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TRADE POLICY REVIEW OF ISRAEL

Since 1985, Israel has been implementing a far-reaching programme of market-oriented economic reforms which has resulted in substantial liberalization of the trade régime, according to the GATT Secretariat's report on Israel's trade policies and practices.

The structure of the Israeli economy has changed over the last decade. Inflation has fallen substantially and the economy has adapted to sustain the economic growth needed to achieve important policy objectives such as absorption of immigration and the modernization of the economy. "It is not clear," says the report, "whether the current rates of growth of exports and investment are sufficient to replace construction as the engine of economic growth. Long term growth depends on the continued expansion of industrial capital stock and infrastructure, as well as on the better utilization of resources, in particular human capital. Vigorous pursuit of structural reforms is necessary to make the economy more flexible and more attractive to foreign investment. Such reforms should embrace efforts to increase competition, including through privatization and stimulation of private initiative, labour market reform, and further liberalization of the trade régime, in particular in agriculture."

In recent years, government intervention in economic activities has been cut back, mainly through further deregulation in areas such as capital and money markets, liberalization of foreign exchange controls, foreign trade régime, and privatization. However, the State still plays a leading rôle in the Israeli economy. The public sector, government-owned companies or government-controlled institutions account for more than two-thirds of economic activity. Monopolies and cartels are still prevalent, controlling a large part of the business sector and posing a major obstacle to free competition.

More than three-quarters of imports come from countries with which Israel has signed preferential free-trade agreements. It is the only country in the world to have FTAs with the three major trading entities - the United States, the European Union and the European Free Trade Association. Most Israeli products benefit from free access to the markets of these developed countries. This situation has given Israel an advantage over other countries competing in the same markets.

With the objective of spurring competition by increasing trade with third countries, particularly with the fast growing economies of Asia and Latin America, Israel has also been dismantling import barriers unilaterally over the last three years. In 1992, imports from third countries increased by 15 per cent, and the new markets received well over half of the increase in Israeli exports.

As a result of the Uruguay Round, almost all the Israeli tariff will be bound. Israel's market access offer consists in increasing the number of bound rates and lowering existing binding levels. Tariffs will be reduced by an average of 24 per cent over the next five to ten years and will be eliminated in a number of sectors. In agriculture, tariffication will replace import quota restrictions with tariff rate quotas, though at very high above-quota rates which will be reduced by 15 per cent over the transitional period. Israel also agreed to limit domestic support and export subsidies for agricultural products. Domestic support will be reduced by 12 per cent in value terms over a ten-year period, and export subsidies cut by 22 per cent in value and 13 per cent in volume.

In summarizing its observations, the report also points out that recent positive political developments in the region may have important implications for the evolution of trade and economic development. The peace and economic agreements signed with the Palestine Liberation Organization should benefit both parties in areas such as trade, investment and tourism. The main economic gains for Israel from the peace process would, however, be derived indirectly through a relaxation and eventual elimination of the Arab boycott, together with the reduction of political risks of investing in Israel. The results of the recent Casablanca Summit give reason for hope in this regard.

Notes to Editors

1. The GATT Secretariat's report, together with a report prepared by the Government of Israel will be discussed by the GATT Council on 19-20 December 1994 under the Trade Policy Review Mechanism (TPRM). This is the first review of Israel since the launching of the TPRM in December 1989.

2. The TPRM enables the Council to conduct a collective evaluation of the full range of trade policies and practices of each GATT member at regular periodic intervals, to monitor significant trends and developments which may have an impact on the global trading system.

3. The two reports, together with a record of the Council's discussion and of the Chairman's summing up, will be published in due course as the complete trade policy review of Israel and will be available from the GATT Secretariat, Centre William Rappard, 154 rue de Lausanne, 1211 Geneva 21.

4. The reports cover developments in all aspects of Israel's trade policies, including domestic laws and regulations, the institutional framework, trade-related developments in the monetary and financial sphere, trade practices by measure and trade policies by sector. Attached are the summary observations from these reports. Full reports will be available for journalists from the GATT Secretariat on request.

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5. Since December 1989, the following reviews have been completed: Argentina (1992), Australia (1989 & 1994), Austria (1992), Bangladesh (1992), Bolivia (1993), Brazil (1992), Canada (1990, 1992 & 1994), Chile (1991), Colombia (1990), Egypt (1992), the European Communities (1991 & 1993), Finland (1992), Ghana (1992), Hong Kong (1990 & 1994), Hungary (1991), Iceland (1994), India (1993), Indonesia (1991 & 1994), Japan (1990 & 1992), Kenya (1993), Korea, Rep. of (1992), Macau (1994), Malaysia (1993), Mexico (1993), Morocco (1989), New Zealand (1990), Nigeria (1991), Norway (1991), Peru (1994), the Philippines (1993), Poland (1993), Romania (1992), Senegal (1994), Singapore (1992), South Africa (1993), Sweden (1990 & 1994), Switzerland (1991), Thailand (1991), Tunisia (1994), Turkey (1994), the United States (1989, 1992 & 1994), Uruguay (1992) and Zimbabwe (1994).

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TRADE POLICY REVIEW MECHANISM
ISRAEL

Report by the Secretariat - Summary Observations

Since 1985, Israel has been implementing a far-reaching programme of market-oriented economic reforms. Under the Economic Stabilization Programme, inflation was brought down from an annual rate of over 300 per cent to about 11 per cent in 1993, while structural reforms have resulted in substantial liberalization of the trade régime. Today, Israel places little reliance on trade policy instruments to attack the external symptoms of persistent domestic macro-economic imbalances. While significant progress has been made in a number of areas, most notably tax reform, financial market liberalization, and exchange and trade policies, Israel's commitments in the Uruguay Round and favourable external developments will contribute significantly to the process of economic reform.

Since its establishment in 1948, Israel has experienced strong economic growth, allowing its rapidly growing population to enjoy increasing standards of living. GDP per capita is currently around US$12,000. Until the early 1970s, gross domestic product had expanded by around 10 per cent on average per year, before slowing to some 3 per cent annually in the 1980s. Growth has picked up again since 1990, driven initially by a buoyant construction activity linked to a large influx of immigrants; GDP has grown at an annual rate of around 6 per cent over the last three years.

Israel, although often classified as an emerging market, has many of the characteristics of an advanced economy. The services sector accounts for the largest part of GDP, followed by manufacturing and construction. The principal manufacturing branches include some with a relatively high level of technological content, such as electrical and electronic equipment, as well as metal products, food, beverages and tobacco, and chemical products. The agricultural sector is highly capitalized and relatively small, accounting for around 5 per cent of GDP and less than 4 per cent of employment; these shares have declined sharply in recent years.

The structure of the Israeli economy has changed over the last decade, adapting to sustain the economic growth needed to achieve such important policy objectives as absorption of immigration and the modernization of the economy. It is not clear whether the current rates of growth of exports and investment are sufficient to replace construction as the engine of economic growth. Long-term growth depends on the continued expansion of industrial capital stock and infrastructure, as well as on the better utilization of resources, in particular human capital. Vigorous pursuit of structural reforms is necessary to make the economy more flexible and more attractive to foreign investment. Such reforms should embrace efforts to increase competition, including through privatization and stimulation of private initiative, labour market reform, and further liberalization of the trade régime, in particular in agriculture.

The large inflow of immigrants, while posing serious adjustment problems, has at the same time offered great opportunities for the economy. Immigration has pushed up unemployment to record levels of around 11 per cent; however, highly-educated immigrants are a valuable source of human capital which can sustain economic growth and development.

The State continues to play a leading rôle in the Israeli economy. The public sector, government-owned companies or government-controlled institutions account for more than two-thirds of economic activity in Israel. Furthermore, monopolies and cartels are still prevalent, controlling a large part of the business sector and posing a major obstacle to free competition. Progress in privatization has appeared slow, although the Government has tried to give it further impetus, especially since 1991. As in many other countries, privatization in Israel has had many objectives: to reduce government

intervention in the business sector and encourage more efficient economic activity; to raise capital and develop a stable capital market; and to reduce government debt.

Israel in World Trade

Israel's shares in world merchandise exports and imports in 1992 were 0.3 and 0.5 per cent, respectively. In that year, it ranked as the 30th largest exporting and 27th importing country in the world, counting the European Union as a group. Foreign trade is highly important for the economy; merchandise trade is the equivalent of more than 50 per cent of GDP and there is significant trade in commercial services.

Throughout most of its history, Israel has run a merchandise trade deficit. This has increased sharply in the last few years, from around US$2 billion in 1989 to almost US$6 billion in 1993, with the sustained expansion of domestic demand that accompanied the large influx of immigrants. Export recovery in 1992 and 1993 was not sufficient to offset the strong growth of imports associated with relatively buoyant domestic demand. Israel has also registered an increasing deficit on services account, although this declined in 1992. Israel still relies heavily on unilateral transfers of funds; in 1992, the total deficit on goods and services was more than offset by large private and official unrequited transfers, which reached almost US$7 billion. Consequently, the current account registered a surplus of US$218 million.

Exports and imports have risen rapidly over recent past years, reflecting Israel's growing integration into the world economy and helping overcome the limitations of its small domestic market. Strong growth in domestic demand and the removal of trade barriers are among the main factors explaining the increase in imports over the past three years.

The structure of Israel's trade is that of an advanced economy: exports are mainly made up of manufactured goods, while imports, which are relatively highly diversified, show a predominance of intermediate (production inputs) and investment goods. The structure of merchandise exports has moved away from agriculture. Cut diamonds continue to represent the largest single item in trade; more than 25 per cent of exports; however, owing to their relatively small local value added, the net impact of diamond exports is less significant. Around 70 per cent of exports other than diamonds are industrial products, mainly metals, machinery and electronics, chemicals, textiles and clothing, and foodstuffs. Agricultural goods account for around 8 per cent of exports.

Trade agreements - as well as its exclusion, until recently, from regional trade for political reasons - have shaped Israel's geographic trade patterns. More than three-quarters of imports come from countries with which Israel has signed free-trade agreements. The European Union, whose agreement with Israel dates from 1975, accounts for half of merchandise imports and one-third of merchandise exports. The United States is the second largest trading partner; its share of Israel's exports has grown rapidly since the implementation of the FTA in 1985, while its share of imports has remained relatively stable over the decade. EFTA countries, with which Israel's FTA entered into force only in 1993, account for 3 per cent of exports and almost 10 per cent of imports. Countries not covered by a free-trade agreement account for around 30 per cent of exports and 25 per cent of imports. Among these, major export markets are Japan and Hong Kong; Japan is also an important source of imports.

Institutional Framework

Israel is a parliamentary democracy with three branches: the legislature (the Knesset), the executive (the Government), and the judiciary. The President, head of State, is elected by the Knesset

for a 5-year term. Policy-making and executive authority is vested in the Government; the Prime Minister must be a member of the Knesset and the Government is subject to the confidence of the Knesset. The independence of the judiciary is guaranteed by law. Israel has no formal constitution, but has a number of Basic Laws covering key areas of public life.

The Executive holds the main responsibility for formulating and implementing trade policies. All trade legislation and international agreements are subject to ratification by the Knesset. Approved legislation must be signed by the President before promulgation.

The main Ministry responsible for the formulation and implementation of trade and trade-related policies is the Ministry of Industry and Trade. Other ministries, such as Finance, Agriculture and Foreign Affairs, are normally involved in the formulation of trade legislation in areas under their responsibility. Coordination in trade policy implementation is done through the Committee for International Economic Affairs.

In formulating trade policies, the Government consults regularly with the business and other sectors. Universities, private and public research institutes carry out studies on general government policies. However, there is no independent statutory body with a formal mandate to carry out regular public review and assessment of economic and trade policies. The existence of such an institution could provide valuable input into the domestic debate about the impact of policies on the economy.

Trade Policy Features and Trends

Israel became a contracting party to the GATT in July 1962. The General Agreement is not directly incorporated into domestic law. Israel has been party to three Tokyo Round Agreements - on Technical Barriers to Trade, on Government Procurement and on Subsidies and Countervailing Measures - and an observer in five other MTN Codes. Israel's multilateral obligations will expand significantly as a result of its acceptance of the Uruguay Round single undertaking and the Plurilateral Agreement on Government Procurement. M.f.n. treatment is extended to all countries, whether or not GATT contracting parties.

Recent evolution

Israel's trade policy objectives include greater integration into the world and regional economy, diversification of export markets, and improvement of the competitiveness of Israeli products and companies. The Israeli market for industrial products is relatively open to international competition. Furthermore, since 1991, Israel has complemented its free-trade agreements by autonomously reducing barriers against imports from third countries. These reforms have opened its market to competition from countries not covered by FTAs, particularly the fast-growing economies of Asia and Latin America, and reduced potential trade diversion.

Until recently, most imports into Israel were subject to discretionary import licensing. The trade liberalization programme implemented since 1991 brought a radical change in the system. Tariffs replaced licences and quantitative restrictions as the main instrument of import protection for industrial goods; although initially set at high levels, they are being gradually reduced, according to a pre-announced programme, to a range of between 8 and 12 per cent. The removal of trade barriers, in particular the "tariffication" of import licensing requirements, has helped increase efficiency and added transparency to the import régime. Agricultural products were not included in this programme.

The success of the trade liberalization programme will depend on the consistency of its implementation. Since the programme has no firm legislative basis and is subject to individual

administrative decisions regarding special levies, it is very important to keep to its pre-determined path and avoid policy reversals. The Israeli authorities appear firm in their resolve to maintain the pace and scope of liberalization.

Recent positive political developments in the region may have important implications for the evolution of trade and economic development. The peace and economic agreements signed with the Palestine Liberation Organization should benefit both parties in areas such as trade, investment and tourism. The main economic gains to Israel from the peace process would, however, be derived indirectly, through a relaxation and eventual elimination of the Arab boycott, together with the reduction of political risks of investing in Israel. This process could boost foreign direct investment and increase Israel's access to new markets. The results of the recent Casablanca economic summit give further cause for optimism in this context.

Type and incidence of trade policy instruments

Israel's use of trade policy instruments has changed considerably in recent years. Administrative protection has been reduced and the transparency of the trade régime has increased. These changes resulted mainly from autonomous reforms undertaken by Israel; its multilateral commitments undertaken in the Uruguay Round will consolidate this process and provide insurance against future policy reversals.

Following the elimination of administrative restrictions on imports, the main instrument of border protection on industrial goods is the tariff. For most agricultural products, import licensing requirements and quotas, previously maintained for balance of payments purposes, are to be replaced by tariff quotas following the implementation of the Uruguay Round Agreement; however, import restrictions will be maintained for a few agricultural products.

As noted, most of Israel's imports enter duty-free or at reduced rates under the FTAs. In mid-1993, ad valorem m.f.n. import duties ranged from zero to 100 per cent, with a simple average of 8.3 per cent. M.f.n. duty-free treatment is granted for about 40 per cent of tariff lines. Most tariffs are applied on an ad valorem basis; however, the tariff structure is complex, with more than 85 different ad valorem rates and specific, combined and alternative rates. It is difficult to estimate the real tariff burden on m.f.n. imports, as ad valorem equivalents of specific, combined and alternative rates are not readily available; use of non-ad valorem duties also reduces transparency in the cost of protection to consumers and user industries. The Government envisages the gradual replacement of non-ad valorem duties by ad valorem rates. Tariff escalation in most manufacturing areas is likely to give domestic processing industries higher effective protection than that extended to intermediate products and raw materials. In general, tariffs on consumer goods are higher than those levied on investment goods and production inputs.

M.f.n. tariffs are to be gradually reduced to maxima of between 8 and 12 per cent under a clearly defined programme. The early announcement of the programme gives certainty to the business community over the future. Moreover, the implementation of the Uruguay Round will bind tariffs on all except 17 agricultural tariff lines; this will improve the predictability of the Israeli tariff, although some bound rates will initially be extremely high.

Variable import levies have been used to protect a number of agricultural products. These levies are designed to achieve domestic price stability by imposing a variable charge on imports in order to maintain a constant landed price of foreign goods: their current ad valorem equivalents are not available. The levies are to be eliminated under Israel's Uruguay Round commitments.

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Internal taxes affecting both imports and domestically-produced goods include value-added tax at 17 per cent and purchase taxes at various rates ranging up to 240 per cent. These taxes do not discriminate, in principle, against imports or among foreign suppliers, but there have been complaints about the purchase tax calculation method, which appears to discriminate against imports. However, the Israeli Government has already introduced certain changes to rectify these problems.

Customs valuation in Israel has, until now, been based on the Brussels Definition of Value, and applied on a cost, insurance and freight (c.i.f.) basis. Israel did not adhere to the Tokyo Round Customs Valuation Agreement. When importation is done by a sole distributor, the declared customs value may be increased, providing broad discretionary power, at least potentially, to customs officials. This situation is to change with the implementation of the Uruguay Round agreements, under which Israel is committed to adopting the GATT valuation system.

Until recently, import licences were widely used by Israel to control imports of most products. Such requirements affecting the industrial sector were eliminated in 1991; however, in certain branches, automatic licences have been retained for monitoring purposes. In the agricultural sector, pending the application of the Uruguay Round agreement, discretionary import licensing still appears to be the binding constraint, rather than the tariff; some licensing requirements may result in virtual import prohibitions, as licences are granted only when domestic supply falls short of demand.

Global import quotas have been applied to a number of fresh and processed agricultural products. Quota levels have been set in line with past import levels, and administered on a "first come, first served" basis. Most import quotas will be eliminated upon implementation of the Uruguay Round Agreement; they are to be replaced by tariff quotas. However, these will, at least initially, provide a similar level of protection to Israeli farmers.

Other trade policy instruments affecting imports include technical regulations, standards, health regulations and sanitary and phytosanitary controls. Standards in Israel may be either voluntary or mandatory, and are, in principle, applied uniformly to domestic and imported goods. As a general rule, Israel appears to adopt international standards. However, certain trading partners have raised concerns about the implementation and use of standards, as well as on testing procedures which appear to differ as between domestic and imported goods. Around 23 per cent of standards are mandatory regulations, mainly in the food sector.

Israel does not apply specific rules of origin to imports from m.f.n. sources. Imports from countries with which Israel has signed a free trade agreement are subject to rules of origin established under those agreements.

One State-trading enterprise in the sense of Article XVII of the GATT, the Government Trade Administration, was until recently the sole agency authorized to import meat, soybeans and wheat. These markets have now been liberalized, and any food processing plant can import these products directly.

Government procurement in Israel is relatively important, given the high level of State participation in the economy. There is no central government procurement office; public sector entities and enterprises make their own purchasing decisions, under general guidelines. Government agencies and public institutions that receive official financial support are required to give a 15 per cent price preference to local products. In certain cases, offset agreements may be negotiated. Agencies covered by the GATT Government Procurement Agreement are not required to follow the price preferential and offset requirements.

Israel has one free-trade zone, located in Eilat. Enterprises established in this zone are permitted to import and process raw materials for re-export as finished products, free of customs duty, licences or other taxes. This zone was established with a view to encouraging, in particular, tourism, industrial activities and international trade.

No duties, taxes or charges are levied on goods exported from Israel. Export licences are maintained mainly on agricultural products for sanitary and quality control reasons. There are no voluntary restraints, surveillance or similar measures affecting exports from Israel. Export prohibitions are maintained in connection with international agreements or to follow United Nations' resolutions. Export prohibitions may also result from legislation restricting trade with countries maintaining an embargo against Israel.

Direct export subsidies have recently been eliminated. Current measures aimed at encouraging exports include import duty drawback, tax exemptions, export financing facilities, export insurance and export promotion and marketing assistance. General export promotion measures are administered by the Israeli Export Institute. Until recently, an implicit subsidy to Israeli exporters was provided by the foreign exchange risk insurance scheme, designed to protect exporters against erosion of foreign currency earnings when depreciation of the sheqel lagged behind inflation. The subsidy element in the scheme was estimated at around 2 per cent when it was eliminated in July 1993.

It appears from Israel's agricultural schedule in the Uruguay Round that export subsidies are granted to products such as fresh flowers, citrus fruit and fresh vegetables. It is not clear to the GATT Secretariat how these are provided or what their impact is on the sector.

Various incentives are granted to industry, for example to promote high technology research and development; and according to the location of the firm or investment, particularly through regional assistance.

Sectoral policies

In general, government intervention is still more extensive in agriculture than in industry, although recent changes have reduced administrative involvement. Significant border protection to agriculture is extended through the widespread use of non-ad valorem tariffs and non-tariff measures, such as variable levies, import licences and quotas. Such non-tariff measures are to be eliminated under Israel's commitments in the Uruguay Round negotiations. For much of the manufacturing sector, effective protection against imports is overall probably very small, because most imports from major suppliers enter into Israel duty-free; discrimination against m.f.n. sources is being cut back under the tariff reduction programme. Manufacturing sectors receiving high nominal tariff protection against non-FTA sources include footwear, clothing, textiles and furniture.

Israel's trade policy seeks, in principle, not to discriminate among sectors. However, within each sector, tariff escalation by degree of processing is common. In certain sectors, including textiles and wood, the programme of tariff reductions provides for higher final rates and a longer time period to attain them. Most importantly, agriculture has been extensively protected against international competition.

The agricultural sector in Israel has been traditionally regarded as fulfilling important national rôles, in particular national security, food self-sufficiency and regional/rural development. The promotion of mixed farming and of co-operative farming settlements has been an important element in government policy. Functioning in a framework organized and widely controlled by the Government, the sector benefited from widespread protection against import competition. Agriculture was the only sector

not included in the 1991 liberalization programme; nevertheless, most production subsidies were cancelled in 1991, although some indirect subsidization may persist. Under Israel's Uruguay Round Schedule, a few agricultural products are shown as benefiting from export subsidies.

Agricultural imports are mainly subject to specific duties, for which ad valorem equivalents are not readily available. Other trade measures applied to the sector have included variable import levies, restrictive import licensing, import quotas and strict sanitary and phytosanitary requirements. A large number of agricultural products receive unlimited protection against imports, as licences to import them are not normally granted when there is sufficient domestic production, regardless of price considerations. Restrictions on agricultural imports were excluded from the trade liberalization programme, but will be largely eliminated as a result of Israel's commitments under the Uruguay Round Agreement. Their implementation will increase transparency and reduce potential distortions in domestic resource allocation.

A number of marketing and production boards - some statutory - administer marketing and production arrangements in areas such as vegetables, flowers, citrus, poultry, groundnuts and fruit. The boards' activities may have limited price competition in certain agricultural goods.

The manufacturing sector is relatively more open to import competition. Import licences, which affected most industrial imports until 1991, have been largely eliminated, and although temporary high tariffs are currently applied, they are to be reduced. Manufacturing sectors with relatively high average ad valorem m.f.n. tariffs include footwear, clothing, furniture and textiles. For some of these sectors, combined and alternative duties are used.

Temporary measures

Israel maintains no emergency safeguard measures under Article XIX of the GATT. Safeguard actions under the FTAs have been used on few occasions.

New trade legislation passed in 1991 provides for temporary import relief measures, including anti-dumping, countervailing and safeguard duties. It appears that these have not been used so far. Complaints about dumping or subsidization can be initiated by a local manufacturer, his representative or the Director-General of the Ministry of Industry and Trade. An Advisory Committee, whose deliberations are secret, handles investigations. Temporary measures can be taken under the form of a surety for payment of the duty. The decision to impose definitive duties is taken by the Minister of Industry and Trade, who is required to take into account trade relations between Israel and foreign countries and considerations affecting the entire economy. A sunset clause provides for anti-dumping or countervailing duties to remain in effect for three years, unless a shorter period is specified. An importer may also request the re-examination of any order after one year, and appeal procedures are available at every stage of the proceedings. Findings are published in the Official Gazette. Currently, no anti-dumping or countervailing duty is in force.

New initiatives

Israel's economic stabilization programme, initiated in 1985, led to a number of structural reforms. In recent years, government intervention in economic activities has been cut back, mainly through further deregulation in areas such as capital and money markets, liberalization of foreign exchange controls, foreign trade reform, and privatization.

The Israeli Government remains committed to ongoing reform in its trade régime. Despite the prevalence of free-trade agreements and the important recent liberalization efforts, some non-tariff

barriers persist, mainly in the agricultural sector and to a lesser extent in industry. Many of these are to be reduced under Israel's Uruguay Round commitments.

Israeli consumers and industries will benefit from increased free trade through lower prices and greater availability of imported products. The liberalization of foreign exchange controls and the recent removal of the subsidy element in the exporters' exchange rate insurance scheme eliminated elements of distortion.

Certain recent developments, not directly linked to trade or economic policy, can also bring enormous impetus to economic growth in Israel, as well as in the whole region. The successful conclusion of the peace process should give an immeasurable boost to the Israeli economy by encouraging investment and opening up new trade opportunities in the region.

Trade Policies and Foreign Trading Partners

Israel is a supporter of an open multilateral trading system and has played an active rôle in the Uruguay Round. It has made significant progress in reducing import licensing restrictions; moreover, non-tariff restrictions affecting agricultural trade are expected to be replaced by tariff quotas under the Uruguay Round Agreement, improving the transparency of the system. The structure of m.f.n. tariffs remains complex and, with tariffication of import licences, certain rates are still relatively high; in this context, it is important for improved domestic resource allocation, as well as for trading partners not covered by free-trade areas, that Israel pursues its course towards lower, more uniform m.f.n. tariff rates.

Most of Israel's imports enter under preferential terms; most of its exports also benefit from free access to the markets of developed countries. The operation of Israel's free-trade agreements is not, in itself, incompatible with either its participation in GATT or the development of its comparative advantage; but care should be taken to avoid any trade diversion away from most efficient import sources. In this connection, the broader multilateral liberalization now being undertaken by Israel, bound through its commitments in the Uruguay Round, shows the Government's willingness to consolidate the process of trade liberalization and integrate Israel into the multilateral trading system.

TRADE POLICY REVIEW MECHANISM
ISRAEL

Report by the Government - Executive Summary

In the three past years the Israeli expansion has averaged 6 per cent a year, employment has risen at an annual 4 per cent, and inflation fell under 10 per cent a year, but in 1993 it rose again to 11 per cent. In addition, the external debt, the balance of payments, and the fiscal system remained under control.

To cope with the challenge of integrating 470,000 new immigrants, that is, a tenth of its population since 1989, Israel had to generate accelerated expansion, while preserving the macroeconomic balance.

The government strategy was to keep on with the liberalization process, and to refrain from direct interventions, as much as possible. This was in line with a global policy, initiated in the 1960s, when Israel became a member of GATT. At that time, the entire Israel newborn economy was protected by strong protectionism. Gradually, all the sectors have been submitted to foreign competition, the monopolies have been dismantled, and the government has reduced its influence on the economy. This process brought Israel into the international trade flows, starting with the implementation of bilateral agreements, first with the EEC, then with the United States and recently with EFTA countries.

The Israeli Government has pursued this policy despite an unfavourable external environment. Yet, this determination appears to have been successful: Israeli exports have conquered new markets to compensate for the slowdown of the traditional partners' economies. During the period under review, foreign trade grew at a faster pace than GDP, or international trade. Expansion in exports was mainly due to manufactured goods, in particular high-tech items, and to a surge in tourism. The increase in imports consisted of durable goods, and semi-processed items. The increase in import of input items shows that imports are linked to the general economic growth.

This growth trend is connected to the massive immigration, and is also the result of the ongoing policy, aimed at encouraging initiative and the private sector. Yet, the liberalization process involves a steady reduction of public involvement in the economy, with the dismantling of customs and non-customs barriers, tax reform, planned phasing out of the budget deficit. This policy, in line with the recommendations of GATT, is implemented in the secure legal framework of a democracy, ensuring a strong application of the law through an independent judiciary institution.

Yet the persistent deficit of the commercial balance has not been phased out and the balance of payments needs unilateral transfers from outside. Within, the level of unemployment although on the way to being reduced, is unbearable in the small Israeli society. As a result, the tremendous effort of the Israeli economy to face up to both a massive immigration and an international crisis while maintaining the principles of the liberalization process should be pursued. Future developments rest on the ability to increase the investment effort, to channel it to competitive companies, research and development and infrastructure.

Part One: Trade Policy and Practices

Objectives of Trade Policy

General Description

Located in the Middle East, on the Mediterranean coast, Israel is a small country whose surface is occupied by 60 per cent desert. Created forty-six years ago, the State of Israel has integrated successive waves of immigration from all around the world. The last arrivals, coming from Ethiopia and the former USSR, brought the Israeli population up to 5 million inhabitants, increasing it by 10 per cent within a three year period. The population density, 215 per square kilometre, one of the highest in the region after Lebanon, is particularly high in towns and in the coastal area.

Due to the small size of its domestic market, Israel turned to exports as an indispensable way of financing imports to supply the country and compensates for the lack of raw materials. As a result, the objectives of Israel's trade policy are access to export markets and guaranties of supplies.

Whereas the new-born economy was strongly protected, gradually foreign trade and exchange controls have been eased and more sectors of the economy have been exposed to foreign competition. This new policy, initiated in the 1960s when Israel became member of GATT aimed at an export oriented economy. Since Israel was cut off from its neighbouring markets and had to sell overseas, the EEC and the United States were the first countries to sign agreements with Israel. They still are its main trading partners although the country has diversified its foreign markets.

Indeed, the Israeli economy is highly dependent on foreign trade, exports and imports respectively accounted for 33 per cent and 41.5 per cent of the GDP in 1993. The sustained growth experienced in the three past years, at an annual rate of 6 per cent is dependent on international trade.

The basic objective of Israel's trade policy is to seek economic independence. The goal is to reduce the trade deficit by speeding export growth and entering new foreign markets. Given that the main trading partners of Israel are the EC and the United States, a continuous trade policy objective has been to improve trade relations with these countries. Israel also tried to develop commercial ties with other countries. The first achievements are already perceptible in the results of trade. The geographic diversification of Israel's foreign trade has become one of the trade policy objectives. In this context, the increase in the number of Israel's foreign trade partners and the deepening of the existing commercial flow, depend to some extent on the results of the Uruguay Round. Israel's actual interest, considering its present option, is to act in an open international environment.

Sectoral Developments

Whereas the contribution of agriculture and services to the GDP is higher than to exports, the share of industry in exports is much larger than in the GDP.

There are no specific sectorial trade policy objectives. Trade policy emerged as a consequence of existing economic constraints and of national goals such as immigration, employment, security and regional development.

Agriculture

A case point is the agricultural sector. At the beginning of the State, the country had barely enough food to survive. Given Israel's geographic location and climate characterized by desert soil and scarcity of water the range of possible products was limited. In order to extend the cultivated

areas as well as to diversify products research was initiated. As a result, Israeli agriculture was scientifically based. Since then the main goal of agricultural policy has been to achieve and maintain self-sufficiency for commodities worth growing in Israel. This objective has been achieved for fruits, vegetables, poultry, eggs, milk and milk products. Moreover, Israel soon became an exporter of agricultural products, mainly citrus fruits. Though it is still dependent on imports for meat, oil, grains, rice and sugar.

As a result of a general trend in the economy that favours the development of industry and services, there has been a relative decline of the agricultural sector that presently accounts for only 3 per cent of GDP and the proportion of workers employed in agriculture fell to 3.5 per cent of total Israeli workers. Since 1987, about 24 per cent of self employed farmers have left agriculture and the real farm income has fallen by 1/3. The present policy is aimed at preventing a further deterioration of the sector, maintaining the level of agricultural production and preserving all existing agricultural settlements. Israeli agricultural policy seeks to ensure that economic, social and cultural conditions are comparable to those of other groups: Typical Israeli farmers organizations, like the collective village, "kibbutz", or the cooperative village called "moshav", have been the adequate framework for that policy. But these structures have been weakened by a financial crisis. The policy favours the assurance of an equitable income for farmers by creating additional economic activities in the settlements, within and beyond the agricultural field.

Whereas the two basic principles of agricultural policy are self sufficiency and maintenance of the farming population, there are additional non-economic objectives, such as security, immigrant integration, geographical distribution of the population and settlement of the land. Recently, in the context of a growing concern for ecological problems, agriculture is also responsible for maintaining the fertility of the soil, protecting the countryside and the environment.

Thus, during the last years, while safeguarding the principles mentioned above, Israel agricultural policy has been influenced by a general economic trend towards more liberalization. This trend takes into account the specificity of the sector, as well as the existing developments in external markets. To maintain its share in export markets Israel must improve agricultural efficiency through sustained progress in Israeli comparative advantages.

Specific objectives require specific measures. Agriculture to a large extent is still organized and controlled by the Government. Agricultural production, water supply, marketing at home and abroad, and prices, have been regulated through different statutory bodies. The production and marketing boards were set up to attain economic objectives, which were: production stabilization according to market requirements, support of grower's minimum revenues, research and development promotion. The boards also contribute to achieve non-economic objectives linked to social, territorial or security purposes.

Agricultural subsidies still require public funds. Supporting the prices of agricultural output accounted for an average 0.8 per cent in 1981-83, compared to 0.4 per cent of the GDP in 1987-90. Thus, the State involvement has been reduced and as a result, it can easily be compared to foreign subsidies to agricultural prices that accounted for 0.7 per cent of the GDP in all the EEC countries in the later period.

With regard to foreign trade, exporters must have an export licence. The requirement of a licence is also in force for importers. In addition, variable levies are requested for the importation of almost all agricultural fresh and processed products and there are taxes and charges on imports. International agreements deal specifically with agricultural products. With the EEC there is a separate preferential agreement beside the free trade zone.

Despite these measures, a liberalization process is on the way: subsidies, governmental aids and controls have been reduced. Subsidies on the production of eggs for consumption, milk and poultry have been abolished. Grain import has been privatized. Production restrictions in certain sectors such as orchards have been phased out. The domestic market has been deregulated. Gradually, production and marketing board influence has been reduced. The citrus and flowers marketing boards still exist, but they have lost their monopolistic status. Agriculture has become less dependent on official approval for obtaining directed credit and consequently the cost of credit has gone up.

The present situation of agriculture is still dependent on climatic variations and on the situation and prices of external markets. At the end of 1990, for example, agriculture faced a dramatic water shortage, water quotas were reduced and the structure of production was modified. Additional difficulties are linked to the world market, since it is saturated and competition is getting harder. In the late 1970's, competition in European markets increased when additional Mediterranean countries became members of the EEC (Spain, Portugal). In order to preserve its foreign market share despite increasing competition. Israel developed products to meet the foreign demand. This led to the development of new species and the growing in Israel of an increasing number of new products such as flowers.

The share of exports in agriculture production has steadily declined since 1987 accounting for only 17 per cent in 1992, with no significant change in 1993. So did the share of agriculture in the growth of exports, despite great efforts of diversification such as flowers, avocado and tropical fruits. Indeed, the terms of trade defined by the difference between the price changes in Israel's agricultural exports on foreign markets and the price index of purchased inputs for export crops, deteriorated at an annual average of 3.7 per cent between 1985 and 1990. Despite this trend, Israel's agriculture has increased steadily in quality and productivity. For example, labour productivity increased by 10.3 per cent in 1992.

The objective of the present agricultural policy is, in the short run, to ease the transition from subsidized and controlled organization to liberal, export-oriented agriculture, while preserving agricultural life. In the long run, the aim is to let the liberalization process shape agriculture into a scientific industry, producing a full range of entirely new products. At the present time, agriculture is facing a hard transitional period. The base of a scientific industry already exists, but the whole rural structure is involved in financial problems that have to be solved in order for the sector to improve its capabilities.

Industry

The industrial sector accounted for an average 31.5 per cent of the GDP in the last three years (at 1990 prices). Its growth in 1992 was greater than that of the GDP. The contribution of the main branches of industrial production in 1992 was as follows: mining and metallic minerals: 8 per cent, textiles and clothing: 9 per cent, paper and printing: 10 per cent, food: 11 per cent, wood, rubber plastics, chemical and petroleum: 16 per cent, metal products and machines: 17 per cent, electric and electronic equipment: 29 per cent.

In 1991 and 1992, 92.1 per cent of exported goods were industrial; in 1993 it was 93 per cent. Whereas growth of agricultural exports has slowed down, industrial exports grew by 9.5 per cent in 1989, 10.9 per cent in 1992 and 14 per cent in 1993. The increase in industrial exports has been particularly strong in the electronics branch, where the rate of growth has been 20 per cent.

During the first years following the creation of the State, there were no markets and the allocation of resources resulted from policy makers' decisions. The Government and the General Organization of Workers, the Histadrut, owned a major part of industry. Now with the more liberal atmosphere government policy is targeted mainly on regional incentives to encourage industry. The ongoing policy

of privatization appears to be a turning point. Even companies that are not being privatized are being managed like private ones.

The basic object of the present industrial policy is to create a competitive environment for the private sector and let it focus on high-tech industry. In addition, absorption of new immigrants in the labour market constitutes a national priority. This means initiating important investments in infrastructure and education, privatization and reducing some rigidities in the financial and labour markets. The Government intervened to give incentives to employ new workers and is still helping to carry out additional investments, in particular in the research and development sector. The comparative advantage of Israel's industrial development consists of an extremely skilled workforce paired with a very strong infrastructure of science and technology. Israel spends 2.9 per cent of it's GNP on research and development, a higher proportion than any other country.

The chemical branch, comprising rubber, plastic products, chemicals and petroleum, expresses and emphasizes the improvement of the economy as a whole in 1992, since a significant part of its products consists of semi-processed items. Production grew by 13 per cent, and chemical exports grew by 11 per cent, despite the 3 per cent decrease in dollar prices on the worldwide markets. There was a sharp rise in investments in 1992 - 25 per cent - compared with an average 8.5 per cent in the 1988-92 period. The profitability of the branch grew by 10 per cent in 1992. The workforce of the branch did not increase and remains at 21,000 persons while labour productivity improved by 22 per cent in 1992, compared to the previous year.

The food, beverages and tobacco industries employ 19,000 workers. The production expanded by 3 per cent in 1992, compared to an annual average of 0.5 per cent between 1988 and 1992 and it accounted for 11 per cent of industrial production in 1992. Exports have declined since 1991, and accounted for 7 per cent of total industrial export in 1992 and 5.3 per cent in 1993. Investments increased dramatically in 1991 and 1992, by respectively 24 and 36 per cent, which accounted for 9 per cent of the total investments in the industrial sector. The Israeli food industry is becoming more sophisticated relying on research and development, which are carried out in universities, government research institutes, industrial companies and farms. The standards and controls on production have been defined in accordance with those of Israel's principal trading partners. The trend is towards increased consumer information on the composition of the product and on prices, to create a more transparent market. In addition, the consideration of the environment and the growing concern with health prevention has a greater influence on the composition of the product, its preservation, packaging and transportation.

The textile, like the food industry, is one of the oldest in Israel. It had to adapt itself to new technologies and to the evolution of the market. 55,000 employees, accounting for 15 per cent of all the employees in the industrial sector, are working in the textile industry. Among them, 25 per cent work in textiles and 75 per cent in clothing. The production of the branch grew by 11 per cent in nominal prices in 1992. The increase in investments has grown at a particularly fast pace: 4.7 per cent in 1990, 4.6 per cent in 1991 and 60.6 per cent in 1992. Exports grew by 11 per cent in real terms in 1992 against the previous year. The main destinations of the exports are the EEC countries, which accounted for 63 per cent and the United States, which accounted for 27 per cent.

The electronics industry, transport equipment and miscellaneous accounted for 30 per cent of the industrial sector product in 1992, with a 9 per cent increase in 1992 and 33 per cent in 1993, after two consecutive years of 6 per cent growth. Their share in total industrial exports was 44 per cent in 1992, while the increase in exports was 20 per cent the same year; in 1993 the share was 40 per cent. The investments in the branch were 30 per cent of the industrial investments, as a result of a sustained growth in 1990 and 1991 and a slight decline in 1992. The impressive development of this industry is due to a combination of factors: a very high demand linked to the country's defense needs, a high

level of scientific and technological manpower and close cooperation between the fields of research and business. This industry is by far the largest in value added. Many Israeli companies that were mainly involved in military production and research have converted to production for the civilian sector.

Services

In Israel many small sized enterprises are involved in the supply of services and in the exports of that sector. The foreign services account shows a surplus, which accounted for US$1.3 billion in 1992, thanks to a surge in tourism, but in 1993 there was a deficit of US$800 million.

Tourism, trade, finances, food, legal, education and health services account for 45 per cent of the GDP. The role of this very dynamic sector is to provide jobs and take an increasing part in the expected export growth. The share of the supply of services that is exported went up to 24 per cent in the 1990-92 period. Among the exports, transport, tourism and linked activities, and computer software are the chief items. The increase in the export of services accelerated in 1991 - 1992: 6.5 per cent, compared to 3.2 per cent in 1988 - 1990, thanks to the increase in foreign tourism. The total export of services in 1993 reached US$8.2 billion; the main items being transport with US$2.5 billion and tourism with US$2.2 billion.

Israel benefits from a highly developed network of communications and transportation. Yet, the policy in this sector is to channel extensive investments in this field during the next years, to improve the infrastructure and through that to improve the functioning of the whole economy. The total infrastructure investment during 1994 - 1996 is expected to reach US$7.09 billion, according to the pluri-annual budget.

Real output rose by 6 per cent in 1990 and 1991, and 10 per cent in 1992, due to higher productivity, particularly in communications, port navigation and air transportation. Recently, in order to improve the state of the roads, additional investments have been realized in infrastructure. They grew by 8 per cent in 1991, 7 per cent in 1992, 28 per cent in 1993 and 8 per cent in 1994.

The Import and Export System

The Israeli trade policy is based on the principle of freedom of trade and industry. Accordingly, the import and export of goods are in principle free and left to the initiative of the economic operators.

The State intervenes only for reasons of public order, mainly security or health. The import of agricultural products is subject to a more restrictive system.

More than 80 per cent of Israeli imports are free from customs duties. 70 per cent of foreign trade is organized in agreements covering trade relations with the US, EC and EFTA countries. The liberalization programme of September 1991 applies to other countries, mainly South East Asia, Latin America and Eastern Europe. The principal tariffs still in place are applied to imports from those countries.

Until 1978, the principle of foreign trade has been the strict control of exports, imports and exchange rates. The controls have been gradually reduced and in 1978 the law set up free trade as the rule and controls as the exception reflecting the policy of liberalization.

Before the enacting of the Free Trade Ordinance in 1978, the Imports Ordinance prohibited the importing of goods unless licensed by a competent authority. The purpose of the present legislation - The Free Import Ordinance - 1978, is the opposite. Free imports are the rule. Exceptions are specified in addendum.

Likewise until 1978, the Ordinance of Exports enacted interdiction of exporting unless under a special licence. Under The Free Exports Ordinance - 1978, exports are free but for a very small number of products.

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