1999 Country Reports on Economic Policy and Trade Practices
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ISRAEL

Key Economic Indicators

(Billions of U.S. Dollars unless otherwise indicated)

	1997	1998	1999 1/
Income, Production and Employment:			
Nominal GDP	99.0	99.0	96.4
Real GDP Growth	2.9	2.2	2.0
GDP by Sector:			
Agriculture	2.0	2.0	2.0
Manufacturing	17.0	16.0	15.0
Construction	7.0	7.0	6.0
Services	40.0	43.0	43.0
Public Sector	34.0	33.0	34.0
Per Capita GDP (US$)	17,150	16,570	15,775
Labor Force (000s) 2/	2,210	2,270	2,320
Unemployment Rate (pct) 2/	7.7	8.7	8.7
Money and Prices (annual percentage growth):			
Money Growth (M2) (pct) 3/	26	23	30
Consumer Inflation (pct) 3/	7.0	8.6	3.2
Exchange Rate (NIS/US$) 2/	3.45	3.80	4.20
Balance of Payments and Trade:			
Total Exports FOB	20.9	21.2	21.4
Exports to U.S.	7.3	8.3	8.5
Total Imports CIF 4/	28.7	27.0	29.7
Imports from U.S. 4/	5.4	5.4	6.3
Trade Balance 4/	-7.8	-5.8	-8.3
Balance with U.S. 4/	1.9	2.9	2.2
External Public Debt (gross)	26.2	27.4	27.5
Fiscal Deficit/GDP (pct)	2.8	2.4	3.2
Current Account Deficit/GDP (pct)	3.3	2.3	2.5
Debt Service/GDP (pct) 5/	6.5	6.5	6.5
Gold and Foreign Exchange Reserves 6/	20.3	22.7	21.9
Aid from U.S.	3.1	3.0	2.9

Aid from Other Countries	0	0	0

1/ 1999 indicators estimated using partial-year data.
2/ Annual average.
3/ December to December.
4/ Excludes defense imports.
5/ Includes private sector debt service.
6/ At end of year.

1. General Policy Framework

Israel is a small open economy, increasingly competitive internationally in such high technology sectors as telecommunications, software, pharmaceuticals, and biomedical equipment. Israel's economy grew rapidly in the first half of the 1990s, with growth averaging six percent annually. This expansion, during which Israel's economy grew in real terms by a cumulative 40 percent, was stimulated by a wave of immigration from the countries of the former Soviet Union and the erosion of Israel's economic isolation following peace agreements reached with Jordan and the Palestinians. Rising incomes and the needs of the immigrants encouraged a strong upsurge in imports, including from the United States. Merchandise imports almost doubled between 1990 and 1996, rising from $15.1 billion to $29.6 billion; imports from the United States grew from $2.7 billion to $6.0 billion over the same period. Export growth, although strong, did not keep pace, and the current account deficit widened to over five percent of GDP in 1996.

Since the mid-nineties, economic growth has slowed markedly. The economy grew only 2.2 percent in 1998 while per capita GDP fell. Growth in 1999 is expected to be about 2 percent. The economic slowdown was caused by a number of factors, including reduced immigration, the Asian financial crisis and restrictive monetary and fiscal policy, implemented to overcome the large budget deficits in the mid-90's. The government tightened fiscal policy beginning in 1997 in order to avert a potential crisis in Israel's balance of payments. This tightening cut Israel's budget deficit by roughly two percent of GDP. Fiscal restraint continued into the 1998 and 1999 budgets, but slower than expected growth resulted in an estimated increase of the budget deficit in 1999 from 2.4 to 3.2 percent of GDP. The proposed FY 2000 budget (not yet passed by the Knesset) calls for a budget deficit of 2.5% in 2000. The government hopes to reduce the deficit to 1.5 percent of GDP by 2003. Defense spending remains the largest single component of the Israeli budget, although defense spending dropped from around 25 percent of GDP in the early 80s to less than 10 percent of GDP in 1998. In recent years, the most rapidly growing portions of the budget have been in the area of social services, such as health care, education, and direct payments to individuals and institutions. Between 1990 and 1998, for example, education spending rose 83 percent after inflation, while transfer payments increased by 76 percent.

Since 1994, the Bank of Israel has maintained high interest rates in its campaign to slow inflation and to achieve eventual price stability. Its chief policy instrument is the interest rate charged on its "monetary loans" to the commercial banks; it also adjusts domestic liquidity through purchases and sales of treasury bills, and by adjusting the volume of its borrowings from the banks. With imports of goods and services amounting to some 45 percent of GDP, Israel's inflation rate is strongly influenced by exchange rate developments. After the consumer price index had risen only 3.0 percent in the twelve months ending in July 1998, the lowest rate of price increase recorded since the 1960s, a sharp decline in the value of the shekel in subsequent months gave a swift upward boost to inflation. The CPI finished up more than 8 percent for the year. In 1999, inflation has remained consistently low, with an inflation rate of around 3 percent expected at the end of the year. Israel's official inflation target for 2000-2001 is 3-4 percent.

2. Exchange Rate Policy

The shekel floats within a pre-defined target zone against a basket of currencies: the U.S. Dollar, Yen, Euro, and Pound Sterling. As a matter of policy, the Bank of Israel does not intervene in the foreign exchange markets as long as the shekel remains within the target zone, although it is obligated to do so once the limits of the zone are reached. During the first half of 1997, for example, large-scale capital inflows caused the shekel to appreciate to the edge of its target zone. To keep the shekel within the zone, the central bank was forced to absorb the inflow of foreign currency and to sterilize the effect on domestic liquidity of such purchases through increased borrowings from the public.

Israel ended all foreign exchange controls for current transactions in 1993. In mid-1998, at the time of its fiftieth anniversary celebrations, Israel ended almost all of its remaining capital controls, except for limits on Israeli institutions' foreign investments and on access by non-Israelis to longer-term derivatives in the domestic market.

3. Structural Policies

Over the past decade, Israel has gradually reduced the degree of government involvement in and control over the economy while increasing the influence of domestic and international competition. Israel signed a Free Trade Agreement with the United States in 1985 and has similar agreements with the EU, the EFTA, and seven other countries. Since 1991 Israel has been unilaterally reducing tariffs on imports from countries with which it does not have trade agreements. This policy of increasing exposure to international competition has led to a significant restructuring of Israeli industry, causing job losses in such traditional light manufacturing sectors as shoes and textiles.

Significant reforms with important commercial implications for U.S. companies are being undertaken in several sectors. The most significant progress has been made in the telecommunications sector. In 1997, two private consortia, each with a U.S. firm as a participant, began offering international telephone service in competition with the established government-owned company; prices for international calls fell by as much as 80 percent almost immediately. Further plans for liberalization of the telecommunications sector include allowing more cellular telephone operators (there are now three), and opening up domestic landline service to competition.

The government raised almost $4 billion from the sale of shares in government-owned companies and banks in 1997 and 1998. The most important of these transactions was the sale to a U.S.-Israeli investor group of a controlling 43-percent stake in Bank Hapoalim. Bank Hapoalim is Israel's largest bank and has extensive holdings in Israeli industry. The government has sold off pieces of most other Israeli banks: it now retains majority ownership in only two of the five largest banks. The pace of privatization slowed in 1999; receipts for the first eight months of the year totaled under $300 million, less than one-third of the target for the year. The next big target for privatization is probably Bezek, the state domestic phone company. Efforts to sell all or part of the state airline El Al have stalled; it is unlikely that El Al will be privatized anytime soon.

The state power company, Israel Electric (IEC), dominates electricity generation and distribution in Israel. Under current law, independent producers can generate up to ten percent of Israel's electricity; another ten percent of Israel's power needs could be met by imports. Both areas could provide opportunities for U.S. companies. Progress towards opening up the electricity market to competition, however, has been very slow. Currently, IPPs or imports are meeting virtually none of Israel's power needs.

4. Debt Management Policies

The gross foreign debt of the public sector totaled $27.5 billion as of June 1999, all of it medium to long-term, and much of it guaranteed by the U.S. Government. Israel borrowed $9.2 billion between 1993 and 1998, for example, in bonds guaranteed by the United States intended to assist with the absorption of the immigrants from the former Soviet Union. The external liabilities of the banking system and non-financial public sector brought Israel's total gross foreign debt to $56 billion as of mid-1999. After netting out foreign assets of $44.3 billion, the country's net debt stood at $11.7 billion.

Anticipating the end of the U.S. loan guarantee program, the government began in 1995 to tap the international bond markets under its own name. Thus far, it has made successful offerings in the U.S., European, and Japanese bond markets.

5. Aid

U.S. assistance to Israel for fiscal year 1999 included $1.92 billion in military aid, of which over $1.4 billion was earmarked for procurement from the United States. U.S. aid also included economic assistance of $960 million and various forms of support for military R&D, notably for missile defense.

6. Significant Barriers to U.S. Exports

With the exception of some categories of agricultural produce and processed foods, all duties on products from the United States were eliminated under the 1985 United States-Israel Free Trade Area Agreement (FTAA) by January 1, 1995. The FTAA liberalized and expanded the trade of goods between the United States and Israel, and spurred discussions on freer trade in services, including tourism, telecommunications, and insurance.

Israel ratified the Uruguay Round Agreement on January 15, 1995. Israel became a member of the World Trade Organization on April 21, 1995 and implemented the WTO regime on January 1, 1996.

The U.S.-Israel FTAA allows the two countries to protect sensitive agricultural subsectors with nontariff barriers including import bans, quotas, and fees. These limitations have been carried forward into the WTO regime. Most quantitative limits have been translated into Tariff Rate Quotas (TRQs), while items previously banned now bear prohibitively high tariffs or fees that make imports of such goods uncompetitive with domestic production. The principal U.S. goods affected by these measures include poultry and dairy products, fish, and most fresh produce.

In late 1996, the United States and Israel agreed on a five-year program of agricultural market liberalization. The agreement covers all agricultural products, and provides for increased access during each year of the agreement via TRQs and tariff reductions. This agreement will be renegotiated in 2000. Despite an Israeli commitment to issue all TRQ licenses for a given year no later than October 31 of the previous year, there continue to be substantial delays in the licensing of U.S. products. Division of general quotas into impractically small and non-commercial individual lots deters potential buyers from quota utilization.

Israel has largely eliminated a unique form of protection for locally produced goods known as “Harama,” meaning, “uplift.” This was a 2 –5 percent addition applied at the pre-duty stage to the CIF value of goods to bring the value of the products to a supposedly “acceptable” level for customs valuation. Israel calculates import value according to the Brussels Definition of Value (BDV), a method that tolerates uplifts of invoice prices. Israel is not a signatory to the WTO Valuation Code, although it has expressed its intention to become one.

A second uniquely Israeli form of protection is called “TAMA.” TAMA is a post-duty uplift designed to convert the CIF value plus duty to an equivalent wholesale price for purposes of imposing purchase tax. Coefficients for calculation of the TAMA vary from industry to industry and from product to product.

In addition, purchase taxes from 25 to 95 percent are applied to goods ranging from automobiles to alcoholic beverages. Israel has eliminated or reduced purchase taxes on many products, including consumer electronics, building inputs, and office equipment. Where remaining, purchases taxes apply to both local and foreign products. However, when there is no local production, the purchase tax becomes a duty-equivalent charge.

Israel has reduced the burden of some discriminatory measures against imports. Although Israel agreed in 1990 to harmonize standards treatment, either by dropping health and safety standards applied only to imports or making them mandatory for all products, implementation of this promise has been slow. Enforcement of mandatory standards on domestic producers can be spotty, and in some cases (e.g., refrigerators, auto headlights, plywood, and carpets) standards are written so that domestic goods meet requirements more easily than do imports. In September 1998, Israel amended its packaging and labeling requirements to allow non-metric packaging as long as information on pricing in standard metric units is provided. This change has facilitated the entry of U.S. food products packaged in non-metric sizes. Israel has agreed to notify the United States of proposed new mandatory standards to be recorded under the WTO.

The Standards Institute of Israel is proposing a bilateral Mutual Recognition Agreement of Laboratory Accreditation with the United States that could result in the acceptance of U.S.-developed test data in Israel. The proposed program would eliminate the need for redundant testing of U.S. products in Israel to ensure compliance with mandatory product requirements. The Israeli cabinet decided in August 1999 that official Israeli standards could incorporate in their entirety more than one foreign standard. The government is developing implementing regulations. Once the regulations go into effect, this has potential to significantly reduce trade advantages enjoyed by products from the EU over goods of U.S. origin.

The government actively solicits foreign investment, including in the form of joint ventures, and especially in industries based on exports, tourism, and high technology. Foreign firms are accorded national treatment in terms of taxation and labor relations and are eligible for incentives for investments in priority development zones after receiving the approval of the Ministry of Industry and Trade. The incentive program provides grants of up to twenty percent of the amount of capital invested and tax benefits for investments in the development priority regions. There are generally no restrictions on foreign ownership, but a foreign-owned entity must be registered in Israel. Profits, dividends, and rents can generally be repatriated without difficulty through a licensed bank. Over 2000 U.S. companies have subsidiaries or other representation in Israel, according to the Israel-American Chamber of Commerce. Investment in regulated sectors, including banking, insurance, and defense-related industries, requires prior government approval.

Israel has one free trade zone, in the city of Eilat. In addition, there are three free ports: Haifa, Ashdod, and the port of Eilat. Enterprises in these areas may qualify for special tax benefits and are exempt from indirect taxation.

Israel is a signatory to the Uruguay Round Procurement Code, intended to enable more open and transparent international tendering procedures for a wide range of government entities. However, while some government entities notify the U.S. Government of tenders valued at over $50,000, many do not, and the notices that are received frequently carry short deadlines and are often only in Hebrew. Moreover, U.S. suppliers have been locked out, to date, of Ministry of Defense food tenders for the army and other security forces. Complex technical specifications and kosher certification requirements discourage foreign participation. Recently, however, there have been new efforts to facilitate purchase of U.S. food products for the Israeli military.

The government frequently seeks offsets (subcontracts to Israeli firms) of up to 35 percent of total contract value for purchases by ministries, state-owned enterprises, and municipal authorities. Failure to enter into or fulfill such industrial cooperation agreements (which may involve investment, co-development, co-production, subcontracting, or purchase from Israeli industry) may disadvantage a foreign company in government awards. Although Israel pledged to relax offset requests on civilian purchases under the FTAA, Israeli law continues to require such offsets. Israeli Government agencies and state-owned corporations not covered by the Uruguay Round Government Procurement Code follow the "Buy Israel" policy to promote national manufacturers.

Israeli law provides for a 15 percent cost preference to domestic suppliers in many public procurement purchases, although the statute recognizes the primacy of Israel's bilateral and multilateral procurement commitments. The cost preference for local suppliers can reach as high as 30 percent for firms located in Israel's priority development areas.

In addition to its WTO multilateral trade commitments and its FTAA with the United States, Israel also has free trade agreements with the European Union, Canada, the Czech Republic, Slovakia, Turkey, Hungary, Poland, Slovenia, and the EFTA states. It also has a preferential trade agreement with Jordan. With respect to all other countries, Israel has substituted steep tariffs for nontariff barriers previously applied, and is gradually reducing those tariffs. Israel's import liberalization program and negotiation of new free trade agreements have diluted U.S. advantages under the bilateral FTAA.

As part of the Middle East Peace Process, Israel has granted duty free access to its market for 50,000 tons of fresh and processed agricultural products from Jordan. It has also committed itself to allowing unlimited access for agricultural produce from the Palestinian Authority.

7. Export Subsidies Policies

The U.S.-Israeli FTAA included an agreement to phase out the subsidy elements of export enhancement programs and to refrain from new export subsidies. Israel has already eliminated grants, except in the case of agricultural export and import substitution crops. In 1993, Israel eliminated the major remaining export subsidy, an exchange rate risk insurance scheme which paid exporters five percent on the FOB value of merchandise. Israel still retains a mechanism to extend long-term export credits, but the volumes involved are small, roughly $250 million. Israeli export subsidies have resulted in past U.S. antidumping or countervailing duty cases. Israel has been a member of the WTO/GATT Subsidies Code since 1985.

Israel's Parliament, the Knesset, passed legislation in 1994 authorizing the creation of Free Processing Zones (FPZs). Under the terms of the law, qualifying companies operating in the FPZs would be exempt from direct taxation for a twenty-year period, and imported inputs would be free from import duties or tariffs. Companies in FPZs would also be exempt from collective bargaining and minimum wage requirements, although subject to other labor laws. The legislation was originally intended to promote investment in export-related industries, but the wording of the legislation as passed does not limit applicant companies to exporters or providers of services to overseas clients. Government ministries continue to discuss details of the FPZ's. As of November 1999, no FPZ's had yet been established, although one had been proposed for the Beer Sheva region.

8. Protection of U.S. Intellectual Property

Israel is a member of the World Trade Organization (WTO), and projects that it will be in compliance with its commitments under the Trade Related Aspects of Intellectual Property (TRIPS) Agreement by January 1, 2000. Israel expects to pass legislation before the end of 1999 that will amend its patent, trademark, copyright, and other relevant laws to bring it into compliance with TRIPS. The pharmaceuticals industry, however, has raised questions about whether the TRIPS implementation law will satisfy the data protection requirements of TRIPS section 39.3. (More on pharmaceuticals below.)

The GOI is also developing an updated copyright law, which it expects to bring to the Knesset in 2000. The proposed legislation would include enhanced rights of distribution in connection with rental rights and imports of copyrighted materials. Rental rights would include all protected works, including sound recordings, cinematographic works, and computer programs. Current Israeli patent law contains overly broad licensing provisions concerning compulsory issuance for dependent and nonworking patents. The government is working on revisions of laws on patents, cable broadcasting, trademarks and other areas.

Israel is a member of the World Intellectual Property Organization (WIPO), and is a signatory to the Berne Convention for the Protection of Literary and Artistic Works, the Universal Copyright Convention, the Paris Convention for the Protection of Industrial Property, and the Patent Cooperation Treaty. Israel is also a member of the International Center for the Settlement of Investment Disputes (ICSID) and the New York Convention of 1958 on the recognition and enforcement of foreign arbitral awards.

In February 1998, the Knesset passed a separate amendment to the Patent Law which will allow non-patent holders to manufacture limited quantities of patented pharmaceutical products prior to the expiration of patent rights, in preparation for submitting data necessary to obtain marketing approval to Israeli and foreign health authorities. The amendment also provides for a limited extension of the patent term for pharmaceutical products. The United States unsuccessfully objected to the amendment and urged that Israel model its law on the comparable provision of U.S. law.

Israel passed legislation early in 1999 that would weaken patent protection by permitting parallel importation of patented pharmaceutical products. The United States has urged Israel not to enact the proposed legislation due to its potential adverse impact on the rights of U.S. patent holders.

In April 1998, the U.S. Trade Representative placed Israel on the "Special 301" Priority Watch List due in large part to U.S. concern over an increase in illegal copying and sale of video and audio recordings. In June 1998, USTR submitted an "Action Plan" to the Government of Israel addressing outstanding U. S. concerns, including increasing piracy levels of cable television transmissions, audio and videocassettes, compact disks, and computer software.

In March 1999, the GOI submitted to USTR a report on its IPR enforcement activities and its progress in fulfilling the Action Plan. The GOI said its accomplishments included legislation to bring Israel into compliance with TRIPS obligations by the end of 1999, establishment of a new police unit dedicated to combat IPR violations, and establishment of an inter-ministerial committee under the Ministry of Industry and Trade to monitor progress on IP enforcement.

Nevertheless, on April 30, 1999, USTR announced, based on its special 301 review, that the GOI had made little progress in implementing the 1998 Action Plan. As a result, USTR placed Israel on the priority watch list. In making this announcement, USTR cited specific concerns about:

- the inadequacy of Israel's copyright law;
- amendments to the pharmacists law that weaken patent protection for pharmaceuticals;
- high levels of IPR piracy, particularly audio CD's;
- insufficient police and prosecutorial attention to IPR cases.

USTR will conduct a Special 301 out-of-cycle review of Israel's IPR protection in December 1999.

9. Worker Rights

a. The Right of Association: Israeli workers may join freely established organizations of their choosing. Most unions belong to the General Federation of Labor (Histadrut) and are independent of the government. In 1995, Histadrut's membership dropped sharply after the federation's links with the nation's largest health care fund were severed. A majority of the workforce remains covered by Histadrut's collective bargaining agreements. Non-Israeli workers, including nonresident Palestinians from the West Bank and Gaza who work legally in Israel, are not members of Israeli trade unions but are entitled to some protection in organized workplaces. The right to strike is exercised regularly. Unions freely exercise their right to form federations and affiliate internationally.

b. The Right to Organize and Bargain Collectively: Israelis fully exercise their legal right to organize and bargain collectively. While there is no law specifically prohibiting antiunion discrimination, the Basic (i.e., quasi-constitutional) Law against discrimination could be cited to contest discrimination based on union membership. There are currently no export processing zones, although the free processing zones authorized since 1994 would limit workers' collective bargaining and minimum wage rights.

c. Prohibition of Forced or Compulsory Labor: Israeli law prohibits forced or compulsory labor for both Israeli citizens and noncitizens working in Israel.

d. Minimum Age for Employment of Children: Children who have attained the age of 15 and who remain obligated to attend school may not be employed, unless they work as apprentices under the terms of the apprenticeship law. Nonetheless, children who have reached the age of 14 may be employed during official school holidays. The employment of children aged 16 to 18 is limited to ensure adequate time for rest and education. Ministry of Labor inspectors are responsible for enforcing these restrictions, but children's rights advocates contend that enforcement is unsatisfactory, especially in smaller, unorganized workplaces. Illegal employment of children does exist, probably concentrated in urban light industrial areas.

e. Acceptable Conditions of Work: The minimum wage is set by law at 47.5 percent of the average national wage, updated periodically for changes in the average wage and in the consumer price index. Union officials have expressed concern over enforcement of minimum wage regulations, particularly with respect to employers of illegal nonresident workers. Along with union representatives, the Labor Inspection Service enforces labor, health, and safety standards in the workplace. By law, the maximum hours of work at regular pay are 47 hours per week (eight hours per day and seven hours before the weekly rest). The weekly rest must be at least 36 consecutive hours and include the Sabbath. Palestinians working in Israel are covered by the law and by collective bargaining agreements that cover Israeli workers.

f. Rights in Sectors with U.S. Investment: Worker rights in sectors of the economy in which U.S. companies have invested are the same as described above.

Extent of U.S. Investment in Selected Industries -- U.S. Direct Investment Position Abroad on an Historical Cost Basis **--** 1998

(Millions of U.S. Dollars)

Category		Amount
Petroleum		41
Total Manufacturing		2,344
Food & Kindred Products	71	
Chemicals & Allied Products	65	
Primary & Fabricated Metals	15	
Industrial Machinery and Equipment	-11	
Electric & Electronic Equipment	1,709	
Transportation Equipment	5	
Other Manufacturing	490	
Wholesale Trade		91
Banking		0
Finance/Insurance/Real Estate		386
Services		(D)
Other Industries		(D)
TOTAL ALL INDUSTRIES		3,067

(D): Suppressed to avoid disclosure of data of individual companies.

Source: U.S. Department of Commerce, Bureau of Economic Analysis.