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# WHY ISRAEL'S WESTERN ECONOMY MATTERS

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A Top-to-Bottom Analysis of Economic Characteristics



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# **Why Israel's Western Economy Matters:**

## **A Top-to-Bottom Analysis of Economic Characteristics**

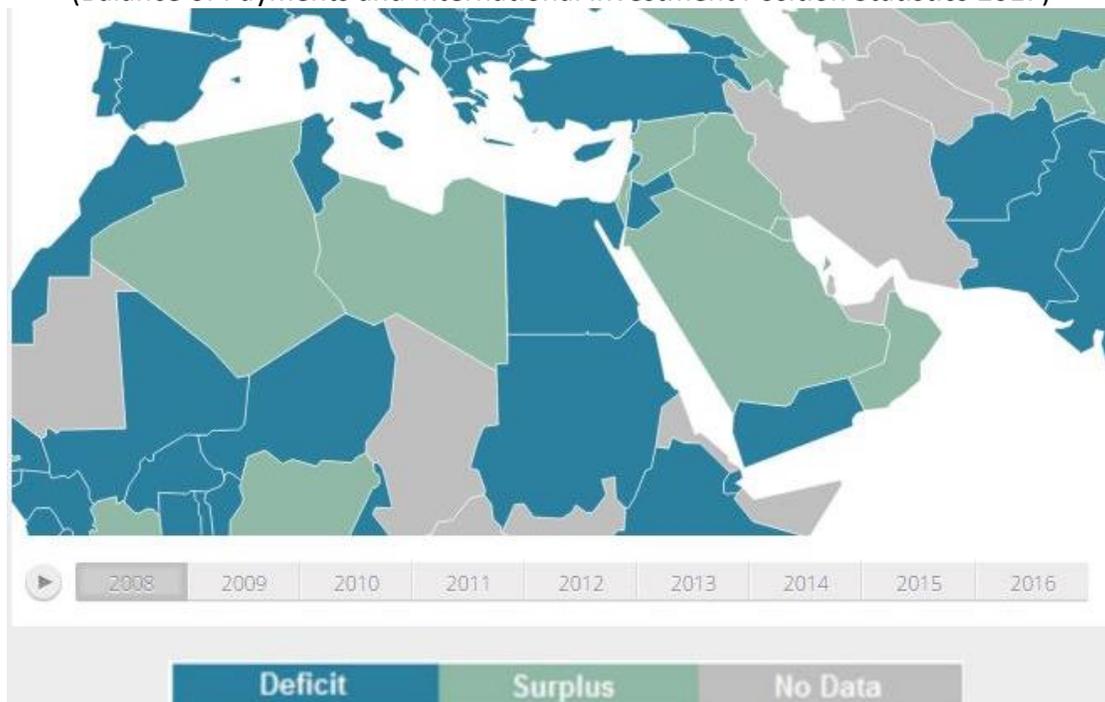
### **Introduction**

The question of whether Israel can be conceptually categorized as Middle Eastern can be analyzed through an almost infinite number of axes. This paper seeks to scratch the surface of this question as analyzed through a macroeconomic perspective through three different lenses. The answer to this question is relevant for discussing the different social webs in which Israel is imbedded. When two neighbors go into business together, they establish ties not only in an economic sense, but are essentially forced to socialize with one another. Without saying that economics causes the social ties between the west and Israel or vice versa, this paper shows that there is more meaning to economics than just money. There are many different characteristics that can be analyzed when speaking of economics, but this paper chooses to look at the following issues: where exports are going and where imports are coming from, the way the United States treats different nations in the region with respect to aid money, the global credit ratings given to each country, and finally, this paper looks at the relations of private sector investments from foreign investors. Choosing these areas gives a good illustration of what is going on in the big picture of the economy of Israel by seeking patterns in bilateral, multilateral, and private flows of cash and credit. This paper evaluates these economic indicators from several sources in order to establish that Israel should not be considered a part of the Middle East when looking at any of these factors.

It is important to look at these three factors when determining the economic standing of Israel because it gives a much clearer picture of what is truly happening with flows of cash in

the region. Map 1.1 designates each nations' account balance from 2008. The balances indicate the amount of money entering and exiting the government budget of each respective country. Choosing 2008 as a year which we have sufficient data for, we can see that in this undetailed look at the region that there is truly nothing that stands out as Middle Eastern, Eastern, or Western because there are a large mix of surplus and deficit accounts. If it were this simple, then we would see many countries in the Middle Eastern region with surpluses or deficits, but there is no consistency throughout the region that stands in contrast to any other region of the world. By looking at direction of trade, aid, credit, and private investment, we can make a more clearly distinguished category of "Middle Eastern" in terms of economy.

*Map 1.1 Account Balances of Countries in and Surrounding the Middle East*  
(Balance of Payments and International Investment Position Statistics 2017)



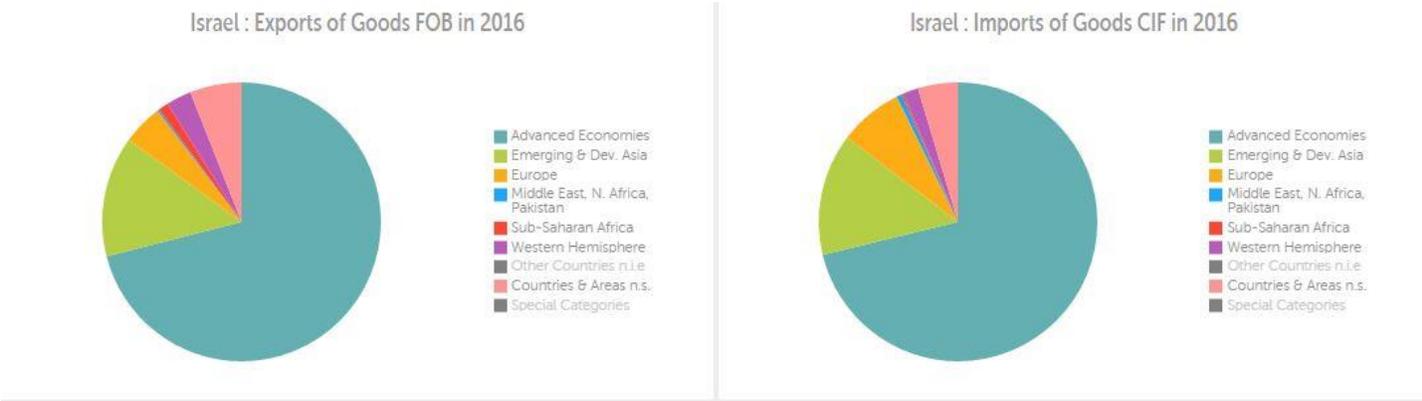
The implications of this conclusion is that there are mutually reinforcing factors of economics, politics, and social interactions that become very relevant for almost any issue we

can take into account. Starting at the level of total exports and imports and looking at gradually smaller and more precise indicators, we can eventually see that this matters for individuals and private business in the countries of analysis.

**Direction of Trade in the Middle East**

In this section I will use statistics from the International Monetary Fund to show that the way that Israel trades compared to other countries in the region should exclude Israel from being considered Middle Eastern. Specific examples of Egypt and The United Arab Emirates can give us a general idea of what different economies in the area tend to do and show us that Israel is significantly different. To begin, we can look at graph 1.1 in order to establish the direction of trade of imports and exports from Israel. This chart was taken directly from the IMF website on the Direction of Trade Statistics (DOTS) for the year 2016.

*Graph 1.1: The Direction of Trade on Israel (Direction of Trade Statistics Israel 2017)*



This Graph shows the entirety is Israel’s reported trade to different regions of the world and different economies. The graph can be used to look at trade relationships by simply looking at who Israel ships products to and who the import products from. Since the regional map

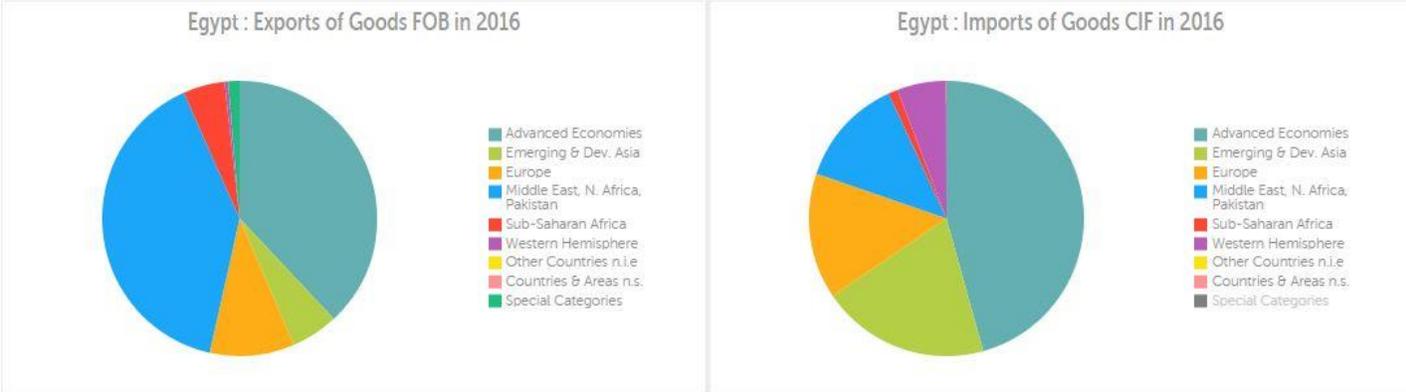
pointing to deficits and surpluses can't tell us anything about what it means to be Middle Eastern, this information is necessary. At a glance, we can see that almost no trade occurs between Israel and other Middle Eastern countries while almost 75% of all trade in both directions goes toward advanced economies, most of which are western. When looking at this graph, it is important to distinguish what each of these categories mean, because there are several countries in Europe that are also advanced economies, and the same goes for some Asian countries. The IMF only reports each country in one of the two or more categories that it fits into, with the highest degree of preference given to the advanced economy section. For example, the UK is in Europe, but is also an advanced economy and therefore would be counted as advanced.

Israel's top ten trade partners are as telling as the entirety of their trade statistics. Michigan State University has compiled trade statistics from The UN Comtrade and World Bank data to show that the only country in the Middle East to place in the top ten trading partners is Turkey (Michigan State University 2017 Israel). Turkey is far below other countries such as the U.S. in first and other advanced economies such as China and Germany. This is important for more than just economic reasons. Countries' trade partners are often indicative of shared culture, respect, and other interests and this, so far, indicates a stronger tie to the west than to any other part of the world.

The difference between Israel and the rest of the middle east can be further shown by looking at other countries. I chose to look at Egypt as well as the United Arab Emirates in this category because between the two countries there is a representation of many different goods

which each of them export. Graph 1.2 shows Egypt’s imports and exports and Graph 1.3 shows the UAE’s imports and exports.

*Graph 1.2: The Direction of Trade Statistics on Egypt (Direction of Trade Statistics Egypt 2017)*

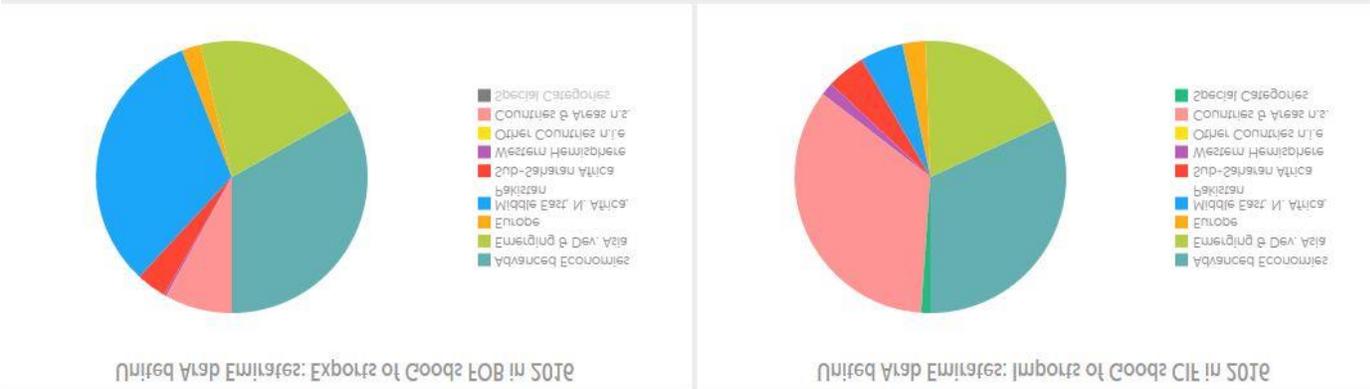


Here we can see that Egypt has a fundamentally more diverse set of trade partners throughout the world and even a difference between the categories of imports and exports. The imports and exports are essentially a mirror image of each other with respect to Israel, but in Egypt there is a greater discrepancy between the two. With less than half of each category going to advanced economies, we can already see a difference between the two. Also notice how Egypt has a large portion of their trade going toward other Middle Eastern countries. The Michigan State University compilation shows that of Egypt’s top ten exporting countries, exactly five are in the Middle Eastern region (Michigan State University 2017 Egypt). This shows that Egypt is strongly tied to the Middle East when we look at exports and imports and that the country also has a diverse set of trade partners.

A second country I look at in order to see DOTS is the United Arab Emirates. This country has a large portion of its economy based in oil exports, so one could easily have thought that a

majority of its exports and imports would be between advanced economies who need the oil for industrialization. Graph 1.3 shows that this is not the case and, like Egypt, the UAE has a very diverse set of trade partners that are not advanced economies. Less than half of all the trade to and from the UAE is with advanced economies, although the country has a very different relationship to the Middle Eastern region when comparing exports and imports. Michigan State University is less helpful here and shows that the top ten trading partners are all advanced economies (Michigan State University 2017 United Arab Emirates). This can be explained by the number of trade partners the UAE has, where a small number of transactions between many different partners account for a larger portion of the total and a smaller number of large transactions are made between the advanced economies, putting them at the top of the list of trade partners. The total of the trade with all these other small scale partners outweighs the total of advanced economies, but the advanced economies individually make larger transactions and therefore are still at the top of the trade list. Regardless, the point is that the socio-economic ties that the UAE has are far more diverse than Israel.

*Graph 1.3: The Direction of Trade Statistics on the United Arab Emirates*  
 (Direction of Trade Statistics U.A.E. 2017)



The patterns that we see in the Direction of Trade Statistics in Egypt and the United Arab Emirates are thoroughly reflected in the economies of other nations across the Middle East. This means that the differences seen between these two countries and Israel are also differences between other countries in the Middle East and Israel, such as Kuwait, Saudi Arabia, and Iran (Direction of Trade Statistics 2017). Because of these facts, we must consider Israel as something that is separate from the Middle East. The next question is, can we consider Israel as a part of the West? The next sections will look at this question.

### **United States Aid Money**

The previous section established that based on large scale trade, we cannot say that Israel is a part of the Middle East. This section uses an analysis of the way the United States allows Israel and Egypt to use aid money in order to establish that this extension of aid differs greatly in the way western countries treat Israel. This conclusion will be further supported by the following section on international credit ratings and private investments. This section draws on reports from the U.S. Government Accountability Office (GAO) and Congressional reports to show that Israel is given significant agency in spending aid money while Egypt is heavily restricted in the way they can spend the cash given to them through the U.S. Department of Defense (DOD) and United States Agency for International Development (USAID).

The Congressional report on aid to Israel is the most convincing and even admits to a large difference in the amount of money going to Israel as well as the privileges extended to Israel on how they can spend this money (U.S. Congress 2014). In the introduction of the CRS report, the author points out that Israel is the largest recipient of bilateral US aid since World

War II and because of congressional support, the country is allowed many privileges that no other recipient has. These benefits include the ability of Israel to do defense research on U.S. soil in concert with the U.S. DOD as well as the ability to spend aid from the United States on goods from Israeli companies (U.S. Congress 2014). This same report shows that the rhetoric of aid to Israel has long been explained as giving Israel a “Qualitative Military Edge” when compared to neighboring countries because of their disadvantage in terms of numbers and geographic size, thus, the vast majority of US aid goes to military spending such as the Iron Dome missile defense system, David’s Sling, and the Arrow I, II, and III projects (U.S. Congress 2017). In 2008, the Arms Export Control Act was amended in section 36 to ensure that any trade in arms will be evaluated to ensure that there is no possibility of the sale adversely affecting Israel’s security.

The CRS report also goes into detail on what Israel is permitted to do and what happens with funds given by USAID. The USAID program called American Schools and Hospitals Abroad (ASHA) has given the majority of the aid for the Middle Eastern region to Israel and they have been recipients of this aid since 1957 (U.S. Congress 2014). The Program is designed to give aid money to schools and hospitals across the world that make efforts at perpetuating the ideals of the schools and hospitals of America, which is something to consider in our question of Israel being a part of the west. There has also been millions of dollars given to a programs that the report calls Business and scientific cooperation programs. The BIRD, BSF, and BARD foundations are several entities designed for reasons from energy cooperation to agriculture (U.S. Congress 2014).

The U.S. also gives a significant amount of aid to Egypt because of the Camp David Accords, which is why it is a good country to compare to Israel in the U.S. treatment of foreign aid. The Camp David Accords created an obligation to give Egypt two-thirds of the aid which the U.S. gives to Israel, so we know that there is a significant amount of aid which we can look at in comparison to Israel through the GAO report. This report looks at the fiscal years of 2009 through 2014 and shows exactly how much money is being spent on which projects. The rhetoric surrounding aid to Egypt is significantly different than that of Israel, mostly focusing on economic growth and counterterrorism efforts. Despite the different rhetoric, significant amounts of money is still put toward militarization and less so toward USAID programs for economic and humanitarian efforts (United States of America Government Accountability Office 2015). At the time of the report through fiscal year 2014, Egypt had received approximately \$64 Billion since 1979, \$40 Billion of which was for military assistance (United States of America Government Accountability Office 2015). This may seem quite similar to Israel in terms of the proportion of where the dollars are going, but a closer look at the policies of aid tell us that the United States treats each aid recipient very differently.

We already have seen the advanced weapons capabilities that U.S. aid has given Israel and shown that they are allowed to develop their own weapons technology such as the Iron Dome Missile Defense System through many different cooperative avenues. This turns out to be a very key difference when it comes to Israel and the Middle East as well as the rest of the world which the U.S. supports. Egypt is not allowed to spend money on their own soil in their own defense industry, the result being that they have to buy weapons either in parts or wholly assembled from the United States. Examples of this would be purchases of M1A1 tanks or the

F-16 combat aircraft by Egypt (United States of America Government Accountability Office 2015) while we allow Israel to purchase the more advanced weapons systems of the F-35 combat aircraft as well as develop their own defense industry (U.S. Congress 2014). The result of this is that Israel not only has the qualitative military edge that the rhetoric purports to serve, but they are able to bolster their own military/ weapons industry that stands on its own instead of developing a weapons dependence on the United States.

There is already academic work on the ways in which the United States treats Israel as its fifty-first state (Newman 2012) and it seems as though this rings quite true with respect both military and economic aid. The United States tends to give Israel extensive leeway with its aid usage while restricting quite heavily the ability of other countries like Egypt to purchase goods outside the U.S. offer. When talking about foreign aid money, Israel seems to fit into the west more easily than it does the Middle East, but to further this point, I will talk about the final category of credit ratings and the results in foreign private investments in the next section.

### **Foreign Private Investment and Credit Rating**

The idea of crediting and lending shapes where private investments go and therefore we can start talking about the way in which individuals from different nations and regions interact economically rather than talking about the nations as a whole. This section will outline both credit and foreign private investment in tandem because they are mutually reinforcing factors. I will give a brief overview of two different major credit evaluation organizations and then take a look at several specific private investments that prove the credit worthiness of the countries of in the region.

The credit rating of a country is important for several reasons for the purposes of this paper. Most notably, it gives us an estimate of the likelihood that credit will be extended to a nation. Secondly, because this credit analysis looks at the strength of central banks, the political climate of a nation, and several other factors, it is also a good way to monitor the stability of the entire market of a country and therefore used as a metric for private investors. I will be comparing several countries through the Standard & Poor's (S&P) index as well as Moody's index because these organizations have been around for over 100 years and have been central to the analysis of the stock markets of America and abroad. For the purposes of this paper, the differences in methods used are not as important as the actual credit ratings given by each system, but are available to look at through each services' website (Understanding Ratings). The credit rating system of each is fairly straightforward with "AAA" being the highest for S&P and "Aaa" being the highest for Moody's. It logically descends in each index alphabetically with several nuances such as plus(+) and minus (-) signs as well as distinctions in the number of letters to indicate that the rating is meant to either be a short or long term calculation. In table 1.1 below, I have compiled the credit ratings for a few countries for comparison from each index's data. This chart was compiled by taking select countries' information from a chart that the Guardian online Newspaper made in 2010 with S&P and Moody's data. I purposely left out a majority of the countries on this chart because they were in regions that were irrelevant for this paper.

*Table 1.1 S&P and Moody's Global Credit Index (Rogers 2010)*

Country	S&P	Moody's
Israel	A+	A1
Egypt	B-	B2
Oman	A	A1
UAE	N/A	Aaa
U.S.	AA+	Aaa
Jordan	BB	Ba2
Lebanon	B	B1

It may appear that there is not explicit patterns in what we see across the Middle East, with several countries being highly recommended for credit approval and investment, but the countries with high credit have something in common. The only three countries on the table that are in the middle east are the UAE, Oman, and Israel, the first two being oil rich states that have lots of excess funds and collateral to put up. Other countries like Jordan and Egypt fall short of credit approval for several reasons, such as political instability. The rating is not the only thing that separates Israel from the other Middle Eastern countries. In fact, in 2012 S&P gave a press release saying that it would keep Israel's credit rating the same, despite the

inability of Israel's government to pass a budget at the time of rating their credit (Filut 2012).

Why would the credit rating of a country remain the same when there is no budget to monitor their fiscal policies? The statement contained answers which alluded to the governments past considerations of paying off debt as a cornerstone of their policy. Would this happen if an oil-rich state stopped producing oil or made any lofty financial changes? This is a hard answer to find and say for certain, but the western style democracy present in Israel certainly didn't hurt in this calculation of credit and government obligation to pay off debt.

The credit ratings of countries are interesting and relevant in their own right, but what this section is attempting to do is develop an understanding of the socio-economic ties between the citizens of different countries. The credit that was just talked about is an important indicator for many private companies that are thinking about investing, and I find that when looking at private investments, Israel is also a western economic entity. Private companies of venture capitalism such as Sequoia Capital have taken a stake in Israel's start up industry (Company Overview of Sequoia Capital Israel). Originally located in California, the company took a leap into international status by its first expansion into Israel (Bond-Graham 2014). Microsoft has recently boasted of its 25<sup>th</sup> anniversary in Haifa, also citing startups as a good reason for investment in Israel (Sommer 2002). Microsoft also has programs of youth outreach and teaching to inspire the Israeli youth, becoming a part of the community instead of simply a large company in the area (Microsoft). Citigroup is also in Israel, and they take the cake when it comes to large foreign finances in Israel with the expansion into Israel in 1996 and becoming the first foreign bank with full banking license abilities in the country (Citigroup).

These are just a few foreign investments that have been placed in Israel that started in the west.

These are large companies, but their economic impact goes much further than just their own finances. These companies not only have branches in Israel, but focus most of their time on innovation, development, and startups that they don't take on in other countries that they are located. Of course Microsoft has facilities in East Asia, but they just manufacture parts. Venture Capital firms such as sequoia are also in many countries, but in their specific instance their first expansion was into the Israeli market. Finally, Citigroup is in many, many countries, but they were excited to become the first foreign bank with all the capabilities of domestic banks in the country. They wanted to make that expansion because they were trusting in the market and the peoples' ability to support their business.

In the comparison to the rest of the Middle East, the same excitement over foreign investment can be seen in several of the small emirates around the Persian Gulf, but not nearly so in any other country. Citigroup has branches of CitiBank in many Middle Eastern countries but they don't have the same story of the first foreign entity with full banking status in these places. Microsoft has resources available in all but the most remote and war-torn countries, but keeps its support branches focused mostly in OECD countries and certainly does not invest back into the community the way they do in Israel. Sequoia Capital is limited to just the U.S., Israel, India, and China but has many companies throughout the world that they've help start (Sequoia). These are only three companies, but are representative of a lot of the economic growth of the world economy in the past 30 years. Israel is looked upon quite favorably by all three of these investors, and while they also invest in other countries, it is not nearly to the

extent which they allocate resources to Israel. This does not prove that Israel is Western, but it does put significant distance between Israel and the economic Middle East and establishes social ties between Israel and the West. The oil rich states around the Persian Gulf are the closest thing to Israel in the Middle East when looking at foreign private investments, but these are the exception, not the rule.

### **Conclusion**

This paper gave a glimpse at just a few economic indicators to argue that Israel is not a part of the Middle East. It is important to clarify that by showing how these economic ties to the west can lead to social ties, this paper is not arguing that the cause of *all* the social ties between the West and Israel are economically rooted. This paper also brings up several new questions that need to be answered. For example, what portion of the S&P credit rating system is political rather than simply focused on the money? Another would be inquiring further into my assertion that these foreign private investors are socially tied to Israel. Perhaps there is a lot less social capital being developed by these sorts of companies outside the three that I have analyzed. Regardless, with the information presented in this argument it cannot be denied and there is next to nothing that ties Israel to the Middle East.

This paper has looked at three different flows of cash and credit between the West and the Middle East to find that Israel should definitely not be considered part of the Middle East when looking at social-economic ties between countries. From the top down, it must be seen through these different factors that Israel is in a completely different economic situation than the rest of the Middle East and very closely tied to the West. Direction of trade statistics show

that almost three-quarters of Israel's trade in both directions is from advanced economies and other countries in the region have approximately half of that trade level with advanced economies. When looking at U.S. foreign aid, it can be seen that in a strict comparison of Egypt and Israel, there are distinct advantages given to Israel in the fungibility of aid. While Israel can practically use aid on whatever they desire, states like Egypt are subject to quite a bit of contingency clauses when making use of aid. Credit can be talked about with a fairly strict divide in the Middle East between oil and non-oil economies, with the exception of the fantastic credit given to Israel. This credit rating is subject to more review than the other axes of analysis that I have gone through because there are many reasons that good credit can remain through extenuating circumstances, however; the case is still evident that credit creates a platform for investment from foreign entities that end up creating social capital.

Through these different lenses, I have taken a large view of Israel's economy and broken it down to the private sector investments of foreign investors. With the examples of Microsoft, Sequoia, and CitiGroup, I have shown that there are more prospects to this economic link than just money. Each of these private investors have had to make a decision to take billions of dollars' worth of assets to a foreign country, sometimes in the first foreign expansion in the company's history, like Sequoia. The end result is investment in the communities that these originally Western companies are making, like Microsoft's youth development practices. Israel can be categorized as Western when looking at the economy for all of the reasons discussed here.

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