility for a water exchange scheme. It would be cheaper to supply Israel's Negev with Nile water than to pump water from the Sea of Galilee, as is presently being done. The water now supplying the Negev could be pumped from the Sea of Galilee to closer destinations on the West Bank.

Cooperation between Jordan and Israel would permit storing the Yarmouk's winter floodwater in the Sea of Galilee, for use by Jordan and the West Bank when needed. The cost of conveying Yarmouk water to the Sea of Galilee would be only \$30 million, which is far less than from any other source, and the project would make it possible to utilize an additional 200 million cubic meters of water per year.

The project would support the peace process in that it would enable Jordan to expand the agricultural development of its main irrigated area, the Ghor Valley, and would offer some relief for Jordan's severe urban water shortages, as well as increasing water supplies to the West Bank.

The Litani waters are already fully utilized or earmarked for future Lebanese development projects. Nevertheless, marginal quantities (some 100 million cubic meters per year) might be allocated for a diversion into the Jordan River drainage basin, for supply to the West Bank, Jordan and—political circumstances permitting—also to Israel.

Energy

In the Middle East the imbalance in the distribution of energy resources is particularly acute. Israel and the four Arab countries directly bordering her lie outside or on the margin of the oil belt that stretches from Iran and Iraq to the Persian Gulf. Only Egypt and Syria have their own petroleum reserves, and these are not large enough to allow for long-term exports. Lebanon, Jordan and Israel have virtually no oil. However, an optimal utilization of energy resources which are available could be facilitated by

cooperation. One potential type of cooperation could be overall integration of the electric power transmission grids of Israel, Egypt, Jordan and Lebanon. By taking advantage of the differences in peak demand periods, power supply shortages in one country might be made up from surpluses in the other, leading to a better utilization of power generation capacity and thereby reducing the overall cost of electric power.

Another area of potential cooperation is the generation of hydroelectric power. One such hydroelectric project would involve diverting water from the southern section of the Litani River to the Jordan basin, to take advantage of the greater descent to the Sea of Galilee (to 200 meters below sea level) than to the Mediterranean coast. The southern Litani waters thus diverted might then be used to supply the West Bank, Jordan or Israel. A second project which has been proposed is the joint Jordanian-Israeli production of hydroelectric power through exploiting the 400 meter elevation difference between the Mediterranean or the Red Sea and the Dead Sea.

Gas Pipeline

In Egypt, as elsewhere in the world, natural gas is found either associated with oil (in which case it must be separated from it) or in independent subterranean pockets. Liquefaction of natural gas for shipping, which is very capital-intensive, decreases the profitability of natural gas exploitation by adding substantially to its final sales price.

Our proposal calls for the construction of a natural gas pipeline from the Nile Delta to the Beer Sheva and Zohar regions, to supply industrial enterprises (mainly chemical) in the south of Israel, to the Ashdod power station, and to the Gaza Strip. The amount of gas transported annually would be 2 million tons of fuel oil equivalent (FOE), to be conveyed by a 28" pipeline, 290 km long. At \$15 per barrel of FOE, the project would provide Egypt with an income of over \$200 million per year and provide Israel with clean and relatively inexpensive fuel.

An Israel Terminal for the TAPLINE (Trans-Arabian Pipeline)

The existing TAPLINE was constructed in the 1940s by Standard Oil of California and the Texas Oil Company for the export of Saudi Arabian oil to the West. With the outbreak of hostilities in Palestine in 1947, the entrepreneurs decided to divert the pipeline from Haifa to Sidon in Lebanon. The unrest that subsequently overtook Lebanon made the line inoperative.