Final Report

An Analysis of the Potential for Collaborative Commercial and Industrial Ventures in the Near East Region

prepared for

Sadat Peace Foundation
U.S. Agency for International Development

Policy Planning International, Inc.
Washington, D.C.
August, 1988

F I N A L   R E P O R T

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by

William T. Irelan
Douglas S. Land
Delwin A. Roy

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EXECUTIVE SUMMARY

This paper presents the results of a study of the potential for collaborative commercial and industrial ventures in the Near East region, in particular between Egypt and Israel. The study was undertaken by the firm of Policy Planning International under contract to the Sadat Peace Foundation, with funding provided by the U.S. Agency for International Development (USAID). The data on which the study is based were derived from a review of the available literature on the subject, a survey of U.S. corporations active in the region and a field survey of actual case examples. The research team spent approximately two weeks each in Egypt and in Israel in October and November, 1987.

The principal findings and conclusions of the study are:

- o The rapid privatization of the economies of the region has led to significant cross-border commercial and financial flows unimpeded by political constraints.

- o A surprising and substantial amount of commerce has developed between Egypt and Israel since the signing of the Camp David Accords, much of it private trade passing unreported through unofficial channels.

- o Egypt is the principal beneficiary of existing trade, owing primarily to large government-to-government sales of crude oil to Israel. Excluding oil transfers, the trade balance favors Israel by a wide margin.

- o No joint investment projects have developed to date.

- o The principal constraints to the further development and expansion of bilateral commercial and industrial relations are primarily economic and financial; political constraints inhibit but do not prevent the development of further business linkages.

- o The principal economic complementarities between the two countries lie in agriculture, tourism, energy (petroleum and natural gas), technical services and selected product manufacturing (agro-industrial, textiles, chemicals and water use devices).

- o Opportunities for the development of joint production projects are circumscribed and will likely take many years to evolve absent special incentives. The best long-term possibilities will be found in manufacturing for third country markets, with selected opportunities available to produce jointly for the Egyptian market.

To alleviate the principal existing constraints, the team suggests the creation of joint business groups, trade finance/promotion agencies and a joint investment authority.

CONTENTS

I. Introduction

The purpose of the study reported on herein was to initiate an evaluation of the potential for specific collaborative commercial and industrial ventures in the Near East region, in particular between Egypt and Israel. The study aimed to determine the kinds of business relations that reasonably can be expected to develop between private commercial, industrial and service enterprises of the two countries given present economic, political and other constraints. An underlying intent of the study was to determine how such business relations might be successfully consummated.

The study was undertaken under the auspices and financial sponsorship of the U.S. Agency for International Development (USAID) at the suggestion of the Sadat Peace Foundation. USAID provided the Foundation with a grant of $50,784 to finance the necessary research and the Sadat Peace Foundation subcontracted the work to Policy Planning International, a Washington, D.C. applied research and consulting firm.

The research program was composed of two stages: (1) a desk-top literature review and survey of U.S. companies active in the region; and (2) a field research effort of several weeks' duration. The agreed approach to the field work was to use the methodology of the case study, at least to the extent possible within the very limited time constraints imposed by the budget.

Four such cases were to form the basis of the inquiry. All four were to involve the analysis of a commercial venture between an Egyptian and an Israeli firm. Of the four, two were to be retrospective in nature, one a success and the other a failure. The remaining two were to be prospective in nature. In addition, two of the four were to be reviewed for their potential for industrial collaboration.

The constraints faced in consummating each collaborative enterprise were to be identified and examined. A separate and more general constraints analysis was also to be undertaken. An attempt was to be made to specify how the contraints identified might be removed or how ventures might work within such constraints.

The proposed Scope of Work for the research proved in general to be realistic and feasible. As will be apparent, however, some of the objectives and expectations of the program were not attainable, owing to an insufficiency of data, and had to be somewhat modified. Policy Planning International assumes full responsibility for the accuracy of the data on which the following report is based and for the judgments drawn and recommendations made.

As indicated, the report focuses on the current state of economic cooperation between Egypt and Israel and the potential for expanding economic relations between the countries given existing constraints. The research team has attempted to identify and relate what is actually taking place and to assess the practical prospects for further economic normalization between the two countries.

II. Regional Trade and Investment: An Overview

A. Background

Of the few existing works to date on the subject of economic cooperation between Israel, Egypt and the Arab countries, the most comprehensive is Economic Cooperation and Middle East Peace, by Haim Ben-Shahar, et.al., an as yet unpublished manuscript on the subject funded by the Armand Hammer Fund for Peace in the Middle East. This comprehensive work sets forth a concept: "Of all forms of intercourse among individuals and nations, economic relations are the least personal and the least affected by the emotional and ideological burdens left behind by the conflict" (page 7); and a conclusion: "...economic cooperation between Israel and Egypt (and, eventually, other Arab countries)...(has) been and will be for a long time, subordinated to political considerations." (page 18)

There is in the findings of the study reported on herein substantiation of the Ben-Shahar "concept" and a suggestion that its "conclusion" may not be as binding and as restrictive as its authors have concluded, largely owing to fundamental changes occurring in the regional economy. It will be useful before proceeding to the body of this report to review the most significant of those changes and their longer-term implications for Middle Eastern economic development.

B. Changing Economic Map of the Middle East

Since the oil embargo in 1973 huge accummulations of surplus capital have opened Arab country economies long considered isolated and self-contained. New technologies have flooded the region and labor has migrated from the very poor, labor surplus economies of Egypt, the Sudan, Jordan, Syria, and Yemen to the very rich, capital surplus economies of Saudia Arabia, the Emirates and Kuwait, thereby considerably diluting the "national" characters of the economies of the latter.

More significantly, these migrant labor populations have become a conduit of vast sums of funds--remittances--that have re-entered their countries of origin with increasing and profound effect. Almost within a matter of years local and national labor markets have been transformed _en bloc_ to a regional labor market with wage and salary structures moving independently of restrictive national economies. Consequently, expectations for disposable income, life-styles, careers and overall modernity (including political and economic liberalization) have no longer been containable by political fiat.

In tandem with the emergence of this phenomenon have come new energies and new funds that have been channeled toward "privatization" of economic activity, particularly in the closed economies. The informal sector in Egypt, Yemen, Jordan and the Sudan has grown enormously. More and more economic activity, often financed by perfectly legitimate and liberalized means (such as the own-import regulations in Egypt and Yemen that permitted the import of all kinds of goods with remittance earnings), has moved outside the direct influence and control of governmental organizations and agencies. As one former Egyptian Minister of Economy puts it, "the Central Bank has been gutted."

Although always difficult to substantiate empirically, these informal, often unreported or "hidden" economic flows appear to be reaching truly significant proportions. Total remittances in Egypt are thought to be in the neighborhood of from $10-12 billion annually (officially reported receipts have never exceeded $4 billion); in the Sudan, remittances are placed at $2 billion (1984)--officially reported transfers have never exceeded $400 million; and in the Yemen Arab Republic approximately $4 billion is known to be in circulation while official bank deposit figures have never registered more than approximately $2 billion.

Smuggling activity, often financed by unrestricted and unregulated Islamic banking and financial institutions as well as by expatriate earnings held abroad or offshore, is of considerable dimension. It is reasonably estimated that officially reported imports are in the case of Yemen failing to capture and report illegal imports of as much as 60 percent over and above recorded levels. In Egypt a blossoming trade in hashish is thought now to have reached the neighborhood of $2 billion per annum.

There are of course positive and negative consequences of such informal activity. But when, as in the case of Egypt, this "hidden" (or black, gray or unreported) private economy reaches a level amounting to as much as one-third to one half of officially recorded Gross Domestic Product, the significance of such activity is obvious.

It can be concluded that a rapid privatization of previously highly restricted national economies is underway. Billions of dollars being held offshore from Egypt, Israel and other countries of the region are being invested at home and around the region in ways that circumvent governmental plans and controls. Economic forces currently at work in the informal sector cannot and most probably will not be significantly affected or controlled by even the most assiduous government effort. Political attempts to constrain, restrict, redirect, or capture these privately held funds are meeting with modest results at best. Privatization of economic activity is for all intents and purposes here to stay in the Middle East. Any recovery in oil prices (predicted for 1992) will serve only to accelerate this trend.

C. Privatization and Regional Economic Cooperation

The likely relevance of changing national and regional economic activity and behavior in the Middle East is apparent: If the rules of the economic game are being rewritten, is it useful to continue viewing the issue of Arab-Israeli economic cooperation within a framework of nationally controlled and self-contained economies that no longer exists? With the change in circumstances new opportunities for cooperative endeavors have appeared and, conversely, traditional barriers have fallen by the wayside.

As will be discussed later in this report, Israeli private business interests have already tapped into informal economic flows to Egypt. The evidence may be too minimal to draw any hard and fast conclusions at this point, but it is clear that economics in the form of market demand is influencing personal/ business decisionmaking throughout the region without regard for political concerns. As such this may be the major implication of the evolving course of Middle East economic development in the last quarter of the twentieth century.

Although informal sector economic activity is not entirely subject to government interference neither is it entirely free from such interference. There is clearly a degree of governmental acquiescence in play, if not aiding and abetting in effect. It is also possible that the governments of the region really have no viable alternatives; better then to let informal activity develop than to admit the inability to control it (there is very solid evidence of this in the recent case of the Islamic Companies of Egypt--which on a completely unregulated basis may have at one time controlled over $8 billion in depositors' funds).

Can expanded trade and investment between Israel and Arab countries become a reality by tapping into these unrestricted and unregulated flows of capital, finance and services? It is concluded in this report that this is indeed possible and is happening, at least with regard to routine trade between Israel and Egypt. The picture appears more complex and problematic with respect to investment projects or co-ventures of any kind.

Thus, it is also concluded in the report that the kinds of mega-projects put forth as "feasible" in the Ben-Shahar study--often of very large dimension calling for major sums of capital--could never be brought to realization through the use of these free floating offshore capital resources. The sheer scale of the proposed economic cooperation exceeds the capacity of either Egyptian or Israeli private resources seriously to contemplate. Morever, the political visibility of such projects is too high, both countries restrict investment capital flows to projects external to their respective economies and, at least in the case of Egypt, only limited experience could be marshaled successfully to manage and operate such large, technologically complicated production schemes.

Notwithstanding, the fact remains that the linking of informal economic activity with the movement of goods and services of Israeli origin to Egypt, or indeed to other Arab countries, is an existing and an important building block for future cooperative project development. It can at the very least lead to the development of the smaller project, although under current circumstances even the smaller project may be limited in scope and ambition because of continuing commercial and political risks.

In sum, privatization of Middle Eastern economies is leading to greater intra-regional trading, involving both Israel and Egypt, but also other Arab countries. It appears that this process will almost certainly continue to expand and develop. Whether investment in anything more that a modest level of small joint production or marketing projects will follow in the near future is more doubtful, at least partly because such activities are still too much the prisoner of political and economic constraints around the region.

D. Conclusions

Within the next decade the economics of the Middle East region will be greatly altered and will almost certainly bear little resemblence to the not-so-distant planned economies that proliferated throughout the Arab world under the influence of Gamal Abdel Nasser and which, to a lesser extent, prevailed in the socialist policies and programs of Israel. Those economic policies have in varying degrees been discredited, economic circumstances have fundamentally changed as a result of the oil boom in the Arabian peninsula, and private economic forces have been let loose which, to the extent possible, will seek their own optimum market opportunities without regard to political considerations. Consequently, economic development in the Near East region will likely be more market-driven than ever before, with the result that cross-border economic activity will increase, particularly between Israel and selected Arab countries.

II. Elements of Cooperation: The Setting

For economic and commercial collaboration to develop between Egypt and Israel, there must be not only an economic, but also a social and political foundation for it. There must also be a mutual interest in such collaboration and a willingness to pursue it. In varying degrees all of these factors exist at the present time.

A. Economic Complementarities

The existence of some degree of economic complementarity is generally considered a pre-requisite to the development of economic and commercial relationships between national economies. The concept of complementarity incorporates, inter alia, factor endowments, productive capacities (including states of technology currently applied), market demand, which is driven primarily by per capita income and cultural background, and the marketing process, entrepreneurship and innovation.

The mere existence of identifiable complementarities between national economies does not, ceteris paribus, ensure that mutually beneficial trade and investment will occur. Economic feasibility is a necessary although not a sufficient condition for the establishment of economic and commercial intercourse.

Although the Israeli and Egyptian economies stand at two quite different levels of development, complementarities do exist between them. The most apparent among these lie in the areas of agriculture, certain product manufacturing (agro-industrial, textiles, chemicals and water use devices), energy (petroleum and natural gas), tourism and technical services.

1. Agriculture

Agriculture is the leading sector of the Egyptian economy. Egyptian agriculture is based on the high-yield productivity of rich alluvial soil coupled with the controlled cultivation possible through an extensive surface irrigation system. Increased productivity on traditional land can be achieved only through the use of improved farm management techniques, greater mechanization and more advanced production inputs. Semi-arid land can be reclaimed only through the use of high technology irrigation systems.

Agriculture has also been an important sector in Israel's economy. Much of Israeli agricultural development has resulted from the exploitation of semi-arid and semi-productive marginal land. In exploiting this land Israel has developed superior irrigation and other agricultural technology and advanced farm management practices. It has also developed an extensive agronomic research capability which has greatly increased yields of local food crops under existing climatic and soil conditions. It should be noted that Israel is relatively self-sufficient in food and has achieved substantial export markets for its agricultural products.

To achieve their great success in agriculture, the Israelis have undertaken a massive capital spending program financed by foreign investment, foreign aid and recurrent donations. The substantial capital requirements of the agricultural methods used to make the desert bloom in Israel may not be easily met in Egypt. However, much Israeli agricultural technology can be adapted to Egypt without the need for large amounts of capital.

More than perhaps in any other sphere Israel's technology and experience in agriculture is uniquely suitable to Egyptian development needs. Israel has the research capability and technical services Egypt needs to improve productivity on "old" lands and to reclaim "new" lands in the marginal desert areas adjacent to the Nile Valley.

By contrast Egypt appears to have considerably less to offer Israel in the field of agriculture. Technologically, Egypt is more advanced in multiple cropping and in the area of riverine irrigation techniques, both of which have some applicability in Israel. Egypt also grows a few selected agricultural commodities of potential interest to the Israeli market, including raw cotton, dry legumes and watermelon seeds.

2. Manufacturing

In the manufacturing sector the situation appears similar to the picture presented by agriculture. Israeli industry has been rapidly developing a focus on high-tech, capital intensive research capacity, with the goal of offering industrialized countries low-cost "grey matter" for new product development. In addition Israel has successfully re-oriented its manufacturing sector in recent years toward exports directed at the lucrative markets of Europe and the United States.

Egyptian industry on the other hand is a combination of such heavy industry as iron and steel, aluminum, cement and fertilizer, textiles and consumer products manufactures for the local market. Few manufactured goods are competitive on the international market and little international level high-tech research or manufacturing capability exists in the country. Nonetheless, Egyptian export performance has been improving in recent years.

Egypt represents a market for such Israeli manufactured goods as agricultural equipment and chemicals, chemical dyes for the textile industry, water filters and water meters. It is not as likely a market for consumer products, a wide range of which is already produced in Egypt in increasingly higher quality form and largely protected from foreign competition. Moreover, Israeli products tend to be designed, both technically and commercially, more for European and American markets.

Egypt, on the other hand, appears to have little near-term possibility of penetrating the Israeli market for manufactured products. Products manufactured to meet the modest demands of the Egyptian mass market hold little market appeal in a country with a markedly higher per capital income and which looks to European and U.S. products as a standard. Consequently, Egyptian products are not likely to compete successfully with either local Israeli manufactures or import competition. Finally, the small size of the local Israeli market is also a deterrent to the development by Egyptian manufacturers of products capable of penetrating that market.

The greatest area of potential complementarity in the manufacturing sector may lie in the area of joint venture production for third country markets. Israeli and Egyptian firms could, for example, underake joint manufacturing projects in Egypt for the Egyptian and/or export markets, melding Israeli technology, management and marketing skills with lower-cost

Egyptian labor. Textiles and garment production would be likely candidates for such co-ventures.

Both Israel and Egypt have unexploited access to market opportunities in Europe and the United States which together they could likely exploit more fully. Israel, for example, has a Free Trade Agreement with the United States and special trading arrangements with the European Community. Egypt has preferential agreements with the European Community and unexploited quotas in the U.S. textiles market.

3. Technical Services

Egypt is a market for Israeli technical services in agriculture, as previously indicated, and also in industry, for example, in marketing, production engineering, packaging, etc. In addition, there are some indications that the private sector in Israel is offering advice to the engineered-products industry in Egypt. There is apparently also extensive cooperation taking place at the technical level in the textile industry. The Egyptian textile industry is well behind in the development of synthetics and Israeli technical assistance (as well as Israeli textile chemicals laundered through the free zones) is helping the industry to catch up.

Some of Israel's leading textile firms have been engaged in ongoing discussions with Egyptian textile companies on the subject of modernizing the Egyptian textile export industry. These nascent efforts have not yet resulted in directly observable economic and business cooperation. They are nevertheless important signs that the private manufacturing sectors of both Egypt and Israel are interacting with increasing frequency.

But for the already noted areas of riverine irrigation and multiple cropping, there appears to be little potential for Egypt to provide technical services to Israel.

4. Energy

The supply and demand of crude oil represent the principal example of an existing, natural economic complementarity between Egypt and Israel. Israel produces no oil and therefore imports all of its needs. Egypt is, at least for the time being, a net exporter of crude petroleum. Not surprisingly, the principal commodity Egypt sells currently to Israel is crude petroleum. It sells Israel the total output of its Sinai oilfields (40,000 b/d) under arrangements reached as part of the Camp David Accords, a supply that accounts for 60% of Israeli oil import requirements. Natural gas is another industrial commodity Egypt could sell to Israel. There is some potential for Israel to sell Egypt refined petroleum products in small quantities. There do not appear to be, however, any obvious ways the two countries might collaborate in the petroleum sector beyond the existing trading relationship.

Although the petroleum trade does not appear to offer much room for expansion, there are sound economic arguments for the development of trade in natural gas between the two countries. Egypt has an excess of natural gas which could be profitably sold in Israel. Because of Israel's proximity to the Nile Delta gas collection wells, Egypt could provide the gas to Israel without going through the capital intensive liquification process that would be required for export to most other markets. Israel would benefit from having an alternative to imported petroleum in its manufacturing sector. Several studies have been done of the feasibility of such a project and several multinational corporations and international agencies have expressed an interest in the idea. However, the scale and political sensitivity of the project appear to preclude its implementation at the present time.

5. Tourism

Tourism is an area of some of the greatest potential complementarity between Israel and Egypt. Both are lands of great touristic interest and both rely substantially on tourism for foreign exchange earnings.

As for complementarity, there is first of all the possibility of inter-country tourism. Experience thus far is not encouraging, however. Most of the tourism has been one way; Israelis visit Egypt in substantial numbers but only a disappointing handful of Egyptians venture to Israel. There appear to be various explanations for the lack of Egyptian tourism to Israel. Egyptians are not noted tourists; when they do have the opportunity to go abroad, Europe is their preferred destination. Israel does not offer Egyptians the general touristic sights, such as the Pyramids, that Egypt offers Israelis. Egyptian touristic interest in Israel is focused mainly on religious sites, which for reasons of prevailing political sensitivities and denominational disputes, neither Moslem nor Christian Egyptians are yet willing to visit. Some difficulties in the issuance of visas to Israel by the Egyptian government appear also to inhibit Egyptian tourism to Israel.

Of perhaps greatest potential in the area of inter-country tourism is the prospect for Israeli tourism into the Sinai. The Israelis are interested in offering casinos and gambling facilities to their tourists which are permitted in Egypt but not in Israel. Thus far Egypt has been reluctant to grant permission for Israeli firms to develop this area. An existing law, obviously a response to Israeli proposals, prohibits foreign firms from investing in the Sinai. The Egyptians simply do not believe that foreign participation in the development of the Sinai is required. A compromise under consideration would permit the letting of management services contracts to Israeli firms to run the casino/hotel projects aimed at Israeli tourists. Israeli sources project $500 million in additional foreign exchange earnings by 1990 for Egypt from Israeli and Israeli-originated tourism if the projects go forward.

There is even greater potential for mutual cooperation and benefit from foreign tourism. Both countries have well developed tourist industries, which will permit them to exploit the complementarity that exists with respect to foreign tourism quite easily. Thus, the Egyptian tourism industry now benefits from the fact that a Swedish tourist to Israel without difficulty can combine his trip there with a visit to Egypt. The Israeli tourism industry benefits from the fact that European or American visitors to Egypt can now continue on easily to the Holy Land. Such linkages of course require the collaboration of travel agencies on both sides of the border.

B. Existing Trade Relations

1. Reported Trade

Officially, trade between Egypt and Israel is reported to stand at about $170 million annually, with a $166 million balance in Egypt's favor. Indeed, Egyptian sales to Israel are higher than those to any Arab country. However, these figures conceal the fact that the bulk of trade is in Egyptian oil exports to Israel, approximately $150-160 million in crude transfers per year, which but for Camp David would be sold elsewhere. These crude transfers are being sent to Israel (through a pipeline) by foreign oil companies. These companies, operating in Egypt, take receipt of this oil as payment in kind for their technical services and Israel is used as a trans-shipment point to European refining facilities of the oil not utilized in Israel.

Non-oil trade stands at some $8-10 million in statistically reported annual sales. Egypt is reported to be selling Israel raw cotton, cotton yarn, watermelon seeds, textiles, handicrafts, granite and other landscaping stone. Israel is currently selling Egypt a variety of seeds, plants, layer chicks and hatching eggs, tissue culture, chemical dyes, irrigation equipment and technical services. Although the reported non-oil trade balance was previously in Israel's favor, Egypt prevailed in both oil and non-oil trade officially reported during the past year.

Of interest is the fact that almost all of the apparent Egyptian exports to Israel were under public sector auspices. Most Israeli exports to Egypt went through the private sector, some of which were nonetheless destined for Egyptian public sector consumption, particularly in the textile industry.

2. Unreported ("hidden") Trade

Commerce between Israel and Egypt appears to be much more active than is generally thought or is reported by official statistics. An unknown amount of trade occurs between third parties and is not reported as trade between the two countries. On occasion, the routes by which Israeli goods enter Arab markets are informal or through entry points where, given the various peculiarities of reporting methods in use, the flow of goods goes unregistered.

There may be and no doubt are political reasons for under-reporting actual trade flows, but there is no evidence that the methods used for tallying imports and exports have been altered for the specific purpose of misrepresenting the situation. Rather, the private sector has been innovative on both sides, Egyptian and Israeli, in finding the means by which to sell goods with the least commercial complication. In the Egyptian case, this means that there is a large, and mostly unrecorded, flow of trade from Israel entering through the Egyptian free zones.

Israel's actual, as opposed to officially reported, exports to Egypt reportedly amount to approximately $70 million per annum (see Table 1 on the following page), giving Israel a quite favorable trade balance with Egypt excluding oil. Israel has focused on increasing sales of chemicals, primarily for the textile industry, and of farm products to Egypt.

Sales of chemicals to Egypt by Israel now exceed $60 million annually. Because many of these chemicals are used in factories located in the duty free zones, Egyptian official trade statistics do not include these imports, nor, for the same

Table 1. Israeli Exports to Egypt by Selected Commodities
(thousands of dollars)

Commodity	1983	1984	1985
Chemicals	66	64,187	63,603
Cottonseed oil	429	7,182	3,133
Feed	3,165	1,744	89
Cattle	0	2,665	0
Live Poultry	1,143	0	0
Poultry Meat	0	22	86
Canned Meat	0	367	215
Milk	0	392	529
Beer	10	193	70
Cigarettes	0	28	5
Fruit juices	0	1	16
Frozen vegetables	0	0	12
Seeds	0	30	0
Total Agriculture	5,744	13,232	5,196

Source: U.S. government.

reason, do they include total agricultural imports from Israel. The latter were recorded in Israeli official trade statistics at $13.2 million in 1984.

Many "hidden" imports from Israel to Egypt are found in high value products such as Israeli beer ($70,000 in 1985), fruit juices and cigarettes. These items are purchased by the Egyptian hotel industry through the free zones and lie completely outside the official Egyptian banking system (because such imports are typically financed with the remittances of Egyptian migrant labor held offshore). CAPMAS, the organization that maintains and records official trade data in Egypt, recognizes an official import as being "official" only when established as a current claim against foreign exchange. Since these Israeli imports are financed literally outside the country and the official banking system, they are not identified by CAPMAS. It is also noted that these Israeli imports entering through the free zones are not merely processed and then re-exported to third countries; virtually all of them are transferred from the free zones directly into the Egyptian market. (See Table 2 on the following page.)

In the Sinai region (and, hence, through the Port Said and Suez Canal free zones), there appears to be a special, on-going border trade with Israel, again largely unreported in Egyptian official trade data. According to the Israeli data noted in Table 1 above, milk exports rose to $529,000 in 1985; Egypt recorded no such imports of milk in its 1985 data.

Table 2. Imports from Israel Reported by Egypt

(thousands of dollars)

Commodity	1982	1984	1985
Total imports	68,985	63,455	15,020
Total agriculture	18,615	4,010	136
Cattle	0	1,055	0
Live Poultry	6,311	0	0
Frozen Poultry	445	0	0
Milk	7	0	0
Butter	491	0	0
Eggs	3,442	0	0
Bananas	2,144	0	0
Apples	205	0	0
Chocolates	6	0	0
Animal feed	5,439	259	119
Cottonseed oil	0	1,742	0

Source: U.S. government.

3. Unrealized Potential

The figures available for both officially reported and "hidden" trade suggest that a lively and quite substantial level of commerce has already developed between Egypt and Israel. It seems evident that even before Camp David a considerable volume of trade was carried on through third parties and countries. Total reported and unreported trade between the two countries now exceeds $200 million per annum (including oil), making Israel a trading partner of some significance to Egypt.

It is not easy in any statistically significant manner to measure the degree to which the possibilities for bilateral trade between Egypt and Israel have been developed or, conversely, the degree to which unexploited opportunity for trade still exists between the two countries. Given the history of mutual animosity and isolation and the continuing political distance between Egypt and Israel, it can reasonably be assumed that political constraints continue to inhibit at least to some extent the full development of commercial opportunities between them. For example, trade could be expanded significantly were the Government of Egypt to open the Sinai to Israeli tourism and agree to sell natural gas to Israel. Non-political constraints likely inhibit even more seriously the further development of bilateral trade and economic relationships.

Although the bulk of the potential for economic cooperation under existing circumstances may well have been exploited, it seems reasonable to conclude that substantial opportunities for economic cooperation remain to be developed once the principal existing constraints are eliminated.

C. Other Collaborative Relations

Apart from the growing commercial relations recorded above, other forms of related Egyptian/Israeli cooperation have been initiated or proposed. Some of the activity has been nurtured by the U.S. government, specifically by USAID's Tri-National Regional Cooperation Program. This program was initiated in 1980 and has been slowly expanding. It involves cooperative research among American, Egyptian and Israeli scientists in four areas of interest to Egypt and Israel, as follows:

- a program of medical research in epidemiology, focusing on malaria and other tropical diseases involving NIH, Ein Shams University and the Kuvin Centre of Infectious and Tropical Diseases of Hebrew University

- a program of research in agriculture involving the University of California and the Israeli and Egyptian Ministries of Agriculture, known as the Tri-National Agricultural Technical Exchange (TATEC)

- a program of cooperative arid lands research involving San Diego State University, the Egyptian Ministry of Agriculture and Ein Shams and Al Azhar Universities, and Ben Gurion University of the Negev, known as (CALAR)

- a program of cooperative marine sciences research involving the New Jersey Marine Sciences Institute and counterpart Israeli and Egyptian centers

The Tri-National Research Program involves what those who direct it call "soft and hard" technical assistance and technology transfer; in multiple cropping where Egypt has considerably more experience and Israel is interested in drawing on it; in dairy production where Israel has the technical edge but Egypt has the advantage in low cost feeds; and in medicinal plants where Egypt has, in the Sinai, a range of plants with very promising medicinal qualities.

Another promising area of collaborative research has been in the area of "plasticulture," involving a process called plastic mulching. The plastic mulching process uses plastic sheeting and metal bromides that literally bake the impurities out of cultivated soil. The process results in the growth of beneficial bacteria that aid in restoring and improving the productivity of arable land, often by as much as 400 percent. The process has been field-tested in five Egyptian governorates, but to date has not resulted in commercial application.

Egypt and Israel have also developed a bilateral agricultural research program independent of the U.S. sponsored regional program. Two projects, at Gamaaza and West Nubarriyya, in Egypt, involve joint research on the use of Israeli technology and inputs, such as irrigation systems, seeds and plants. Israel supplies two technicians for these projects.

Israel would like to see greater movement and more public support from the Egyptian government for these and other bilateral programs. Egypt, however, prefers for collaboration to develop carefully and in a measured manner, an approach arguably typical of how Egypt deals with foreigners in general, and not surprisingly so in view of its experience with the Soviet Union in the 1960s and the previous two millenia of foreign domination. The approach cannot necessarily be construed as directed specifically against the Israelis.

Some privately organized cooperative efforts have been conducted, including an effort by Brandeis University to stimulate private co-ventures in agriculture to be financed by U.S. investors. Brandeis' Center for Social Policy in the Middle

East recently conducted a tri-national seminar on "Cooperation in Food Production in the Private Sector" aimed at promoting and encouraging nascent commercial and other co-ventures in the field of agriculture.

Generally, participants in these programs from both Egypt and Israel have had unrealistic expectations of the role of the sponsoring agency. In the case of AID programs, the participants appear to believe that AID will underwrite any proposal they develop. Some Egyptian participants in the Brandeis program expected the program sponsors to make an unqualified commitment to invest in the projects identified. The dialogue that has developed as a result of these bilateral initiatives may stall unless program sponsors recognize that the participants expect more than just a forum for communication.

Another program of interest is the Armand Hammer Fund for Peace in the Middle East at Tel Aviv University, a program of research on economic collaboration endowed by its namesake. It has produced a major volume of proposals under the direction of Prof. Ben Shahar, former Chancellor of Tel Aviv University. The proposals are typically for large-scale government-to-government project collaborations, such as a $200 million joint cement project in the Sinai and other "mega-projects" obviously designed for their visibility and political impact. None has yet attracted much support beyond that of its authors.

Notwithstanding, many private sector businessmen suggested that the lack of public sector mega-projects may be inhibiting further exploitation of private sector opportunities. While the mega-projects may not be totally economic, implementation of this type of project would give economic collaboration a cachet of acceptability and help to develop an entire class of workers experienced in interacting with each other. Development of a class of individuals in both countries with a working knowledge of each others' business customs and manners would substantially assist the overall development of commercial interaction between the two countries.

D. <u>Societal Attitudes</u>

Based on the field data obtained, it appears that neither Israelis nor Egyptians are greatly aware of the degree to which economic relations have developed between the two countries in the post-Camp David period. To the extent that awareness exists, there are degrees of suspicion on both sides bred obviously of the many years of belligerency. At the same time, there are many on both sides who welcome or accept increased trade as a natural and appropriate result of the normalization of relations.

Hostility continues to exist, however, across both borders. In Israel, many people remain skeptical about the future of the peace treaty and therefore feel uncomfortable about "trading with the enemy." The lack of experience with Egyptians also accounts for a lack of trust in dealing with them. Israelis who might otherwise have commercial reason to pursue business in Egypt therefore refrain from doing so. In Egypt, businessmen dealing with Israel tend not to publicize the fact for fear of customer backlash. In many if not most cases labels are removed from Israeli products before being sold in the Egyptian marketplace.

Many Israeli companies routinely ship unmarked products to their customers in Egypt.

Nonetheless, markets and the economic necessities of life tend to overpower lingering political antagonisms and dictate trading patterns and relationships. Nowhere is this fact better demonstrated than in the case of the "Waly melon." A new melon has been introduced on the Egyptian market in the past year which is small and tasty and different from any melons previously known in Egypt. The melon is the product of research in Israel and has been adapted to Egypt as a result of the bilateral agricultural research effort between the Israeli Ministry of Agriculture and its Egyptian counterpart, of which Mr. Youssef Waly is the current minister. The fact that the melon is essentially of Israeli origin is apparently relatively widely known and accepted.

Of significance also is the fact that many Egyptian entrepreneurs and businessmen expressed a lively interest in doing business with Israeli companies. Perhaps as many as ten Israeli companies have appointed Egyptian agents in an effort to explore seriously commercial possibilities. For reasons explored elsewhere in this report, no similar effort is underway in Israel by the Egyptians.

Many Egyptian firms also expressed interest in joint ventures with Israeli firms, if the Israelis would provide all of the technology and most of the risk capital required for the project. Some interest was shown by Israeli counterparts in undertaking joint ventures with the Egyptians although there was great concern over the risk involved in investing capital and resources in a country whose future political relations with Israel remain in their judgment so uncertain.

Of greater importance, however, is the fact that Israelis rarely invest outside their borders, even in those countries which have formal and friendly relations with the government of Israel. Almost without exception, the Israeli Central Bank makes it quite difficult if not legally impossible for Israelis to invest directly in foreign manufacturing capacity. Given that the Egyptians showed no desire to invest directly in joint venture projects in Israel, the expressed interests of the Egyptians to develop joint ventures with the Israelis will not easily be satisfied.

E. Political Attitudes

Economic collaboration presupposes political normality as much as anything else. The existing trade and other relations between Egypt and Israel are balanced on a thin political reed if past experience is any guide. Apart from the oil supply requirements of Camp David, economic relations were essentially frozen during Israel's invasion of Lebanon and did not resume until following the withdrawal of Israeli troops. Economic collaboration will clearly be hostage to political realities for a long time to come. Nonetheless, both Egypt and Israel have demonstrated substantial political support for the development of economic relations between the two countries.

In any event, it can be argued that political relations have not proved to be a serious constraint to increased trade. All sorts of trading occurs in the Middle East region in clear contravention of government prohibitions. Israel and Egypt, as well as other Arab countries, have taken advantage of market opportunities in complete disregard of politics. Further increases in trade may therefore be as much or more dependent on the removal of non-political constraints as on anything else.

This conclusion would not necessarily obtain in the case of investment projects because the investment of risk capital typically will be undertaken only in the shade of long-term political stability and harmony.

F. Conclusions

A broad review of the economies of Egypt and Israel suggests economic complementarities in the industry, agriculture, energy and tourism sectors and in technical services. The immediate opportunities for bilateral cooperation lie primarily in the commercial arena. Longer term opportunities exist for private collaborative manufacturing in Egypt and possibly export marketing to international markets. The major government-to-government projects proposed by some appear to have little future absent financing by interested third parties such as the U.S. government.

In general, it would appear that at the present time much of the exploitable complementarity between Egypt and Israel is of a one-dimensional commercial nature. Egypt has a need and Israel has the wherewithal to fill it (agricultural inputs, equipment) or Israel has a need and Egypt has the wherewithal to fill it (oil). There are not that many cases where the two sides need to collaborate beyond the level of buyer and seller. Nonetheless, the relations that have already developed are substantial and make sound economic sense.

Perhaps the most important conclusion to be drawn from the "hidden" trade and the formal and informal technical assistance/exchange taking place is that it indicates that cooperation is possible and that the two processes of "hidden" trade and technical exchange tend to highlight otherwise unknown product and industrial areas where complementarities exist. This is in effect market identification in action and its future importance should not be overlooked simply because the scale is presently unknown.

It is difficult to determine from the data available to what extent commercial complementarities have already been exploited, although it seems clear that a substantial proportion of immediately existing potential for commerce has already been realized. If the principal opportunities lie in agriculture, it would seem that prospects for Israeli trade and technical assistance to Egypt will continue to grow in proportion to Egyptian investment in the agricultural sector. Israel specializes in reclaiming marginal agricultural land and Egypt plans an indefinite program of up to 100,000 hectares of land reclamation per year. Opportunities for expanded trade in tourism and natural gas depend largely on Government of Egypt policy. Absent special incentives, joint production projects will develop only very gradually.

Although social and political attitudes in the respective countries are not uniformly positive with regard to economic collaboration, the negative views have been muted and have had only a minimal impact on the realization of collaborative economic relations.

Cooperation on scientific and medical research has proved to be relatively uncomplicated to develop and has already resulted in some mutually useful activities.

III. Complementarity Analysis

The research team spent approximately one month in the field, two weeks in Egypt and two weeks in Israel. Team members attempted to interview every source known to be involved in or knowledgeable about commercial and economic relations between Egypt and Israel. The team believes it was able to see the vast majority of such individuals and companies.

As indicated in the previous section fundamental economic complementarity of measurable proportions exists between Israel and Egypt. During the field research on this project, concrete examples were identified of the full range of complementary commercial activities actually underway. A number of proposals for complementary industrial projects were also identified. Summaries of each commercial and industrial case example follow.

A. Commercial Complementarity Survey

The objective of the study was to compile mini-case studies of selected examples of collaborative ventures involving Israeli and Egyptian firms. The team was to prepare four such cases of commercial ventures, two retrospective studies and two prospective studies. Of the two retrospective studies, one was to be of a successful venture and the other of a failed attempt.

The ability to develop full case materials is always constrained by the degree to which the subjects of the studies are willing to share the necessary data and, in the case of this report, by time considerations and political sensitivities. It has proved difficult for all of the above reasons to gather the materials necessary to compile the kinds of formal case studies envisaged. Accordingly, the research team has relied on a more discursive approach to the description of the case examples than had been its intention. Nonetheless, the case "examples" presented serve to demonstrate quite clearly the specific kinds of private commercial relations currently underway between the two countries.

Two points should be borne in mind in reviewing the case presentations. First, the universe of instances of formal business collaborations between Israeli and Egyptian firms actually identified is small. Second, the small number of identified examples of private commercial collaboration does not indicate per se any limit on the possibilities of such collaboration. Indeed, the vast majority of such collaborations were unidentifiable because they pass through unreported channels. The more important issue, commented on in each case presentation, is whether any constraints inhibit the expansion of the universe and, if so, whether those constraints are subject to intervention and modification.

Altogether the team identified a number of case examples of ongoing or attempted commercial collaborations. The team was interested only in those activities that attempted to exploit an opportunity for an ongoing market or an ongoing collaboration with a local partner. The principal among these are recounted below.

RETROSPECTIVE CASE EXAMPLES

(Successes)

CASE EXAMPLE ONE:	Agricultural Equipment Trader
Sector:	Agriculture
Product/ Service Lines:	Irrigation equipment; chemicals; fertilizers; hybrid seed varieties
Origin:	Israeli (1980)
Financial Indicators:	Sales of $1.75 million to Egypt in last two years

The first example of a formal attempt to establish commercial relations between Egypt and Israel following Camp David was the establishment by Israel's leading trading company of an office in Egypt in 1980, shortly following the signing of the Camp David Accords. The office was set up through a German trading company subsidiary. It was established as a liaison office rather than as a trading company. The actual trading is done through an Egyptian firm owned by that company's Egyptian agent.

The use of the German subsidiary was clearly a device to conceal the Israeli origin of the firm and to avoid creating visibility problems in the uncertain early days of the post-Camp David period. The power behind the throne is an Israeli, the general manager, who was born in Egypt and speaks fluent Arabic. The general manager lives in Egypt although he travels frequently back and forth to Israel.

This German/Israeli/Egyptian combination focuses on the sale of Israeli agricultural equipment and inputs. It represents the largest Israeli manufacturer of irrigation equipment, one of its subsidiaries. The company also sells chemicals for the plastic mulching process of soil cleaning, fertilizers, and hybrid seed varieties for vegetables, melons, cucumbers and tomatoes.

To ensure success, the Israelis let nothing interfere with the flow of goods. They take all the risk by selling through the Egyptian company on consignment. By importing the equipment themselves they can sell in Egyptian pounds, thus eliminating, for their customers, the problem of finding foreign exchange. They then buy foreign exchange in the market whenever they can for repatriation to Israel. They keep their operation going by applying for import licenses well in advance and keeping a supply of pre-approved licenses available for a series of importations. This also eliminates, for their customers, the problem of obtaining the import license.

The Israelis also capitalized the Egyptian manager's trading company, which participates in all the Cairo International Trade Fairs and has an active sales efort throughout the country. An Israeli irrigation engineer is regularly in residence to help prospective buyers design appropriate systems and to install and initiate operation of those systems.

This firm indicated that getting import licenses was a major problem. While it takes but 1-2 weeks to obtain a license to import from Europe, it takes up to two months to get a license to import from Israel. This results from the extra layer of approval required in the case of Israeli goods, i.e., for national security. The request is first submitted to the Ministry of Agriculture; if approval is granted, the request must pass through a security clearance before going on to customs for approval in the normal course.

The success of this venture can be ascribed to the willingness of the Israelis to take 100% of the risk and 100% of the initiative while allowing the Egyptian agent some of the profit. It is not at all clear that the commercial incentives are high enough to sustain this type of activity in the long run on a purely commercial basis.

CASE EXAMPLE TWO: Poultry Stock Breeder

Sector: Agro-Industry

Product/
Service Lines: Poultry breeder stock, hatching eggs

Origin: Egyptian (1980)

Financial
Indicators: $7 million in purchases from Israel in 1986

The second case example involves an Egyptian poultry breeder who has developed an ongoing relationship with the Israeli Poultry Breeders Union (PBU) for the supply of layer chicks and hatching eggs. He began in 1980 by importing 2000 single chicks by plane and by his own car. He had reached a level of 500,000 chicks per week and one million hatching eggs per month at the time the Egyptian government issued regulations curtailing such imports as a means of encouraging the development of local industry.

The Egyptian prefers Israeli chicks and eggs for several reasons. The Israelis have bred chicks that are resistant to local climatic and environmental conditions as well as poor Egyptian management practices and are less expensive than competitive products from Holland.

In addition to layer chicks, hatching eggs and turkey layer chicks, the Egyptian buys some of his requirements for feed concentrate from Israel. He prefers to buy Israeli products because he can buy in the smaller quantities suitable to his needs. Although Israeli feeds may be more expensive on a unit basis, the ability to purchase in smaller quantities eliminates storage requirements and provides an overall lower cost of material to the users. He also buys feed additives and soy meal from Israel. He buys from ten different companies and imports by truck, sending his trucks to the border for pick up.

This company purchases some $7 million in Israeli products per year and could double the amount if import restrictions were lifted. Layer chicks and hatching eggs account for three-fourths of the total. The $7 million are the bulk of the $12 million per year of import requirements of this company. All things being equal, the Egyptian owner indicated that he would import everything from Israel.

The PBU offers him a sweetheart deal--all purchases on credit. With no requirement to open a letter of credit, as is the case with the other Israeli companies with which he deals, he can order without immediate concern over obtaining the necessary foreign exchange. He has had a credit balance as high as $850,000 with the PBU. As in Case Example One the ability to engage in this type of transaction on an open account basis makes this a very attractive deal to the Egyptian partner. It is not clear if the same type of activity would have been pursued if more restrictive commercial terms had been required.

His major constraint has been in obtaining licenses. He indicated a four-step process, going from security, which can take an unlimited amount of time, to Ministry of Agriculture, which takes about two weeks' time, to customs, one hour, and finally to the Ministry of Economy and Foreign Trade, which also can take an unlimited amount of time.

CASE EXAMPLE THREE: Agricultural Development Firm

Sector: Agriculture

Product/
Service Lines: Irrigation equipment; agricultural inputs; technical services

Origin: Egyptian (1986-87)

Financial
Indicators: $1.1 million in purchases from Israel in 1986

The third case example involves an Egyptian agricultural development firm that has given a management contract to an Israeli parastatal organization to provide technical assistance services in agriculture. This company does joint ventures with local investors to reclaim marginal desert land. The Egyptian development firm pays the Israeli firm to provide the necessary technical assistance and to help it purchase agricultural inputs and equipment for the local investor. The local investor, typically an absentee, pays for the land and the infrastructure, i.e., the irrigation equipment, agricultural inputs, etc. The Egyptian development firm takes 50% of the profit from crops sold as its fee for organizing and managing the project.

Essentially this Egyptian company buys a package of Israeli technology, applies that package as its contribution to equity in an agricultural development project and profits from the results of the application of the Israeli technology to its partners' land.

The Israeli parastatal company simply sells its services as a normal private consulting firm, charging international level fees around the world in order show a profit like any private firm. It has so far rejected the Egyptian's overtures to join in a joint venture farm development project because it does not as a rule participate in project equity.

One serious constraint noted by the Egyptian owner was what he felt was an overzealous interest in his Israeli business by the Egyptian security services. He claimed his telephone lines were tapped and that he was called in repeatedly for questioning whenever he went to Israel on business or had contacts with Israelis. Security's involvement represented more of a nuisance factor to him than anything else, but was still an unwanted intrusion.

This is the only case in which the direct involvement of the security services was noted above and beyond questions of security clearances for import licenses and visas. It is thus not clear how widespread a problem this might be or to what extent it may be an isolated one involving particular individuals. To the extent that the security services of either country become involved in private business matters, it will clearly have a deterrent effect on many potential business deals.

CASE EXAMPLE FOUR:	Agricultural Equipment Dealer
Sector:	Agriculture
Product/ Service Lines:	Irrigation equipment
Origin:	Egyptian (1985)
Financial Indicators:	$500,000 in purchases from Israel in 1986

The fourth case example involves an Egyptian agricultural development company similar to that in Case Example Three. This company was established two years ago, essentially to operate as the exclusive dealer for two Israeli drip irrigation equipment manufacturers. The two companies produce equipment complementary to each other, one producing the emitters and the other the pipes.

The Egyptian company maintains a warehouse of inventory of the Israeli manufacturers' products. As dealer the Egyptian company must market these products on its own, which it does through formal advertising as well as by word of mouth. Frequently, the successful completion of one project will lead to new business with a neighboring farmer. Local advertising, done both in the major newspapers and on billboards, displays the manufacturers' names, but does not parade their Israeli origin. The product does not say "Made in Israel," but rather made by the Israeli firm for the Egyptian firm.

This Egyptian company is walking a fine line. It wants potential customers to know the product is Israeli, because Israeli irrigation equipment is held in high regard in the marketplace, but it does not want to publicize the fact.

The Israeli suppliers provide the Egyptian company with 90 to 120 days suppliers' credit, although the order must be backed by a letter of credit. Because the Egyptian company pays interest on the suppliers' credit, it compares this rate to that offered by its bank and takes the least expensive option.

The bulk (95%) of the Egyptian company's sales are of irrigation equipment. It also offers customers seeds, plants and technical assistance. As is the case with the other two companies selling irrigation equipment in Case Examples One and Three, the suppliers maintain an irrigation engineer to help design, set up and trouble-shoot the systems sold.

As in Case Example Three most of the customers are absentee investors in reclaimed land (95%) rather than traditional farmers (fellahin). A soil analysis is done, appropriate crops selected, the system designed and set up and farming begun. The company does essentially turnkey farm development projects.

Equipment is imported via Cyprus, although the boat comes directly from Israel. Seeds can be brought in in a suitcase; 20,000 LE can be placed in a small bag. This company feels that the Israelis will dominate the irrigation equipment market in Egypt. European and U.S. products are too expensive, and in its judgment, Israeli products the best anyway.

This company reported no serious constraints to doing business with Israel.

CASE EXAMPLE FIVE: Parastatal Technical Services Firm

Sector: Agriculture

Product/
Service Lines: Technical services in agriculture

Origin: Israel (1983-4)

Financial
Indicators: $250,000 in sales to Egypt in 1986

The fifth case example involves an Israeli parastatal organization that provides technical services in agriculture for a fee. This organization has already been cited in describing the activities of other cases. It operates on a commercial basis but is owned by the Israeli government. It is an internationally experienced and sophisticated company that has provided both consultancy and management services around the world. On occasion the company has taken a small equity or quasi-equity position in projects.

The company began in Egypt with bilateral government programs, the already cited Gamaaza and West Nubarriya projects, but has now begun to provide services to two or three private agricultural development firms. They currently have two technicians working on private sector projects in Egypt. The Egyptians find their international level fees expensive and have proposed a joint venture approach to the business as a way of reducing the cost of the Israelis' services.

The constraint the Israelis face in marketing their technical services in Egypt is primarily financial--the Egyptians find it difficult to pay the international level fees charged by the Israeli firm.

CASE EXAMPLE SIX: Travel Agency

Sector: Tourism

Product/
Service Lines: Travel agency

Origin: Israeli/Egyptian (1979)

Financial
Indicators: $1 million in Egyptian sales of travel services to/from Israel in 1986

The sixth case example of a successful collaboration is in the field of tourism. This case began in 1979 shortly after Camp David when an Israeli travel agent contacted an Egyptian agency with a proposal to initiate a tourist trip between Israel and Egypt. The Egyptian agency agreed to cooperate and the first trip was organized to bring an Israeli tourist group by boat from Israel to Egypt. It was organized with President Sadat's approval on condition that no Israeli nationals be included in the first trip. When the boat docked there was an Israeli girl on board and it took a direct call to Sadat to get permission for the group to enter the country.

This same Egyptian company was agent for Nephertiti Airlines, the predecessor to Air Sinai, the subsidiary of EgyptAir later set up specially to ply the Israeli trade. In the 1980s the border at El Arish was declared open and the Egyptian company began running buses to the border to exchange passengers with Israeli travel companies. The Egyptian company earns 10-12% of its annual earnings from Israeli business, which is a year-around business. Most of the business is one way, with European travelers and U.S. Jews coming to Egypt from Israel. Apart from expatriates in Egypt visiting the Holy Sites in Israel and returning, there is little round-trip business from Egypt. Few Egyptians go to Israel and tourists in Egypt typically do not continue their travel to Israel.

The Israeli firm with which the Egyptian firm is cooperating has provided the Egyptian firm with some important business linkages, for example, introducing it to the incentive travel business. Currently, the Egyptian owner is the Chairman of the International Incentive Travel Association.

The borders are open now by air, land and sea. There are no commercial barriers to tourism. There is no need for Egyptian and Israeli firms to invest in each other's firms or to undertake joint ventures for the basic tourist business available. All collaboration has been on the usual cooperative basis that prevails in the travel business.

The main constraints to further tourism are political, religious and social. For example, the government of Egypt requires special visas for Egyptians who wish to visit Israel, which appears to be a serious deterrent to many potential visitors. As noted elsewhere the government also does not encourage Israeli-originated tourism in the Sinai. In another vein, Egyptian Coptic Christians are refusing to visit Israel in protest against an alleged Israeli government decision against their rights in the Old City of Jerusalem. Social contraints, such as the disapproval of friends, also inhibit Egyptians from traveling to Israel.

(Failures)

CASE EXAMPLE ONE: Agricultural Trading Firm

Sector: Agriculture

Product/
Service Lines: Trading

Origin: Israeli (1981-82)

Financial
Indicators: No profits

The first case example identified of a failed attempt at Israeli/Egyptian trade involved an Israeli private trading company that hired an Egyptian agent and set up shop to sell Israeli agricultural products. After several years the operation was closed down reportedly for financial reasons. The company claimed that the Egyptians lacked sufficient hard currency to pay their bills. The Israeli company required confirmed letter of credit transactions which most Egyptian customers seemed unable to comply with.

This failure is completely consistent with the successes previously noted. The Israeli company was offering essentially the same products as did its more successful counterpart in the first example of a successful case. The only true difference between the two firms was in the financing terms they offered. Together the two cases demonstrate that if the Israelis are willing to provide for full financing of Egyptian requirements, trade appears to move forward - when the Israelis hesitate about the financial terms, the Egyptians will not and apparently cannot do business.

CASE EXAMPLE TWO: Irrigation Equipment Manufacturer

Sector: Agriculture

Product/
Service Lines: Irrigation equipment

Origin: Israeli (1986)

Financial
Indicators: Not available

The second case example of an unsuccessful attempt to undertake commercial operations involved an attempt by an Israeli irrigation equipment manufacturer and an Egyptian investment/ trading company to arrange an exclusive agency or dealership for the importation of Israeli irrigation equipment to Egypt. The Israeli company first approached the Egyptian company to become its dealer. The Egyptians indicated their lack of experience in this area and their need for technical support from the Israelis or even a joint venture. The Israelis refused, indicating their interest was limited to exports only. The Egyptians thereafter agreed to go forward on the condition that the Israeli company provide experts to help market and set up the systems.

The negotiations finally broke down on the Israeli company's refusal to export on consignment and the Egyptian company's refusal to open LCs, warehouse and take the risk of failing to sell a product for which they had no experience. The potential profits were apparently not attractive enough to convince the Israelis themselves to underwrite the substantial financial requirements and assume the considerable risks of the deal.

CASE EXAMPLE THREE: Solar Energy Firm

Sector: Energy

Product/
Service Lines: Solar equipment

Origin: Israeli (1985-86)

Financial
Indicators: Not available

The third case example involved a U.S./Israeli solar energy firm that wanted to sell its equipment for the construction of a power plant in Egypt. The company first approached the Ministry of Energy in Egypt about building a 30MW plant to provide energy to the grid. The project was shelved because of its high cost ($80-100 million) and inability to compete with existing subsidized energy.

Another project was proposed, to do a 1MW demonstration project, for purposes of evaluating costs and management problems. The current proposal would cost $6 million. AID has been asked to fund it, but has not yet agreed to do so. The company itself does not participate in the equity of a utility project. They lend money in those cases where project revenues can cover all debt service, provide technology and oversee the development of a project. If the system proved useful and economic in Egypt, however, they would consider participating in a private project to produce their solar energy equipment there.

At first the Egyptian Ministry of Energy proposed that the firm look for private partners. This proved infeasible because solar energy cannot compete profitably with subsidized energy sources available in Egypt. One of the primary reasons the solar project cannot be economically feasible is that the Egyptians will not consider the opportunity cost of the oil that is presently being used in the production of domestic electricity. The actual cost to produce the electricity now being used in Egypt should be calculated by looking at the foreign exchange that could be earned as a result of the sale of displaced oil. If the economics of the solar project were calculated using the opportunity cost of the oil, the project might be economically feasible on its own merits. However, until the Egyptian Energy Ministry is willing to evaluate such a project on the basis of its opportunity costs, a solar project cannot be undertaken by private interests.

At the present time everyone is waiting for the other to make a move and all are looking to AID. AID is canvassing the Germans because the mirrors for the project would be sourced in Germany. The Israeli company says that if AID came up with half the money, the Israeli, Egyptian and West German governments would probably come up with the rest.

This project appears to fall within the general category of mega-projects not likely to proceed under existing circumstances.

CASE EXAMPLE FOUR: Egyptian Government Purchase

Sector: Agriculture

Product/
Service Lines: Agricultural products

Origin: Egypt (1986)

Financial
Indicators: Not available

The fourth case example involved a private order by the Egyptian Ministry of Agriculture for Israeli banana plants in the form of tissue culture. The order was placed with an Israeli kibbutz. Egyptian banana plants are of poor quality and the tissue culture, which is free of germs and insects, promised to offer a substantially improved variety of the banana plant for Egyptian cultivation. Because it takes four months of cultivation before the tissue culture can be delivered, the kibbutz asked the Ministry of Agriculture to open a confirmed letter of credit four months in advance of delivery. Without the LC the kibbutz was not willing to grow the plants. The kibbutz offered to reduce its usual requirement to 20% of the sales price but the Ministry of Agriculture still refused. The Ministry then said it would take a much larger number of plants if delivered within one month, apparently thinking that if the period of exposure was shortened the LC would not be required. The kibbutz countered with an offer to provide a much shorter and less valuable plant, which is what could be promised within the proposed time frame. The deal was never consummated.

This case demonstrates how a misunderstanding of business realities and a lack of sufficient communication can foul a deal.

CASE EXAMPLE FIVE: Israeli Bids on GOE tenders

Sector: Chemical

Product/
Service Lines: Insecticides

Origin: Egypt (1981-82)

Financial
Indicators: Not available

In 1981-82 many Israeli companies reportedly bid on Egyptian government tenders. The first successful company was an insecticide producer awarded a bid for $300,000. The Egyptian government asked the company to provide the product without requiring an LC, saying essentially "rely on us." The company refused because of the uncertainties and potential risks involved, citing, for example, an Egyptian law that says no Bill of Lading may be relied on if presented before an LC is opened. The Egyptian government is reportedly still holding a $30,000 performance bond even though they have rejected the bid, claiming the Israeli company failed to meet the terms of the bid. The government continues to ask the Israelis to renew the bond, but has so far not called it.

It is not clear exactly what happened to this transaction. Each side seems to have a different view. But it is cases like this that have dampened the interest of this and many other Israeli companies in doing business in Egypt. No company will waste time bidding on contracts it thinks are rigged against it. In this case, some Israelis think that the bid for the insecticides was sabotaged for political reasons. As one knowledgeable individual put it: "When the Ministry of

Agriculture buys a large order of equipment from Israel, it becomes a major international political problem for them."

In any event, this Israeli company like many others sells into a broad segment of the international market, of which Egypt is just another sub-market. Having other market opportunities, this and other disenchanted Israeli companies will quickly relegate Egypt to a secondary position on their list of market priorities. They will not likely wait around hoping for the circumstances to change.

PROSPECTIVE CASE EXAMPLES

One as yet untapped opportunity for Israeli/Egyptian commercial collaboration is with water meters. Egypt has a serious water resource problem. It must take measures to conserve and make more efficient use of existing resources. One need is for better management of the use of those resources, which in turn requires better measurement of that use. However, only two local companies manufacture water meters at present. Neither company produces a product of very high quality and even together the two do not meet market demand. As need outstrips supply, there is an obvious market opportunity for Israeli made meters.

A second possibility for commercial collaboration is with tissue culture products. Israel produces tissue culture plants already adapted to Middle Eastern climatic and soil conditions. Preliminary experimentation in Egypt suggests the possibility of a direct transfer to Egypt of these higher yield, more disease resistant Israeli plants. Again the commercial potential for Israel in this area seems clear.

A third possibility lies with plastic mulching or plasticulture. Substantial experimentation is already underway with Israeli plasticulture in Egypt, with significant success recorded. Israel is advanced in this area and is only one of two countries, along with France, that produces the metal bromide chemical used in the soil cleansing process involved. This may represent another good possibility for commercial collaboration between the two countries.

B. Industrial Complementarity Survey

As previously noted the likelihood of the development of joint ventures or co-ventures is somewhat problematic, particularly in the short term. Egyptian entrepreneurs appear to welcome Israeli participation, particularly if they offer investment capital. The Israelis are reluctant and to some extent unable to become involved for a combination of reasons, some political, some competitive and some purely practical.

Yet there are many compelling reasons for Egypt and Israel to collaborate in the industrial project sphere in the future. Egypt has a substantial population of unemployed or semi-employed unskilled and semi-skilled workers, whereas Israel needs labor to expand in many industrial subsectors. Israel has technology, management and marketing skills for export, all of which Egypt needs in profusion.

Presently, however, there appear to be only a few selected possibilities for the economical production and marketing of Israeli technology and products in the Egyptian market. The opportunity for collaboration to produce or market Egyptian products or services in Israel is even more limited. Opportunities exist for co-production in Egypt of Israeli agricultural equipment, poultry breeding stock and water use measurement devices. There appears also to be a number of possibilities for a combination of Egyptian and Israeli resources to produce and market successfully to an international or third country export market, focusing generally on the textiles industry and, more particularly, on garment manufacturing and marketing.

In view of established theories of international trade and development, however, it may be premature to look for any rapid development or substantial joint production activity between Egypt and Israel. Joint production is usually the last stage in a multi-stage process. First, the saturation of home markets and the downturn in a product's life cycle force domestic companies to identify export markets to maintain demand for their products. Second, if the demand for the product is established in the export market, the company may look to a production venture in the host country to supply host country demand. Finally, direct investment and joint ventures with host country business enterprises may develop.

Rarely will businesses in two countries establish any type of joint venture unless they have previously developed mutually satisfactory relationships based on lower risk import/export interchange. Each step along this progression is supported by the expectation of earning higher profits abroad than would be possible in the home market. In most cases, successful completion of bilateral trading activity is a necessary pre-condition to other forms of cooperative business ventures, in particular joint production schemes.

Active import and export business helps the residents of each country to gain an effective understanding of the business environment in the other's country. Local practices in the financial, social, and regulatory arenas are learned and then perfected. Without the development of this type of mutual understanding, beginning in the import/export market, more complex forms of international ventures would not be possible.

Until trade relations are more firmly established between Egyptian and Israeli concerns, there can be only modest expectation of joint venture projects. Some that might logically develop in the future are described below. It should be expected that initial investment projects will be small in size and grow with the development of the market.

CASE EXAMPLES

Of the commercial cases reviewed there were several that represented possible bases on which to develop industrial collaboration. The most likely relate to agriculture, food production (agro-industry), water use management and textiles.

CASE EXAMPLE ONE: Irrigation Equipment Manufacturing

Sector: Agriculture

Product/
Service Lines: Irrigation, other agricultural equipment

Egypt plans to reclaim up to as much as 100,000 feddans (1 feddan = approx. 2 acres) of semi-arid desert land every year during the next Five-Year Development Plan. Most of this land can be economically reclaimed only through the use of advanced irrigation technology. Egypt does not have access to sufficient water resources to reclaim such an amount of desert land by surface irrigation techniques and, in any case, the authorities have essentially forbidden the use of surface irrigation in new lands development.

One Egyptian entrepreneur indicated that his studies suggested a market for drip irrigation systems of 300,000,000 meters per year or 1.5 billion meters over the period of the Plan. This is calculated at 3000 meters per acre and based on Egyptian government projections that 90% of the technology used in new lands development will be drip irrigation.

Most (70%) of the drip irrigation equipment, particularly the pipes, will likely be produced in Egypt. This equipment will be of lower quality but will appeal to the farmers for reasons of cost. Several Egyptian entrepreneurs indicated a great interest in a joint venture with an Israeli drip irrigation equipment company. These individuals believed that a joint venture could produce quality equipment at competitive prices and would ensure the Israelis' position in the market.

Thus far no Israeli company has shown any serious interest.

CASE EXAMPLE TWO: Poultry Breeding

Sector: Agro-Industry

Product/
Service Lines: Parent stock

There is a large and growing poultry market in Egypt. One major Egyptian entrepreneur is already cooperating extensively with the Israeli Poultry Breeders Union in the development of his business. (See previous section.) The Egyptian company is importing layer chicks and hatching eggs to supply its operation. It would like to move to the next level of self-sufficiency by establishing a parent stock farm.

This Egyptian entrepreneur has already rented farm land near the Pyramids and has plans to begin operations in early 1988. He has invited the Israelis to join him in a joint venture in which each side would retain a 50% share and the Israelis would participate in management. The Israeli side appears willing to participate in this scheme, but reported that they had not yet decided what share of equity to take.

The total investment cost of the projet would be $500,000.

CASE EXAMPLE THREE: Water Meter Production

Sector: Industry

Product/
Service Lines: Meters

Water use management is a major problem in Egypt. A Prime Minister's committee has recommended that a water meter be installed in every house, starting with Cairo, in order to measure use of, and ultimately to conserve, water. Only two military companies produce water meters in Egypt and they produce only 1 inch, 3/4 inch and 1/4 inch sized meters. Importation of the 1 inch and the 1/4 inch meters is permitted but importation of the 3/4 inch is forbidden. Yet the demand for that type of meter is well beyond the production capacity of the existing companies. A government tender for two million 3/4 sized meters was announced last year, but the two domestic companies were unable to fill the order.

An Israeli kibbutz produces a good quality meter of the 3/4 inch size and at least one Egyptian trader has already placed orders with the company for other types of meters. The Egyptian is keen on developing a joint venture with this Israeli company to produce the 3/4 inch meters to fill the current vacuum. The Israeli company indicated an interest in this project idea.

CASE EXAMPLE FOUR: Garment Manufacturing

Sector: Textiles

Product/
Service Lines: Garment design, manufacture

Israeli fashion design and production capacity is well developed. Israel also has marketing capabilities in Europe and America not yet available to Egypt. Israeli industry, however, appears to have limited capability for expansion owing principally to a lack of low cost labor and materials. Egypt has both the labor and textile materials required.

Thus, a fourth good possibility for a co-production project appears to lie in textiles with Egyptian companies serving as contract suppliers of Israeli fashion products. The possibility of a joint venture in the textile area has been considered for more than eight years by some of the largest and most financially successful Israeli firms. An obvious idea for a joint venture would involve the production and marketing of garments for export markets in Europe and America. Because the primary goal of such a venture would be to increase export earnings on both sides, Israeli financial authorities might be more willing to permit Israeli companies to provide the investment capital such a project would need.

C. Conclusions

The experiences of the case examples identified and described herein suggest a number of conclusions relative to the issue of commercial and industrial complementarity between Egyptian and Israeli business interests:

- Although the bulk of existing trade between Egypt and Israel is public sector-oriented, specific examples of private commercial collaborations were identified.

- The cases identified involved collaborations in agriculture, technical services for agriculture, agro-industry (food processing and agricultural equipment), and tourism, each offering substantial potential scope for expansion.

- All of the successful case examples had a sound and legitimate economic underpinning; none were undertaken solely for reasons of "showcasing" the principle of collaboration.

- The concrete cases identified involved collaborations where the parties' economic incentives for doing business outweighed the disincentives posed by the existing constraints.

- In the cases identified the principal impediments to business encountered were non-political, in particular economic and financial.

- Practices and policies that curb trade and investment expansion by the private sector, especially that beyond national borders, are currently in evidence in both countries.

- In general, the failed attempts at commercial collaboration can be ascribed mainly to implicit weaknesses in the business concepts involved or to other legitimate business reasons.

- The lack of any investment or co-production projects appears to result primarily from a general Israeli orientation against overseas investment, an Egyptian lack of capital and the fact that trade relations, on which investment projects are generally built, are of relatively recent origin.

- Joint manufacturing for third country markets may represent the most significant longer-term opportunity for co-ventures, but such projects will likely develop only over an extended period of time.

IV. Constraints Analysis

The issue of constraints to expanded regional economic cooperation is one of the most important aspects of this report. The research team identified the major constraints inhibiting expansion of trade/investment relations as economic, commercial, financial, political, cultural and natural resource in nature. Of these economic constraints are probably the most intractable and least subject to intervention.

Limitations inherent in the respective economies of the two countries, Egypt and Israel, have been noted. These are largely matters of their economic histories, factor endowments, states of technological development and applications in such important sectors as energy, agriculture and industry, and of the human experiential and educational levels attained.

Differences in economic policy represent another form of constraint. This category is divisible into two major components:

- national policies, economic or political, that seek to control or regulate the flow of commerce, capital and investment to and from each country, but not specifically to each other. Included in this component would be the degree to which either country pursues policies and incentives or disincentives that promote and further private sector involvement in the overall development of the national economy.

- national policies, economic or political, that seek to control, regulate or inhibit directly or indirectly the flow of commerce, capital and investment with a specific country or countries (in this instance either Egypt restricting relations with Israel or vice versa). Included in this would be, for example, the restrictive use of customs and tariff regulations, regulations as to product specifications or origin of products, business or tourist travel restrictions, bureaucratic red tape or harassment and internal security force harassment.

In this regard, Egypt and Israel have a long history of economic separation and each has pursued a quite different approach to its economic development. It is certainly a truism to note that neither the Egyptian nor the Israeli national economies, and the financial, monetary, trade, development and fiscal policies which guide them, <u>were devised or have been restructured</u> with a view toward the need, feasibility of or desire to do business with each other.

Assuming a mutual goal of increasing economic interaction, it would be necessary to devise, in consultation with interested business parties <u>on each side</u>, a package of preferential trading and investment policies, incentives and institutional developments to reach that goal. It would be equally necessary to mount bilateral educational and informational business exchanges because any incentive packages devised <u>would almost certainly be dependent upon the interest and responsiveness of both the Egyptian and Israeli business communities</u>.

This research effort has, not surprisingly, found that a wide range of constraints are to be found in the context of existing economic relations between Egypt and Israel. Standing alone these constraints paint a somewhat gloomy picture. It is therefore important in reading this section to keep in perspective the substantial existing trading relationships and considerable future opportunities identified and reported on in previous sections. The constraints identified represent a barrier to increased trade and investment between Egypt and Israel, but not necessarily an insurmountable one.

A. Economic

A major constraint on collaborative enterprise is the fact that the two economies are in quite different stages of development. Much of the Israeli economy is geared toward the development and manufacturing of high technology goods for export to industrialized countries. Egypt is not a market for such goods. Similarly, Israeli opportunities for joint venture manufacturing lie in high technology operations with U.S. and European firms rather than with low-tech Egyptian firms.

Other economic constraints are in evidence. Egypt does not produce many manufactured goods required by the Israeli economy and those that it does produce are not sufficiently competitive in quality to succeed in the Israeli market. Israel and Egypt are natural economic competitors in certain areas. For example, both compete for the European market for flowers and winter fruits and vegetables.

B. Commercial

Despite proximity to the Egyptian market and obvious transport savings, Israeli goods and services are not necessarily competitively priced; some are, some are not. Many Israeli sales are still channeled through third parties and third countries to avoid controversy, forcing the seller to add as much as a 10% premium to his cost.

Egyptian firms are generally not export oriented and not all that experienced in serving an export market. They will face the same difficulties in packaging, quality control, marketing and shipping on a timely basis for the Israeli market that they face in exporting to other markets.

There is also a category of commercial constraints that is largely attitudinal and behavioral in origin. The terms "trust," "personal relations" and, most importantly, the "familiarity" with which the private businessman, of whatever national origin, can approach a new market situation are key to the attitudinal and behavioral constraint issue. Few outside investors or traders are willing to enter new markets in the absence of a local business partnership in which considerable trust and confidence has developed between the parties involved. Up to the present time, however, few such partnerships have yet developed between Israeli and Egyptian businessmen.

Another problem is the lack of the TIR system of bonding. Without this system trucks from the two countries are unable to cross each other's borders.

C. Financial

Several fundamental financial obstacles must be overcome before any substantial additional trade can be expected.

The principal problems identified on both sides of the border are institutional in nature. For example, there appears to be only one Egyptian commercial bank active in the Egyptian/Israeli cross border trade. Another example is the Israeli government's apparent unwillingness to extend export support programs to trade with Egypt.

Other difficulties exist, but they are generic problems not specific to commercial and economic relations between these two countries. Egyptians lack foreign exchange. It is typically difficult for them to open confirmed letters of credit required by the Israeli exporter. They have the same problem in dealing with other foreign suppliers. Egyptian banks require 100% collateral to back up an LC, which effectively eliminates the purchasing power of many Egyptians.

The United States and other OECD countries alleviate this problem through bilateral aid programs which help the Egyptians finance donor country product imports. The Israelis have no bilateral aid program in Egypt with which to provide the necessary finance.

In every case identified of a successful Egyptian/Israeli trading venture, Israeli firms have provided the necessary finance by offering preferential treatment in terms of LCs, long-term payment, and no foreign exchange requirements. Just as the successes were generally a result of favorable financial treatment from the Israelis, the failures appear largely to result from Egyptian problems with LCs, credit, or foreign exchange.

D. Political

There appear still to be serious governmentally imposed constraints on economic activity between the two countries. On both sides the issue focuses principally although not exclusively on trade.

On the Israeli side the push seems clearly to be for marketing Israeli products and services. The government has demonstrated little interest in or support for private Israeli investment or joint venture project development in Egypt. As one experienced Israeli trade consultant put it "the Israeli government is responsible for many of the problems associated with Israeli firms operating in Egypt."

A principal example of this assertion can be found in the Israeli export insurance program offered as a tool for promoting exports. Although export insurance is theoretically available to any Israeli company that exports products, firms exporting to Egypt often face very long delays in obtaining approval of the insurance applications; many do not receive approval in time to make a sale.

Credit is also cited as a problem for Israeli companies trying to do business with Egypt. The Israeli Central Bank has several programs to allow companies access to long-term credit if the purpose of the loan is to increase output to fill export demand. Companies applying for these programs to meet Egyptian demand have faced delays and outright refusals. Because of the absence of any non-government, long-term credit facility in Israel, companies that cannot get loans from the Central Bank, often cannot expand their plant capacity. These companies can get the business in Egypt, but they cannot finance production expansion to serve that business.

Another problem relates to foreign investment by Israeli firms. Most of the government programs available to Israeli companies encourage exports, but discourage foreign investment by Israeli firms. This policy orientation may be a serious obstacle to further expansion of joint Egyptian/Israeli projects.

The Egyptian government for its part still creates barriers to the development of commercial and economic relations. The most concrete example is that the government imposes a more demanding procedure on clearing import licenses for the importation of Israeli goods than it does for imports from other countries. By obliging the Egyptian importer to pass through a security clearance procedure in addition to the other clearance requirements, the government adds typically as much as two months to the clearance process. This creates a negative environment for trade with Israel and reduces the competitiveness of Israeli firms in the Egyptian market. It also gives the government the ability, and thus the continuous threat, of pigeon-holing licenses for Israeli goods indefinitely, something it did during the Israeli invasion of Lebanon.

Another government created obstacle can be seen in the difficulties Egyptian businessmen face in obtaining visas for business trips to Israel. The process can be long and time-consuming and the applicant may be subject to lengthy examinations of his reasons and purposes in making the trip. The fact that the process inevitably involves the security system in and of itself puts a damper on travel to Israel. Few individuals wish to invite the security services into their lives and businesses. If the Egyptian businessman succeeds in traveling to Israel, he may be subjected to endless questioning upon his return. What did he do, where did he go, whom did he see, etc., etc.?

Another apparent governmentally imposed constraint can be found in the failure of Israeli companies to bid successfully on government of Egypt tenders. The one tender won by an Israeli firm was never consummated, giving rise to the suspicion in Israeli quarters that the Egyptian government maintains a silent veto against such public business transactions.

It is also not clear whether the government of Egypt, as is the case with the Israeli government, discourages private investment of foreign exchange resources by Egyptian investors outside the country. Nor is the Egyptian government's general position on the development of joint Egyptian/Israeli projects within Egypt clear. No such projects have gotten much beyond the discussion stage at this point. Whether such projects would in practice be encouraged, tolerated or discouraged must remain a subject of speculation.

The government has made its position in this regard very clear, however, with regard to the Sinai. Egyptian law forbids the investment by foreign investors in projects in the Sinai, a prohibition aimed clearly against Israeli investment in the area.

E. Cultural

The Egyptian public, the consumer, appears to have mixed emotions about trade with the former enemy. There appears to be respect for the quality of Israeli products, at least known products such as irrigation equipment. Yet there continues to be antipathy toward purchasing and using products originating in Israel. Some Egyptians have refrained from working on scientific exchange programs for fear of losing consultant opportunities in the Arab Gulf. There may be official peace between Egypt and

Israel but the larger problem of Arab-Israeli relations and the continuing Palestinian problem overshadow bilateral relations.

On the Israeli side there appears to be a sense that the Egyptians do not offer much of interest to Israel. The outlook is westward to Europe and America for consumer products and commercial relations in general.

Another constraint which can be termed either economic or cultural or a combination of the two is the relative isolation of the Egyptian as compared to the Israeli economy. But for cotton Egypt does not have a long history of exports. Egyptian entrepreneurs have been satisfied with a large domestic market. Consequently, the Egyptians tend to be somewhat passive in their relations with the outside world, Israel now included. Egypt does not even have much experience collaborating economically with other Arab countries, and only modest recent experience with joint venture relationships with industrialized country private firms.

Israel on the other hand has built much of its economic infrastructure on linkages to other Jewish communities around the world and to leading world powers such as Great Britain and the United States. In every sense, and increasingly with its export efforts, Israel is active outside its borders. During the course of the field study, the team found every single Egyptian businessman sought for interviewing at home and available on the appointed day of the visit. Visiting with their Israeli counterparts proved difficult, however, because so many were typically on some business trip in Europe or America promoting their products.

The result is that it is the Israelis who have taken the initiative to explore business opportunities in Egypt and not the other way around. As noted, Egyptian exports to Israel all pass through government channels and likely result from government-to-government arrangements. Few if any Egyptian businessmen have attempted to set up shop and market products in Israel.

The Israeli government is also much more supportive of Israeli companies' export efforts. In Egypt, for example, the Israelis have placed a very active commercial counselor to promote trade with Egypt. This individual was born and lived his early life in Egypt, speaks fluent Arabic and is quite at home in the Egyptian commercial atmosphere. He acts as a kind of intermediary between Israeli and Egyptian firms. He seeks out potential Egyptian buyers and helps them overcome the constraints they face in buying Israeli products and services. He has no apparent counterpart in Israel.

There is nothing inherently wrong with this situation in the short term, although the lack of Egyptian aggressiveness toward Israeli market opportunities obviously limits expansion of bilateral trade. In the longer run, however, a combination of Egyptian apathy and Israeli activeness could fuel long-standing Arab fears about Israeli economic dominance.

F. Natural Resources

A limited natural resource base in both Egypt and Israel represents another significant constraint on the development of collaborative entreprise development. Apart from oil Egypt has few known natural resources not already being utilized. Primary among those in use are crude oil, iron ore, limestone and phosphate rock. Israel's natural resources are limited to phosphate rock, potash, bromides, magnesium and other salts from Dead Sea sources.

There is clearly little opportunity for collaboration in the development of unutilized natural resources, other than in the case of the handful of "mega-projects" previously identified and discussed in the Ben-Shahar study. However, there may be opportunities for Egypt to make use of Israeli technical services and technology for the more efficient exploitation of Egyptian natural resources.

G. Conclusions

Clearly, not all of the constraints cited above are subject to resolution. There is little that can be done with existing economic realities and the available natural resources, for example, or with the cultural barriers created by historical circumstance. But financial problems are subject to intervention and steps can be taken to increase business contacts and foster mutual familiarity. Also, there are impediments in policy and administration of policy which might be subject to rectification. The Government of Egypt could, for example, relax its objections to Israeli-oriented tourism projects in the Sinai and it could agree to supply Israel with natural gas. It could also relax the requirements for visas and import clearances relating to Israel and it could ensure equal treatment for Israeli firms bidding on Egyptian government tenders. The Israeli government could more actively support and encourage relations with Egypt by ensuring the full application of commercial insurance and other programs to trade with Egypt and it could promote Israeli investment in co-production projects with Egyptian firms.

VI. Conclusions and Recommendations

A. Findings and Conclusions

1. Fundamental changes in the economics of the Near East region are well underway. Market forces are overtaking the dirigiste economic policies of the past, with the result that trade and investment funds are moving across national boundaries irrespective of government policy. Economic incentive has led private Arab, particularly Egyptian, and Israeli concerns to interact without regard for existing political constraints.

2. Since Camp David import/export trade and other forms of bilateral commercial endeavors between Egypt and Israel have developed extensively and are ongoing in several markets. This commerce centers on agriculture, manufactured products (principally chemicals), energy (petroleum), tourism and technical services. Israel-to-Egypt trade is channeled principally through the private sector while Egypt-to-Israel trade is distinctively public sector-oriented.

3. Egypt is the principal overall beneficiary of existing bilateral trade, owing to the large volume of crude oil transfers to Israel. Excluding oil sales, which result from agreements reached at Camp David, existing trade between the two countries favors Israel by a wide margin.

4. The total volume of trade between Egypt and Israel is substantially larger than is generally known or acknowledged by the two countries. Because a major portion of this trade flows

through unofficial channels, reported figures understate the actual volume of this activity.

5. Whether bilateral trade between the two countries may be peaking out or whether and to what extent unrealized potential exists for further trade under existing circumstances remains unclear. Some important commercial opportunities, such as Israeli tourism in the Sinai and sales of Egyptian natural gas to Israel, clearly exist but remain unexploited because of political considerations. Apart from these easily identified "missed opportunities," the possibilities for substantial further expansion of market-driven business appear circumscribed in the short term.

6. The principal constraints to the expansion of trade between Egypt and Israel beyond current levels are non-political. These include, _inter alia_, the following:

- a limited number of complementary areas of manufactured goods production
- high cost of Israeli manufacturing
- low technology of Egyptian industrial process
- lack of credit/liquidity in both countries
- severe shortages of foreign exchange in both countries
- Israeli orientation to European and American markets
- domestic market orientation of most Egyptian companies; general lack of export competitiveness
- Egyptian passivity toward exploitation of Israeli market opporunities
- continuing degree of mutual suspicion and reluctance of both peoples to interact with each other

- scarcity of undeveloped natural resources in both countries

7. Certain political constraints exist which inhibit trade, but in most cases only marginally so. Principal among these are:

- difficulty of obtaining Israeli export insurance for goods destined for Egypt
- long advance time needed to obtain Egyptian licenses for the import of Israeli goods into Egypt
- potential loss of other business opportunities in the Arab countries by Egyptians having contact with Israelis
- time consuming and sometimes irksome security requirements applied to all Egyptian businessmen traveling to Israel
- policies prohibiting direct investment by Israelis outside of Israel
- apparent Egyptian discouragement of bidding by Israeli firms on Egyptian government tenders

8. Successful trade is taking place only in those goods where the financial returns to both the buyer and seller are high enough to outweigh the many disincentives to doing business.

9. In the cases identified, political factors did not inhibit any business deal offering the parties sufficiently profitable returns. However, the additional transactional frictions caused by politically motivated obstacles were enough to deter otherwise marginal projects.

10. Given the limitations to increased trade, further integration of the two economies is not likely in the short run unless policy-driven financial incentives are implemented to

increase the return available to the trading parties. These incentives might include such financial mechanisms as low cost credit, special borrowing facilities, or mechanisms to increase access to foreign exchange. Any methods that reduced the transaction costs of the traders' activity would create more trading opportunities.

11. All cases of Israel-to-Egypt trade identified in this study involoved substantial transaction costs. None would have been consummated without the provision of incentives by the Israeli producer. For example, commercial incentives for trading in irrigation equipment and layer chicks exist in the present market, but successful trading in these products is only possible because the Israeli suppliers provide financial incentives to the Egyptian purchasers, including sales on consignment, preferential credit agreements, and substantial flexibility with respect to the required foreign exchange.

12. In the two examples cited above, the overall profitability of the trading relationship for the Israeli producers was sufficient to allow them to provide the financial incentives needed to penetrate and service the Egyptian market. There appear, however, to be few such Israeli products with profit margins potentially large enough to provide the required financial incentives.

13. In general, the propects for joint production projects between Israeli and Egyptian firms appear limited in the near future. None has been consummated to date. Such opportunities

typically follow in the wake of established trading relations, the development of a class of businessmen in each country that fully understands the markets and operating practices of the other, and the liberal availability of investment finance. Israeli restrictions on foreign direct investment, scarcity of Egyptian investment capital and the limited bilateral trading experienced so far as well as other problems represent at least short-term obstacles to the development of joint production projects, either for local or export markets.

14. Special incentive programs and financial assistance would likely be required to promote and stimulate the development of co-venture investment projects in the short-run.

15. The best opportunities for joint production projects appear in the long run to lie in production for both the textile and agricultural sectors with the output targeted to European, American or East European markets. Each country has a significant comparative advantage in certain of the factors of production required for successful commercialization of these products. Israel has a deep-rooted understanding of Western markets, access to the European Community and a Free Trade Agreement with the United States, manufacturing knowledge and design talent needed to penetrate third country markets. Egypt has the low cost labor and raw materials needed to produce products at competitive prices. In addition, Egypt has unexploited preferential access to certain markets through negotiated trade agreements.

16. Nonetheless, few opportunities to pursue joint production projects for third country markets appear currently in prospect. Nor does there appear to be much chance that tri-national projects are likely to develop under current circumstances. A survey of U.S. multinational corporations doing business in the area revealed an almost total lack of interest in the concept.

17. The results of the study substantiate the fact that expanded trade--and ultimately investment--are possible between Israel and Egypt. The appropriate scale and pace of realization of such expanded trade or investment are, however, still in issue. Symbolically, a mega-project would be of great significance; it would capture the imagination, demonstrate serious intent to cooperate; permit large-scale transfer of technology, and might help to dissipate politically oriented constraints. Notwithstanding, mega-projects would be confronted with substantial resistance politically, are typically too large and complex for Egypt's absorptive capacity and would require major and difficult-to-obtain infusions of externally raised capital. Smaller private projects are typically more attractive economically and represent more likely building blocks for future Egyptian/Israeli economic cooperation.

B. Recommendations

As indicated in the body of the report, the research team identified a number of constraints to the further expansion of trade and investment between Egypt and Israel. Some of these constraints are subject to removal or alleviation and some are not. The team recommends herein a series of possible action steps by both public and private interests that might help to remove or diminish those constraints subject to intervention. No recommendations are made as to the appropriate parties to such action steps, although some of the steps proposed would clearly require the intervention of government entities and officials as opposed to private parties.

A variety of methods and approaches might be taken to implement the recommendations that follow. Those proposed herein, tied as they are exclusively to the judgments of the three team members, must be considered as illustrative only, certainly not as a definitive program plan.

The team offers no recommendations with respect to formal political initiatives to be undertaken or to sensitive matters of internal security, national sovereignty or national defense. Such matters are well outside the Scope of Work of this project and, in any event, not within either the individual or collective professional expertise of the team or any of its members.

The recommendations presented are organized according to three categories; organizational initiatives, financial intermediation mechanisms and policy initiatives. Specifics are presented where appropriate, but there is no intent to construct a detailed "road map" for purposes of implementing specific action programs. The development of a strategic plan or road map for the implementation of such programs is the next logical step to follow the submission of this report. It is, however, a subject with obvious political overtones and as such is probably best left to the parties concerned or, if pursued by others, will need the full support and acquiescence of those parties.

Organizational Initiatives

A number of organizational initiatives might be undertaken as a means of promoting further commerical contact and cooperation among private business concerns in the two countries. An organization such as the U.S. Agency for International Development (USAID) would be an appropriate sponsoring agency for such initiatives. Some initiatives that might be taken include:

1. A working group of senior businessmen might be organized, drawn from the Egyptian and Israeli private sectors, to review the findings of this report and to table additional issues or proposals. The objective of the group would be to define the path, i.e., the "road map" that new initiatives in business development might follow, the requisite steps required of each nation to enable those steps to take place, including the feasibility of establishing a permanent "Economic Cooperation Oversight Committee."

The group must be seen to spring from a private sector initiative and not as a government sponsored effort tied to political objectives. Group members must be both discreet and well-connected, able to discourse on important government initiatives quietly and with the confidence that their personal business interests and security would not be jeopardized. The group must operate on a purely business basis; it must not become a public relations forum for the discussion of a non-business agenda. To the extent that the working group lost its business orientation, it would lose the support of the businessmen it sought to mobilize.

2. Following the successful organization of the working group, a more formal "<u>Association of Regional Business</u>" might be organized. Leadership and membership would be drawn from Israeli and Egyptian businessmen already conducting business with each other. Again, this effort should be conducted on a purely business basis with no political mandate appearing on its agenda or in its objectives. The primary function of this group would be educational and informational, a means by which established and interested business parties could meet to pursue their economic opportunities and prospects. The Turkish Management Association in Istanbul and the Jordan Management Association in Amman might be models for such a group. Both have been quite successful in stimulating private sector development and are noted for the excellence of their management education and training centers.

3. The creation of a <u>working group of senior businessmen engaged in banking and financial intermediation, export credit and development banking</u> might be considered. Such a group would be organized in a manner similar to that described for the suggested Oversight Committee. This group's mandate would be to review and ultimately to formulate a package of credit and

investment financing instruments necessary to stimulate and encourage further regional cooperation. The question of whether special subsidies ought to be provided would be a major topic for the consideration of such a group. As with the other organizations suggested, the group on banking and finance would be comprised of those with direct access to the appropriate authorities in their respective countries and would have an exclusively business orientation.

4. A <u>broad range of educational and informational initiatives</u> might also be considered for implementation through technical assistance agencies, universities (specifically Schools of Business, Agriculture, Economics and Engineering), private business associations, trade associations and development education and training organizations and institutions (such as planning institutes, management development institutes, etc.). Such efforts would probably be funded and encouraged most efficiently by a single international donor agency, the most appropriate being perhaps USAID.

The initial effort should be confined to stimulating regional business education and information training activities within and among those institutions that have a non-academic approach to the subject. In the longer term, the objective would be to introduce curriculum on regional business development, marketing, finance, business planning, production technology, etc. in the formal education systems of the nations involved. However, it is not recommended that this be the first step as the business communities in the region typcially consider the formal educational institutions too "academic" in approach and are therefore unwilling to participate in classroom-like training programs. The emphasis must be on "doing business," not on theoretical postulations.

5. An international agency, such as USAID, might take the lead in forming an ad hoc working committee of regional political, economic and business experts (of whatever nationality) and representatives of major international donor and technical assistance agencies and organizations (including those from the private sector such as the Ford Foundation) but not drawn from any of the working groups or associations recommended above. The objective of this ad hoc group would be to act in an advisory capacity, not as "show horses" but as "work horses" to review strategy and tactics for expanding economic cooperation objectively. Membership would be drawn, at least in part, from those well established professionally but not previously associated with the Middle East. These might, for example, be highly qualified individuals with field experience in other regions of the world who have demonstrated an ability in those locations to overcome significant barriers to business and, more generally, to economic development. The objectivity and integrity of such a group must be seen by all parties as above reproach.

Financial Intermediation Mechanisms

Several institutions can be envisaged that might serve to oversee and implement the various financial programs needed to alleviate the financial constraints identified.

1. Joint Investment Authority. A multinational commercial organization might be established for each sector identified as a possible source of a successful joint commercial venture. The two sectors which appear to offer the greatest liklihood of success are agriculture and textiles. The proposed commercial organization would have members from Egypt, Israel and the countries most likely to purchase the products manufactured by the joint venture. A working group might be established for each identified sector.

The proposed organization would have four operating groups for each sector; project identification, finance, marketing and governmental/political. Project identification would seek out project possibilities, provide partner search services and offer funding for feasibility study programs; finance would be responsible for identifying and obtaining the initial funds needed for the proposed projects, the marketing group would identify the purchasers of the products and obtain contracts for the output of the program; and, finally, the governmental/ political unit would facilitate the approval processes in Egypt, Israel and the proposed target market countries.

Each of the four groups must be staffed by members of the business community with specific private sector experience; the project identification group would be headed by an entrepeneur or venture capitalist type; the finance group would be headed by a banker with specific project finance experience, the marketing group would be headed by a senior marketing executive from a consumer or industrial products company and the political/

governmental group would be headed by government officials from both Egypt and Israel.

An important function of the working group would be to distribute the profits from the proposed transactions. One of the primary issues for any proposed venture would be to ensure a fair and appropriate return to both the Egyptians and the Israelis. If the working group had authority to develop the methods by which the returns are divided to the project participants, the possibility for disagreement over the division of the spoils would be reduced.

This proposal suggests that the members of the working groups in the Joint Authority would take an active role in the proposed projects. The program must be designed so as to attract those members of the business community who can commit the resources of their organizations to the identified projects. The Authority would not be helpful if the members are primarily government officials or consultants lacking contacts with the enterprises that can provide needed support for the proposed projects.

2. Trade Cooperation Authority. Both Egypt and Israel might consider establishing a trade promotion office in the other's country to assist with the flow of commerce and investment between the two countries. Thus, the Egyptians would establish a presence in Israel to assist Israelis wishing to do business in Egypt. This office would be available to identify markets, assist with government approvals, and match buyers and sellers. Another office might be opened in Egypt specifically

designed to meet the needs of Israeli/Egyptian commercial relations. The Cairo office would be jointly staffed by Egyptians and Israelis.

The Israelis would do the same. Indeed, they are doing this now to a limited extent with the active efforts of their commercial officer in Cairo. This office, however, appears to be primarily oriented to promoting Israeli sales to the Egyptian market. This office should be geared also toward assisting Egyptians who want to do business in Israel. A joint staffing arrangement would likely be the best option for both parties.

3. <u>Trade Finance Authority</u>. An authority to provide various forms of financial assistance to intra-regional trade would greatly facilitate trade development between the two countries. Below market interest rates, access to LCs, access to foreign exchange and long-term guarantees would all help to encourage bilateral trading relationships. The authority would need an initial round of external funding; however, it could be self sustaining in the long run.

The first product to be offered might be a trade credit guarantee program to remove the credit risk associated with the flow of goods and services between Egypt and Israel. The program would provide an easily accessed form of import/export credit insurance so that any company could be sure of receiving payment for goods delivered. Presently, most companies require an LC or other form of payment assurance. This service would be provided for a nominal fee, and, in the long run, would be self-sustaining.

Access to foreign exchange is needed by both Egyptian and Israeli importers of the others' goods and services. The Trade Finance Authority could be empowered to raise money in international markets at prevailing rates. The borrowing would need a third party guarantee, which might come from USAID or from a private, rated financial institution. If the credit enhancement came from a private company, initial funding for the credit enhancement would be required. Any company using the foreign exchange that is made available by the credit authority would pay a fee for the funds. Although the fee would raise the cost of the trade, the availability of the foreign exchange would offset the cost of the funds.

The credit enhancement used to assist with the foreign exchange might also be used to allow international borrowing for funding a short-term trade development fund. This fund would be similar to the export promotion fund that is available to Israeli firms that are developing export industries. Borrowing from this fund would be limited to those companies that are involved in bilateral trading agreements or which have developed a joint commercial program.

Policy Initiatives

A number of constraints have been identified which might be alleviated by some relatively modest policy initiatives on the part of both the Egyptian and Israeli governments.

1. The Israeli government, for example, might take steps to ensure the expeditious processing of applications for insuring the export of products to Egypt, to make available long-term

credit to Israeli entrepreneurs seeking to expand production for the Egyptian market, and to develop programs offering incentives to investment in Egypt.

2. The Egyptian government for its part might relax the stringent requirements it has set for obtaining licenses for the importation of Israeli products, liberalize the process of obtaining visas for travel to Israel, ensure Israeli firms equal opportunity in bidding on Egyptian government tenders, and clarify its position on investment by private Israeli firms.