The Hebrew University of Jerusalem

Does peace with your enemy affects trade with your friends?

The Effects of the Israeli-Palestinian Conflict on Israeli Exports to the EU

Adrian Filut - 317865244
Faculty of Social Science
The Federman School of Public Policy and Government
The Honors Graduate Program in Public Policy

Abstract

The relationship between trade and conflict has been fascinating politicians as well as economists, philosophers and civil servants for a long time. Almost all the researches had concentrated in the pacifying effects of trade but only a few focuses on the influence of conflict on trade. This investigation attempts to verify the existing hypotheses in one of the main, oldest, most unpredictable and violent cases that Modern history provided: The Israeli-Palestinian Conflict. Since the insignificance of the Palestinian economy to the Israeli one, we study the influence of the conflict on Israel's exports to the European Union, its main trade partner. Using an adaptation of the gravity model of trade, events dataset and alternative variables that describe conflict, we find a significant and considerable influence of the conflict on Israeli-EU trade relationship. The main key finding in this work is that not only conflictive events reduce trade, but also cooperative events, such as consultations, promises or even simple approvals, significantly augment Israeli exports to its main partners in Europe. The empirical results suggest that Israeli policy towards the Palestinian question is an inherent part of its trade policy.

Introduction

The Israeli-Palestinian Conflict has been extremely costly to both people. In addition to the direct costs of war (killed people, physical damages), wars seriously damage the productive apparatus of the belligerents. Wars appeared to be not compatible with trade, which is one of the main ways to achieve sustainable growth and economic development. The Israeli-Palestinian clash is not like common wars: it is especially long in modern history terms, its intensity is highly inconstant and it is difficult to predict its behavior, beginning and last part. While is easier to determine where and when regular wars occur and there immediate effects on trade, it is less clear how and when this particular conflict affects Israeli trade. Because of the scope and nature of the Palestinian economy, the impact of the conflict on dyadic trade between these adversaries is irrelevant: the PA is a negligible trade partner of Israel. Moreover, trade between PA and Israel could rise during "warmer" periods since the inherent dependency of the PA economy to the Israeli one. However, does the Israeli-Palestinian conflict affect trade between Israel and other important trade partner? Do Palestinian riots in Nablus affect the economic attitude of a German consumer towards Israeli products? Do peace agreements, peace conferences or even cease-fires between Israel and Palestinians encourage a French entrepreneur to buy more "Made in Israel" goods?

In this paper I examine the influence of the Israeli-Palestinian conflict on the trade flow with Israel major trade partner, the European Union (EU). Using econometric procedures and a dataset that reflect the evolution of the conflict day by day, I will show that the different *events* of the Israeli-Palestinian clash *significantly* affect Israeli exports to the EU during the last decade: while conflictive events between this dyad diminish Israeli exports to EU, cooperative efforts appear to expand trade between Israel and EU members.

This hypothesis is verified in one of the most volatile, unpredictable and intense epoch of the prolonged conflict: from the signature of the Oslo Agreements on September 1993 to the end Second Intifada.

According to the results, the Israeli policy towards the Palestinian people does affect economic exchange with Israeli main trade partners. Consequently, political actions that apparently are not connected with economic issues are in Israel a tool of trade policy. In spite of the fact that Palestinian economy is irrelevant to Israeli one, it turns

out that progress achieved in conflict resolution can be translated to trade increase and consequently economic growth.

This research contributes to the existing literature that investigates the relationship between conflict and trade by considering one of its main, oldest and most violent cases, which lasts until our times. The "trade promotes peace" hypothesis acquires in this paper a new meaning but especially a new causal direction: "peace with your enemy can promote trade with your friend". Using an adaptation of the gravity model of trade, *events* dataset and alternative variables that describe conflict, we find a significant and considerable influence of the conflict on Israeli-EU trade relationship. The main finding in this work is that not only conflictive events reduce trade, but also cooperative events, such as consultations, conferences, promises or even simple approvals, significantly augment Israeli exports to its main partners in Europe. The empirical results suggest that Israeli policy towards the Palestinian question is an inherent part of its trade policy.

In the next section we present a brief survey of the historical and economic background. In section two we review and analyze the relevant literature that has been published until now. In section three and four we present the research design and the relevant variables. In section four and five we analyze the models and reveal the empirical findings. In last section the results are discussed.

I. Background

In order to understand the temporal and spatial domain in which this investigation is carried out, the background section is divided in two parts. This work analyzes the connection between two relations, i.e. how the war between Israel and Palestinians affects trade between Israel and EU. The first part is historical and concentrates in a concise review of the main events that characterized the Israeli-Palestinian Conflict, while the second one describes the nature and scope of trade relations between Israel and EU.

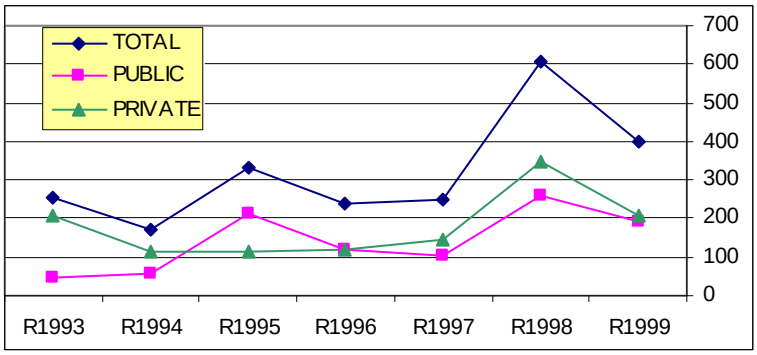
I.a Historical background: The Israeli-Palestinian Conflict- From Oslo to the Second Intifada

After forty-three years of failed attempts, Israeli and Palestinian representative's signed on September 1993 the Declaration of Principles on Interim Self-Government Arrangements, known as the "Oslo Accords", aimed "to put an end to decades of confrontation and conflict" (Declaration of Principles on Interim Self-Government Arrangements, 1993, Introduction). For the first time in history, Palestinians publicly acknowledged Israel's right to exist and compromise to abandon violence, while Israelis recognize the Palestinian right to have an independent state (Declaration of Principles on Interim Self-Government Arrangements, 1993, Article I). The agreement established the Israeli forces withdraw from Palestinians territories (Gaza strip and Jericho) and a phased transitional plan towards the constitution of a Palestinian settlement (Declaration of Principles on Interim Self-Government Arrangements, 1993, Introduction, Article V.1). Former Foreign Affairs Minister Shimon Peres, who signed the agreements on behalf of the State of Israel, lead the approach that Oslo accords will bring a *New Middle East* characterized by technological progress and economic development (Lord, 1998).

However, the accords were received by both populations with skepticism and critique: almost half of the Israeli Parliament members opposed to "Oslo" while in the Palestinian side, Hamas, the Palestinian Islamic Jihad and the Popular Front for the Liberation of Palestine, objected the accords. In addition to the political opposition, intellectual opposition was revealed from both sides. Hazony (1996) asserted that Oslo is based on a misperception of reality and actually started the process of dismantling of the Jewish State, while Lord (1998), said that

Oslo failed to bring peace since it is based on a basic guiding principle that is wrong: the idea of an absolute and comprehensive solution to the Israeli-Palestinian Conflict. In the Palestinian side, Edward Said detracted the peace process from the beginning (Tirado Chase, 1997) defining it as a "misreported and flawed from the start" (Said, 1995). According to Said, Israel will continue to hold Palestinian territories, the settlements will be untouched and Palestinians will never rule over any contiguous territory (Said, 1995).

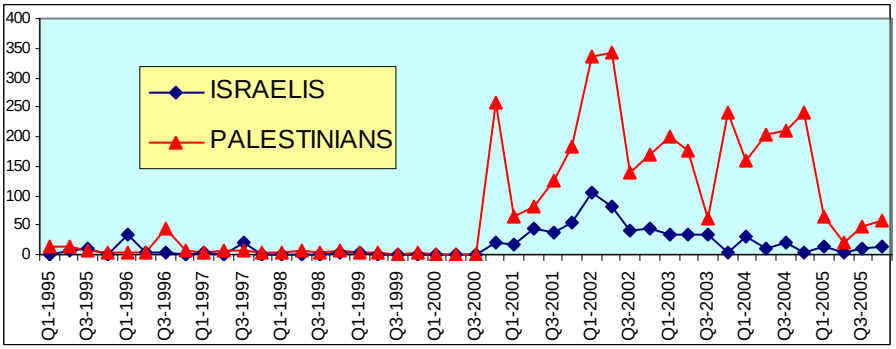
Table 1. Area of Residential Building in Judea, Samaria and Gaza by Initiating Actor, 1993-1999 (in Thousand of Sq. meters)



Source: Statistical Abstract of Israel, Central Bureau of Statistics (CBS) and personal adaptation.

In fact, building in the settlements had never ended even after the signature of the Oslo Accords. Not only had the construction in the territories continued by public initiative but also its pace was accelerated in specific years as seen in Table 1.

Table 2. Number of Killed people in the Israeli-Palestinian Conflict (1995-2005)



Source: B'Tselem and personal adaptation.

Table 2 shows that from Oslo Accords to the Second Intifada there were almost no killed people with some exceptions. In the first quarter of 1996 about 45 Israeli

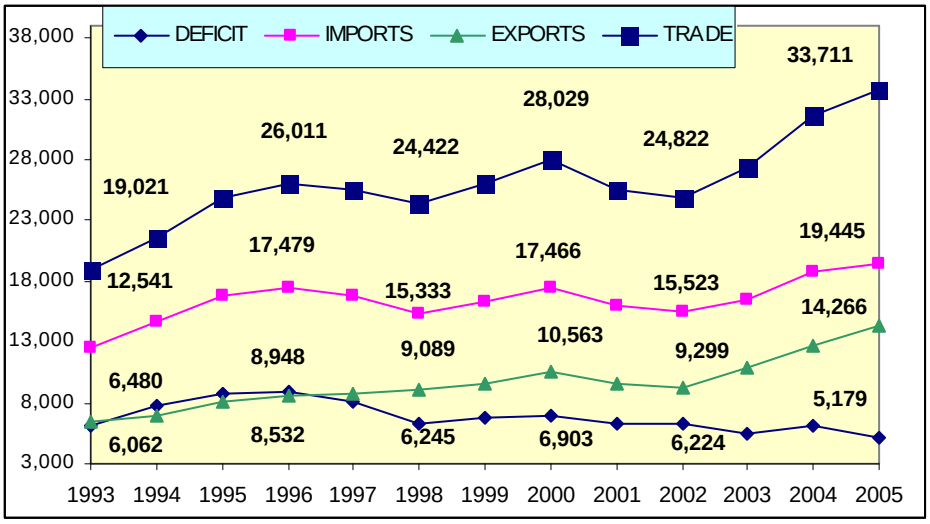
citizens were murdered in a series of suicide bombings, while on the third quarter of 1996 about 50 Palestinians were killed in a three-day riot when Former right-wing Prime Minister Binyamin Netanyahu decided to open a new exit of the Western Wall Tunnel in the Old City of Jerusalem (B'Tselem, 2007).

As seen in Table 2, the relatively "sweet" period of Oslo was abruptly cut by the Second Intifada ("Revolt"), which constitutes the bloodiest epoch within the Israeli-Palestinian Conflict. From the end of 2000 till the end of 2004, about 3200 Palestinians and 630 of Israelis were killed, averagely 225 people per quarter (B'Tselem, 2007). Between those historic events five Prime Ministers of Israel governed: Yitzhak Rabin (who was killed after Oslo signature), Shimon Peres (who signed the Oslo Agreements), Binyamin Netanyahu (Right-Wing Likud), Ehud Barak (Left-Wing) and Ariel Sharon (Right-Wing Likud). Probably, this fact (five leaders from opposite parties in eleven years) describes in a good way the political turmoil that characterized those days.

I.b Economic background: EU-Israeli trade relationship

The European Union (EU) has been the main trade partner of Israel for the last decades, ranked in the first place in Israel's imports while getting the first or second place in its exports. As shown in Table 3, the total amount of trade has been increasing in a rapid path: from 1993 to 2005 trade between Israel and EU sharply rose by 66%.

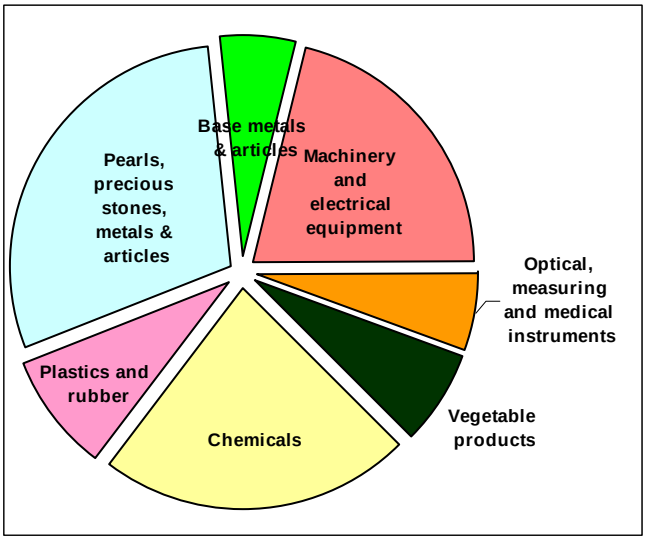
Table 3. Bilateral trade between EU and Israel: Main Parameters (1993-2005)



Source: "Foreign Trade Statistics Monthly", Central Bureau of Statistics (CBS) and personal adaptation.

Israeli exports to the EU represented about one-third of total Israeli exports while Israeli imports from the EU constitutes about 40% of total Israeli imports. Table 3 also reveals that a constant feature of EU-Israel bilateral trade has been the trade deficit of Israel vis-à-vis EU, which during the last years, has been rather constant.

Table 4. Distribution of Israeli exports to the EU in 2004 (%)



Source: "Foreign Trade Statistics Monthly", Central Bureau of Statistics (CBS).

Table 4 shows that EU-Israel trade statistics are traditionally influenced by the substantial trade in precious stones (diamonds), which accounts for about 30% of total bilateral trade.

In 2005, Israel's main exports to the EU consists on chemical products (21%), electrical machinery and equipment (19%), plastic and rubber (8%), vegetable products (6%), optical measuring and medical instruments (5%) and base metals (5%). This internal composition has been quite constant during last years and modest changes were observed in elements' weights.

Israel's major imports from the EU were electrical machinery and equipment (31%), chemicals (14%) and base metals (6%).

The EU's policy towards the Mediterranean region as a whole is ruled by the Euro-Mediterranean Partnership, launched at the Barcelona Summit in 1995 between the European Union and its ten Mediterranean partners (Algeria, Egypt, Israel, Jordan, Lebanon, Morocco, Palestinian Authority, Syria, Tunisia and Turkey). This process

involves the extension of a free trade area across the Mediterranean region through a network of bilateral agreements between the EU and individual Mediterranean partners, aimed to create a Euro-Mediterranean FTA by 2010 (European Commission).

In the same year the EU and Israel signed the Euro-Mediterranean Association Agreement that allows Israeli *industrial* goods to enter into the EU region without any tariffs. However, it is important to underscore that bilateral trade was governed by a previous agreement framework (the Cooperation Agreement) from 1975 and the new document just substituted the former (European Commission).

Possibly the most controversial episode in the whole studied period took place at the end of November 2001 when the European Commission officially "remind" that all Israeli products originated in the Israeli settlements placed in the West-Bank, Gaza Strip, East Jerusalem and the Golan Heights cannot benefit from the preferential import regime agreed within the Association Agreement framework (European Commission). Despite that according to the Association Agreement these settlements have never belonged to the Israeli State, this action irritates many Israelis, as it took place in the harshest phases of the Second Intifada and numerous Israelis understood the laconic notice as a measure of economic punishment.

II. Literature Survey

The relationship between conflict and trade appeared to be one of the "hottest" and oldest issues that captured the attention of economists as well as politicians, philosophers and civil servants in modern history. From Baron of Montesquieu in 1750 to Henry Kissinger in the 70's, throw Richard Cobden and John Keynes- everyone expressed in different ways that economic interdependence in general and trade in particular promote peaceful coexistence (Polachek, 1980; 2005).

During the last decade, several researchers in different fields (political science, international relations and even economics) have been calling into question this conventional truth by showing not only that the relationship between trade and conflict is spurious, but also, that trade and conflict are positive correlated. This wave of publications that has been grasping the most prestigious places in high-status journals such as *Journal of Conflict Resolution*, *Journal of Peace Research, American Conflict*

Management and Peace Science Journal of Political Science[1], triggering an intensive dialogue between competing conceptions that last until now.

According to the classical paradigms in International Relations, it can be said that "Liberals" theorize a negative relationship between trade and conflict; Marxists theorize a positive one, while Realists affirm that the relationship between conflict and trade is unclear (Barbieri, 1996; Barbieri and Schneider, 1999; Goenner, 2004).

The trade-promote-peace hypothesis

Considering always trade as an independent variable and conflict as the dependent one, several scholars attempt to back up or refute the believed pacifying effect of trade, namely, they analyze if intensification in trade relations generates peace or obstructs it.

Polachek (1980) is widely considered the first scholar that investigates, using a utility model, the relationship between trade and dyadic conflict and according to him, they are negatively related.

Oneal and Russett (1996; 1999a; 1999b; 2001; 2005) interests' in the effect of economic interdependence on conflict is a sort of prolongation of their research on the democratic peace theory. Within these works they try to demonstrate that Immanuel Kant's concept of "perpetual peace" created by shared democratic institutions, economic interdependence, and joint commitment to international law and institutions is truthful. Thus, they provide strong support for the pacifying influence of trade relations. Kinsella and Russett (2002) assert that joint democracy and economic interdependence strongly reduce the risk that lower level conflicts will escalate to military disputes, and they also help to prevent conflicts from emerging in the first place.

Gartzke, Li and Boehmer (2001) expand economic interdependence to include financial and monetary integration and arrive to similar conclusions that Oneal and Russett (1996; 1999a; 1999b; 2001; 2005). Gartzke and Li (2003a; 2003b; 2003c; 2003d) conclude, after altering datasets, variable definitions and models that the

[1] *Journal of Conflict Resolution* was ranked in 2006 5/50 in International Relations and 4/85 in Political Science, *Journal of Peace Research* was ranked in 2006 7/50 in International Relations and 5/85 in Political Science, *American Journal of Political Science* was ranked 2/85 in 2006 in Political Science and *Conflict Management and Peace Science* was ranked in 2006 10/50 in International Relations.

relationship between conflict and trade is significant and inverse. In a similar research, Schneider and Schulze (2005) conclude the same.

Martin, Mayer and Thoenig (2005) demonstrate that an increase in bilateral trade between two countries reduces the probability of conflicts between them but increases the probability of conflicts with other countries. Robst, Polachek and Yang (2006) claim that trade reduces conflict to a greater extent when dyads are geographically close, but has a greater effect on cooperation when countries are more distant. Maoz (2006) show that trade relations appear to be an important predictor of international conflict. Specifically, as trade interdependence increase, the level of conflict in the system declines.

In contrast, different works show the opposite. Barbieri et al. (1996; 1998; 2002), probably the main detractor of the "trade-promote-peace hypothesis", find that high levels of economic interdependence can increase the likelihood of military conflicts.

Taking into account four aspects of interdependence (economic, political, diplomatic and military) de Vries' (1990) analysis revealed that interdependence intensify relations among states irrespective of their nature, specifically, it strengthens not only processes of cooperation, but also processes of conflict.

Beck, Katz and Tucker (1998) find that trade appears to shorten spells of conflict but it does not inhibit conflict from erupts, while democracy does so. Goenner (2004) arrive to a similar conclusion: intensive trade relationship does not inhibit disputes while democracy does so.

Ray (2005) shows that even with a control for contiguity and distance between the dyad, the relationship between trade interdependence and conflict for all pairs of states in the system from 1950 to 1992 is positive and significantly.

As opposed to both Oneal and Russett and Barbieri competing theories, Morrow et al. (1999) and Ward and Hoff (2007) assessed that the impact of trade on conflict is indeterminate.

Gartzke and Li (2003a) argue that the lack of correspondence in results between scholars is totally explained by features inherent to the dependent variable construction: the relationship between trade and conflict will be determined by how researchers calculate "economic interdependence", namely, how "trade" is

operationally defined[2]. Hegre (2005) asserts that the reason of the differences is less clear but notes that both Barbieri and Oneal and Russett include controlling variables in their model that are closely related to their independent variables.

However, Barbieri and Schneider (1999) and Oneal and Russett (1996; 1999a; 1999b; 2001; 2005), that lead competing theories, believe that contradictory empirical findings can be partially explained by disparities in data collection, econometrics, model specification and the choice of temporal and spatial domain.

Which come first: the chicken or the egg?

Another interesting point that was less considered and explained by scholars is the *direction* of the causal relation between trade and conflict, that is, who is influenced by who. It can be understood that almost all the surveyed scholars suspect, at least, that the relationship between these two variables is bidirectional since they always lag the independent variables (whether if it is trade or conflict). Doing that, they implicitly infer that the relationship between the variables is reciprocal.

Bidirectional relations between variables have important econometric implications such as simultaneity bias[3]. According to Keshk, Pollins and Reuveny (2004) the trade-conflict research community largely ignored the question of simultaneity because of the difficulty of incorporating a discrete dependent variable in the conflict equation. Polachek (1980) is aware of that uncertainty and by using two-stage least-squares (TSLS) as an econometric technique for estimation in the presence of simultaneity, shows that trade affects conflict. Gasiorowski and Polachek (1982) examine the US-Warsaw Pact dyad for 1967-78 and conclude that Granger causality for short-lag periods runs overwhelmingly from trade to conflict and not from conflict to trade (Barbieri and Levy, 1999).

Pollins (1989b) offered a theoretical argument for simultaneity, but did not test the relationship. Reuveny and Kang (1998) use a Granger causality procedure to test simultaneity, and they find it. Oneal, Russett and Berbaum (2003) check this point,

[2] Barbieri et al. (1996; 1999) use different combinations between dyadic trade and **total trade** as the dependent variable, such as the quotient between them, while Oneal and Russett (1996; 1999a; 1999b; 2001; 2005) refuse to adopt Barbieri's approach and use different combinations of dyadic trade and **GDP**, such as the quotient between them, to quantify "trade".

[3] When independent variables determine the dependent variable, but the dependent variable determines at least some of the independent variables at the same time.

show that trade and conflict are reciprocal related and solve simultaneity by lagging the dependent variable (trade).

Keshk, Pollins and Reuveny (2004) main results suggest that the proposition that conflict reduces trade is markedly stronger and more robust than the Liberal claim that trade reduces conflict.

This point is crucial since its policy implications. If trade brings peace maybe all efforts might be invested in economic and trade policy - peace will come afterwards. However, if peace or war affects trade then there are good economic reasons to look for peace and the energy may be allocated in other places.

So…Does Conflict affect Trade?

Relatively little research has been done on conflict/cooperation as a determinant of trade during this time (Keshk, Pollins and Reuveny, 2004). For instance, the works of Barbieri and Oneal and Russett (1996; 1999a; 1999b; 2001; 2005), that are vehemently contradictories in almost everything, share one thing: an exclusive focus on the effect of economic interdependence on conflict. Recently, more and more scholar started to concentrate on the effects of conflicts on trade. Bliss and Russett (1998; 1999) assure that the influence of militarized disputes on trade is only moderate and inconsistent.

Correspondingly, Barbieri and Levy (1999) show that in most cases war does not have a significant impact on trade relations. Although war sometimes leads to a temporary decline in the level of dyadic trade, in most cases war has no permanent long-term effect on trading relationships and, in fact, trade often increases in the postwar period.

In opposition to Bliss and Russett and Barbieri and Levy, Pollins (1989a; 1989b) findings' bring considerable support to the hypothesis that trade is significantly affected by political relations of amity or enmity between nations and their adjust trade relations to satisfy not only economic but also security goals.

Anderton and Carter (2001) use an interrupted time-series model to study the impact of war on trade for 14 major power dyads. They find strong evidence that major Power war is associated with a decline in trade relative to pre- and postwar periods. They also investigate the impact of war on trade for 13 non-major Power dyads. Here the evidence is weaker but remains supportive to the trade disruption premise.

Oneal, Russett and Berbaum (2003) analyze the relation between trade and war, taking trade as the dependent variable and show that fatal disputes do reduce trade while the effect of a less violent confrontation is limited to the first year after the onset. Keshk, Pollins and Reuveny (2004) find that dyadic conflicts do indeed suppress trade, while trade itself does not have a discernable impact on the likelihood of conflict between those same nations.

Bayer and Ruppert (2004) investigate the effects of war on trade by examining the impact of civil war in one country on the total bilateral trade between the afflicted state and its trade partners. Maybe their most significant finding to this paper is that the effects of civil wars on trade are not limited to countries where the civil wars are occurring but also affect joiners. Moreover, the outcome types of civil wars ("negotiated settlement" in opposition to "decisive military victory") have repercussions for future bilateral trade and, under certain outcomes such as negotiated settlement, their effects can be alleviated (Bayer and Ruppert, 2004). In a similar study Glick and Taylor (2005) analyze the impact of war on trade between the belligerent state and a third-state (neutral) and show that the effect is negative and significant.

III. Research Design

The main purpose of this work is to show if and how the Israeli-Palestinian Conflict (IPC) affects Israeli exports to its main trade partner. Therefore, according to the "peace-promote-trade" supporters, different expressions of conflict/cooperation should inhibit/expand trade. If this effect is relevant in our particular case study we should observe the disturbing effects of the IPC reflected on the trade relationship between Israel and the EU members.

The first hypothesis of this paper is that *an escalation of the IPC leads to a reduction in the Israeli export flow to the EU states.* The second hypothesis, which cannot be automatically assumed from the first one[4], is that *a pacification or recovery in the IPC leads to an increment in the Israeli exports to the EU states.*

[4] The fact that conflictive events can have negative effects on Israeli trade flow to Europe does not necessarily mean that cooperative headlines have positive effects on trade. Cooperative events could have no effects or even negative effects on trade as well.

Instead of bilateral trade, I will concentrate on Israel exports to the EU members, assuming that, besides rational criteria, EU importers may react, by express goodwill or willingness to punish, to Israel's attitude towards the Palestinians by augmenting or diminishing its acquisitions from Israel, and not its sales to Israel (Pollins, 1989a; 1989b). The temporal domain in this research starts in the last quarter of 1993[5] and finished in 2004 by capturing the last crucial developments in the IPC- from the signature of the Oslo Agreements to the end of the Second Intifada. It ends in 2004 because of data restrictions[6]. Because of data constraints and in order to increase the number observations the unit of analysis is quarters and not years. Owing to the nature of data and variables this feature does not harm the quality of the result but just enrich them (Lavy and Fridman, 2006).

IIIa. The Model

Based on almost the entire scholars that attempt to investigate the variables that affect trade I incorporate the control variables that are included in the "gravity model of trade" (Bayer and Ruppert, 2004; Bliss and Russett, 1998, 1999; Estevadeordal, Frantz and Taylor, 2003; Glick and Taylor, 2005; Keshk, Pollins and Reuveny, 2004; Li and Sacko, 2002; Martin, Mayer and Thoenig, 2005; Oneal and Russett, 2001 and Oneal, Russett and Berbaum, 2003).

The gravity model of trade, is supposed to predict bilateral trade flows based on GDP, distances and other factors that in principle, affect trade such as trade agreements and trade barriers. Its name is taken form Newton's gravity law that forecast gravitational interactions between object knowing mass and distance. In its log-linearized form for econometric analysis it received the following form:

$$\ln (\text{Trade Flow})_{1\,2} = \alpha_0 + \beta_1 \ln (\text{GDPState})_1 + \beta_2 \ln (\text{GDPState})_2 - \beta_3 \ln (\text{Distance})_{1\,2} + \varepsilon,$$

where trade flow between two nations is positively related with the size of both economies and negatively related to the distance between them.

[5]The Accords were finalized in Oslo, Norway on August 20, and subsequently officially signed on September 13, i.e., effects of the agreements may be appreciated already in the last quarter of 1993.

6 The relevant dataset ("Levant") finishes in the last quarter of 2004. See the dependent variable chapter

Eichengreen and Douglas (1998) asserted that this model became the workhorse for empirical studies of trade integration to the virtual exclusion of other approaches. According to Anderson and Wincoop (2003; 2004), the gravity equation is one of the most empirically successful in Economics. Estevadeordal, Frantz and Taylor (2003) define it as the most successful model for explaining trade patterns.

This model has been used widely as a baseline model for estimating the impact of a variety of policy issues and has become maybe the most popular model in international trade research (Cheng and Wall, 2005).

However, the gravity model will not be used in its original form because of the different nature of the investigation. Firstly, "distance" is not a variable in this research but a constant, since we are analyzing only one dyad[7]. Therefore half of the model is immediately irrelevant. The GDP variables' function is to describe size, or more specifically, is aimed to separate large, rich or open economies from small, poor or closed ones, while the analyzed countries have not dramatically altered their status during the last decades.

However, economic variables must be included when studying bilateral trade and the gravity model cannot be ignored. Anderson and Wincoop (2003; 2004) and Pollins (1989a) help us to solve the problem. The former sustain that any gravity model should provide the main link between trade *barriers* and trade *flows*. According to the later, every bilateral trade flow model focus upon three basic determinants: *demand-side* factors, *supply-side* factors and elements that impede international trade named by Pollins as *resistance* factors (Pollins, 1989a).

Demand-side factors: The best way to gauge EU countries demand for international products is to check their whole imports. Since Israeli exports to the EU represents less than one percent of total EU imports, danger of bi-directionality is almost inexistence.

Supply-side factors: In this case choosing total Israeli exports to the world is more complicate since averagely, one-third of Israeli exports are aimed to the EU so simultaneity is certain. Based on Lavy and Fridman (2006) that investigate the variables affecting Israeli exports, a possible solution to this problem is going for a measure of "industrial production".

[7] The distance between Tel Aviv and Paris or Berlin has never change and will never change.

Resistance factors: Most of the resistance factors that are treated in literature (Pollins, 1989a; 1989b; Anderson and Wincoop, 2003; Glick and Taylor, 2005) such as trade barriers, language and other cultural obstacles, types of regime and currency unions, are problematic to this study since, as distance, they are constant and not variables, at least in the selected temporal domain. Even when variation exists, such as in tariffs, the variation of tariffs across goods is quite large (Anderson and Wincoop, 2003). Based on Lavy and Fridman (2006), that shows that Israeli exports are a function of strict economic variables and "the security situation", I will consider the main independent variables in this research, namely, conflict and cooperation between Israel and Palestinians, as the *resistance* variable.

Therefore, in the log-linearized form, the analyzed equation will be as follows:

$$\ln (\text{exp})_{\text{i-eu}} = \alpha_0 + \beta_1 \ln (\text{ind. production})_{\text{i}} + \beta_2 \ln (\text{imp})_{\text{eu}} - \beta_3 \ln (\text{conflict/cooperation})_{\text{p-i}} + \varepsilon,$$

where **(exp) i-eu** are the Israeli exports to the EU states, **(ind. production) i** is the Israeli industrial production, **(imp) eu** are the sum of the EU states imports from the world , **(conflict/cooperation) p-i** is a measure to evaluate the Israeli-Palestinian conflict and **ε** is the residual.

III.b Dependent Variable

The dependent variable, ***trade***, is the sum of total Israeli exports to the fifteen European countries that were part of the European Union until the Fifth Enlargement on 1 May 2004 (EU-15[8]). Those countries are the main core of the EU and the selection was aimed to avoid the disruptive effect that the Eastern Europe countries may cause to the entire dataset. Moreover, since the temporal domain ends in the last quarter of 2004, there are not good reasons to include them in this article given that those nations enter in the EU in the middle of the second quarter of 2004, i.e. almost at the end of the temporal domain. The data is in millions of U$S dollars, F.O.B (free on board) and quarterly calculated, and extracted from the "Foreign Trade Statistics Monthly" section of the Israeli Central Bureau of Statistics (CBS).

8 EU15: Austria, Belgium, Denmark, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, Netherlands, Portugal, Spain, Sweden, United Kingdom.

Following the gravity model and most, if not all, scholars that analyze how conflict/cooperation affects trade (Bliss and Russett, 1998, 1999; Morrow et al., 1999; Li and Sacko, 2002; Gartzke and Li, 2003a; Bayer and Ruppert, 2004; Keshk, Pollins and Reuveny, 2004; Glick and Taylor, 2005; Martin, Mayer and Thoenig, 2005) the dependent variable (trade) is always *logged*.

IIIc. Independent Variables

In order to avoid the reciprocal effect of trade on the independent variables, the dependent variable is measured at time $t + 1$ while our independent variables are measured at time t, that is, all the independent variables are *lagged* (Beck, Katz and Tucker**,** 1998; Bliss and Russett, 1998; 1999; Oneal and Russett, 1996; 1999a; 1999b; 2001; 2003; 2005; Morrow et al., 1999; Li and Sacko, 2002; Gartzke and Li, 2003a; Oneal, Russett and Berbaum, 2003; Bayer and Ruppert, 2004; Glick and Taylor, 2005; Martin, Mayer and Thoenig, 2005; Maoz, 2005).

The possible danger of simultaneity in this research is minor because of the variables' nature[9]. However, it is important to show causality by following what Oneal, Russett and Berbaum (2003) called "the spirit of Granger's test of causality". Granger (1969) proposed that a variable X might be a cause of Y if past values of X can be used to predict Y more accurately than using past values of Y alone (Oneal, Russett and Berbaum, 2003).

IIIc.1.1 Conflict and Cooperation

Nearly all scholars used the Militarized Interstate Disputes (MID) dataset compiled by Correlates of War Project (CoW) of University of Michigan in order to evaluate war (Barbieri et al., 1996; 1999; 2003; Bayer and Ruppert, 2004; Bliss and Russett, 1998, 1999; Dorussen, 2006; Gartzke et al., 2001; 2003a, 2003b; 2003c; 2003d; Glick and Taylor, 2005; Keshk et al., 2004, Krustev, 2006; Maoz, 2006; Martin, Mayer and Thoenig, 2005; Morrow et al., 1998; 1999; Oneal et al., 1996; 1999a; 1999b; 2001; 2003; 2005; Schneider and Schulze, 2005; Ward and Hoff, 2007).

[9] The danger of simultaneity is almost inexistence since the relations are evaluated in the framework of co-integration that is "immune" to simultaneity, as almost all the variables in this research are I (1), i.e. their order of Integration is one (Lavy and Fridman, 2006) .

In this work this database is absolutely obsolete since this paper completely concentrates in only one single war that actually, has never ended. The popular solution to this problem is compiling events data (de Vries, 1990; Gasiorowski, 1986; Kinsella and Russett, 2002; Polachek, 1980; Polachek and Seiglie, 2006; Pollins, 1989a; Reuveny and Kang, 1996; Robst, Polachek and Chang, 2006). This is not a problem but an advantage. Firstly, MID allows checking war or "not war" but never cooperation, which is a crucial variable by itself (Robst, Polachek and Chang, 2006). Secondly, discrete variables functioning as dependent variables are extremely problematic and positively conduct to mislead results (Beck, Katz and Tucker, 1998; Green, Kim and Yoon, 2001; Keshk, Pollins and Reuveny, 2004). Possibly that is the reason why Reuveny (2003) affirm that it would be beneficial for international relations field to routinely used events data. Events data comprise bilateral interactions reported in press media and these types of data have the advantage of being able to incorporate conflictive interactions, as well as cooperative exchanges (Polachek and Seiglie, 2006). In this paper cooperation and conflict between parts will be based on the Kansas Events Data System (KEDS) of University of Kansas. KEDS is a computer program that creates event data from machine-readable text (Schrodt, Simpson and Gerner, 2001). The KEDS/Reuters data set in the Middle East used in this research, named ***Levant*** dataset, was able to identify the major trends in international conflict and cooperation in the region and appeared as extremely accurate. Overall levels of net cooperation and specific patterns over time are generally consistent with the narrative record for the dyads examined (Schrodt and Gerner, 1994). While this new systems of data compiling were initially received in the academic world with great skepticism, during the last decade several articles using KEDS-coded data have been published in the top peer-reviewed journals in Political Science, including the *American Political Science Review*, Am*erican, Journal of Political Science*, *Journal of Conflict Resolution* and *International Studies Quarterly* (Schrodt, Simpson and Gerner, 2001). Although, the KEDS system appeared as highly accurate, *Levant* dataset is described as the most precise within KEDS. Moreover, *Levant* "has been the benchmark to develop all the system (KEDS)" and "is the most detailed work (of KEDS)" (Schrodt, Simpson and Gerner, 2001, 15).

IIIc.1.2 Operationalizing the Independent Variable

The dataset used in this paper to measure conflict or cooperation is *Levant* dataset which is a folder containing tab-delimited text file of weekly totals of events by major event type according to WEIS code[10]: verbal cooperation, material cooperation, verbal conflict, and material conflict - for the following dyads: USA-Israel, USA-Palestinians, Israel-Palestinians and Israel –Lebanon (Middle East). Its coverage is from April 1979 to December 2004. Because of the aim of this work only Israel-Palestinians dyads are used. From 1979 to 1999, the stories were taken from the Reuters agency. After 1999 to 2004, stories were taken from Agence France Presse (AFP). It is important to underscore that the switch of sources in the *Levant* database (from Reuters to AFP) has occurred during the temporal domain of this work. However, this exchange did not alter the event reports, at least not in the *Levant* case (Schrodt, Simpson and Gerner, 2001). As it was said, the *Levant* is a dataset composed by events. These events are classified in twenty-two types of event according to WEIS categorization. The 22 events are compiled in four categories: Verbal Cooperation (2817 events), Material Cooperation (443 events), Verbal Conflict (1098 events), and Material Conflict (2531 events). In order to simplify the analysis[11] the four categories will be summarized in two variables that will be evaluated in the regressions: Conflict (***conflict***) and Cooperation (***cooper***). Furthermore, these variables will constitute the "raw material" to construct the further independent variables in order to check the hypotheses.

[10]For further information about WEIS, see Gerner et al. (2002), Goldstein (1992), Polachek (1980; 2006), Schrodt et al. (1994; 2001).

11 Besides the simplification aim, is less clear if the standard citizen is able to differentiate verbal cooperation to material cooperation, while in the studied period several verbal conflicts transformed promptly in material conflict.

Table 5. Distribution of WEIS event by category and variables

CATEGORY	AGGREGATION	VARIABLE
01 Yield	Material Cooperation	***Cooper***
02 Comment	Verbal Cooperation	***Cooper***
03 Consult	Verbal Cooperation	***Cooper***
04 Approve	Verbal Cooperation	***Cooper***
05 Promise	Verbal Cooperation	***Cooper***
06 Grant	Material Cooperation	***Cooper***
07 Reward	Material Cooperation	***Cooper***
08 Agree	Verbal Cooperation	***Cooper***
09 Request	Verbal Cooperation	***Cooper***
10 Propose	Verbal Cooperation	***Cooper***
11 Reject	Verbal Conflict	***Conflict***
12 Accuse	Verbal Conflict	***Conflict***
13 Protest	Verbal Conflict	***Conflict***
14 Deny	Verbal Conflict	***Conflict***
15 Demand	Verbal Conflict	***Conflict***
16 Warn	Verbal Conflict	***Conflict***
17 Threaten	Verbal Conflict	***Conflict***
18 Demonstrate	Material Conflict	***Conflict***
19 Reduce Relations	Material Conflict	***Conflict***
20 Expel	Material Conflict	***Conflict***
21 Seize	Material Conflict	***Conflict***
22 Force	Material Conflict	***Conflict***

Source: Gerner et al., (2002), and Personal Adaptation.

Concretely, the ***conflict*** and ***cooper*** variables represent the amount of each type of dyadic interaction (cooperation or conflict) between the actors (Israel and Palestinians) in the selected temporal domain.

In addition to this variable formulation we would like to check the robustness of our results using another three other variables articulated by Polachek and Pollins. Polachek et al. (1980, 2006) prefer to use a variable that measure the ***net*** effect of conflict and cooperation.

In order to follow Polachek spirit, that attempt to neutralize the effects of conflict and cooperation and use a single variable that measure excess of violence over appeasement, I will create a new dependent variable (***netconflict***) as follow:

$$\textbf{\textit{netconflict}} = 2 + (\textbf{\textit{conflict}} - \textbf{\textit{cooper}}) \,/\, \text{Min}\,(\textbf{\textit{conflict}} - \textbf{\textit{cooper}}),$$

where ***conflict*** and ***cooper*** were already defined and Min (***conflict*** - ***cooper***) is the minimum value of ***conflict*** minus ***cooper*** in the series. The inclusion of Min (***cooper***) permits us to use ***netconflict*** in a logged mode, according to the Gravity Model[12].

On the other side, Pollins (1989a) use a single-composed variable too, which he named "*weighted cooperation variable* (w)" (Pollins ,1989a, 749). The variable looks like as follows:

$$\textbf{\textit{"w"}} = cooper * (cooper \,/\, (cooper + conflict))$$

However, one single change will be introduced. Pollins' ***"w"*** is a product and according to him, the first factor is aimed to zero the variable when no cooperation actions are registered in order to avoid bias in results. Since this possibility in our series does not exist (both ***cooper*** and ***conflict*** are always greater than 0) and relative cooperation is well evaluated without the first factor, it will be annulated. Therefore, the weighted cooperation measure (***wcooper***) in this research will be as follows:

$$\textbf{\textit{wcooper}} = \textbf{\textit{cooper}} \,/\, (\textbf{\textit{cooper}} + \textbf{\textit{conflict}}),$$

Besides Pollins' weighted *cooperation* variable I will create an *additional* variable, named weighted *conflict* variable (***wconflict***), by substituting ***cooper*** for ***conflict***:

$$\textbf{\textit{wconflict}} = \textbf{\textit{conflict}} \,/\, (\textbf{\textit{conflict}} + \textbf{\textit{cooper}}),$$

Pollins variables have an important advantage on Polachek ones since they consider "good" or "bad" headlines (nominator) as a portion of the *total* number of publications (denominator). According to theory and the main hypotheses of this work the three variables that estimate conflict or conflict excessiveness (***conflict***, ***netconflict*** and ***wconflict***) are expected to be *inversely* connected to trade, while this relationship must be significant. Concurrently, I expect the relationship between the

[12] (***conflict- cooper***) or (***cooper- conflict***) is a measure that provides positive as well as negative values. Since the log function does not exist in the negative field, the Min (***conflict- cooper***), a fixed number that in this case is 143, permit us to transform the whole series into a non-negative measure that can be logged. The addition of number 2 allows us to obtain a series in which values are greater than 1 (or 1).

two variables that appraise cooperation (***cooper*** and ***wcooper***) and ***trade*** will be positive.

IIIc.2.1 Further Independent Variables: Controlling Variables

As explained in previous chapters there are two controlling variables: EU imports to the world and Israeli Industrial Production. *The different IPC measures largely discussed earlier, fulfill, in this particular investigation, the role of the main independent variable as well as the role of the resistance factor.*

IIIc. 2.1.1 Operationalizing the Controlling Variables

To evaluate the EU imports to the world I create ***impeu*** variable, which is the aggregation of total imports of the fifteen European countries that were part of the European Union until the Fifth Enlargement on 1 May 2004 (EU-15)[13]. The data is in millions of U$S dollars[14], quarterly calculated and extracted from the "International Trade" section of the OECD Main Economic Indicators (MEI). According to the gravity model, ***trade*** must be a positive function of ***impeu***.

The second controlling variable is ***ind***, which is an adaptation of the Bank of Israel Total Industrial Production Index. Since the index is calculated monthly and all the empirical research is done quarterly, the monthly indexes were groped by quarters and the new value was divided by three (simple average). As with ***impeu***, ***trade*** must be a positive function of ***ind*** as well.

IIId. Unit of Analysis

Once the relevant variables in the model are presented and explained is easier to justify the selected unit of analysis that in this research is "quarter" and not "year" as in most of the reviewed papers. Since we analyze one dyad and only eleven years, the regression would have been composed only by eleven observations if "years" would been considered as unit of analysis. This is, undoubtedly, an insufficient number of observations for a four-variable regression. If quarterly data is adopted then the

[13] For further information about the selected EU states see Dependent Variable chapter

[14] Originally in billions, but adapted to millions in order to be compatible with the dependent variable.

number of observation is automatically quadruplicated (Reuveny and Kang, 1998; Lavy and Fridman, 2006). Then, with quarterly analysis we have ten times as many observations as variables are considered. However, not only quarterly analysis is necessary in this research but also preferable because of the inherent nature of the analysis: since the observations of the conflict/cooperation dataset (independent variable) are composed by weekly headlines, the consumer attitude towards Israeli products is much faster. Therefore, the year unit is less relevant.

IV. Analysis

In order to examine whether the IPC significantly affects the Israeli exports flows to Europe, four separate regression analyses are estimated for the analysis of the dependent variable (***trade***). The four alternative models evaluate the impact of the four different independent variables that measure conflict/cooperation: (1) ***conflict and cooper,*** (2) ***netconflict,*** (3) ***wconflict*** and (4) ***wcooper***. Therefore, the form of "Model 2" for example, will be:

$$\ln(trade) = \alpha 0 - \beta 1 \ln(netconflict) + \beta 2 \ln(ind) + \beta 3 \ln(impeu) + \varepsilon$$

In order to check the hypotheses OLS regressions will be used to estimate the expected effects.

Table 6. Effect of the IPC on Israeli trade flows to the EU – End of 1993 to end of 2004

	TRADE *(t)*			
Independent Variable	**Model 1**	**Model 2**	**Model 3**	**Model 4**
CONFLICT *(t-1)*	-0.054**	-	-	-
	(0.022)			
COOPER *(t-1)*	0.059**	-	-	-
	(0.025)			
NETCONFLICT *(t-1)*	-	-0.100***	-	-
		(0.057)		
WCONFLICT *(t-1)*	-	-	-0.102*	
			(0.039)	
WCOOPER *(t-1)*	-	-	-	0.105**
				(0.046)
IND *(t-1)*	0.84**	1.20*	0.71**	0.94*
	(0.38)	(0.33)	(0.37)	(0.35)
IMPEU *(t-1)*	0.82*	0.67*	0.87*	0.81*
	(0.19)	(0.15)	(0.17)	(0.16)
Constant	-6.25*	-6.00*	-6.33*	-6.43*
	(1.13)	(1.08)	(1.04)	(1.07)
R-squared	0.84	0.82	0.84	0.83
Adj. R-squared	0.82	0.81	0.83	0.82
Durbin-Watson	2.10	1.99	2.07	2.05

Standard errors are in parentheses.
All variables are logged.
*p<0.01; **p<0.05; p***<0.1; Number of Observations= 41 after adjustments; Prob (F-statistic) = 0.0.
Linear combination of variables are always stationary (all p<0.0001) after Augmented Dickey-Fuller Test.

V. Results

V.a. The IPC and Israeli Exports to EU

The results of the four regressions that are exposed in Table 6 support our claims about the relationship between the IPC and the Israeli export flow. These results are significant at a .05 level in Model 1, Model 3 and Model 4, while p<0.1 in Model 3. Every Model enjoys of a high level of R-squared and, more important, there is almost no difference between R-squared and Adjusted R-squared (higher than 0.8). In addition to this, the t-values of the independent variables are larger than 2 (or smaller than -2)[15]. Moreover, the values of the Durbin-Watson test always fluctuate between 2 and 2.1, revealing that there is no autocorrelation in the residuals.

[15] Expects in Model 3 where t-value is greater than 1.7.

Model 1, shows, according to the hypothesis, that ***conflict*** is significantly inverse to ***trade*** (β= -0.054) while ***cooper*** has a positive influence on ***trade*** (β=0.06). Since all the models are linear-log equations it can be said that the results measure elasticity. Therefore, a variation of 1% in the number of "optimistic" publications augments Israeli exports to EU (IEE) by approximately 0.06%. Since these variables affect the same export flow, the importance of one single variable is much clearer now.

Model 2 evaluates the hypothesis but neutralize both effects in one single variable following Polachek (1980; 2006) literature. Results are altered by scope but not in concept: ***netconflict*** is significant and negatively affects trade as well (β= -0.1). In this case, an increment of 1% in the "net" published "bad news from Israel" reduces quarterly IEE by averagely 1.8 million dollar, taking into account average Israeli exports to EU states by quarters during the temporal domain.

Model 3 and 4 confirm and reinforce what Model 1 and 2 show: the IPC partly predicts the Israeli trade flow to EU. The signs of the "adjusted Pollins index" of relative conflict and cooperation are according to theory: ***wcooper*** is positively related to trade (β= 0.105) and ***wconflict*** is negatively related to ***trade*** (β= -0.102). In those models (3 and 4) a rise of 1% in the "weighted" reports of the IPC alters IEE by averagely 2 million dollars per quarter. In this case, the influence of a "marginal" headline depends of the total amount of news reported in the same quarter, the more the number of news the less influence. If we consider the average amount of ***cooper*** and ***conflict*** in the sample and construct ***wcooper***, an extra good new per quarter represented approximately 1.9 million dollars.

Both controlling variables behave as expected. The relationship between IEE and the EU countries demand for international products (***impeu***) is clearly positive and is the most significant relationship in all Models (t-values are always greater than 4). Besides EU imports, ***ind*** was significant too and coherent related to trade in the four Models.

As expected, political variables do affect economic ones (such as trade) while economic variables still showed larger influences than the political ones (de Groot et al., 2004; Ward and Hoff, 2007).

Besides these results that unquestionably show a strong and negative relationship between IPC and IEE, it is interesting as well to check, based on Glick and Taylor (2005), the lagged effects of the IPC on IEE but not only by one period but also, for

example, by two periods. Explicitly, how IPC events that happen in *t-2* (and not in *t-1*) affect IEE in time *t*.

Table 7. Effect of the IPC (lagged by two-periods) on Israeli trade flows to the EU – End of 1993 to end of 2004

Independent Variable	TRADE(*t*)			
	Model 1	**Model 2**	**Model 3**	**Model 4**
CONFLICT(*t-2*)	-0.056*	-	-	-
	(0.021)			
COOPER (*t-2*)	0.058**	-	-	-
	(0.024)			
NETCONFLICT(*t-2*)	-	-0.104***	-	-
		(0.058)		
WCONFLCIT (*t-2*)	-	-	-0.093**	-
			(0.037)	
WCOOPER (*t-2*)	-	-	-	0.131*
				(0.045)
IND (*t-1*)	0.88**	1.16*	0.87**	0.90*
	(0.38)	(0.33)	(0.35)	(0.33)
IMPEU (*t-1*)	0.84*	0.71*	0.83*	0.87*
	(0.20)	(0.16)	(0.17)	(0.17)
Constant	-6.67*	-6.29*	-6.50*	-6.97*
	(1.26)	(1.2)	(1.17)	(1.16)
R-squared	0.82	0.81	0.82	0.83
Adj. R-squared	0.80	0.79	0.80	0.81
Durbin-Watson	2.13	1.89	2.12	2.10

Standard errors are in parentheses.
All variables are logged
*p<0.01; **p<0.05; ***p<0.08, Number of Observations = 40 after adjustments; Prob (F-statistic) = 0.0.
Linear combination of variables are always stationary (all p<0.0001) after A.D.F Test.

As seen in Table 7, results are similar, both conceptually and numerically, to those who were showed in the previous table. Therefore, even if the IPC get quieter in period *t-1*, it might be taken into account that IEE was certainly altered by the events that happened in period *t-2*. It is especially interesting to see the behavior of ***wcooper*** in *t-2*: its coefficient reaches the highest value (β=0.13), which means that cooperation events that happened in *t-2* augment trade more that conflictive events in *t-2* reduced it.

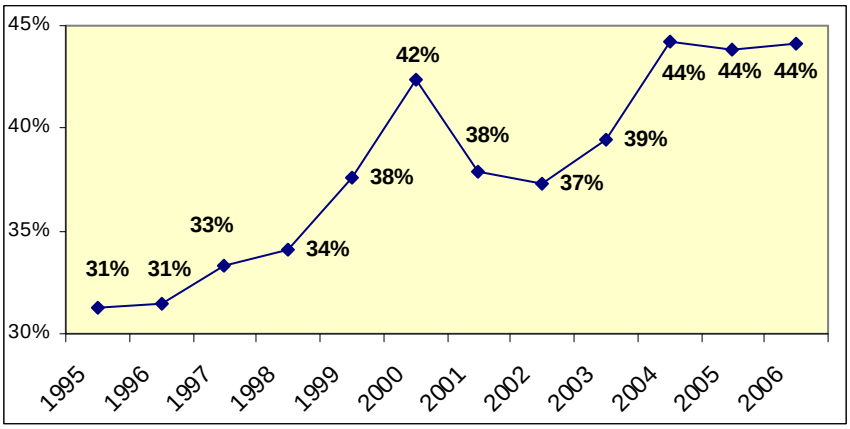
These results permit us to understand the temporal *scope* of the IPC influence on IEE and it can be said now, that the IEE in any quarter was influenced by the IPC events in the previous *two* quarters and not only in the previous quarter[16].

VI. Conclusions

This research provides empirical support for the discussed claim that conflict deters trade while cooperation alters it in one particular but representative scenario at a very particular epoch: the Israeli-Palestinian Conflict during its more intensive hours.

For Israel, a marked export-oriented economy as seen on Table 8, it is not just trade; there are exports to its main target market: the EU core countries.

Table 8. Exports of goods and services as a percentage of GDP at 2005 prices (in %)



Source: Statistical Abstract of Israel No. 58, (CBS) and Personal Adaptation.

According to the conflict/cooperation variables the IPC affects in different scopes. The variables ***conflict*** and ***cooper*** are not relevant to measure the scope of influence since they affect the same export flow and neutralize each other. However, they illuminate and reinforce the results.

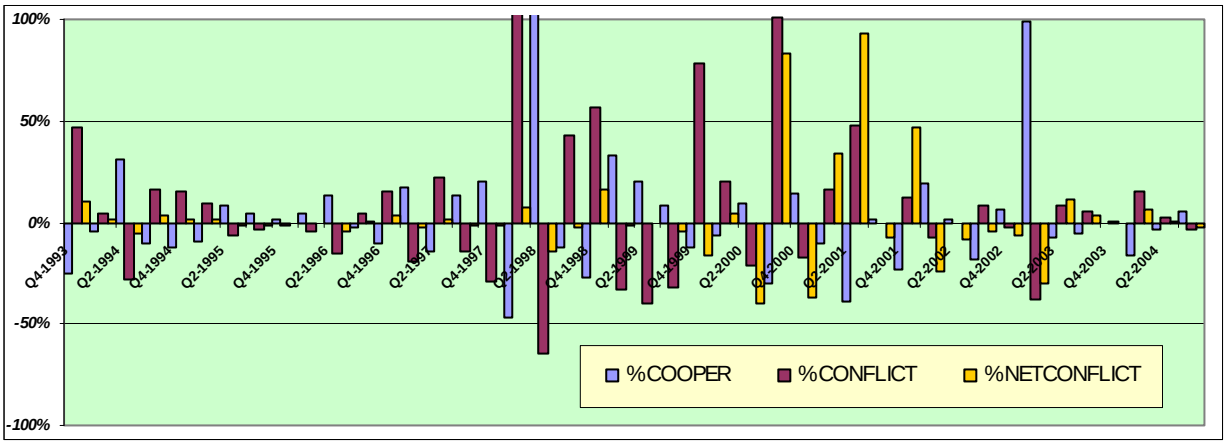
Within the rest of the variables results are unequal since the inherent nature of them. According to ***netconflict***, the variable was quarterly augmenting by 3% during the temporal domain. Therefore, if average ***netconflict*** and IEE is considered, according to the regressions results, the IPC cause an average IEE reduction of about 5.5 million dollars per quarter, or 22 million dollars per year. To this amount, we may add the extra sum that comes from the *t-2* period (another 5.5 million dollars per quarter

[16] The four IPC variables are not significant anymore if they are lagged by three periods (*t-3*) or more.

and 22 million dollars per year). So far, the amount arrives at 44 million dollars per year, times eleven years (the temporal domain) and rapidly we arrive to 484 million dollars .This is a respectable sum of money that have never "seen Israeli pockets" nor entered into the Israeli tax system.

In ***wconflict*** case, based on the same calculation, the sum reaches 1.2 billion dollars.

Table 9. Change on independent variables by quarters (in %) – End of 1993 to end of 2004



Source: "Levant Dataset", Kansas Events Data System (KEDS) and Personal Adaptation

Besides this estimation that is based on *average* figures, Table 9 shows that acute changes were registered in the conflict variables in particular periods (specially during the Second Intifada), changes that may altered economic life of the whole Israeli population.

The other side of the coin and the more optimistic one is that progress on IPC resolution positively fosters Israeli exports to the EU. All this critical information based on this research might be taken into account not only by foreign policy designers but also by Israeli economic leadership as according to the exposed empirical evidence, "security" policy is an inherent part of "trade" policy.

Those inferences are relevant not only for Israeli leadership but for other statesmen that rule countries involved in intractable conflicts that had never ended, such as the Pakistani-Indian Conflict, were its immediate resolution is unlikely.

Israeli "conflict-managers" might read the "writing on the wall" that from now is statistically proved as well: conflict is economic damaging, but more important, cooperation is worthy in the short term.

Bibliography

Anderson, J. E. and E. van Wincoop. 2003. "Gravity with Gravitas: A Solution to the Border Puzzle", *American Economic Review*, 93 (1): 170–92.

Anderson, J. E. and E. van Wincoop. 2004. "Trade Costs", *Journal of Economic Literature*, 42 (3): 691–751.

Anderton, C. H. and J. R. Carter. 2001a. "The Impact of War on Trade: An Interrupted Times-Series Study," *Journal of Peace Research*, 38 (4): 445-457.

Anderton, C. H. and J. R. Carter. 2001b. "On Disruption of Trade by War: A Reply to Barbieri & Levy", *Journal of Peace Research*, 38 (5): 625-628.

Barbieri, K. 1996. "Economic Interdependence: A Path to Peace or a Source of Interstate Conflict?" *Journal of Peace Research*, 33 (1): 29-49.

Barbieri, K. and R. Alan Peters II. 2003. "Measure for Mis-Measure: A Response to Gartzke & Li", *Journal of Peace Research*, 40 (6): 713-719.

Barbieri, K. and J. S. Levy. 1999. "Sleeping with the Enemy: The Impact of War on Trade," *Journal of Peace Research*, 36 (4): 463-479.

Barbieri, K. and G. Schneider. 1999. "Globalization and Peace: Assessing New Directions in the Study of Trade and Conflict," *Journal of Peace Research*, 36 (4): 387-404.

Bayer, R. and M. C. Rupert. 2004. "Effects of Civil Wars on International Trade, 1950-92," *Journal of Peace Research*, 41 (6): 699-713.

Beck, N., J. N. Katz and R. Tucker**.** 1998. "Taking Time Seriously: Time-Series-Cross-Section Analysis with a Binary Dependent Variable", *American Journal of Political Science*, 42 (4): 1260-1288.

Bliss, H. and B. Russett. 1998. "Democratic Trading Partners: The Liberal Connection, 1962-1989", *Journal of Politics*, 60 (4): 1126-1147.

Bliss, H. and B. Russett. 1999. " Democracy and Trade: Ties of Interests and Community" In G. Geeraerts and P. Stouthuysen (ed.), *Democratic Peace for Europe: Myth or Reality*, pp. 75-89. Brussels: Vub University Press.

Cheng, I. and H. J. Wall. 2004. "Controlling for heterogeneity in gravity models of trade and integration," Working Papers 1999-010, Federal Reserve Bank of St. Louis.

Copeland, D. C. 1996. "Economic Interdependence and War: A Theory of Trade Expectations"**,** *International Security*, 20 (4): 5-41.

Declaration of Principles on Interim Self-Government Arrangements, Washington D. C., 13 September 1993.

de Groot, H. L. F., G. Linders, P. Rietveld and U. Subramanian. 2004. "The Institutional Determinants of Bilateral Trade Patterns," *Kyklos*, 57 (1): 103-123.

de Vries, M. S. 1990. "Interdependence, Cooperation and Conflict: An Empirical Analysis", *Journal of Peace Research*, 27 (4): 429–444.

Dorussen, H. 2006. "Heterogeneous Trade Interests and Conflict: What You Trade Matters", *Journal of Conflict Resolution*, 50 (1): 87–107.

Eichengreen, B. and D. A. Irwin. 1996. "The Role of History in Bilateral Trade Flows," NBER Working Papers No.5565, May 1996.

Estevadeordal, A., B. Frantz and A. M. Taylor. 2003. "The Rise and Fall of World Trade, 1870-1939," *The Quarterly Journal of Economics*, 118 (2): 359-407.

European Commission Site, EU and the World, Trade Issues, Bilateral Trade Relations with Israel. Available at: (http://ec.europa.eu/trade/issues/bilateral/countries/israel/index_en.htm)

Gasiorowski, M. 1986. "Economic Interdependence and International Conflict: Some Cross-National Evidence", *International Studies Quarterly*, 30 (1): 23-38.

Gasiorowski, M. and S. W. Polachek. 1982. "Conflict and Interdependence", *Journal of Conflict Resolution*, 26 (4): 709-729.

Gartzke, E. and Q. Li. 2003a. "Measure for Measure: Concept Operationalization and the Trade Interdependence–Conflict Debate", *Journal of Peace Research*, 40 (5): 553–571.

Gartzke, E. and Q. Li. 2003b. "All's Well That Ends Well: A Reply to Oneal, Barbieri & Peters", *Journal of Peace Research*, 40 (6): 727–732

Gartzke, E. and Q. Li. 2003c. "War, Peace, and the Invisible Hand: Positive Political Externalities of Economic Globalization", *International Studies Quarterly*, 47 (4):561–586.

Gartzke, E. and Q. Li. 2003d. "Mistaken Identity: A Reply to Hegre", *Conflict Management and Peace Science*, 22 (3): 225-234.

Gartzke, E., Q. Li and C. Boehmer. 2001. "Investing in the Peace: Economic Interdependence and International Conflict", *International Organization*, 55 (2): 391-438.

Gerner, D. J., P. A. Schrodt, Ö. Yilmaz and R. Abu-Jabr. 2002. "Conflict and Mediation Event Observations (CAMEO): A New Event Data Framework for the Analysis of Foreign Policy Interactions", Paper prepared for the Annual Meeting of the International Studies Association, New Orleans, March 2002. Available at: (http://web.ku.edu/keds/papers.dir/gerner02.pdf)

Glick R., A. M. Taylor. 2005. "Collateral Damage: Trade Disruption and the Economic Impact of War, "NBER Working Paper No. 11565, August 2005.

Goenner, C. F. 2004. "Uncertainty of the Liberal Peace", *Journal of Peace Research*, 41 (5): 589-605.

Goldstein, J. A. 1992. "A Conflict-Cooperation Scale for WEIS Events Data," *Journal of Conflict Resolution*, 36 (2): 369-385.

Granger, C. W. J. 1969. "Investigating Causal Relations by Econometric Models and Cross Spectral Methods", *Econometrica*, 37 (3): 428-438.

Hazony, Y. 1996. "The End of Zionism?" *Azzure*, 1 (summer 5756): 74-88.

Hegre, H. 2005. "Identifying How Trade Matters in Empirical Studies of Interstate Conflict", *Conflict Management and Peace Science*, 22 (3): 217-224.

Keshk, O. M. G., B. M. Pollins and R. Reuveny. 2004. "Trade Still Follows the Flag: The Primacy of Politics in a Simultaneous Model of Interdependence and Armed Conflict", *Journal of Politics*, 66 (4): 1153–1179.

Kinsella, D. and B. Russett. 2002. "Conflict Emergence and Escalation in Interactive International Dyads", *Journal of Politics*, 64 (4): 1045-1068.

Krustev, V. L. 2006. "Interdependence and the Duration of Militarized Conflict", *Journal of Peace Research*; 43 (3): 243-260.

Lavy, I. and A. Fridman. 2006. "The Real Exchange Rate and the Israeli Foreign Trade", Bank Israel Survey No. 79, December 2006, Research Department, Bank Israel. (http://israbank.gov.il/deptdata/mehkar/seker79/surv79_2.pdf)

Li, Q. and D. H. Sacko. 2002."The (Ir)Relevance of Militarized Interstate Disputes for International Trade, *International Studies Quarterly*, 46 (1): 11-43.

Lord, A. 1998. "Oslo, the Bomb and Other Homed Remedies", *Azzure*, 4 (summer 5758): 117-136.

Mansfield, E. D., H. V. Milner and B. P. Rosendorff. 2000. "Free to Trade: Democracies, Autocracies and International Trade", *American Political Science Review*, 94 (2): 305-321.

Maoz, Z. 2006. "Network Polarization, Network Interdependence, and International Conflict, 1816–2002", *Journal of Peace Research*, 43 (4): 391-411.

Maoz, Z, R. D. Kuperman, L. Terris, and I. Talmud. 2006. "Structural Equivalence and International Conflict: A Social Networks Analysis", *Journal of Conflict Resolution*, 50 (5): 664 - 689.

Martin, P., T. Mayer and M. Thoenig. 2005. "Make Trade not War?" CEPR Discussion Papers No. 5218, C.E.P.R. Discussion Papers, September, 2005.

Morrow, J., R. Siverson and T. Tabares. 1998. "The Political Determinants of International Trade: The Major Powers, 1907-90", *American Political Science Review*, 92 (3): 649-661.

Morrow, J., R. Siverson and T. Tabares. 1999. "Correction to "The Political Determinants of International Trade", *American Political Science Review*, 93 (4): 931-933.

Oneal, J. R., F. H. Oneal, Z. Maoz and B. Russett. 1996. "The Liberal Peace: Interdependence, Democracy and International Conflict, 1950-1985", *Journal of Peace Research*, 33 (1): 11-28.

Oneal, J. R. and B. Russett. 1999a. "Assessing the Liberal Peace with Alternative Specifications: Trade Still Reduces Conflict", *Journal of Peace Research*, 36 (4): 423-442.

Oneal, J. R. and B. Russett. 1999b. "The Kantian Peace: The Pacific Benefits of Democracy, Interdependence, and International Organizations, 1885-1992", *World Politics*, 52 (1): 1-37.

Oneal, J. R. and B. Russett. 2001. "Clean and Clear: The Fixed Effects of Liberal Peace", *International Organization*, 55 (2): 469-485.

Oneal, J. R. and B. Russett. 2005. "Rule of Three, Let It Be? When More Really is Better", *Conflict Management and Peace Science*, 22 (4): 293-310.

Oneal, J. R., B. Russett and M. L. Berbaum. 2003. "Causes of peace: Democracy, interdependence, and international organizations, 1885-1992", *International Studies Quarterly*, 47 (3): 371-393.

Polachek, S. 1980. "Conflict and Trade", *Journal of Conflict Resolution*, 24 (1): 57-78.

Polachek, S. and C. Seiglie. 2006. "Trade, Peace and Democracy: An Analysis of Dyadic Dispute," IZA Discussion Papers 2170, Institute for the Study of Labor (IZA).

Pollins, B. M. 1989a, "Conflict, cooperation, and Commerce: The Effect of International Political Interactions on Bilateral Trade Flows", *American Journal of Political Science*, 33 (3): 737-61.

Pollins, B. M. 1989b. "Does Trade Still Follow the Flag?" *American Political Science Review,* 83 (2): 465-80.

Ray, J. L. 2005. "Constructing Multivariate Analysis (of Dangerous Dyads)", *Conflict Management and Peace Science*, 22 (4): 277-292.

Reuveny, R. 2003. "Measuring Conflict and Cooperation: An Assessment" In E. Mansfield and B. Pollins (eds.), *New Perspectives on Economic Exchange and Armed Conflict,* Ann Arbor, MI: University of Michigan Press.

Reuveny, R. and H. Kang. 1996. "International Trade, Political Conflict/Cooperation, and Granger Causality ", *American Journal of Political Science*, 40 (3): 943-970.

Reuveny, R. and H. Kang. 1998. **"**Bilateral Trade and Political Conflict/Cooperation: Do Goods Matter?" *Journal of Peace Research*, 35 (5): 581-602.

Robst, J., S. Polachek and Y. Chang. 2006. "Geographic Proximity, Trade and International Conflict/Cooperation", *Conflict Management and Peace Science*, 24 (1): 1-24.

Said, E. W., "The Mirage of Peace," The Nation, 16 October 1995.

Schneider, G. and G. Schulze. 2005. "Trade and Armed Conflict: The Domestic Foundations of Commercial Liberalism", *Mimeo*, University of Konstanz.

Schrodt, P. A. and D. J. Gerner. 1994. "Validity Assessment of a Machine-Coded Event Data Set for the Middle East, 1982-1992", *American Journal of Political Science*, 38 (3): 825-854.

Schrodt, P. A., E. M. Simpson and D. J. Gerner. 2001. "Monitoring Conflict Using Automated Coding of Newswire Reports: A Comparison of Five Geographical Regions," Uppsala, June 2001.

Tirado Chase, A. B. 1997. "Edward Said's Anti-Oslo Writings", Middle East Quarterly, 4(1). Available at: (http://www.meforum.org/article/342)

Ward, M. D. and P. D. Hoff. 2004. "Modeling Dependencies in International Relations Networks ", *Political Analysis*, 12(2): 160-175.

Ward, M. D. and P. D. Hoff. 2007. "Persistent Patterns of International Commerce", *Journal of Conflict Resolution*, 44 (2): 157-175.

Data Appendix

This section is aimed to supply a more detailed description of the sources of different used data in this research.

Area of Residential Building in Judea, Samaria and Gaza by Initiating Actor: this data was obtained from five different Statistical Abstract of Israel (No. 47, No. 48, No. 50, and No. 52) published by the Israeli Central Bureau of Statistics (CBS). The concrete data is taken from Section 22 ("Construction"), Table 22.2 of each edition. Available at: http://www.cbs.gov.il/archive/shnaton52/download/st22_02.xls

Number of Killed people in the Israeli-Palestinian Conflict (1995-2005): the data was extracted from the B'Tselem site (http://www.btselem.org), "Statistics" section, "Fatalities" section, "Intifada fatalities" sub-section (http://www.btselem.org/english/statistics/Casualties.asp). Data before September 2000 can be found (per years) in "First Intifada Table" link (http://www.btselem.org/english/Statistics/First_Intifada_Tables.asp). The same data but per quarters was directly provided by B'Tselem offices in Jerusalem.

Israel-EU bilateral trade relations: All data concern trade relations between Israel and EU were taken from "Foreign Trade Statistics Monthly" published by the CBS (Obtainable at: http://www1.cbs.gov.il/reader/fr_trade/ftmenu_h_v1_new.htm), Section d. (Trade Countries), Table 4 (Imports and Exports by Commodity Group and by Country). The Data used in the "background" section was taken from the EU option. However, the ***trade*** variable was composed by the sum of Israeli exports items to the fifteen countries that composed the EU 15.

Cooperation and Conflict between Israel and Palestinians (1993-2004): The Kansas Event Data System (KEDS) project of the University of Kansas is developed in five geographical areas: the Levant (Middle East), Persian Gulf, former Yugoslavia, Central Asia, and West Africa (Schrodt, Simpson and Gerner, 2001).

The used data in this paper was extracted from the Kansas Events Data System (KEDS), "Data" section, "Levant" option (Obtainable at: http://web.ku.edu/keds/data.dir/levant.html).

EU Imports to the world: Data extracted from the "OECD Statistics Dissemination Project" (http://www.oecd.org/document/58/0,3343,en_21571361_33915056_39384378_1_1_1_1,00.html), "OECD Statistics, beta 1.0." service, "International Trade and Balance of Payments" theme, in the "International Trade (MEI)" dataset. The "International Trade (MEI)" dataset is a subset of the Main Economic Indicators (MEI) database which contains predominantly monthly statistics, and associated statistical methodological information, for the 30 OECD Member countries. The MEI database contains a wide variety statistics that can be classified as Short-Term Economic Statistics. (Obtainable at: http://stats.oecd.org/wbos/default.aspx)
For further details on methodology, see "Methodology for compiling area totals in the MEI" (http://www.oecd.org/document/56/0,2340,en_2649_33715_2073848_1_1_1_1,00.html

Israeli Industrial Production Index: Index extracted from Bank of Israel site, "Series Database", "Industry" section, "Industrial production index - total (excl. diamonds)" (Available at: http://www.bankisrael.gov.il/series/en/series-additional-info.html?series=TPR.M).

Israeli Exports as a percentage of GDP: Data extracted from Statistical Abstract of Israel No. 58, Section 14, Table 14.2 compiled by CBS. (Available at: http://cbs.gov.il/shnaton58/download/st14_02x.xls).