GENERAL AGREEMENT

TARIFFS AND TRADE

RESTRICTED
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Limited Distribution

Committee on Balance-of-Payments Restrictions

1993 CONSULTATION WITH ISRAEL

Background Paper by the Secretariat

1. This paper has been prepared in accordance with paragraph 7 of the Declaration on Trade Measures Taken for Balance-of-Payments Purposes adopted by the CONTRACTING PARTIES on 28 November 1979 (BISD 26S/205-209).

I. Previous consultation with Israel

2. Israel has consulted with the Committee on 20 occasions (between 1960 and 1991). At the last consultation held on 26 November 1991, the Committee noted the improvement in Israel's current account position in 1989 and 1990. It also noted that Israel's balance-of-payments deteriorated in 1991 and was likely to come under pressure, as a result, inter alia, of the economic consequences of sharply increased immigration.

3. At this meeting, the Committee welcomed the fact that Israel, as a part of a comprehensive trade liberalization programme, abolished most non-tariff measures introduced for balance-of-payments reasons and replaced them by temporary higher tariffs with a timetable for reduction.

4. The Committee also noted that import licences were still maintained on agricultural products, and that the tariffication of import restrictions had resulted in high temporary tariffs applied to m.f.n. sources. Some members referred to the possibility of discriminatory effects resulting from the non-application of such tariffs to free-trade-area sources and asked Israel to take steps to minimize any harmful effects. They also called attention to the fact that Israel, in introducing additional temporary charges on four tariff items, had exempted some m.f.n. partners from their application and urged Israel, in line with its undertaking to the Committee, to bring these charges into conformity with the General Agreement.

5. The Committee encouraged Israel to continue the process of import liberalization, including the acceleration of its tariff reduction programme, and to announce a time schedule for the phasing out of remaining restrictions in place for balance-of-payments purposes, including the import levy (BOP/R/195, para. 27 to 30).

II. Main changes in Israel's trade system since the last consultation

(a) Import licensing and customs duties

6. As stated in Israel's Basic Document for the last consultation with the Committee, since September 1991, all quotas and most non-tariff restrictions on imports from third countries (i.e., those not covered by free-trade agreements) have been abolished and replaced by higher tariffs. Licences

goods.[1] Prior import licences, for monitoring reasons, are still required until September 1994, for imports considered sensitive such as textiles, clothing, footwear, plywood, and fertilizers. Licences for this category of items are issued automatically (Bank of Israel, Annual Report 1991).

7. Most products from the U.S., the E.C. and EFTA receive duty free treatment in the Israeli market under the free trade agreements concluded with these countries. High duties apply to imports from the rest of the world. For these, an ongoing liberalization programme has set tariffs of 20 to 75 per cent (with the exception of textiles and wood, for which tariffs range up to 110 per cent).[2] The programme is due to gradually (each year) and linearly reduce tariffs to a range of 8 to 12 per cent, according to the category of the product, over a period of 5 to 7 years.[3] At the end of the programme, customs duties will be at a level of 8 per cent for raw materials and 12 per cent for intermediate and finished goods. Agricultural imports are excluded from the liberalization programme.

(b) Import levy

8. A temporary import levy is still applied to imports of all products at the rate of 2 per cent. This levy was introduced in 1982 with the purpose of reducing Israel's balance-of-payments deficit. In August 1992, the Government of Israel announced to the GATT that the level of the import levy would be reduced to 1 per cent not later than 31 December 1994 (L/7092).

9. The additional temporary import surcharge introduced in September 1991, (see paragraph 4) was abolished on 1 January 1993.

(c) Foreign exchange

10. Foreign exchange to pay for authorized imports is granted automatically by the banks upon presentation of relevant documents (import documents, bills of lading and letters of credit). Advance payments for imports to be supplied within one year were permitted as of July 1992. Previously, importers were authorized to transfer up to 35 per cent of the order or US$50,000, whichever was higher.

11. In July 1992, all Israeli residents were permitted to keep foreign currency they recieve from abroad in resident foreign currency accounts (so-called PAMAH accounts), purchase foreign securities on approved foreign stock exchanges and purchase Israeli shares quoted overseas. Residents may not keep bank accounts abroad, or purchase foreign currency with cash, except for up to US$3,000 for travel abroad. Exporters may deposit 10 per cent of their foreign currency earnings in foreign banks for up to a year, but the rest must be deposited with a local bank (although this may be kept in foreign currency). As of end-April 1992, residents were allowed to own and engage in the trade of gold ingots and coins.

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[1]International Monetary Fund, Exchange Arrangements and Exchange Restrictions, Annual Report 1992.

[2]A detailed comprehensive list of duty increases implemented in September 1991 was provided by the Government of Israel in Annex I to its Basic Document for the 1991 consultation (BOP/307).

[3]The specific timetable for tariff reductions and the final duties were attached as Annex II to document BOP/307 presented by Israel.

12. The 4 per cent tax on the purchase of foreign currency was due for abolition on 1 January 1993.

(d) Customs valuation practices

13. As noted in document BOP/W/141, in 1990, the "TAMA" practice, under which declared import values were raised for domestic taxation purposes, was amended; registered importers now have the option of declaring the actual wholesale value of their products in the same way that domestic producers do. However, it is reported that this option has not been used by importers. Israel's customs valuation system (HARAMA) remains in effect, allowing uplift adjustments of virtually all products imported into Israel by exclusive agents. The adjustments are made within a range of 2 to 10 per cent.

(e) Other recent developments

14. On 17 September 1992, Israel signed a Free Trade Agreement with EFTA States (Austria, Finland, Iceland, Liechtenstein, Norway, Sweden and Switzerland) which entered into force on 1 January 1993. The FTA covers trade in industrial products, fish and other marine products and processed agricultural products. Bilateral arrangements between Israel and each EFTA State provide for measures to facilitate trade in agricultural products. On the entry into force of the agreement, both the EFTA States and Israel eliminated all duties and other charges having equivalent effect on products covered by the agreement (L/7129).

III. Macroeconomic and Trade Developments[4]

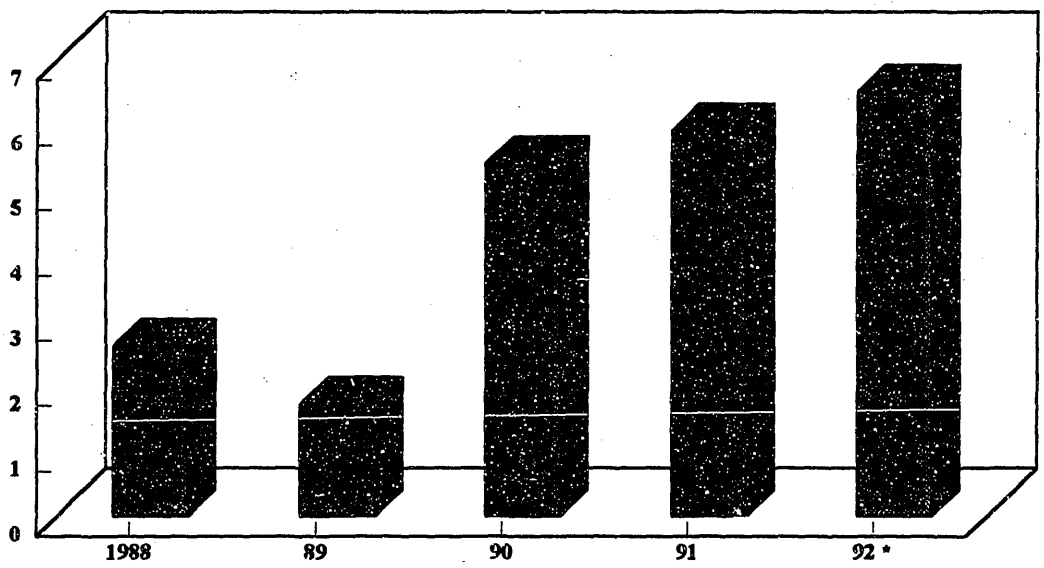
(1) Introduction and Overview

15. Real GDP growth of the Israeli economy averaged 6 per cent between 1990 and 1992, up from an average of some 2 per cent in 1988-89 (Graph 1). By far the most significant development in the past three years affecting the economy has been the very large inflow of immigrants. Net immigration since 1989 has expanded the total population by some ten per cent. This has had repercussions throughout the economy, giving rise to an increase in the rate of unemployment from 8.9 per cent to 11.2 per cent between 1989 and 1992, a decline in the rate of nominal wage inflation (from 23 per cent in 1988 to 13 per cent in 1992), a very substantial rise in gross fixed investment in 1990-91 (mostly in government financed or guaranteed construction of dwellings), and strong growth in aggregate demand.

16. In 1992 the net inflow of immigrants fell to 75,000, down from around 180,000 per year on average in 1990-91. Consequently, the government scaled back its housing investment programme, and aggregate demand growth slowed. This was offset by an increase in export earnings from both merchandise and services (tourism), as the foreign sector recovered from the disruption caused by the Gulf war and benefitted from an improvement in international competitiveness (a decline in the real effective exchange rate). Inflation fell substantially in 1992, standing at 9.5 per cent at the end of the year, reflecting the fall in wage inflation and a decline in the growth of housing prices. Despite the rise in the outlays of the government associated with public investment in housing and income support for new immigrants, government expenditures as a proportion of GNP remained stable during 1990-91, and are estimated to have fallen by 1.5 percentage points in 1992. As government revenues were roughly unchanged in 1992, the government's deficit expressed as a proportion of GNP fell by the same amount.

[4] Unless stated otherwise, all data reported in this section are drawn from IMF reports.

Graph 1 - Israel - Real GDP growth, 1988-92
(Annual percentage change)



*Preliminary.
Source: IMF.

17. Both national savings and investment increased significantly in the 1988-92 period, savings increasing by 27 per cent, (from 18.1 to 23 per cent of GDP), investment growing by 40 per cent, (from 17.5 to 24.6 per cent of GDP) (Table 1). Much of the rise in gross domestic investment after 1990 reflects public investment in housing. Between 1989 and 1991 private saving accounted for over 100 per cent of national savings, as the public sector dis-saved.[5] In 1989-90 the current account was in surplus, national savings exceeding gross investment in those years. However, the magnitude of the surplus declined by over half between 1989 and 1990. The declining trend continued in 1991 and 1992, with the current account shifting to a deficit of respectively 1.4 and 1.8 per cent of GDP, reflecting the fact that gross investment increased substantially faster than national savings. Between 1988 and 1992 the current account balance went from a surplus of 2.7 per cent of GDP in 1989 to a an estimated deficit of 1.8 per cent in 1992 (Graph 2).

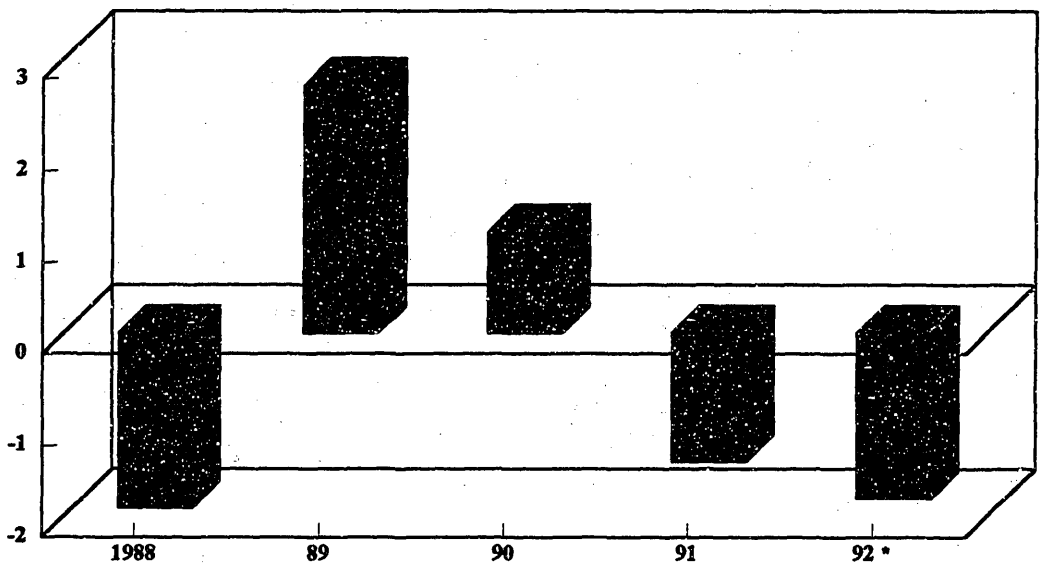
[5] Data allowing a breakdown of the gross investment data into a private and public sector component were not available. Savings-investment gaps for the public and private sector could therefore not be constructed.

Table 1
National saving, investment and the current account, 1988-92
(Percentage of GDP)

	1988	1989	1990	1991	1992
Gross investment	17.5	16.0	18.8	24.4	24.6
National saving	18.1	18.9	19.5	22.6	23.0
Private saving	17.5	21.1	20.8	22.9	20.5
Public saving	0.7	-2.2	-1.3	-0.3	2.5
Current account balance	-1.9	2.7	1.1	-1.4	-1.8

Source: IMF.

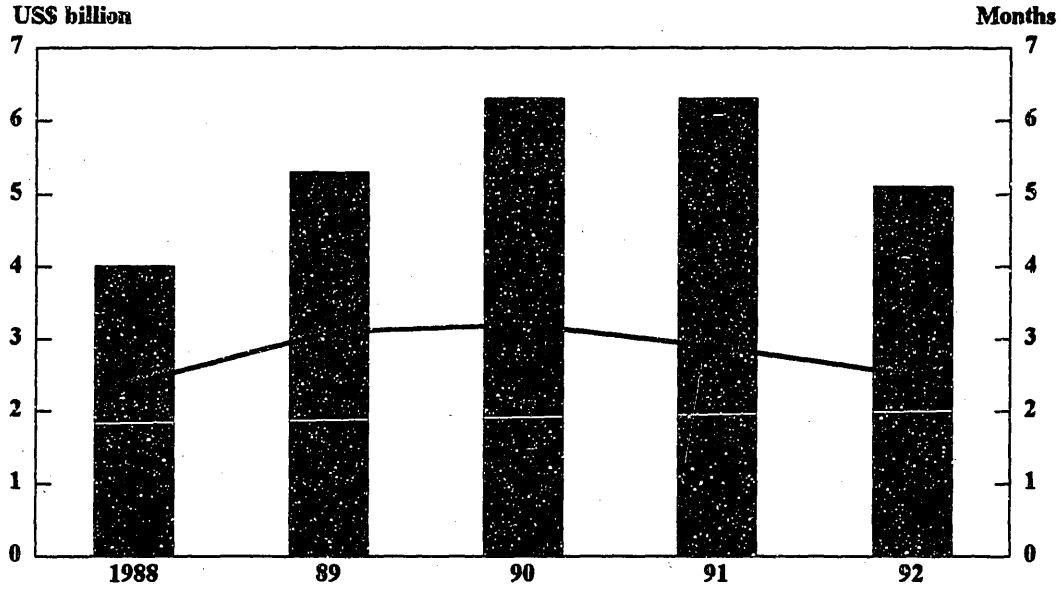
Graph 2 - Israel - Current account balance as a percentage of GDP



*Preliminary.
Source: IMF.

18. Official reserves have been equivalent to between 2.5 and 3 months of imports of goods and services since 1989, at the end of 1992 standing at US $5.1 billion, down from $6.3 billion in 1991 (Graph 3).

Graph 3 - Israel - Gross international reserves and months of imports of goods and services



*Estimates.
Source: IMF.

(2) Balance of payments

19. The value of merchandise exports has been rising slowly since 1989 (Table 2). Having been flat in 1990-91 at some US $12.2 billion, merchandise exports increased to $13.4 billion in 1992, an increase of almost ten per cent. Virtually all of this growth occurred in industrial products (see also Table 3 below), and was partly the result of the adoption of a "crawling peg" exchange rate system at the end of 1991, preceded by a 3 per cent devaluation of the shequel. As realized inflation in 1992 was significantly less than anticipated when the rate of crawl (depreciation) was set for 1992, the export sector's real international competitiveness improved. However, imports have risen much faster than exports, growing from $12.9 billion to $18.7 billion in 1992; thus rapid expansion was associated with the growth in aggregate demand and output resulting from the large scale immigration and the government's policy responses mentioned earlier.

20. Throughout the recent period Israel has run a merchandise trade deficit, which has increased steadily from some 4 per cent GDP to over 9 per cent in 1992. Israel has also registered deficits on its services accounts, although these declined between 1991 and 1992. The travel (i.e., tourism) account registered deficits in 1990 and 1991 as a result of the Gulf war, in contrast to an average surplus of some $200 million in 1987-89. In 1992 the travel account returned to a small surplus of $26 million, up from a deficit of $500 million in 1991. The balance on investment income has been negative throughout 1987-92, although the trend has been towards steadily smaller deficits. This largely reflects a rise in receipts, as payments were stable.

21. Despite the rise in services exports and the resulting strengthening of the services trade balance (largely due to the partial recovery in tourism receipts), the aggregate deficit on merchandise, services

and investment income remained virtually unchanged at US $7.2 billion (or 10.2 per cent of GDP) in 1992. This deficit was offset to large extent by net transfers from abroad of US $6.0 billion. Consequently, the current account deficit in 1992 stood at $1.2 billion, or 1.8 per cent of GDP. This compares to a $0.8 billion deficit in 1991 and a $0.6 billion surplus in 1990. Intergovernmental transfers fell by $1.6 billion in 1992 - in part as the result of the end of the Gulf war - and are currently back at the level of 1990. Private transfers have been expanding steadily since 1988, and approach the magnitude of net intergovernmental transfer flows.

22. Capital flows were further liberalized during 1992, continuing a process set into motion in the late 1980s. This has resulted in a significant change in the composition of capital flows. There has been both a shift from long term to shorter term net borrowing, and a large increase in the errors and omissions item, which grew from $0.7 billion in 1990 to $1.9 billion in 1992 (Table 2). The latter appears to reflect in large part the repatriation of capital following the liberalization of capital controls and the interest rate differentials between Israel and major currencies in the rest of the world. Taking into account the errors and omissions item, Israel's capital account has either been in rough balance or in surplus since 1989. The declining trend in the current account balance has therefore been accompanied by a similar trend for the overall balance of payments, which went from a surplus of $1.4 billion in 1989 (or 3.1 per cent of GDP) to an estimated deficit of $1.2 billion in 1992 (1.8 per cent of GDP). Total reserves increased between 1988 and 1990, growing from $4.0 billion to $6.3 billion (or 2.4 months of imports of goods and services to 3.2 months). After remaining stable in 1991 at $6.3 billion, reserves fell in 1992 to stand at US $5.1 billion at the end of the year (2.5 months of imports).

Table 2
Balance of payments, 1988-92 (US$ billion)

	1988	1989	1990	1991	1992[1]
Merchandise exports	10.1	11.2	12.3	12.2	13.4
Merchandise imports	-13.4	-12.9	-15.1	-16.9	-18.7
Merchandise trade balance	-3.3	-1.7	-2.8	-4.8	-5.4
Service exports	4.2	4.4	4.8	4.9	6.1
Service imports	-4.7	-5.0	-5.8	-6.5	-6.8
Services trade balance	-0.5	-0.6	-1.0	-1.6	-0.7
Net investment income	-1.6	-1.4	-1.2	-0.9	-0.9
Net transfers	4.6	4.9	5.7	6.4	6.0
Intergovernmental	(2.8)	(2.7)	(3.2)	(4.8)	(3.2)
Other transfers	(1.8)	(2.2)	(2.5)	(2.6)	(2.8)
Current account balance	-0.8	1.2	0.6	-0.8	-1.2
Medium longterm capital	-0.7	0.2	–	-0.2	-0.2
Short-term capital	-0.2	-1.3	-0.8	-0.6	-1.7

Table 2 (cont'd)

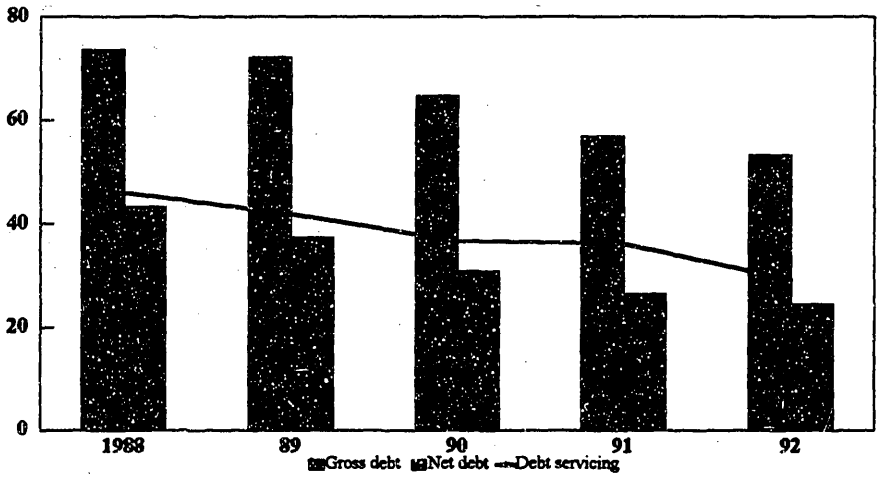
	1988	1989	1990	1991	1992[1]
Capital account balance	-0.9	-1.1	-0.8	-0.8	-1.9
Errors and omissions	0.2	1.3	0.7	1.6	1.9
Overall Balance	-1.5	1.4	0.5	--	-1.2
Memorandum item:					
Reserves[2]	4.0	5.3	6.3	6.3	5.1

[1] Estimate
[2] Foreign exchange, gold and SDRs
Source: IMF

External debt

23. The absolute magnitude of gross external debt has been relatively stable since the late 1980s. It stood at US $34 billion at end 1992, up from $32 billion in 1987. Given the growth rates of aggregate output (Graph 1), external liabilities as a share of GNP have declined significantly, falling from 90 per cent of GNP in 1987 to 53 per cent in 1992 (Graph 4).[6] Net external liabilities (i.e. net of official reserves and the foreign assets of commercial banks) are substantially smaller than gross liabilities, having fallen from 51 per cent of GNP to 24.5 per cent of GNP in 1992. The government accounted for about 78 per cent of total net debt in 1992, of which 63 per cent took the form of bonds. Debt-service ratios have also improved since the late 1980s, the ratio standing at 29 per cent in 1992, as compared to 46 per cent in 1988.

Graph 4 - Israel - Gross and net external debt as percent of GNP and debt service ratio



Note: Net external debt = gross external debt minus foreign assets of commercial banks, special reserves and export credit.

Source: IMF.

[6] It should be pointed out that there may be some upward bias with respect to the extent to which debt ratios improved given the large unrecorded capital flows in recent years (as reflected in the rise in the errors and omissions item on the capital account).

Direction and composition of merchandise trade

24. Israel's most important trading partner is the EC, which accounts for one-half of merchandise imports and one-third of merchandise exports (Graph 5). The other important trading partner is the United States. Together, the EC and the U.S. account for two-thirds of exports and imports. The pattern of trade has been relatively stable since 1988. The EC's import share has fallen slightly, while its export share has risen somewhat (by 1.5 and 1 percentage point, respectively). In relative terms, imports from Japan have increased substantially, rising by over 40 per cent since 1988.

25. The commodity composition of Israel's trade has undergone greater change. Imports of diamonds fell markedly between 1989 and 1991, whereas imports of both consumer and investment goods increased significantly (Table 3). During 1992 the rate of growth of investment goods imports declined, reflecting the slowdown in construction activity, while imports of consumer goods continued to expand. Export growth has been concentrated in industrial sectors (excluding diamonds), which now account for 70 per cent of total exports. Diamonds constitute another 25 per cent.

Table 3
Commodity Composition of Merchandise Imports and Exports, 1988-92
(Per cent of total)

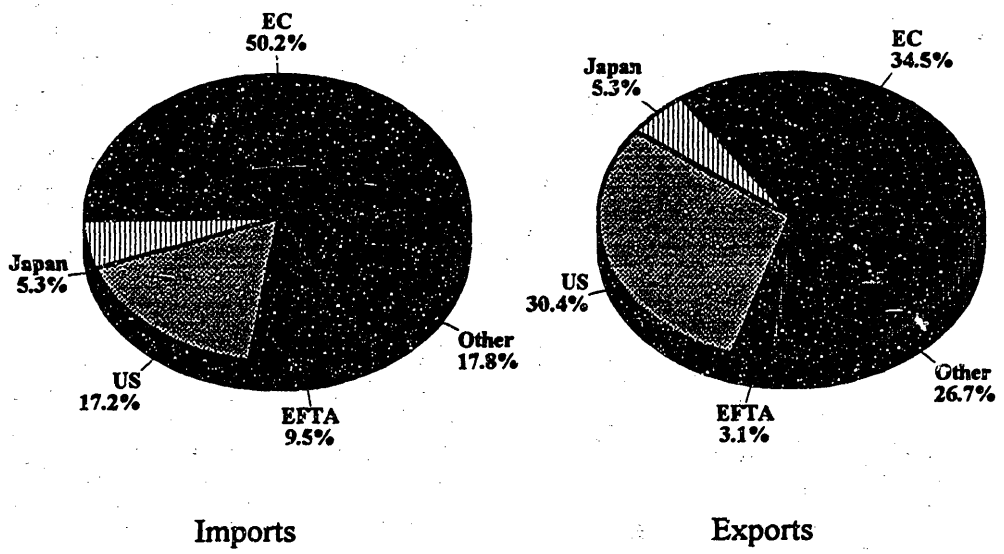
	1988	1989	1990	1991	1992
Imports					
Consumer goods	11.9	10.2	10.6	11.2	12.4
Nondurables	6.0	5.9	5.7	5.8	5.9
Durables	5.9	4.3	4.9	5.5	6.5
Intermediates	74.2	77.8	74.9	70.8	70.5
Diamonds	19.7	22.0	19.2	15.3	15.7
Fuels	8.6	9.6	10.2	8.8	9.2
Other	45.9	46.2	45.6	45.7	45.6
Investment goods	16.0	12.4	14.8	18.3	17.5
Machinery/equipment	11.1	9.5	19.8	12.7	12.1
Other, including re-exports	- 2.1	- 0.3	- 0.3	- 0.3	- 0.4
Total (US$ million)	12,287	13,027	15,107	16,688	18,557
Exports					
Agriculture	6.0	4.9	5.7	5.9	5.0
Citrus	1.9	1.2	1.6	1.5	1.4
Other fruit/vegetables	1.2	1.1	1.5	1.6	1.4
Other	2.9	2.6	2.6	2.8	2.2

Table 3 (cont'd)

	1988	1989	1990	1991	1992
Industrial (excl. diamonds)	66.6	65.9	67.6	69.8	70.4
Ores/minerals	2.9	2.9	2.5	2.7	2.5
Food, beverages	5.6	5.3	5.7	4.8	4.4
Textiles, clothing	6.8	5.9	6.8	7.6	7.7
Other light industrial	9.6	9.6	11.2	10.8	11.4
Chemicals	11.8	11.9	12.5	13.0	12.3
Machinery, electrics	30.0	30.3	28.9	31.0	32.1
Diamonds (net)	30.0	28.9	27.9	27.4	25.8
Total (US$ million)	9,445	10,669	11,603	11,219	12,444

Source: IMF.

Graph 5 - Israel - Direction of trade, 1992



Source: IMF.

Public finance and macroeconomic developments

26. As mentioned earlier, despite the burden imposed on the economy of absorbing the large scale immigration of the early 1990s, the general government deficit has been declining as a proportion of GNP. Since the mid-1980s both general government revenues and expenditures as a proportion of GNP have fallen substantially, from some 70 per cent of GNP in 1985 for both variables to an estimated 54 and 57 per cent for revenues and expenditures, respectively, in 1992. The deficit was reduced from over 6 per cent of GDP in 1989 to 4.2 per cent on average in 1990-91, and is estimated to have fallen to 2.8 per cent in 1992, largely because of lower than expected (and budgeted) immigration in that year. More generally, the decline in the deficit of the public sector is due to expenditures as a share of GNP falling faster than revenues. In absolute terms, expenditures have declined by 5.5 per cent between 1989 and 1992, while revenues have remained unchanged. The 1993 budget foresees a further reduction in the central government's deficit, largely as the result of further reductions in public spending.

27. Since the mid-1980s the government has reduced its reliance on direct taxes for revenue. Both income and corporate marginal tax rates were reduced in the 1986-92 period, as were certain employment taxes. Conversely, indirect tax rates (the VAT) were increased. The share of customs duties in total income from indirect taxation has fallen sharply in the last decade, currently accounting for only 5 per cent of indirect tax revenues. There has also been a change in the composition of public spending. Direct subsidies granted to specific industries and defence spending declined in relative importance, while the share of spending on social services such as education, health and welfare increased.

28. Consolidated central government debt has increased substantially since the late 1980s, rising by 84 per cent between 1988/89 and 1992 in terms of new shequalaim and 32 per cent in US dollars. Nominal growth in aggregate output has, however, been greater than the increase in outstanding debt. The average stock of debt of the central government has fallen from 150 per cent of GDP in 1988/89 to 130 per cent in 1992. Debt service payments have also declined, from 24.3 per cent of GDP in 1989/90, to an estimated 18.7 per cent of GDP in 1992. Three-quarters of outstanding central government liabilities are domestic, the remainder foreign.

29. Consumer prices have been relatively stable since 1988, the average growth in the consumer price index being about 18 per cent during 1988-91. In 1992 the average annual rate of inflation fell significantly to 12 per cent. The relatively stable, albeit high, level of inflation up to 1991 reflected both entrenched inflationary expectations (as expressed through the wage and price setting process) and a policy of monetary accommodation. However, real factors also had a substantial impact, especially on the components of the price index. Thus, the large-scale immigration led to a declining trend in non-housing prices which was largely offset by sharply increasing housing prices. The decline in inflation realized in 1992 was in part due to the wage-depressing effect of the increase in the labour force and the slowing of the rise in housing prices as supply began to catch up with demand and the pace of immigration slowed.