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THE HIDDEN COSTS OF THE ISRAELI/ HAMAS CONFLICT

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ABSTRACT

IT IS NOT A REVELATION THAT THE HOSTILITIES BETWEEN ISRAEL AND THE PALESTINIAN TERRITORIES HAVE BEEN COSTLY. WHILE THE DIRECT COSTS TO THE ISRAELIS ARE ESTIMATED TO BE AS HIGH AS $269 MILLION PER DAY (WROBEL, 2023), THE COSTS TO THE PALESTINIAN TERRITORIES ARE INCALCULABLE GIVEN THE PHYSICAL DEVASTATION AND HUMAN DEATHS RESULTING FROM THE ISRAELI RETALIATION. HOWEVER, IT IS THE POSITION OF THIS ARTICLE THAT THESE DIRECT COSTS ARE UNDERSTATED, GIVEN THE SIGNIFICANT INDIRECT (OPPORTUNITY) COSTS THAT ARE BEING INCURRED, IN PARTICULAR, BECAUSE OF REDUCED FDI INFLOWS CAUSED BY POLITICAL, SOCIAL, AND CULTURAL INSTABILITY IN THE REGION.

KEYWORDS: MENA (MIDDLE EAST AND NORTH AFRICA), FDI (FOREIGN DIRECT INVESTMENT), MNES (MULTINATIONAL ENTERPRISES).

1. INTRODUCTION

The objective of this article is to examine the direct and indirect (opportunity) costs of the Israeli/ Hamas conflict. The scope of the study extends beyond the financial and opportunity costs of the combatants to the regional countries that are being affected by the hostilities.

No attempt is made to access the direct costs to the predominately Muslim nations in the Middle East and North African (MENA) countries that view Israel as a real or potential enemy, although some increased military expenditures are expected.

However, opposition to Israeli retaliation to Hamas aggression has led to anti- Zionist reactions in the predominately Muslim countries in the MENA region. By early 2023, these reactions have produced relatively little overt hostility, but in the view of foreign investors, this could intensify in the future (Yacoubian, 2023). If so, this could clearly lead to a reduced inflow of private capital into the region, including foreign direct investment, because of perceived instability in these countries.

2. THE CONFLICT AND THE DIRECT COSTS BEING INCURRED BY ISREAL

In late 2023, it was estimated that the war with Hamas was costing Israel an estimated NISI billion ($269 million per day) and will be in the final analysis more expensive for Israel than any one of its prior regional conflicts (Wrobel,2023).

Moreover, the long-term costs of the war to Israel, according to the Institute of National Securities Studies, is estimated to be between NIS 150 billion to NIS 200 billion, or approximately 10 percent of the Israeli GDP. Spending by the Israeli government will "include billions of shekels on defense for the war effort; absorbing wages for the hundreds of thousands of drafted reservists; funding compensation for the war-affected businesses; and the reconstruction and rehabilitation of communities devastated during the October 7 Hamas terror onslaught" (Wrobel, 2023, p.2).

Faced with the high war costs, the Israeli government has been forced to cut programs designed to support religious education in the country and has been forced to defend the shekel by drawing down over $5 billion in reserve currencies. (Wallace, 2023).

In summary, because of the conflict, Israeli public revenues are falling, borrowing costs are on the rise, and overall government spending is increasing dramatically (Staff of AL Jazeera, 2023).

3. THE COMFLICT AND PALESTINEAN DIRECT COSTS

The cost burden of the conflict in Palestinian territories is nearly incalculable. The destruction of infrastructure and productive resources by the Israeli retaliation has been widespread, to say nothing about the loss of manpower, including manpower skills. The UN has estimated that the war in Gaza could set back economic growth and development in the Palestinian territories by more than a decade. It is estimated by Al Jazeera that economic development could be set back by as much as 16 years (Staff of Al Jazeera, 2023).

The Palestinian economy is locked into a cycle of underdevelopment in part because of internal conditions and in part because of Israeli control over the territory. The Palestinian economy is dependent on Israel for their goods and resource markets, including basic services like water and electricity. In 2022-2023, the Israeli economy was worth nearly $500 billion (GDP), while the Palestinian GDP was just over $20 billion (Staff of Al Jazeera, 2023).

4. THE DUNNING MODEL

The extent to which the conflict in Israel can discourage foreign direct investment (FDI) in Israel, the Palestinian territories, as well as in other MENA regions can best be understood by applying the conceptual framework of John Dunning, as set forth in his eclectic theory of FDI (Dunning, 1971, 1980, 2000).

The part of the framework, relevant to this article, relates to Dunning's identification of "pull" factors that summarize the attractiveness of economic, social, and political conditions that exist in potentially target countries or regions for FDI inflows. They are (1) political or social stability, (2) effective government policy including in the area of property rights protection, (3) financial market sophistication and stability, (4) the size and stability of product markets in target areas, (5) the availability and quality of labor markets, as measured by worker training and productivity, and (6) available government-sponsored entry incentives and subsidies. (Dunning, 1980, Tolentino, 2001).

5. THE HISTORICAL EXPERIENCE OF THE MENA REGION IN ATTRACTING FOREIGN DIRECT INVESTMENT INFLOWS

Foreign direct investment capital flowing into the MENA region since the early 2000s has played a major role in promoting economic growth and development in MENA countries, including Israel. It is estimated that inward FDI in the form of greenfield investments represented nearly 5 percent of MENA GDP from 2003 to 2012. Interestingly, non-producing MENA countries attracted significantly more greenfield FDI than their oil-producing counterparts during this period (Islamic Development Bank Group, 2023).

There is evidence that historically cultural ties in the MENA region have triggered inward FDI. Similarly, commonalities in cultures and languages have fostered greenfield investment, particularly given the link to social stability (Dunning's condition #1). In the first decade of the 2010s, MENA nations were able to attract FDI at significant levels not only because of social stability but also because of product market, resource market, and human capital potential. (Dunning's conditions #1 and#2). These factors are all important to would-be foreign direct investors. (Caccia et al, 2023).

Despite the spurt in inward FDI flowing into the MENA regent in the early 2000s, the development-supporting and job-creating inward FDI proved not to be sustainable. In fact, it has been relatively stagnant over the past decade. Inward investment flows in MENA countries peaked in 2007 and by 2008 it reached less than 50 percent of the 2007 level. (Islamic Development Bank Group, 2023).

COVID-19 was largely responsible for the decline in inward FDI during this period as MENA countries were forced to implement quarantines, even to the extent of closing borders, which clearly had a negative impact on would-be foreign investors. Investments in manufacturing and tourism were particularly disrupted by lock-down border closings. Other factors were the after-effects of the earlier “Arab Spring “and other signs of growing instability in the region, politically, economically, and culturally (Caccia et al, 2023).

What is particularly disturbing is the fact that declining inflows of FDI began before the Hamas military attack and the retaliation by the state of Israel. The impact of the hostilities has given foreign direct investors significantly more reason to withhold private capital funding.

As mentioned above, it is predictable that all MENA nations, even the non-combatants, will witness declining FDI inflows in the future. The governments of predominately Muslim nations will likely be forced into public policy positions that could cause political, economic, social, and cultural instability (Yussef, 2023). Also see (Yacoubia, 2023).

6. THE NEGATIVE FOREIGN INVESTMENT EFFECTS ON THE CONBATANTS

The major opportunity costs, of course, will fall on Israel and the Palestinian territories (the combatants). Given the war-ravaged destruction that the latter has incurred, FDI inflows would be unthinkable until massive reconstruction of every type of infrastructure and productive facility is completed. The significant effects of the war on the entire power system in Gaza will most likely be the major deterrent in this regard.

Although the physical devastation in Israel has not been as severe, it is likely that the conditions in the Dunning model will combine to severely limit the inflow of new FDI capital into Israel. Dunning’s so-called “pull” factors relate to the attractiveness of political, social and economic conditions in the investment-targeted country (Tolentino, 2001). Clearly, in reference to all three areas of these conditions, the hostility in the region, including in Israel, has produced conditions of instability, not stability.

It is likely that Israel may incur the most disinvestment in the region as evident in an application of all six of Dunning’s pull factors (Dunning, 1980, 2000).

First, the stability of Israel’s product markets has been and will continue to be disrupted as the country transitions to more of a war economy and prepares for the possibility of future hostility (pull factor #1). Increased taxation and good shortages in the early 2020s have already discouraged consumer spending and predictably the percentage of military and related forms of government spending in Israel will continue to surge.

Secondly, the Israeli retaliation in Gaza has placed a heavy burden on manpower. With more soldiers and support staffs, fewer uncommitted workers remain to serve Israeli production ambitions in the private sector (pull factor #2).

Financial market instability in Israel has been a major consequence of the hostilities (pull factor #3). The expense incurred by the Israeli government in supporting all aspects of the war has put tremendous pressure on the government budget, producing large deficits and borrowing needs, despite the elimination of non-defense spending in the process (Wallace, 2023).

Other evidence of financial stress in Israel includes the requirement to sell off significant amounts of foreign reserves by the Israeli government attempting to stabilize financial markets for the purpose of supporting the exchange value of the shekel (Dulaney, 2028).

Political tension and instability in Israel are not entirely based on the conflict with Hamas. The unpopular move by Netanyahu to shift decision-making power from the Israeli judiciary to the administration has certainly added to the unrest and political instability in the country (pull factor #4). Israeli government policy has historically been supportive of the rights of foreign investors, but now questions have been raised (Sachs and Dews, 2020).

7. U.S. SUPPORT OF ISREAL AND REGIONAL FDI IMPLICATION

No one would question the importance of regional political and social stability in attracting inward FDI inflows, as well as private external capital in general. U.S. support of the Israeli campaign against Hamas has certainly generated anger and resentment among predominately Muslim nations in the MENA region and beyond (Guyer, 2023).

Since the U.S. is a major exporter of FDI capital in the MENA region, the question arises to what extent will tension and instability in the region translate into disinvestment and reduced FDI inflows. It is predictable that not only will FDI from the U.S. be affected but other major investors from Western Europe and the Far East will likely view the instability in the MENA region as a reason to allocate new investment capital elsewhere (Caccia, 2023).

There are signs that that the war in Gaza is spreading to other countries in the region with more to come. Muslim resentment in near-by countries has already produced violence and retaliation aimed at U.S. forces as well as against Israel. For example, on 12/26/2023, Iranian backed militia struck a U.S. base in Erbil with a drone attack killing three. In response, U.S. forces bombed three locations in Iraq targeting Kataib Hezbollah (Staff of the Boston Globe, 2023).

The U.S. retaliated on December 31, 2023, for an attack on U.S. cargo shipping in the Red Sea, opening fire on Houthi rebels killing several of the attackers (Staff of the AP, 2023). In cooperation with the British, the U.S. also launched a bombing campaign against Houthi bases in Yemen in mid-January 2024, extending the hostilities (Schmitt and Cooper, 2024).

Tension has also developed at the Israeli/ Lebanon border during early 2024 with military confrontation between Israeli and Hezbollah factions. Israel has been carrying out extensive strikes on Hezbollah targets in Lebanon near the border, a clear-cut case of the widening of the war (Selyukh and Kahn, 2023).

8. CONCLUDING THOUGHTS

Without question, the destructive effects of the Israeli /Palestinian conflict on human resources, productive resources, infrastructure, as well as on residential/health care resources will require an infusion of needed external financing. Although the combatants in the conflict will need the greatest capital infusions, other MENA nations will be candidates for some external support based on the impact of the conflict on the investment climate in the entire region (Youssef, 2023). Political, economic, and social instability throughout the region has had negative effects on the incentives of traditional private investors to commit new capital funding.

If needed private funding, particularly for Israel and the Palestinian territories, is not forthcoming where will the capital come from? The most likely sources would be the World Bank and the IMF. The World Bank has been a major supporter of economic development over time, but it has focused its lending on lessor developed countries. Consequently, the World Bank has funded more development projects in central and southern Africa than in the middle east. Given the devastation of the war in Israel and Palestine, the need for finding of major reconstruction and development projects, particularly in the war zone, is significant. World Bank funding would seem to be a viable solution to the problem. It is highly unlikely that private capital inflows will fill the need. (Masters, Berman, and Chatzky, 2023).

Finally, IMF support is needed as well, considering the effects of the Israeli /Palestinian conflict on financial and currency stability on the region. The IMF is committed to support economic policies in target countries by stabilizing domestic financial markets and foreign exchange markets to promote economic development. The need is evident in the MENA region, particularly in Israel and the Palestinian territories (Staff of the IMF, 2023).

The purpose of this article is not to evaluate propose long-term solutions to the conflict in Israel and beyond, such as the two-country model. However, whatever solution emerge from negotiations, two requirements would seem to make sense, namely absolute security for Israel and some level of autonomy for the Palestinian territories.

9. MANAGERIAL IMPLICATIONS

It is a central objective of multinational enterprises to allocate assets domestically and internationally for the purpose of promoting maximum productive efficiency and maximum profitability.

In managing this process, MNEs must weigh the factors and conditions in FDI-targeted regions or countries that give the investor either a competitive advantage or disadvantage.

It is argued in this article that the Dunning Eclectic Model provides a good framework for governing this decision-making process. Also, the focus of the article provides a constructive example of how conditions in investment-targeted regions can change significantly over a short period of time in altering a one-time favorable investment venue into an unfavorable one.

The recent history of the MENA region, as examined in this article, provides a good example of how political, social, or economic changes in targeted areas can alter the attractiveness if the investment venue. During the period from 2003 to 2012, because of favorable internal conditions, inward FDI represented nearly 5 percent of MENA regional GDP. However, this spurt in development-supporting capital inflows proved not to be sustainable. FDI inflows into the MENA region have slumped since the late 2010s ,first as the result of the Covid crisis, but more recently as the result of growing political, social, and economic instability linked growing tension in Israel and the outbreak of violence.

The changes in the attractiveness of the MENA region as an international investment target over a few short years provide a valuable learning experience for FDI investors.

10. RECOMMENDATIONS FOR FUTURE STUDY

1) Case studies are needed to examine the foreign direct investment strategies of large enterprises (MNEs). What specific conditions in target countries encourage inward investment flows and which conditions discourage the same?

2) Case studies are also needed to examine the FDI strategies of smaller and medium-size foreign investors with the same objectives in mind.

3) Studies have indicated that investment incentives such as subsidies and tax relief can be effective in attracting inward FDI. To what extent has the MENA region, including Israel and the Palestinian territories, used such investment incentives?

4) Studies are needed of fiscal stress in the MENA region, including government budgetary pressures.

5) Cultural, economic, and social stability have been affected in the MENA region as the result of the conflict in Israel. To what extent has this led to FDI disinvestment?

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