## SUMMARY

1. Israel has not been spared the effects of the global economic crisis, but its financial system has weathered the crisis comparatively well. Since its last TPR, in 2006, real GDP growth has averaged around 5% per year, only interrupted by a sharp decline in growth in 2009. Recently, there are again signs of slowing economic activity. The resilience and stability of the financial system has been attributed, *inter alia*, to cautious lending and limited exposure to "toxic" assets by Israeli banks, and a conservative supervisory approach by the Bank of Israel. There was no need for any bank bailout or major stimulus programme, although the Government has substantially increased its exposure to credit guarantees in order to stimulate exports. Public debt as a percentage of GDP has been reduced (74% in 2011).

2. Israel is a high-income country with a GDP per capita of US$31,000 in 2011, up from US$17,700 ten years earlier. Its GDP of about US$240 billion is roughly equal to the size of Singapore's. Some of Israel's main economic challenges lie in the high burden of defence spending, low labour-market participation among certain communities, and resulting income inequality. Israel has been largely dependent on imports for its energy needs, but major discoveries of offshore natural gas may change its economic prospects.

3. The Israeli economy is dominated by high-tech goods and services. The main high-tech (non-defence) activities are in the area of computer components manufacturing, software engineering, medical technologies, and pharmaceuticals. Israeli businesses also play an important role in the world's diamond industry.

4. One of the core strengths of the Israeli economy is its capacity for innovation, be it in agriculture or the high-tech sector. Expenditure on civilian R&D amounted to about 4.4% of GDP in 2010, the highest share in the world. Israel's innovation policy encourages domestic R&D in generic and applied technologies, including the development and acquisition of intellectual property rights, through a range of incentive schemes. The availability of domestic and foreign venture capital further encourages start-up companies.

5. A significant share of foreign direct investment is made in Israeli start-up companies. Investments in the industrial sector benefit from export-contingent incentives. Israel maintains foreign ownership restrictions in a few sectors, including air and maritime transport, telecommunications and broadcasting, energy, and tourism, mainly for public interest, (energy) security and cultural reasons. There is no special approval or screening process for investments by foreigners.

6. Israel is a relatively export-oriented economy. Its trade continues to be affected by the geopolitical situation that prevails in the Middle East, which seriously impedes trade between Israel and its neighbours. The European Union and the United States remain Israel's main trading partners, although Israel's trade with Asia continued to increase over the review period. The current account has been in surplus since 2003.

7. Israel pursues trade liberalization through active participation in the DDA negotiations, bilaterally through reciprocal preferential agreements, and unilaterally through autonomous initiatives. Israel's network of FTAs covers some of its main trading partners (EU, United States, EFTA, and Turkey), although none of its FTAs currently includes services provisions. Since its last TPR, Israel has concluded a free-trade agreement with MERCOSUR, and Israel and the European Union have further liberalized their bilateral trade in agricultural products. FTA negotiations have been launched

with India and Colombia. Nonetheless, the relative importance of trade via free-trade agreements has steadily declined due to the rising importance of trade with Asian countries.

8. In the summer of 2011, Israel experienced unprecedented popular protests against the high cost of living, triggered by consumer complaints about high prices of some dairy products ("cottage cheese uprising"). In response, and as part of a package of reforms, the Government has unilaterally dismantled some import barriers. Applied MFN tariffs on a range of non-food consumer goods were eliminated with immediate effect (400 tariff lines at HS 8-digit level). In July 2012, the Government announced a further unilateral initiative to eliminate or reduce import duties on items such as electrical appliances, textiles and apparel, and food.

*Trade policy measures*

9. Israel's average applied MFN tariff is 7% in 2012. Over half of the tariffs are duty-free lines, and less than 5% of tariff lines exceed the 20% rate. The average applied MFN tariff on non-agricultural products is relatively low (4.2%), while tariffs on agricultural goods (WTO definition), average 24.5%. For agricultural products, market-access opportunities are provided, *inter alia*, by duty-free access (i.e. about one third of applied MFN tariffs are zero), preferential tariffs, and over 100 agricultural tariff quotas (MFN and preferential). Numerous mixed or compound MFN duties add complexity to the agricultural tariff regime. Israel has not yet transposed its Schedule of concessions from HS 1996 nomenclature, which makes a comparison with its applied MFN tariffs (HS 2012) difficult because of the difference in nomenclatures.

10. Since its last TPR, Israel has launched trade facilitation initiatives for authorized economic operators and couriers (pre-clearance of air shipments). On the other hand, Israel maintains non-automatic import licensing procedures on a vast range of products for various reasons, such as health, safety, security, and tariff-quota administration. Up-to-date notifications would help improve the transparency of these import procedures. In general, Israel's notification record has been mixed. There is room for improvement in a number of areas where Israel has outstanding notification obligations, such as agriculture, regional trade agreements, and import licensing.

11. Israel maintains export licensing and approval (permit) schemes but there are no export taxes or levies. Israel has not used export subsidies on agricultural products since 2010. One export state-trading enterprises is active in the groundnut sector.

12. Israel has made considerable progress in aligning its technical regulations and food standards with mandatory standards of international, regional or foreign origin. The Government aims to accomplish full harmonization of Israeli technical regulations with overseas mandatory standards by end-2012 (end-2013 for food standards). Israel has notified three new or revised SPS measures since its last TPR in 2006. The SPS notifications concern alignment of Israel's phytosanitary import requirements with international standards, and an amendment of BSE-related import requirements.

13. Israel remains a significant user of anti-dumping measures, but overall the incidence of new measures remains within the long-term trend. During the review period, Israel introduced safeguard legislation to implement the WTO Agreement on Safeguards and initiated two safeguard investigations.

14. Israel applies value-added tax on imported and domestic goods and services currently at the rate of 16%. A number of items, including fruit and vegetables, are zero-rated. Certain luxury and consumer goods, as well as alcoholic beverages are subject to purchase tax. For the assessment of purchase tax on imported products, Israel uses a type of surcharge, called TAMA, which approximates domestic wholesale prices. A tax reform for alcoholic beverages is to be implemented

by 2014, whereby TAMA will be cancelled and replaced by a specific tax on domestic and imported alcoholic beverages alike.

15. Israel is party to the Agreement on Government Procurement (GPA) and has participated in the negotiations of the revised GPA. Israel has made a number of market-access commitments that enhance the opportunities for foreign companies to compete in its government procurement market. It has also undertaken to phase out its offset regime with respect to procurement covered by GPA. It will progressively reduce the current 20% offset level and eliminate offsets entirely after 15 years from the entry into force of the revised GPA for Israel. The Israeli tenders legislation has been reformed since 2006.

16. Israel has a well developed intellectual property system, which underpins the country's status as one of the most innovative economies. A significant development in Israeli intellectual property law is the introduction of the Copyright Act 2007, which, *inter alia*, replaced the doctrine of fair dealing with that of fair use, thus providing a more flexible approach to copyright exceptions - an exceptional step that few jurisdictions have taken so explicitly. Israel has reached an agreement with the United States to amend certain pharmaceutical IPR provisions relating to patent-term extension, patent-application publication, and data exclusivity.

*Sector developments*

17. Israel continues to face competition-related challenges for reasons such as high tariff protection (agriculture), the small size of the economy, a certain degree of geographic isolation with little regional trade and language barriers, contributing to market-entry barriers. One of the Government's key policy objectives has been to enhance competition in the domestic market. Since its last TPR in 2006, it has made a series of structural reforms in various sectors to strengthen competition in the economy, including in financial services, telecommunications, and transport services. Moreover, a reform of the competition law in the area of oligopolies has been enacted.

18. The services sector is the leading economic activity in Israel, accounting for around three quarters of GDP and employment. Far-reaching structural reforms have been carried out in Israel's financial services sector since 2006, to promote competition and enhance the efficiency of financial intermediation. The capital market reform (Bachar reform) has fundamentally transformed the landscape of Israel's financial system by requiring banks to sell their holdings in mutual and provident funds, in order to break up the high level of concentration in the sector. Insurers and other intermediaries, including foreign enterprises, have entered the market for those financial services that were traditionally controlled by banks. The Israeli market has been opened to foreign underwriters, investment advisers, and portfolio managers to provide their services in Israel.

19. The Government has introduced further reforms in the telecommunications market with the aim of stimulating price competition and service innovation among operators. Reforms include a substantial reduction of mandatory interconnection fees; improved portability; an incentives-based regulatory regime to encourage the establishment of wholesale markets for fixed-line and mobile telephone services (mandated access to fixed networks, mobile virtual network operators), and promotion of infrastructure-based competition by granting additional UMTS network licences. The establishment of an independent regulatory authority for telecommunications is still under consideration by the Government.

20. Israel is a net-importer of transportation services; most of Israel's trade is done by sea or air. Since its last Review, Israel has further reformed its port subsector to stimulate competition and increase the ports' lagging productivity. A new port-user fee scheme, introduced in October 2010, is

being phased in, to put an end to imports effectively cross-subsidizing exports, and to base the tariffs on costs. The new scheme also encourages night-time cargo handling. Privatization of Israel's state-owned port companies began in 2010.

21. The Government reformed its air transport policies, during the review period, to encourage more competition between airlines. The Antitrust Law was amended to remove airlines' immunity from legal scrutiny of commercial arrangements that are likely to harm competition. A number of anti-competitive code-share agreements have since been disallowed by the Israel Antitrust Authority. The Government has concluded more liberal air services agreements with the United States, Colombia, and the EU, as well as with other aviation partners to allow for multiple designation of airlines on scheduled routes and carriers' freedom to determine frequency and capacity of flights.

22. The manufacturing sector contributes about 15% to GDP and employment. The relatively labour-intensive traditional industries, such as the food and textiles industries, have declined further as a share of manufacturing GDP, reflecting Israel's comparative advantage in capital-intensive high-tech goods. The Government's main policy initiatives to strengthen the competitiveness of Israel's manufacturing sector include establishing of a more favourable tax environment for manufacturers within the framework of the reform of the Law on Encouragement of Capital Investment, and substantially increasing assistance for R&D. Other policy developments include the sector's greater openness to (duty-free) manufacturing imports resulting from unilateral trade liberalization and Israel's enlarged network of FTAs.

23. Israel's agriculture sector is small (about 2% of GDP). Israel has traditionally been a net-importer of agricultural products. Land-intensive crops, such as wheat, sugar, and oilseeds are mostly imported. With its mild climate and advanced technologies, Israel has been exploiting its comparative advantage in fruit, vegetable, and flower production. The Government influences the productivity and competitiveness of the agriculture sector, *inter alia*, through its control over the allocation of, and assistance for, basic factors of production (land, water, and foreign labour). For food security reasons, the Government has a strong regulatory role, particularly in the dairy and egg sectors. The dairy sector is tightly regulated and controlled throughout the production chain, with measures ranging from milk production quotas, to retail price controls of some basic dairy products. MFN tariffs on dairy products average almost 110%. Overall, Israel's level of support for its agriculture sector is one of the lowest among all OECD members. Border measures, notably tariffs, remain Israel's main instrument of support to agriculture. The "bill" for agricultural support is paid mainly by Israeli consumers - they would benefit from the opening of Israel's food markets to more import competition.