THE ARAB BOYCOTT AGAINST ISRAEL AND ITS UNINTENDED IMPACT ON ARAB ECONOMIC WELFARE

Master of Arts in Law and Diplomacy Thesis
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ABSTRACT

For 45 years, the Arab world imposed an economic boycott against the State of Israel that was designed to weaken the Jewish State’s economy and ultimately destroy its chances of survival in the region. While a great deal of literature exists on the topic, little research or analysis has been done regarding the costs incurred by the Arab states imposing the economic weapon against its enemy. This thesis makes one of the first efforts at understanding the self-defeating policy of intentionally distorting trade and investment patterns through the use of a boycott and the consequences for doing so. Given renewed calls for reinstating the economic boycott against Israel as a result of a rise in tensions in the region since 2000, it would be prudent for those considering to restore the policy to first consider the detrimental impact a boycott would have on their own economies.

This paper approaches the analysis by proposing two hypotheses: 1) The Arab policy of boycotting Israel and blacklisting non-conforming companies created an unfavorable environment for foreign direct investment in the Arab world and 2) the boycott led to a terms of trade worsening and a reduction in the volume of trade of Arab countries, leading to an overall decrease in national income and economic welfare. This thesis substantiates the hypotheses proposed by drawing upon concepts of international trade and investment while also opening up questions for future research.
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I. Introduction:

In November 1994, the First Middle East/North Africa (MENA) Economic Summit was convened in Casablanca, Morocco to discuss opportunities for greater economic cooperation among governments in the region. Towards that end, representatives of the Gulf Cooperation Committee (GCC)\(^1\) announced their intention to end their participation in the 45 year Arab boycott against Israel (see text of announcement in Appendix, Exhibit 1). The declaration was an historic change of policy that would have significant trade and investment implications for the region and the entire world. While the Arab boycott’s impact on the Israeli economy and even on the economies of other trading nations has been well documented, its economic impact on the participating Arab states has undergone little, if any, analysis. Given basic economic principles, however, it is my contention that the Arab states’ use of an economic weapon to bring about a political outcome through the use of a boycott had the unintended effect of injuring the participants’ own economic welfare, causing greater damage to themselves than ever formally recognized.

Proving such a contention has important policy implications given today’s renewed calls for reinstating the Arab Boycott against Israel in light of the reemergence of violence between Israelis and Palestinians since September 2000. Furthermore, countries like Lebanon and Syria have chosen not to cease their application of the boycott against Israel despite the decision to do so by other Arab states. By understanding the detrimental impact of using a boycott to serve their political end, Arab countries may be encouraged to rethink their strategy for the sake of their own economic welfare.
II. Methodology:

This paper will begin by defining boycotts in terms of how they have been used historically and towards what end. The next section will then establish the context for this paper by providing a brief overview of the events that led to the establishment of an economic boycott against Israel and how it impacted the Israeli economy. I will then propose two key hypotheses: 1) The pursuit of an economic boycott against Israel created an unfavorable environment for Foreign Direct Investment in participating Arab countries which thus hindered economic growth in those Arab countries, and 2) the use of a boycott as a non-tariff barrier to trade distorted trade patterns such that the Arab countries faced a terms of trade worsening that reduced their economic welfare. If proven - using a number of different economic indicators characterizing the Arab world during the period of the boycott and in the years following the end of the policy - these hypotheses will show the detrimental effect that the boycott had on Arab economies.

III. Boycotts as a Weapon:

Individual countries, groups of countries and international organizations have, for decades, employed boycotts, a form of economic sanctions, as a tool to both penalize the actions of, and coerce a change in policy by, the targeted country. Defined as a “form of reprisals whereby a state may institute by itself and through its nationals an interruption of commercial and financial relationships with another state and the state’s nationals,”2 boycotts often have a detrimental impact on the targeted country’s economy. Such effects include a loss of export markets, an inability to access critical imports, the receipt of lower prices for embargoed exports, and the imposition of higher prices paid for substitute imports. In deciding whether or not to impose a sanction to bring about a
particular political end, most countries consider the likelihood that such effects will indeed occur and cause the intended burden on the targeted country. However, few countries conduct an exhaustive cost-benefit analysis of an economic boycott policy in which the costs to their own economy are considered. This is for two reasons: 1) it is extremely difficult to quantify the costs to the boycotting country, especially given the intangible costs on an economy and the extended time it might take for an economy to reflect the costs, and 2) the overall burden is perceived as being extremely trivial, especially for a large economy.\(^3\) According to one study, the cost to the boycotting country is typically only 1% of a country’s GNP.\(^4\) As will be discussed later, such narrow perceptions and limited calculations mislead countries into believing that there is more to gain than lose in imposing an economic boycott to pursue political ends.

Not only is it important to consider the economic aspects associated with the imposition of a boycott, but it is also worthy to recognize the impact of such a policy on the investment flows into the boycotting country. Chapter VI of this thesis will delve into this issue in the context of the hypothesis that boycotts create unfavorable environments for attracting foreign direct investment. Finally, there is a legal dimension to the discussion of boycotts and whether or not they may be used as an economic weapon against a third country. Various interpretations of both national and international laws have contributed to the debate and play an important role in determining the price boycotting countries pay in adhering to their policy. In particular, chapter VI will include a discussion on how the UN Charter, GATT and U.S. laws each address the issue of boycotts and will highlight the importance of considering the legal ramifications of adopting such a policy.
IV. Background:

A. An Historic Overview:

In 1945, the Arab League, then composed of Egypt, Lebanon, Syria, TransJordan, Iraq, Yemen and Saudi Arabia, formally announced an economic boycott against all Jewish products in reaction to expectations that a Jewish state was to be established in the region (see Appendix: Exhibit 2 for current list of Arab League Members). The declaration called upon all Arab “institutions, organizations, merchants, commissions agents and individuals…to refuse to deal in, distribute, or consume Zionist products or manufactured goods.”5 Once Israel was established in 1948 as a result of the UN Partition Plan, an all out war ensued in which Egypt, TransJordan, Lebanon, Syria and Iraq attacked the new state in the hopes to drive it out of the region. Unexpectedly faced with an even stronger Israel following their defeat, the Arab countries sought to supplement their military aggression with an economic weapon – a more formal economic boycott against the State of Israel. According to the Arab League, by 1949, the boycott was designed to “bring about the eventual collapse of the State of Israel and [will] reveal that it is not economically viable in the midst of a hostile world.”6 The following map illustrates the size of the Arab world versus the small State of Israel.7
In 1951, a policy of blacklisting non-conforming companies was implemented and a Central Boycott Office (CBO) was established in Damascus, Syria to manage the activities of its boycott branch offices in member countries. By the 1970’s, few companies could afford not to comply with the Arab Boycott: Arab petrodollar wealth and the oil weapon were used successfully to extort foreign compliance with the foreign policy goals of Arab states.

Finally, after six major Arab-Israeli wars, six years of Intifada, and 45 years of economic boycott, an historic handshake between Israel’s Prime Minister, Yitzhak Rabin and PLO Chairman, Yasser Arafat opened the door for economic cooperation among all nations in the Middle East, including Israel. The 1993 Oslo Peace Accords thus prompted the Gulf Cooperation Council to announce its support for the end of the boycott and to encourage the rest of the members of the Arab League to normalize trade relations with Israel. The move prompted a surge of trade and investment in Israel by European and Asian companies and the initiation of a number of joint cooperation projects between Israel and Arab countries. Companies in the Far East and Europe embraced Israeli technology, telecommunications, and construction products, exported goods to the Israeli market and engaged in multi-million joint venture projects. For Israel, the welcomed end to its pariah status not only served as a political gain but also as an economic opportunity to strengthen its own economy.

B. Structure of the Arab Boycott:

The boycott was designed to have as widespread an impact on Israel’s ability to thrive as possible. Towards that end, three major components characterized the policy:
1) **Primary Boycott**: No Arab country should import Israeli goods or export goods to the Israeli market, either directly or indirectly.

2) **Secondary Boycott**: No Arab country should conduct business with any company already doing business with Israel.

3) **Tertiary Boycott**: No foreign company should do business with another foreign company that has links to Israel.

Together, these policies were designed to deprive Israeli access to foreign export markets and to raw material imports needed for their industries. As a country with limited natural resources, Israel relied heavily on raw material imports. The primary boycott aimed to cut Israel off from their closest markets (i.e. their Arab neighbors) such that the prices of their exports and imports would be excessively high due to transportation and insurance costs. The intension was to make Israel less competitive on world markets and increase the cost of living in Israel. The secondary and tertiary elements of the boycott lured trade away from Israel and towards the Arab world by essentially blackmailing companies to choose sides of the political and economic divide. Companies that chose to engage in commercial relations with Israel, including docking at Israeli ports, were blacklisted and forbidden from entering the Arab market. Blacklisted companies were (but not limited to) those which:

- Had a main or branch office in Israel
- Had an assembly plant in Israel
- Held shares in Israeli companies
- Declined to answer questionnaires from the Central Boycott Office regarding relationship with Israel
- Incorporated within its own product components of a blacklisted company
• Used blacklisted insurance or shipping companies

• Were pro-Zionist or employed pro-Zionists

• Participated in Jewish organizations or contributed funds to pro-Israeli groups

Afraid to endanger their access to Middle Eastern oil and alienate the entire Arab world and its large market, most governments tolerated the choices made by domestic companies to avoid commercial relations with Israel. Thus, for 45 years, most multinational firms chose to stay out of the Israeli market in order to continue business relations with the Arab world.

A telling case involving Tecumseh Products of Michigan, a manufacturer of compressors and refrigerators, illustrates the creative implementation of the boycott policies and the extent to which they attempted to shape international trade patterns. Tecumseh was blacklisted soon after signing a licensing agreement with the Israeli company, Amcor, for the use of its refrigeration technology in 1958. While this did not cause Tecumseh great concern, the company soon faced pressure from its own US commercial customers who used its products. The Central Boycott Office threatened to cut off Tecumseh’s customers’ exports to the Arab world if Tecumseh did not suspend its commercial relations with Israel. Under pressure from its own customers, Tecumseh had little choice but to put its sales to its domestic customers ahead of its business relationship with the Israeli firm. Thus, the boycott and its blacklisting policies not only threatened companies doing business with Israel, but also extended as far as the customers of those companies engaged in business transactions with Israel.
V. Impact of Boycott on Israel:

A. Costs to Israeli Economy:

The use of non-tariff barriers to trade against Israel and the implementation of a
blacklisting policy served as powerful deterrents against engaging in commercial
relations with Israel. For instance, despite the U.S. Export Administration Act of 1969
that discouraged US exporters from cooperating with the boycott and that required them
to report all boycott requests, the Commerce Department in fact ‘looked the other way’ in
cases where US companies complied with the boycott regulations. Given the fact that US
exports to Arab countries were estimated to reach $10 billion by 1980, of which each
billion of such exports represented 40-70,000 jobs for American workers,\textsuperscript{11} Under-
Secretary of State James Baker expressed his concern to the Subcommittee on
International Trade and Commerce in 1975 that the enactment of laws prohibiting
compliance with the boycott would result in significant trade losses for American
businesses. Thus, before the 1977 U.S. law that finally made it illegal for US companies
to partake in the discriminatory trade practice against Israel, 92% of American companies
exporting to Arab countries complied with the boycott by not interacting with the Israeli
market.\textsuperscript{12} In fact, US exports to 18 Arab countries in 1971 reached $1 billion, and grew to
$5.4 billion in 1975, and $8.36 billion in 1978.\textsuperscript{13} Similarly, there are numerous instances
in which the British government failed to intervene when there were clear cases of British
companies complying with the discriminatory aspects of the Arab boycott. By the early
1980’s, the UK had yet to enact any anti-boycott legislation and simply advised
businesses to rely on their ‘own commercial judgment’ in their business dealings in the
Middle East. Israeli trade with Germany, though amounting to $1.1 billion by 1990,
remained limited due to a lack of substantial German capital investments in Israel, no
joint ventures or technology transfer agreements and the absence of German Government purchases of Israeli goods.\textsuperscript{14}

Japanese companies, including Mitsubishi, Mitsui, Mazda, Toyota, Honda, Nissan, Sumitomo (metals), Suzuki and Yamaha (motorcycles), Shiba, Hayakawa, Nippon Electric (radio and TV sets), and Japan Airlines as well as all Korean automakers avoided trade and investment opportunities in Israel throughout the 45 years (with some exceptions).\textsuperscript{15} Japanese companies, in compliance with the boycott regulations, prohibited their raw material exports or imports to be carried on Israeli-owned ships. The Kawasaki Dockyard Company of Kobe, for example, cancelled negotiations to build an oil tanker for Zim, Israel’s international shipping line, because Kawasaki was already in business dealings with Egypt and did not want to come into conflict with the boycott’s policies.\textsuperscript{16} The Japanese government, despite its insistence that the government had a policy of free and non-discriminatory international trade, tolerated such “business decisions” and even went as far as to deny reciprocal landing rights in Tokyo for ELAL, Israel’s national airline.

Economists and others have made a number of attempts at estimating the costs of the Arab boycott on Israel’s economy. While the numbers provide some indication of the possible costs, in reality it is difficult to disentangle the multiple variables other than the boycott that may have dissuaded foreign firms from doing business with Israel. Nevertheless, it is worthwhile to consider some calculations that have been made in the effort to understand the effectiveness of the economic weapon against Israel. In 1985, authors Gary Clyde Hufbauer and Jeffrey J. Schott calculated the costs to Israel by basing
their data on the assumption that Israel would have mirrored Lebanon’s trade pattern had the boycott not existed: Lebanon sold 60% of exports and took in 22% of imports from Middle Eastern countries between 1957-1962 and 44% and 6% respectively in 1968-1971. Hufbauer and Schott conclude that Israel suffered an annual cost of $258 million as a result of the boycott. Their calculation is as follows:

<table>
<thead>
<tr>
<th>Time Period</th>
<th>Reductions in Israeli Exports: welfare loss valued at 15% of estimated lost sales</th>
<th>Annual cost to Israel</th>
<th>Reductions in Israeli Imports: welfare loss valued at 15% of estimated lost trade</th>
<th>Annual cost to Israel</th>
</tr>
</thead>
<tbody>
<tr>
<td>1951-1960</td>
<td>$25 million</td>
<td></td>
<td>$16 million</td>
<td></td>
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<tr>
<td>1961-1972</td>
<td>$69 million</td>
<td></td>
<td>$12 million</td>
<td></td>
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<tr>
<td>1973-1980</td>
<td>$667 million</td>
<td></td>
<td>$127 million</td>
<td></td>
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<tr>
<td>Annual Average, 1951-1980</td>
<td>$214 million</td>
<td></td>
<td></td>
<td>$44 million</td>
</tr>
<tr>
<td>Total Annual Average: 1951-1980</td>
<td></td>
<td></td>
<td>$258 million</td>
<td></td>
</tr>
</tbody>
</table>

Other estimates, each one based on different assumptions, are more conservative and fall more in the range of $60-$70 million of annual losses during the 1960’s. In short, Ephraim Davrath, Israel’s Deputy General for International Affairs of the Ministry of Finance noted in 1982 at an Israel-EEC Cooperation Committee meeting that “there is no doubt that trade and other fields of economic cooperation would have expanded at a much faster pace, and that Israel’s chronic deficit would have been lower, had it not been for the effect of the Arab boycott.” It is significant to note that, however great the costs, the Israelis still enjoyed relatively positive economic growth during the years of the boycott as seen in Exhibit A below.
**EXHIBIT A**

<table>
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</tr>
</thead>
<tbody>
<tr>
<td>GDP Growth (Annual %)</td>
<td>5</td>
<td>6</td>
<td>7</td>
<td>5</td>
<td>2</td>
<td>4</td>
<td>1</td>
<td>3</td>
<td>5</td>
<td>7</td>
<td>2</td>
<td>1</td>
<td>7</td>
</tr>
</tbody>
</table>

**B. Israel as a Favorable Export Market and Source of Imports:**

The flood of trade and investment that took place once the boycott barriers were removed most vividly illustrates the power and success those barriers had when in place. As soon as the boycott was lifted, Japanese and Korean companies jumped at the opportunity to buy, sell and collaborate with Israelis. No longer afraid of jeopardizing their trade and investments in the Arab world or endangering the countries’ delicate access to Arab oil supplies, Asian countries and companies recognized the economic benefits of free trade with Israel. For example, once Japanese car manufacturers, Mitsubishi, Mitusi, Nissan, Toyota and Mazda agreed to trade with Israel in the early 1990’s, Japanese and Korean cars quickly surpassed European cars in most categories as the most popular among Israeli consumers.²¹

Israel’s strong buying power made the small country a promising export market, perhaps even more promising than the Arab countries combined on a per capita basis: Israel's total imports for 1996 were $30 billion, nearly $5,000 per person in a country of less than six million. In contrast, the Arab countries with a total population of 270 million imported $140 billion in 1996, just over $ 0.50 per person.²² Moreover, Israel’s household final consumption expenditure per capita ranged from 54% to 193% (between
1960 and 2000) greater than the household expenditure per capita of five Arab countries combined (See Exhibit B). Thus, although Arab countries offered greater numbers in terms of population, individual Israelis had a greater capacity to purchase higher priced goods than their counterparts in Arab countries. As a result, today, Samsung Electronics, Daewoo, Nomura, Goldtron, Hutchison Telecomm, Nissho Iwai, LG Group, Sony, Toyo Ink, Hyundai, Acer Computers, Sumitomo Trading, Fuji, Honda, among many others are all invested and trading with Israel.

EXHIBIT B

Not only did Israel serve as a favorable market for foreign exports, but also many countries eagerly imported Israeli goods. Between 1990 and 1997, Israeli exports to India grew from $69.6 million to $364.8 million and exports to Japan climbed from $546.5 million to $1,029.4 million. Total exports to Asia grew from $1047.8 million to $4,094.2 million. Israeli exports to Taiwan, Indonesia and Malaysia totaled over $1 billion in 1995, and grew 30% annually in the years following. The improvement in Israel’s level of exports coupled with an increase in foreign direct investment in the Israeli economy
contributed to the country’s 6% average annual growth in GDP between 1991-1995, a drop from a three to a two-digit inflation rate, a reduction in the unemployment rate and a per capita income of approximately $16,000.26

C. Israel as a Favorable Environment for FDI:

Not only did Israel expand and diversify its list of trading partners (i.e. Japan, S. Korea, Europe, etc.), but the country also enjoyed unprecedented levels of foreign direct investment following the end of the boycott. Levels of foreign direct investment skyrocketed from $40 million in 1970 to $1.6 billion in 2000. (See Exhibit C).27

EXHIBIT C

What made Israel such an attractive country for FDI once the boycott was lifted? Despite its small size, Israel was seen as offering a highly skilled and highly productive labor force at wages lower than Europe’s. In addition to attractive financial incentives and tax relief offered by the government to foreign investors, firms could rely on the fact that the country’s democratic political system posed no risk of nationalization and expropriation policies. Foreign investors could also take advantage of Israel’s unique status as a member of free trade agreements with both the United States and the European Union.
Many foreign companies have invested in Israel in order to enjoy the benefits of a tariff-free route into Europe. Overall, foreign firms invested in Israel enjoy the benefits of liberalized import and export conditions.

VI. Hypotheses & Findings:
Although it is indisputable that the Arab boycott negatively impacted Israel’s economy and development (although it did not destroy it to the extent planned), the Arab policy of boycotting Israel may have also unexpectedly and unintentionally hurt the economies of those Arab countries participating in the boycott – the boycotting countries’ own policy resulted in “shooting themselves in the foot.” Evidence to support this assertion will be based on two hypotheses:

1) **Unfavorable FDI Environment**: The Arab boycott against Israel demonstrated to potential foreign investors that the region remained politically unstable and thus unfavorable for Foreign Direct Investment in Arab countries. Furthermore, boycott policies drove greatly needed, lucrative foreign direct investments out of the country.

2) **Terms of Trade Worsening**: The application of sanctions against Israel went counter to the economically proven benefits of free trade. By prohibiting imports into and exports from Israel using non-tariff barriers to trade, Arab countries experienced a deterioration in their terms of trade that resulted in an overall reduction in their economic welfare.
A. Unfavorable FDI Environment:

Proving the first hypothesis, ‘Unfavorable FDI Environment,’ has been unexpectedly challenging to prove. Historical Foreign Direct Investment (FDI) data for most Arab countries is either unavailable or incomplete. For those that do provide data, a growth trend of FDI following the end of the boycott is either unsubstantial or inconsistent since there is no historical data from which to derive a trend (See Exhibit D below and Appendix: Exhibit 3 for more details). Whether or not a lack of data was the culprit, it appeared that many of the countries did not exhibit rising FDI levels once the boycott was lifted. There may be several reasons why most of the Arab countries did not experience a surge in FDI levels after the boycott was lifted, including a lack of formal incentives to attract foreign investors, an overall need for economic reforms in Arab countries, foreign concerns over the unpredictability of non-democratic, authoritarian rule in Arab states (i.e. expropriations), and the threat of Islamic fundamentalism in the region. Moreover, it may be that foreign investment moved into Israel and completely out of Arab countries once the boycott was lifted. These factors taken together may have countered the positive development of ending the boycott and stabilizing trade relations with Israel. Had Arab countries addressed and corrected both their unattractive political and economic policies, perhaps a greater influx of FDI would have taken place. In contrast, the data clearly indicates that Israel experienced a large influx of foreign direct investment following the end of the boycott in 1994 (refer back to Exhibit C) mainly because the smaller companies that could not afford to violate the boycott and Asian companies that had obediently kept out of its market eagerly entered Israel once the taboo was nullified.
Another explanation for the lack of any trend in foreign direct investment levels but that helps to prove that strict adherence to the boycott was detrimental to Arab economic welfare may be found in the inconsistent manner in which the blacklisting policy was enforced. While the threat of blacklisting succeeded in driving investment plans of *small* companies away from Israel and towards the Arab states, many large companies were able to serve *both* markets without suffering blacklisting measures. There are numerous cases, most notably with IBM, Coca Cola, American Express and Hilton Hotels, in which threats were made by the Central Boycott Office to end commercial contacts with these companies if they continued relations with Israel only to back down when the companies answered with a resolute ‘*No.*’ The following illustrates the resolve of Hilton Hotels when faced with threats:

> “*Should Hilton persist in going ahead with its contracts in Israel, it will mean the loss of your holdings in Cairo and the end of any plans you might have in Tunis, Baghdad, Jerusalem or anywhere else in all Arab countries.*” – Secretary and Counsel of the American-Arab Association for Commerce and Industry in New York
As Americans, we consider Arabs and Jews our friends and hope that ultimately we can all live in peace with one another. There was no threat from Israel when we opened our hotel in Cairo. Our Corporation finds it shocking that the Committee should invoke the threat of boycott condemnation in the case of our contract with the people of Israel.
– Conrad Hilton

The Central Boycott Office’s decision to make some exceptions resulted from the realization that ending commercial relations with these companies and other major ones would have hurt the Arab economies by causing unemployment, higher prices for substitute products and lower quality goods. These exceptions may help explain why there is little difference in FDI levels before and after the implementation of the boycott.

There are, however, a few documented cases in which large companies did refuse to comply and the Central Boycott Office did not allow an exception to be made. Most notably were the cases of RCA and Ford Motor Company. In 1966, Ford entered into a licensing agreement with an Israeli firm to assemble knocked down trucks and tractors. Since Ford already had assembly plants located in Egypt, Morocco and elsewhere, the Central Boycott Office gave the company an ultimatum to cancel its agreement with the Israeli company. When they refused, Ford was blacklisted and its plants were shut down across the Arab world – resulting in an estimated $200 million loss per year for Ford.28 But the loss was not one-sided: the Central Boycott Office’s call to shut down all Ford operations resulted in 6,000 people losing their jobs in Lebanon alone. Similarly, RCA’s refusal to close its phonograph pressing operations in Israel not only resulted in a $10 million loss per annum for RCA, but likely led to high levels of unemployment in the Arab world when its operations were shut down by the Central Boycott Office.29
Overall, Arab countries did succeed in monopolizing FDI inflows from small companies during the boycott while also enjoying the benefits of FDI from large companies by making exceptions to their simultaneous business relations with Israel. The decision to make several exceptions to the boycott rules and thus prevent foreign direct investment leakage demonstrates the fact that strict adherence to its policies would indeed have hurt the economies of the Arab states committed to upholding them. In other words, the Arab boycott could have negatively impacted FDI levels to a greater extent had fewer exceptions been made to the rules. This fact further clarifies the lack of an FDI surge following the end of the boycott.

Despite a lack of evidence pointing to an improvement in FDI levels for Arab countries after the easing of the boycott, the increase in FDI in Israel may possibly have positive implications for the Arab League countries. Once the economic boycott was eased, foreign companies likely reassessed their investment opportunities in the Middle East region as a whole, which now included Israel. Given Israel’s comparative advantage in certain industries (i.e. high-tech, pharmaceuticals, agriculture), many chose to invest there, but perhaps not exclusively. In other words, as these foreign branches and subsidiaries establish themselves in Israel and begin to thrive, the need to extend into the neighboring countries to draw upon their comparative advantage in skilled labor, natural resources, etc. may help attract FDI into the Arab countries. Thus, a trickle effect might take place by which clustering of certain industries may develop across the Middle East overall rather than in Israel alone. Of course, this is currently difficult to prove, as the Arab countries must still focus on improving the state of their economic and political institutions to ensure the safety of foreign investments in their countries. Furthermore,
despite the end of the boycott, in reality most Arab countries still maintain the primary
boycott against Israel (while ending the secondary and tertiary aspects), making such
inter-national cooperation between Israel and the Arab countries (other than Jordan and
Egypt) precarious.

1. Political, Economic and Financial Risk Ratings:
While the Foreign Direct Investment figures fail to conclusively demonstrate the negative
impact of the boycott on the investment climate in Arab countries, an analysis of the
political, economic and financial risk ratings of these countries during the decades of the
boycott may be helpful in supporting the hypothesis that the boycott created an
unfavorable FDI environment for Arab countries. Presented below is a preliminary
application of the concepts of political, economic and financial risk ratings to the case of
the Arab boycott. A more thorough analysis of the data points corresponding to the
various risk categories for each country needs a more dedicated and extensive study than
presented in this thesis paper to uncover the contribution of risk to the investment climate
in the Arab world. Nevertheless, it is worthwhile to begin the discussion with some
preliminary insights drawn from political, economic and financial risk charts covering the
period before, during, and after the imposition of the boycott against Israel.

The PRS Group\textsuperscript{30} has devised a useful International Country Risk Guide (ICRG) that
calculates the risk of a particular country by assigning a numerical value to a
predetermined range of risk components, according to a preset weighted scale. The risk
components are grouped into three Risk Categories – Political, Economic, and Financial
and the total risk points for each Risk Category are combined, according to a formula, to
produce a Composite Risk Rating for a country.\textsuperscript{31}
The graphs seen in the Appendix (see Appendix: Exhibit 4) show that the composite country risk measures for the Arab countries rise rather sharply around the year 1991 and continue to progress upwards during the following years. Since a higher rating actually indicates lower risk, these findings show that the political, economic and financial risks combined (composite risk) declined in 1991 and continued to do so afterwards for the countries in the Middle East.

While the Madrid Conference in 1991 and the Oslo Accords of 1993 are likely the main reason for this reduction in the calculated risk of these countries, it is reasonable to argue that the ending of the boycott as a result of these events further contributed to the improvement in the region’s risk levels in the ensuing years. For instance, the political risk component is calculated by taking into consideration a number of factors including:

a) Government stability       f) Military in politics
b) Socioeconomic conditions  g) Law and order
c) Investment profile        h) Ethnic tensions
d) Internal and external conflict  i) Democratic accountability
e) Corruption                  j) Bureaucratic quality

The existence of the boycott and the negative impact it has on a country, as already discussed in this paper, can be implicated for contributing, at least partially, to the low points (and thus high risk) assigned to each of these political risk components during the years prior to 1991 (see graphs in Appendix, Exhibit 4 for illustration of this fact). For instance, within the component ‘Socioeconomic Conditions,’ a country’s level of unemployment, consumer confidence and poverty are taken into consideration. As will be discussed in the following section of this paper, the higher prices faced by consumers as a
result of the boycott likely contributed to higher poverty levels and lower consumer confidence. Furthermore, as certain Arab industries paid a higher price for abiding by the boycott, their export levels suffered and adjustment costs ensued as people lost their jobs and suffered from unemployment. ‘External Conflict,’ another political risk component, takes into consideration wars, cross-border conflicts and foreign pressures that might have an impact on the risk level of a country. The application of a boycott against Israel is essentially a form of warfare, by economic means. Prolonging tensions by choosing not to engage in trade relations with Israel (and all blacklisted companies) furthered the conflict and only contributed to further political tensions, which are not conducive for attracting foreign investment.

In sum, the lack of supportive data regarding FDI levels is not a sufficient reason to dismiss the merits of this hypothesis. The elevated composite risk levels of the Arab countries coupled with examples of lost foreign direct investment opportunities (and the related benefits of FDI i.e. employment, technology transfer, higher levels of GDP, etc.) helps illustrate the boycott’s role in creating an unstable investment climate and loss in Arab economic welfare. Although some Arab countries were able to escape some of the economic costs affiliated with strict adherence to the boycott policies, it was not enough to improve their overall political, economic and financial risk ratings.

2. Legality of the Arab Boycott:

Proponents of the Arab and the Israeli positions regarding the boycott have attempted to apply legal arguments to justify their respective stands on the issue. While there is some agreement that Arab countries have the right to uphold the primary boycott – the sovereign choice not to have direct trade relations with Israel – there is widespread
disagreement about the legality regarding the secondary and tertiary aspects of the boycott. To understand the various legal arguments, it is worthwhile to consider both international and national laws that pertain to this issue and then ascertain to what degree the laws impact the foreign direct investment climate in Arab states.

Proponents of the Arab position cite various articles of the UN Charter to support their contention that an economic boycott against Israel is legally justified. Chapter IV, Article 39 of the UN Charter provides the legal basis for UN sanctions based on the precondition that the Security Council finds that there is a “threat to the peace, breach of the peace, or an act of aggression.” Articles 41 of the UN Charter allows the Security Council to opt for whatever coercive measures of a non-military kind (including economic sanctions) it considers necessary to preserve world peace and international security.

**Article 41** - *The Security Council may decide what measures not involving the use of armed force are to be employed to give effect to its decisions, and it may call upon the Members of the United Nations to apply such measures. These may include complete or partial interruption of economic relations and of rail, sea, air, postal, telegraphic, radio, and other means of communication, and the severance of diplomatic relations.*

The Arab world thus contended that Israel’s blatant violations of numerous UN resolutions relating to the Israeli-Palestinian conflict and the perpetual state of war between the Arab world and Israel, justified the imposition of an economic embargo against their enemy. Furthermore, Arab countries argued that Articles 51 and 52 of the UN Charter, which provides for the “inherent right of individual or collective self-defense,” also implies permission for self-defense through economic means.
A more thorough analysis of these articles, however, reveals that the use of sanctions requires the agreement of all permanent members of the Security Council and at least four non-permanent members as outlined in Article 27. In order for the Security Council to impose sanctions, it must first determine that there exists a “threat to the peace, breach of the peace, or act of aggression” as stipulated in Article 39. If such a case were found, then states would have the legal right to impose the sanction. This has not been the case regarding the Arab complaint against Israel. In fact, UN sanctions based on Article 41 have only been implemented against a handful of countries such as Rhodesia (1968-1979), South Africa (1977-1994), Iraq (1990-present), among a handful of other countries.

*General Agreement on Tariffs and Trade* – The General Agreement on Tariffs and Trade or GATT was designed to liberalize world trade by reducing tariffs and other trade barriers between trade partners and to end discrimination in international trade practices. When a number of Gulf States applied for admission into GATT in the 1990’s, (see Appendix: Exhibit 5 for dates of Arab country membership to the GATT and WTO), the Clinton Administration recognized the discriminatory aspects of the boycott by stating that ‘the secondary and tertiary boycotts are in conflict with some of the basic principles of GATT.’

Given that the boycott in essence is an absolute quantitative restriction, those opposed to the boycott often point to Article XI of the GATT, which calls for the complete elimination of quantitative restrictions, and Article XIII, which prohibits the discriminatory administration of quantitative restrictions as evidence that the boycott violates international free trade.

*Article XI: General Elimination of Quantitative Restrictions:*
No prohibitions or restrictions other than duties, taxes or other charges, whether made effective through quotas, import or export licenses or other measures, shall be instituted or maintained by any contracting party on the importation of any product of the territory of any other contracting party or on the exportation or sale for export of any product destined for the territory of any other contracting party. (Italics added)

Article XIII: Non-discriminatory Administration of Quantitative Restrictions:

No prohibition or restriction shall be applied by any contracting party on the importation of any product of the territory of any other contracting party or on the exportation of any product destined for the territory of any other contracting party, unless the importation of the like product of all third countries or the exportation of the like product to all third countries is similarly prohibited or restricted. (Italics added)

Accordingly, Israel cited Article XI of GATT in a case brought against Egypt for its practice of blacklisting companies that have ties to Israel and for requiring negative certificates of origin for all imported goods. Negative certificates of origin were used to certify that goods shipped were not of Israeli origin. Yet, proponents of the Arab position pointed out that Article XXI allows for any party to the GATT to waive the basic principle of non-discrimination under certain circumstances by stating that: “Nothing in this Agreement shall be construed to prevent any contracting party from taking any action which it considers necessary for the protection of its essential security interests taken in time of war or other emergency in international relations.” Since Arab states remained in a state of war with Israel since its independence in 1948, they argued for their right to protect their security, according to Article XXI, during this time of belligerency. In 1975, Mohammed Mahmoud Mahgoub, Commissioner General of the Arab Boycott of Israel summarized the nature of the war with Israel and the legitimacy of the boycott with the following words:

“The Arab Boycott is both a preventative and defensive measure: It is a preventative measure because its purpose is to protect the security of the
Arab states from the danger of Zionist cancer; it is a defensive measure because its basic objective is to prevent the domination of Zionist capital over Arab National economics, and to prevent the economic force of the enemy, which is well studied and planned, from expansion at the expense of the interests of the Arabs. "33

Regardless of whose argument holds the most water, in reality very few Arab countries were even members of the GATT during the first two decades of the boycott, making such finger pointing ineffective. While Israel joined the GATT in 1962, Egypt (1970), Morocco (1987) and Tunisia (1990) joined many years later while other countries, such as Algeria, Lebanon, Syria and North Yemen never became members at all. As a result, Israeli citation of GATT rules prohibiting the discriminatory use of quantitative restrictions by the Arab world against the Jewish state provoked little concern from those upholding the boycott. Nevertheless, it may be argued that since the secondary and tertiary boycotts impacted the trade relations of third states, those third states as GATT members had an obligation, as per the Agreement, to maintain an international climate of free and unobstructed trade by opposing the application of the Arab boycott.

In addition to the international laws laid out in GATT and the UN Charter, national laws existed that further precluded, some more strongly than others, the compliance with discriminatory boycotts. European concerns over jeopardizing their access to Arab markets and Arab oil, however, resulted in muted efforts by various Western European governments in passing legislation against the secondary and tertiary aspects of the Arab boycott. France, for example, enacted legislation in 1977 in reaction to a finding that the state-run foreign trade and credit insurance company, COFACE was requiring French exporters to comply with Arab boycott contractual obligations in order for them to receive export insurance from the company. Yet, the legislation was short-lived after the
government issued an avis indicating the greater need to expand French access to oilproducing countries regardless of the boycott. Finally, in 1992, Germany passed an anti-boycott law making it illegal for German firms to include or comply with contractual clauses that isolated Israel economically. The Netherlands passed some measures in the 1980’s that required exporters to register all foreign boycott related requests to the Government and made it a criminal offense to discriminate against a person on the grounds of race while in the process of trade. The British government, concerned over the loss of their exports to the Middle East, chose only to condemn the Arab boycott, but failed to take any legislative efforts at prohibiting compliance with it.

*Export Administration Act* – Despite some European efforts at addressing the discriminatory nature of boycotts, no country has made greater efforts at prohibiting compliance with the secondary and tertiary Arab boycotts than the United States. In particular, the United States’ 1995 Export Control Act (later renamed the Export Administration Act – EAA), included an anti-boycott provision that emphasized three points:

1) The US is opposed to having foreign countries use American business as a tool of economic warfare against a country friendly to the US and encourages US businesses to refuse to comply with the boycott

2) US businesses must report receiving boycott requests to the Secretary of Commerce

3) The President has the power to “prohibit or curtail” exports in order to comply with the Act

Specifically, the provision reads as follows:
It is the policy of the US to oppose restrictive trade practices or boycotts fostered or imposed by foreign countries against other countries friendly to the US, and to encourage and request domestic concerns engaged in the export of articles, materials, supplies or information to refuse to take any action, including the furnishing of information or the signing of agreements, which has the effect of furthering or supporting restrictive trade practices, or boycotts fostered or imposed by any foreign countries against any country friendly to the US. [Section 3(5)]

Accordingly, any US business confronted by a boycott request was, and still is, required to report the restrictive trade practice to the Office of Export Control in the US State Department within 15 days of its occurrence (See Appendix: Exhibit 6 for a copy of the US Department of Commerce, Bureau of Export Administration’s ‘Report of Request for Restrictive Trade Practice or Boycott.’) Based on boycott requests filed with the Office of Export Control, $4.5 billion worth of US sales and proposed sales to Arab countries in 1974 and 1975 were subject to boycott requests and American businesses complied with an estimated 90% of those requests. Such boycott requests often came in the form of questionnaires sent by Arab importers seeking to uncover whether or not the exporting company in question had any connections or interactions with Israel. Additionally, US exporters were often required to produce a certificate to prove that their goods were manufactured in the US and were “not of Israeli origin” and would not be shipped via Israeli port or on an Israeli vessel. In some cases, boycott requests issued by Arab importers required US exporters to certify that no one in the US company’s senior management was Jewish, Zionist, a purchaser of Israeli bonds, or contributor to Jewish organizations. If such relations were revealed, the business deal was rejected in accordance to the Arab boycott policies. As a result, Boycott requests often had the powerful effect of encouraging American businesses to forfeit any relations with Israel in fear of jeopardizing trade relations with the Arab world and all those complying with the boycott.
Despite having collected 22,964 boycott reports during the period of 1965-1969, the Department of Commerce admitted that no action had been taken to prevent compliance nor had any penalties been imposed on companies that failed to file their receipt of a boycott request during that period. Since 1974, however, the Department of Commerce has ramped up its efforts in ending compliance with boycott requests by requiring US exporters to report the receipt of boycott requests or face stiff fines if they neglected to do so. In 1977, Congress passed another law that further prohibited cooperation with the Arab boycott. In signing the bill, President declared that the "issue goes to the very heart of free trade among nations" and that the bill aimed to "end the divisive effects on American life of foreign boycotts aimed at Jewish members of our society." According to a recent interview with Cathleen Ryan, Senior Compliance Officer in the Office of Anti-Boycott Compliance, the Department of Commerce now conducts frequent, random audits to uncover illicit compliance with the boycott by US businesses.39

US Antitrust Law - US Antitrust law has also been cited in relation to the legality of the tertiary aspect of the boycott. The tertiary boycott, which prohibits US companies from doing business with blacklisted companies, in effect interferes with free trade and competition, and thus violates the principles upon which the 1870 Sherman Antitrust legislation was based. As stated by the Supreme Court in 1947, the purpose of the Sherman Act is to “sweep away all appreciable obstructions so that the statutory policy of free trade might be effectively achieved.” In the civil action United States v. Bechtel Corporation, 1976-1977, the US Justice Department’s Antitrust Division drew anti-boycott implications from the Sherman Act. Bechtel, an American construction company, was accused of violating Section 1 of the Sherman Act by entering into agreements and understandings with other companies (who remained anonymous) not to subcontract with
any companies blacklisted by the Arab boycott. While these agreements were made in the context of a large project to be performed in an Arab country, the court found that the Sherman Act was nevertheless applicable since restraints were unnecessarily placed on trade and commerce resulting in an adverse effect on competition. Specifically, in paragraphs 7 and 20 of the complaint, the defendants and co-conspirators were alleged to have participated in the “combination and conspiracy which resulted in an unreasonable restraint of…interstate and foreign trade and commerce in violation of section 1 of the Sherman Act.” As a result, the Bechtel case served as a warning to other companies that the Sherman Act prohibited American companies from refusing to deal, or requiring others to refuse to deal, with other US companies on the Arab boycott blacklist – even if the work is to be conducted on foreign soil.

US Civil Rights Laws – In order to avoid the appearance of being pro-Israeli to Arab importers, many American businesses felt compelled to avoid hiring employees of the Jewish faith. US corporation, Aramco, for example, deliberately avoided using Jewish employees in jobs connected to their work in Saudi Arabia. Such discriminatory practices based on faith clearly violated US domestic civil rights laws. In 1956, the US Senate adopted a resolution stating that attempts by foreign nations to discriminate against US citizens on the basis of their religion was incompatible with friendly relations between states and every effort should be made to uphold the principle of non-discrimination. Furthermore, the Ford Administration presented an anti-boycott package that aimed at preventing “any discrimination against Americans on the basis of race, color, religion, national origin or sex that might arise from foreign boycott practices.”
Taken together, these international and national laws prohibiting - or at least not sanctioning - the use of an economic boycott against Israel made foreign direct investment and trade relations with the Arab world costly both legally and financially. American companies such as Bank of America, Chase Manhattan, Citibank, Chrysler, Ford, General Electric, Hewlett Packard, Hughes Aircraft, Nabisco, and 3M faced large fines for violating anti-boycott laws. Safeway, for example, paid a $995,000 penalty, Sara Lee paid $750,000, and Xerox agreed to a six-month suspension of its export license for trade to the Arab world. In addition to stiff fines for participating in or cooperating with the secondary or tertiary boycotts, US firms complying with the boycott also suffered the loss of foreign tax credits and benefits, including credit for foreign taxes and deferral of the earnings of foreign subsidiaries in accordance with the Ribicoff amendment to the 1976 Tax Reform Act. Thus, in making the decision to invest in the Arab world, companies not only had to weigh the risks of investing in a climate characterized by nationalizations, political unrest, and instability, but also had to consider the risks of violating both international and national laws in complying with the boycott. While it is unclear just how many companies turned away from investing in the Arab world as a result of these calculations, it is nevertheless appropriate to infer that the existence of the Arab boycott did little to attract foreign investment into Arab countries.

B. Terms of Trade Worsening:

Proving the second hypothesis, ‘Terms of Trade Worsening,’ relies on principles of Welfare Economics: the use of non-tariff barriers to trade against Israel caused a worsening in the terms of trade by artificially increasing prices faced by domestic
consumers and consequentialy reducing the economic welfare of Arab states. By breaking down the elements of the boycott, its welfare reducing effect becomes clear.

1. **Prohibiting Israeli/Israel-Related Imports:**

First, the boycott prohibited Arab countries from *importing* any Israeli goods or goods from countries/companies already trading with Israel. As a result, Arab countries were deprived of products that Israel had a comparative advantage in producing, whether agricultural products, machinery or high-tech equipment. According to economic principles of free trade, a country exports those goods in which it has a comparative advantage and imports those in which it does not. Trade that is based on comparative advantage enhances the economic efficiency of all nations by enabling each to specialize. Without access to Israeli goods, Arab countries were left with two welfare reducing choices: 1) import substitution by domestic production and/or 2) importation of similar goods from other foreign sources. Domestic production results in a misallocation of scarce resources and involvement in high cost, inefficient production operations. Importation from a source other than from the boycotted country or blacklisted company results in higher transport, insurance and freight costs, which translates into higher costs to the end consumer. In either case, Domestic production results in a misallocation of scarce resources and involvement in high cost, inefficient production operations (assuming that neither the alternative foreign source nor the Arab country producing domestically has a comparative advantage in producing the good).

Again, not only were Arab countries prohibited from trading directly with Israel, but also from trading with those companies already doing business with Israel. For example, in
1975, two years before it became illegal to abide by the Arab Boycott in the United States, over 1000 American companies alone were already on the Arab Boycott Blacklist for choosing to do business with Israel rather than with Arab countries. Thus, Arab consumers were also deprived of high quality, lower priced imports produced with a comparative advantage in the U.S. and instead faced goods made domestically or inefficiently produced elsewhere. The same can be argued as a result of the entire 6300 foreign companies that were blacklisted and prohibited from exporting to any Arab country. The unnecessarily higher prices faced by consumers was therefore a result of the distortion in trade patterns brought on by the imposition of the Arab boycott. Consumer sensitivity to price is well illustrated by Dina Ezzat of Egypt’s *Al-Ahram Weekly* who recently polled people in the streets of Cairo regarding whether or not they would like to know which products are of Israeli origin so as to avoid purchasing them. While many interviewees enthusiastically supported the idea, another recognized the welfare reducing effect such a policy would cause if reinstated today: “No. Everything is so expensive. If I can find something cheaper than the rest I will buy it, no matter who made it.”

Facing higher priced goods as a result of a policy-induced restriction on trade deteriorates a country’s terms of trade and reduces its national income, further reducing its gains from trade. Experiencing reduced consumer welfare, Arab consumers likely decreased their demand for such higher priced products causing a reduction in the countries’ volume of trade at the same time. The impact of such a reduction in trade volume also depends on the extent to which the Arab country traded with the boycotted country/company prior to the imposition of the boycott and blacklisting measures. If an Arab country purchased the majority of a particular import from the U.S., for example, then the blacklisting of U.S.
companies would have substantially reduced its volume of trade. The cessation of imports from the original, more efficient source coupled with the reduced consumption by consumers given high prices would have substantially impacted the Arab countries’ high volume of trade. Taken together - a terms of trade worsening and a volume of trade reduction - Arab countries made themselves worse off by restricting imports from Israel or from blacklisted foreign firms. Exhibit E provides an equation that captures these two effects.

**EXHIBIT E:**

\[
\downarrow \text{dy} = -\text{Mdpe} + (p - p^e) \text{dM}
\]

<table>
<thead>
<tr>
<th>Change in Real Income</th>
<th>Terms of Trade Effect</th>
<th>Volume of Trade Effect</th>
</tr>
</thead>
<tbody>
<tr>
<td>dy</td>
<td>-Mdpe</td>
<td>(p - p^e) dM</td>
</tr>
</tbody>
</table>

Thus, as the price \((p^e)\) of imports increases as a result of non-comparative advantage trading decisions (terms of trade effect), \(-\text{Mdpe}\) as a whole decreases, contributing to a reduction in a nation’s real income. At the same time, as the price of a domestically made product rises (as a result of the trade barriers put in place) in comparison to its foreign import equivalent (made with a comparative advantage), the difference, or wedge, between \(p - p^e\) increases and the volume of imports \((\text{dM})\) decreases (volume of trade effect), once again having a negative impact on overall real income. \(P\) rises just as with the application of a tariff in a non-free trade environment \(p = (i + \sim) p^e\) where \(\sim\) is the excess cost as a result of inefficient domestic production caused by the trade barrier. In sum, as stated in *World Trade and Payments*, “inefficient restrictions on a country’s
trade, like distortions (natural or policy-induced) in domestic markets, lower the level of a country’s national income relative to its potential.  

It is interesting to note that not only are volume and price effected, but the quality of the products available to the Arab countries that voluntarily choose to limit their trade, are likely to be inferior, even if at a similar price. This is simply because the production process used at home or from a foreign source without a comparative advantage is unlikely to have the efficient means to replicate the high quality without the benefit of economies of scale, skilled labor, advanced capital equipment, etc. On a more positive note, Arab countries that have ended their practice of boycotting Israel and blacklisting foreign firms and that have taken full advantage of free trade should experience a positive shock to their economies such that their Terms of Trade and Volume of Trade improve and contribute to an increase in their real income.

To further demonstrate the inefficient outcomes of implementing a boycott, it is helpful to consider the types of imports Arab countries depend upon and from whom they make their purchases. A quick review of Jordan, Lebanon, Saudi Arabia, Bahrain and Egypt’s imports indicates a number of overlapping goods that all the countries import. Those goods include: machinery and transport equipment; foodstuffs and agricultural products; textiles; and chemicals. Is it then surprising to notice that Israel’s key exports include all five categories of goods? The chart below (Exhibit F) highlights in red those Arab country imports that correspond to the same Israeli exports. These Arab countries, however, (other than Egypt following its peace agreement with Israel in 1979) dismissed the locally available products made in Israel and instead imported from other, more
remote countries and thus incurred high transport and freight costs. For example, Lebanon mainly imports from Italy, France, Germany, US, Switzerland, China and Syria. Saudi Arabia imports primarily from the U.S., Japan, Germany and the UK while Bahrain imports from the U.S., UK, France, Japan and Saudi Arabia. While data pertaining to actual prices paid for imports versus their comparative prices had they been purchased from the country with the comparative advantage (Israel) are difficult to uncover, it is possible to conclude, based on economic theory, that importing goods from remote locations that may not have a comparative advantage in those goods results in unfavorable terms of trade, diminishing a country’s gains from trade and reducing consumer welfare for the importing Arab country.

**EXHIBIT F**

<table>
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<tr>
<th></th>
<th>Jordan</th>
<th>Lebanon</th>
<th>Saudi Arabia</th>
<th>Bahrain</th>
<th>Egypt</th>
<th>Israel</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Imports</strong></td>
<td>• Machinery • Transport Equipment • Foodstuff • Live animals • Oil • Manufactured gds</td>
<td>• Machinery • Transport Equipment • Foodstuff • Agricultural foods • Chemicals • Textiles</td>
<td>•Machinery •Transport Equipment •Chemicals •Oil</td>
<td>•Machinery •Chemical •Foodstuff •Cars</td>
<td>• Machinery &amp; Equipment • Chemicals •Wood products</td>
<td>• Raw materials • Military equipment • Investment goods • Rough diamonds • Fuel • Consumer goods</td>
</tr>
<tr>
<td><strong>Exports</strong></td>
<td>• Fertilizers • Phosphates • Potash • Agricultural products</td>
<td>• Food • Tobacco • Textiles • Chemicals • Metals • Precious stones</td>
<td>• Petroleum • Textiles • Aluminum</td>
<td>• Petroleum • Cotton • Textiles • Metals • Chemicals</td>
<td>• Machinery &amp; Equipment • Agricultural products • Chemicals • Textiles &amp; apparel • Cut Diamonds • Software</td>
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</tr>
</tbody>
</table>
Israel’s attractive technological know-how, its close vicinity (contributing to lower costs of packing, transporting and insuring goods) and its comparative advantage in producing certain goods might help to explain the persistent occurrence of illicit trade between Israel and some of the Arab countries despite the existence of the boycott. In an article published by Forbes on October 22, 1984, the author claimed that the annual volume of trade between Israel and the Arab world was approximately $500 million. For example, Arab importers were able to stock the shelves of their shops with illegally obtained Israeli goods by accessing re-exported Israeli products from Hong Kong, Iran, Romania, Turkey and Cyprus. In 1970, for example, the Central Boycott Office discovered that Israeli pantyhose had been imported into Jordan via Malta. Unofficial reports also indicate that frequent transshipments of Israeli electronics had made their way to Lebanon via European ports since 1958. After 1975, when ‘The Good Fence’ – an official border crossing point between Israel and Lebanon - was opened, Israeli products succeeded in entering both the Lebanese and Syrian markets. In the late 1970’s and early 1980’s, Israelis allowed Lebanese merchants to cross its border to purchase badly needed goods, including food, medical supplies, apparel, construction materials, electronic appliances, batteries, etc., spending $4 million per month. At the beginning of the Peace for Galilee war between Israel and Lebanon in 1982, Israeli trade with Lebanon was estimated to have reached $100 million. Similarly, Israeli agricultural products made their way into Jordan via crossing points between Jordan and the Occupied Territories. In 1996, the Qatari Foreign Minister, Hamed Bin Jasem al-Thani reported that Israel was illegally exporting $2 billion worth of goods (mainly citrus fruit, bananas, cucumbers, and potatoes) to the Gulf states via Cyprus. The author of the Forbes article maintained that ‘anywhere from 10-20% of Israel’s $700 million worth of exports of agricultural
equipment found its way to Arab countries, and that the ‘distinctive black piping of Israeli drip systems can be seen on either side of the Jordan river, and as far away as Saudi Arabia.’

Certainly, it is impossible to prove or disprove the numbers that have been reported since no official records are kept. In various official trade statistic reports, including the IMF’s *Direction of Trade Statistics Yearbook* and the *United Nation’s International Trade Statistics Yearbook*, there is no data regarding trade between Israel and the Arab countries during the boycott period except for Egypt and Jordan in the years following their peace treaties with Israel. In fact, even since the end of the boycott, no statistics could be found (except for Jordan, Egypt, Morocco and Oman) regarding trade flows between Israel and Arab League countries. This surprising finding opens to question the continued protectionist forces that perpetuate the inefficient trade patterns of the boycott years. Most countries have ceased to participate in the secondary and tertiary boycotts since the 1994 announcement by the GCC but have chosen to maintain the primary boycott by choosing not to have *direct* trade relations with Israel. As has been discussed in depth, a lack of free trade has negative repercussions for those economies choosing to limit their international trade opportunities. Thus, it is difficult to contrast the level of trade between Israel and the Arab countries both before and after the end of the boycott.

Not only did Arab countries face higher prices than necessary by choosing not to trade with Israel or with blacklisted foreign companies, but they also deprived themselves of valuable technology transfers through importation from and cooperation projects with Israel that could have greatly aided the development of Arab economies, from
infrastructure and agricultural development to pharmaceutical advancement. As reflected upon by Caves, Frankel and Jones, “restricting trade means restricting the many informal international contacts by which innovations and efficient practices diffuse from their sites of discovery to agents in other nations who can benefit from them.”\textsuperscript{55} The recent Arab Human Development Report published by the United Nations Development Programme cited a troubling lack of knowledge acquisition and technological know-how on the part of Arab nations. The report cites the importance of open trade in order to facilitate technology transfers to the Arab world.

Knowledge acquisition entails not only building on a country’s own knowledge base to generate new knowledge through R\&D but also harnessing and adapting knowledge available elsewhere through openness, broadly defined, including, e.g., promoting the free flow of information and ideas, establishing constructive engagement in world markets, and attracting foreign investment. A commitment to openness is particularly important in view of the current weakness of technological development in Arab countries. This means that importing and adapting technology and internalizing it by learning-by-doing may be the most practical approach in this area...\textsuperscript{56}

By obstructing all access to Israeli goods and technological innovations, Arab nations deprived their economies of greatly needed advancements in infrastructure, agriculture, pharmaceuticals, chemicals, and other areas that contribute to economic and human development. Furthermore, the boycott staved off opportunities for cooperative projects between Israel and its Arab neighbors in such areas as water desalination, soil irrigation and conservation, tourism, health, pestilence control and scientific research all of which could have benefited the economies and the overall well-being of the citizens of Arab countries.

The end of the boycott and the formation of peace between Israel and Jordan and Israel and Egypt opened the opportunity for formal trade and joint project initiatives to take
place between the countries. Israel and Egypt have engaged in scientific cooperation projects in marine agriculture technology, the development of environmental protection resources, cancer research and the prevention of pollution in the Gulf of Eilat.\textsuperscript{57}

Agricultural cooperation is also underway. In 1997, Jordanian exports to Israel reached JD 17.6 million, and imports amounted to JD 9.7 million from Israel. In the first nine months of 1998 alone, trade volume exceeded JD 28 million. In 1998, Israel and Jordan engaged in a joint JD 2 million project to divert scarce water from the Yarmouk River to increase Jordanian access to the greatly needed resource. Israel's former Ambassador to Jordan, Oded Eran, stated in an interview with the \textit{Jordan Times} that “there are hundreds of businessmen from both sides doing business; they may be small in volume, but they do exist.”\textsuperscript{58} He indicated that Israeli agriculture experts enter Jordan on a daily basis to conduct business and share their expertise. Yet, cooperation and trade has not reached the levels first anticipated when the two countries normalized relations. In fact, despite the government’s encouragement of Israeli-Jordanian cooperation, the general population, half of which is of Palestinian origin, refuses to do business with the Israel given their ideological stance toward their neighbor. Eran pointed out in 1998, “How can you develop trade when the presidents of the [industry and commerce] chambers are against cooperation. There hasn’t been one trade delegation to Israel to explore the potential.”

Thus, despite the end of the boycott and the existence of a peace treaty, Jordanians have not fully implemented a policy of non-discriminatory trade and cooperation with Israel, from which there is much to gain. Given that full normalization of trade relations with Israel and the Arab countries has not yet been realized despite the end of the boycott (and the signing of peace agreements in some cases), it is difficult to use trade flow data to
illustrate the contrast between the negative impact of the boycott on Arab economies and the positive impact of liberalized trade.

2. **Restricting Exports to Israel:**

Second, the Central Boycott Office also sought to enforce the boycott rule that Arab countries could not *export* their goods to the Israeli market nor could any country wanting to do business with the Arab world. Certainly, this aspect of the boycott hurt the Israeli economy by forcing the country to seek imports from further distances and perhaps from countries lacking a comparative advantage in producing the particular good. Ironically, however, many researchers have attributed Israel’s innovative and entrepreneurial success as a result of its seclusion from world markets. Drawing upon the country’s military expertise, Israelis developed advanced scientific knowledge and technological abilities that served to reverse some of the negative effects of the boycott and even make the country more attractive to outside countries.

While the Israeli economy struggled to adjust to their boycotted status, the Arab countries also had to pay a price for choosing not to export their products to the Israeli market. Jordan and Lebanon, for example, are often cited as having paid the highest price for acquiescing to the terms of the boycott. Prior to 1948, for example, 80% of Trans-Jordan’s exports went to its neighbor, Palestine, and 20% of its imports came from Palestine.59 Once the boycott came into affect, however, Jordan was forced to re-route its trade via Syria to Beirut instead of using the port in Haifa, Israel, which had served as its sole outlet to the Mediterranean. Not only did Jordan face high costs in developing its own port in Aqaba on the Red Sea as a result of the boycott, but it also lost transit fees for Iraqi oil that used to pass via pipelines in Jordan to be delivered to Haifa. Instead, a new pipeline was constructed across Syrian territory after 1948.
On January 7, 1967, the Lebanese newspaper, Al-Hayyat, carried a report that representatives of the Christian Phalange parties in the Lebanese parliament had confronted the government with their assessment of the Arab boycott against Israel. The representatives pointed out that while the boycott was designed to “tighten the noose around Israel’s neck,” in fact it was hurting Lebanon more than its intended target. They stated that:

*Trade and services constitute a major source of income for every country, and in the case of Lebanon they constitute the backbone of the economy. The boycott of Israel causes Lebanon special economic problems.*

Countries considering boycott activities often, as discussed in the beginning of the paper, overlook the disadvantages of using boycotts as a political weapon, especially when the cost to the economy is perceived as negligible. But, as the rise in unemployment indicates in the cases of RCN and Ford leaving Arab countries, specific domestic sectors are discriminatorily assigned the burden of a government’s actions. According to a study conducted by the U.S. Congressional Budget Office in 1999, the costs of sanctions on the country imposing the policy can be divided into two categories: 1) welfare losses for the nation and 2) losses for particular industries or groups. The study concludes that, although the overall costs to the United States as a whole are negligible when imposing sanctions, the impact on individual sectors and the subsequent adjustment costs that result are significant. An example from United States sanction history may elucidate the point. Between 1980 and 1981, the U.S. imposed an embargo on grain exports to the Soviet Union to indicate Washington’s displeasure with the USSR’s military invasion of Afghanistan. Not only was the impact of the embargo on the USSR negligible, but also
its imposition ended up hurting the farming sector in the United States. More specifically, the Soviet Union enjoyed hearty imports of grain from non-US exporters who could not resist the lucrative opportunity to export grain at higher prices to the desperate Soviet economy. Thus, US imports were sufficiently replaced, albeit causing a worsening in the Soviet Union’s Terms of Trade. But, more to the point, US farmers were disproportionately assigned the burden of Washington’s political interests. Thus, while the embargo did not substantially affect the overall US economy, US farm incomes decreased by an estimated $2.0 to $2.5 billion as a result of a cut of 17 million tons of grains shipped to the USSR. Furthermore, US attempts to offset the reduction in farmer income by purchasing the grain reserves or providing favorable loans to farmers added $2-$3 billion to the federal deficit during FY 1980-1981. In total, the Carter administration’s policy caused greater losses to specific sectors of the U.S. economy than it did to the intended target of its embargo weapon.

This case provides some insight into the impact the Arab boycott likely had on particular sectors within Arab countries. Central Boycott Office directives prohibiting trade with Israel (backed up by the threat of blacklisting, which did not occur in the US-USSR case) likely bruised those sectors within Arab countries that could have benefited from exporting to Israel or to blacklisted companies. From oil exporters to farmers trading livestock, there were immediate gains to be made from free trade with Israel, especially by those Arab countries along Israel’s border (i.e. Egypt, Lebanon, Syria and Jordan). Perhaps even to a greater extent, the cancellation of the blacklisted status of over 6300 companies could have further broadened the customer base for Arab exports from particular sectors, especially in agriculture, fertilizers, textiles, and metals. Thus, the economies of Arab countries sustained adjustment costs in the form of reduced output
and higher unemployment levels as certain industries strained under high costs and a reduced customer base. Yet, the Arab government’s political agenda interfered with the practice of free trade by limiting the country’s exports to only those customers that did not violate the Boycott’s provisions, with some exceptions.

VII. Concluding Remarks:

In sum, the application of economic theory to the case of the Arab boycott against Israel helps to uncover the unanticipated detrimental impact the economic weapon had against those wielding it. The boycott’s negative effect on Arab economic welfare can be summarized as having been the result of a deterioration in the foreign direct investment climate in the Arab world and an unnecessary worsening of the countries’ terms of trade and volume of trade. Limited opportunities for technology transfers and employment by foreign firms as a result of stunted foreign investment levels coupled with reduced consumer welfare contributed to the deterioration of the economic welfare and human development of Arab countries involved in the boycott against Israel.

Although calls for reinstating the Arab boycott against Israel have been featured in every communiqué of Arab meetings since the 2000 Cairo Summit, little action has been taken to actualize its revitalization. Syria, Lebanon, Libya and Iraq appear to be the only Arab countries seriously considering it. One Arab diplomat was quoted in Al-Ahram Weekly as saying “…we do not know exactly how far we can apply a boycott, and what economic consequences it would entail for Arab economies. There has been no comprehensive study that deals with this issue, either on the part of governments or nongovernmental organizations.” It is clear that a great deal more research, beyond the
studies conducted by the United States Congressional Budget Office and this thesis, needs to be conducted to fully understand the negative impact economic boycotts have on those imposing the policy. Furthermore, a thorough examination of historical data needs to be done to formally prove some of the contentions asserted in this paper. To do this, however, data must become more readily available and come from reliable, neutral sources. Nevertheless, it is apparent that Arab countries considering re-invoking such a policy against Israel should weigh the costs of making a political statement using an economic weapon and the benefits of focusing the government’s resources instead on programs that directly improve their countries’ economic welfare.
EXHIBIT 1:

Statement by Gulf States on Arab Boycott
October 1, 1994

The Cooperation Council of the Arab States of the Gulf, having actively supported the Middle East Peace Process ever since the launching of the Madrid Conference, and being fully aware of the important breakthroughs realized so far, particularly in the Palestinian and Jordanian tracks which comprise agreements covering economic cooperation between the Israelis and both the Jordanians and the Palestinians, seriously recognize the importance of a review of the provisions of the Arab boycott of Israel so as to take into consideration progress achieved and substantive future requirements of the peace process.

The GCC member states have constantly reiterated their determination to enhance cooperation with their trading partners in various spheres. Concerning the application of the Arab boycott of Israel, necessary measures have been taken with a view to protecting the mutual interests of the GCC and its trading partners. As a result of these measures and for all practical purposes, secondary and tertiary boycott are no longer a threat to the interests of these partners.

Whereas the Arab boycott of Israel was enacted by the League of the Arab States, and its review to take into consideration developments and requirements of the Middle East peace process must take place, the GCC member states will support all or any initiative for such review presented in the League of Arab States. Further, the GCC believe that a sponsorship of such initiative by Arab parties directly involved in the bilateral negotiations, whether selectively or individually, shall facilitate the required review and ensure a greater chance of success.


EXHIBIT 2:

22 Members of the Arab League (since 1993)

<table>
<thead>
<tr>
<th>Algeria</th>
<th>Egypt</th>
<th>Lebanon</th>
<th>*Oman</th>
<th>Somalia</th>
<th>*UAE</th>
</tr>
</thead>
<tbody>
<tr>
<td>*Bahrain</td>
<td>Iraq</td>
<td>Libya</td>
<td>Palestine</td>
<td>Sudan</td>
<td>Yemen</td>
</tr>
<tr>
<td>Comoros</td>
<td>Jordan</td>
<td>Mauritania</td>
<td>*Qatar</td>
<td>Syria</td>
<td></td>
</tr>
<tr>
<td>Djibouti</td>
<td>*Kuwait</td>
<td>Morocco</td>
<td>*Saudi Arabia</td>
<td>Tunisia</td>
<td></td>
</tr>
</tbody>
</table>

* Members of the Gulf Cooperation Council (GCC)
EXHIBIT 3:

Arab Country Foreign Direct Investment, net (BoP, current US$)

*Data drawn from The World Bank Group, WDI Online

Egypt, Arab Rep.

Saudi Arabia

Lebanon

Kuwait

Lebanon: No data available until 1994
EXHIBIT 4:

Political, Financial and Economic Risk Ratings:

<table>
<thead>
<tr>
<th>COMPOSITE RISK RATING</th>
<th>POINTS</th>
</tr>
</thead>
<tbody>
<tr>
<td>Very High Risk</td>
<td>0 – 49.5</td>
</tr>
<tr>
<td>High Risk</td>
<td>50 – 59.5</td>
</tr>
<tr>
<td>Moderate Risk</td>
<td>60 – 69.5</td>
</tr>
<tr>
<td>Low Risk</td>
<td>70 – 79.5</td>
</tr>
<tr>
<td>Very Low Risk</td>
<td>80 - 100</td>
</tr>
</tbody>
</table>
Country Risk Measures
United Arab Emirates

Graphs from http://www.duke.edu/~charvey/Country_risk/risk
EXHIBIT 5:

Arab country GATT signatories as of the end of 1994 and dates they signed agreement:

Bahrain 13 December 1993
Djibouti 16 December 1994
Egypt 9 May 1970
Kuwait 3 May 1963
Mauritania 30 September 1963
Morocco 17 June 1987
Qatar 7 April 1994
Tunisia 29 August 1990
UAE 8 March 1994

Arab Members of the WTO as of 2003:

Bahrain 1 January 1995
Djibouti 31 May 1995
Egypt 30 June 1995
Jordan 11 April 2000
Kuwait 1 January 1995
Mauritania 31 May 1995
Morocco 1 January 1995
Oman 9 November 2000
Qatar 13 January 1996
Tunisia 29 March 1995
UAE 10 April 1996

Observer Status:
Lebanese Republic
Saudi Arabia
Yemen

Information drawn from WTO website:
http://www.wto.org/english/thewto_e/gattmem_e.htm

EXHIBIT 6:

Report of Request for Restrictive Trade Practice or Boycott
ENDNOTES

1 The Gulf Cooperation Council includes: Bahrain, Kuwait, Qatar, Oman, Saudi Arabia, and the United Arab Emirates.
4 Ibid.
7 Map available from [http://www.iris.org.il/sizemaps/arabwrld.htm](http://www.iris.org.il/sizemaps/arabwrld.htm)
15 Ibid, 27.
16 Ibid, 172.
23 The World Bank Group, WDI Online
27 The World Bank Group, WDI Online
29 Ibid.
30 http://www.prsgroup.com
31 http://www.icrgonline.com
34 Ibid, 23.
39 Telephone interview with Cathleen Ryan, Senior Compliance Officer in the Office of Anti-Boycott Compliance, Department of Commerce, conducted by Joyce Sharon on Friday, February 14, 2003.
41 Ibid, 52.
44 Ibid, 178.
53 Ibid, 119.
54 Ibid, 121.
57 “Israeli Cooperation with Arab Countries,” Jewish Virtual Library, accessed from http://www.us-israel.org/jsource/Politics/Arabs.html
REFERENCES


