

The Peace Process and Economic Trends in the Israeli Economy

The Peace Process, Ratings, and Foreign Investors

As of 1985, Israel has slowly been improving its status on the international credit ratings. This improvement implies that the risk associated with investing in Israel has declined.

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At first, the impetus for this development was found primarily in the adoption of a responsible budgetary policy that served to improve Israel's balance of payments and halted the rampant hyperinflation. However, the sharpest rise in Israel's rating was felt during the years 1993-1996, when the country's risk ratio quickly declined by ten's of percentage points while its rating soared. The various rating companies stipulate external stability as a prior condition for improvement in the risk rating. With the inauguration of the peace process, such a reevaluation was made possible; the ratings improved and with them, consequential economic changes:

- The level of foreign investment in Israel tripled: In the early 1990s, the level of foreign investment was US\$500-700 million annually. During 1995 and the first half of 1996, that level reached US\$2 billion annually. Assuming continuation of the peace process, investments are expected to grow even further, given that the present ratings make investment in Israel, now considered to be one of the world's fastest growing economies, inviting to international institutional investors.
- A significant rise in the investment by foreign investors in Israeli firms operating in sectors involving real assets. In these sectors, investment has grown from zero at the start of the decade to more than US\$900 million from 1995 to mid-1996.

- American investors have become favorable to purchase of stocks issued by Israeli firms. This attitude, the outcome of economic assessments combined with political conditions, can be witnessed in the steady rise in the recruitment of funds during the 1990s, reaching more than US\$500 million during the last two years.

Deposits in Israel Banks and the Peace Process

New immigrants, Jews from the Diaspora, and others can maintain foreign currency accounts in Israeli banks. Stability in Israel's foreign relations presents a significant criterion when deciding to make such deposits. In the early 1990s, average annual deposits reached S\$1 billion, about half deposited by new immigrants. During 1995-1996, deposits reached about US\$ 2-2.5 billion, half of which once again held in new immigrant accounts. This trend partially explains the improvement in Israel's foreign currency reserves.

International Trade and the Peace Process

During the 1980s, international trade between Israel and Third World countries was negligible. The peace process opened many new markets to Israeli goods and, at the same time, eroded the strength of the Arab Boycott. During 1992-1995, exports to Third World countries grew at an annual average of 40% in dollar terms, up from 15%-20% in the previous years. These exports represent about half the growth in Israel's total exports. Cancellation of the Arab Boycott also opened Eastern European markets to Israeli exports, primarily hi-tech.

Trends in growth of imports from Third World countries are weaker, with most of the expected change to take place with and of the period of exposure to imports.

Foreign Aid and Financial Guarantees

US aid to Israel is extended at an average annual level of US\$3.5 billion. As of 1992, US\$2 billion in annual guarantees has been awarded. Additional assistance is received in the form of grants and other vehicles from European countries. The US guarantees are formally linked to the peace process and the suspension of planned expansion investment of settlement on the West Bank. The linkage between foreign aid and the peace process is unequivocal although its is based on past agreements (e.g., the "reassessment" prior to the second Disengagement Agreement signed with Egypt in 1975). Today, such a "reassessment" would be quite problematic due to the level of Israel's economic integration

into the world market as well as the scope of the deficit in the balance of payments (about US\$5 billion in 1996).

Summary

The peace process and Israel's economic development are tightly linked. Every halt in the process has an immediate impact, estimated at a value of billions of dollars, on the scope of foreign investment, foreign currency accounts, bond issues abroad, and international trade. Therefore, the peace process represents a primary condition for the continued growth in Israel's employment, economic development, and social welfare.