GENERAL AGREEMENT

ON TARIFFS AND TRADE

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TRADE POLICY REVIEW MECHANISM

ISRAEL

Report by the Government

In pursuance of the CONTRACTING PARTIES' Decision of 12 April 1989 concerning the Trade Policy Review Mechanism (BISD 36S/403), the initial full report by Israel for the review by the Council is attached.

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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

I. OBJECTIVES OF TRADE POLICY

a. 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.

b. 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.

1. 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, Israeli 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.

2. 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.

3. 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.

II. 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.

III. THE TRADE POLICY FRAMEWORK

There is no Constitution in Israel and the fundamental principles are embodied in Basic Laws. The Israeli legal system follows the Anglo-Saxon model and gives judges a wide authority and discretion to interpret the law.

Two Basic Laws contain provisions that affect trade. There is a Basic Law on the State Economy 1975, which lays down the elementary principles of democracy in the economy: taxes and the State Budget must be legislated. It also states procedure for adopting the Budget Law and requires the inspection of the State Economy by the State Comptroller. An amendment passed in 1982 states that there shall be a three-year pluri-annual budget.

The second Basic Law was passed in 1992, guaranteeing the freedom of enterprise and professional activity with restrictions being permitted only on grounds of security, health, protection of the environment and morality. There are various laws, dealing with specific subjects that give the Government the authority and discretion to introduce a wide range of measures. Ministers are also entitled to issue ordinances that sometimes have to be passed by the Knesset - the Israeli Parliament. An example can be found in the 1991 liberalization program, which resulted from a governmental decision and still has great and lasting impact on trade.

a. Domestic Laws and Regulations

1. Customs laws

The basic provisions on customs administration and management, have been adopted by the Knesset. The basic provisions on customs legislation and in particular the customs houses were set forth in the Customs Ordinance of 1925. The Customs Tariff Law - 1937, regulates the application of customs duties. Under the Customs and Excise Duties Law - 1949, the Minister of Finance is entrusted by order to amend the Customs Tariff and Exemption Ordinance - 1937. These laws set forth administration of customs, determination and payment of customs duties, matters relating to import

or export customs clearance, examination of goods, prevention of smuggling and legal proceedings against infringement. The laws are amended if need arises.

2. The Trade Levies Law

Dealing with safeguard and countermeasure duties, the Trade Levies Law was enacted in 1991. The law defined the circumstances that justify the use of levies in the foreign trade field. The Minister of Industry and Trade, jointly with the Minister of Finance, is empowered to impose levies on imports under certain circumstances. An advisory committee was created to handle complaints of dumped or subsidized imports. The law allows the Minister of Industry and Trade to impose anti-dumping and countervailing duties under specific conditions.

The law was necessary to create a legal framework in order both to be in line with GATT anti-dumping and subsidies codes and to permit adequate protection against unfair trade practices which cause material injury to domestic industry while ensuring the existence of import competition.

3. The Free Import and Export Ordinances

The Free Import Ordinance - 1978, lays down the principle of free imports, with a limited number of exceptions. Exceptions are goods whose import is forbidden. The second category consists of merchandise that require licences.

The Free Export Ordinance - 1978, affirms the principle of free exports but there are three exceptions. Firstly, a list of products whose exportation is forbidden, consisting of live animals, meat, dairy products cereals and other agricultural goods. The second list encompasses merchandise whose export requires specific permission, mainly agricultural products and precious stones. The last consists of products that require licences, e.g. chemical products and various technological equipment.

4. The Compulsory Public Procurement Law

The Compulsory Public Procurement Law states that the Government as well as public institutions must issue public tender in order to purchase goods, services or properties. Amendments to the Law empower the Government, after permission of the Committee of the Knesset for Constitution, Laws and Justice, to give preference to local, international, or to a specific region's proposals. The Ministry of Finance is empowered with the permission of the above mentioned Committee to issue directives for the implementation of the Law.

5. The Foreign Exchange Law

The Foreign Exchange Law regulates transactions involving foreign currency. In the last years, freer policy has been adopted. The Bank of Israel is responsible for the execution of the foreign currency laws. The repatriation of profits derived in Israel by foreign investors is permitted.

6. The Restrictive Business Practice Law

The Restrictive Business Practice Law - 1988, aims to assure that the rules of competition come into play and to prevent the emergence of cartels and monopolies. The law deals separately with cartels, monopolies and mergers, and prescribes different procedures and rules for these three categories. The cartel is determined by its impact on competition. It is a criminal violation to carry out a cartel

or a monopoly arrangement without Court approval. The law is implemented through a Controller of Restrictive Practices and a Restrictive Trade Practices Court.

7. The Standards Law

The Standards Law - 1953, aims to preserve public health and security. Standards apply equally to Israeli and imported goods. For implementation of this policy, the Standards Institute of Israel has been created. The Standards Institute of Israel is a statutory organization that acts independently of the Government. Members of the institute are representatives from all sectors of the economy: consumer organizations, manufacturers organizations, Government offices, engineers, associations, local authorities, science and research institutes, with no sector having a majority. The Standards Institute is responsible for preparing standards, testing the commodities and ensuring the conformity with official standards. There are two different kinds of standards: Official Standards, as declared by the Ministry of Industry and Trade, which are obligatory and require tests, and voluntary standards published by the Standards Institute of Israel. The present policy is to adapt the Israeli standards to international standards and those of its principal trading partners.

8. Legislation for the protection of intellectual property

Israel domestic legislation ensures complete protection of the rights of intellectual and industrial property; the legislation covers all the relevant fields: The Patent Law - 1967, The Designs Ordinance - 1925, The Trade Marks Ordinance new version - 1972, The Appellations of Origin Law - 1965, The Plant Breeders' Rights Law - 1973 and The Copyright Law and Ordinances - 1911 and 1924, whose recent amendments provide protection for computer software.

The Patent Law lays down the provisions for the grant of patents and also provides remedies for patent infringement: a Court of Law may grant relief to the patentee by way of injunction and damages, or order seizure of manufactured goods which are held to have infringed a patent granted in Israel. The duration of protection is 20 years for patents. Under copyright law the duration of protection varies according to the work. It is equal to the life of the author plus 70 years for artistic works.

In order to cope with new technologies and modernize the legislation, the patent, design, trade mark and copyright laws are under review. All the statutory provisions are safeguarded by the Register of Patents within the Ministry of Justice.

9. Legislation for the protection of the environment

Protecting the environment is a relatively new topic in Israel, as in most countries. The importance of the subject has been recognized in Israel, where a Ministry of the Environment has been created. The past decade has seen a breakthrough in the passage of environmental legislation, so that today Israeli law relates to all aspects of the environment. Many laws integrate regulatory and fiscal measures.

Domestic laws cover all the matters involved in this field. The principal laws are: the Public Health Ordinance of 1940 that controls health and environmental nuisances; the Law for the Prevention of noise and shocks - 1960; the Abatement of Environmental Nuisances (civil action) - 1992, which enables a citizen or a group to take civil action in cases of pollution; the Water Law; the Licensing of Business Law which empowers the Minister of Interior in consultation with the Minister of Health and Environment to designate and define businesses requiring a license in order to ensure proper

environmental conditions; the Prevention of Sea Pollution Ordinance - 1980 and Laws - 1983; the Pharmacist's Ordinance (new version) - 1981, which controls hazardous substances and medical drugs.

b. Trade Policy Formulation

The State of Israel is governed according to a democratic system. Important decisions in the economic field are taken at the Governmental level within a general legal framework.

The economic policy is elaborated in the different governmental agencies. Some macroeconomics issues are decided after consulting with the Governor of the Bank of Israel whose responsibility is also to be an advisor to the Government. The overall responsibility for trade policy formulation and implementation rests with the Ministry of Industry and Trade. The other ministries involved are the Ministries of Finance, Economics, Agriculture, Foreign Affairs, etc. Other ministries may be involved, particularly the Ministry of Health and the Ministry of the Environment. A Committee for International Economic Affairs deals with international trade issues. This committee includes the General Directors of the following ministries: Foreign Affairs, Economics, Finance, Industry and Trade and is chaired by the Director General of the Ministry of Finance. Ad-Hoc Committees comprising Ministers and General Directors are created to deal with specific issues.

A large number of bodies and institutions are involved in trade policy formulation: governmental agencies who consult with representatives of the private sector, professional organizations, trade unions, and members of the academic world. There are regular consultations with the Israeli Chamber of Commerce and the Manufacturers Association. Economic policy is now elaborated on the basis of a pluri-annual budget system, which appears to be a better tool to supervise economic performances and provide economic agents with a predictable horizon.

The laws may be initiated by the Government or by Members of the Knesset. If the proposal is governmental, the bill is directly examined in first reading by the Parliament, since it has already been checked by the Government. If the proposal comes from a member of Parliament, the bill has first to be discussed in preliminary reading in a committee of the Knesset. Each law names a specific Minister who is responsible for its implementation. Accordingly, the concerned minister is empowered to issue orders to implement the law.

Basic Law - The Knesset - 1958, provides the legal framework of the Israeli Parliament, which comprises 120 members, elected for a period of four years. The permanent committees of the Knesset work on specific matters, as for example the Committee of Finances. These Committees are regularly informed of ongoing policy, and are empowered to obtain explanations from the appropriate Minister. They are involved in governmental decisions since Ministers have to obtain Committee approval before implementing orders. Various committees are also set up around specific issues. Like the Government, the Knesset committees collect their information from all available sources: private, academic and public, and may hold public hearings in which all kinds of professionals participate.

Being closely informed of events in a specific field, the Knesset Committees can control and review the ongoing policy. Hence, the only regular review of economic policy takes place each year, when the Budget of the State is submitted to the Knesset for approval.

In Israel, like in other democratic countries, the judiciary and the legislative process are separated. The prominent rôle of the Israeli Supreme Court must be noted since it interprets the laws, and acting as High Court of Justice deals with administrative decisions of public authorities. Contradictions that

may arise between a law and a basic law are also brought to the Supreme Court. Hence, the interpretation of the laws by the Supreme Court plays a significant role in the application of the law in Israel.

c. International Agreements

1. General Agreement on Tariffs and Trade - GATT

Israel entered international commercial relations through bilateral agreements. Yet, the ongoing liberalization policy is bridging the gap that existed between bilateral trade and the rest of foreign trade.

Israel has been a member of GATT since 1963. Israel has also joined a number of Tokyo Round Codes. which are the Agreement on Technical Barriers to Trade, 1989, the Subsidies Code, 1985 and the Agreement on Government Procurement, 1983.

2. Other agreements

Israel participates in a number of commodity arrangements aimed at diversification and improvement of competitiveness of commodities (see Appendix 1 for the list of agreements).

Israel is a Member of the International Centre for Settlement of Investment Disputes (I.C.S.I.D.) and of the Multilateral Investment Guarantee Agency (M.I.G.A). Israel is also a member State of many conventions and agreements for the protection of intellectual property (see Appendix 2).

3. Free trade agreements

Israel's free trade agreements as well as joining the GATT were part of a wish to achieve more liberalism. At the present time Israeli policy aims at enlarging free trade agreements to other countries.

Israel has ratified three bilateral Free Trade Agreements with the EEC, the United States and EFTA. These agreements had a significant influence on Israeli trade policy, resulting in more liberalization of trade and of the whole economy. All three agreements have been submitted to GATT. The purpose of these agreements is to promote development of harmonious economic relations and cooperation between the parties, foster the complementarity of their economies and to ensure conditions of fair trade for their mutual benefit.

3.1 Free Trade Agreement with the European Economic Community

The convention was signed in 1975. A Joint Committee is in charge of implementation of these goals. The Agreement deals with industrial goods, and agricultural products are covered as specified in a protocol. Capital transactions, financial or other services are not included in the Agreement.

The Agreement covers products either wholly originating within the territory of one of the parties, or a product in the making of which sufficient work or processing has taken place so that the final product receives a different tariff classification from the classification of the component parts.

This Agreement eliminates most barriers to the import of goods (customs duties as well as quantitative restrictions) and provides a basis for economic cooperation between the parties.

Since 1977, within the terms of this Agreement Israel has enjoyed a complete exemption from EEC import duties on most of its exports. There are also special regulations and tariffs for agricultural products. In return for these exemptions, Israel agreed to expose local industry to competition from the EEC through a gradual reduction of import duties. One hundred percent of tariff abolition was reached in January 1989. Article 3 of the second Protocol permits Israel to reintroduce tariffs if necessary to protect and favour new processing industries not existing when the agreement was signed.

Safeguard measures are permitted in the event of balance-of-payments difficulties of one of the parties.

The Financial Protocol states that the European Investment Bank shall make funds available to Israel in the form of loans devoted to agreed projects.

The duration of the agreement is not limited. There is no dispute settlement procedure.

This agreement reinforced the position of the EEC as the main trading partner of Israel. Imports from the EEC that accounted for 43.1 per cent of Israeli imports in 1975, went up to 50 per cent in 1992 and 49 per cent in 1993, whereas exports to the EEC fell from 44.8 per cent of total Israeli exports in 1975 down to 35.2 per cent in 1992 and 31 per cent in 1993. These figures show that while the trading flows were almost balanced in 1975, from this year onwards, the balance has been in persistent deficit to Israel's detriment. For example, in 1992 the total imports from the EEC accounted for US$9,450 million, against US$4,115 million exports, and in 1993 the total imports from the EEC accounted for US$10,000 million against US$4,200 million exports. The deficit of Israel has expanded for the three past years, from US$2,000 million in 1990, to US$2,749 million in 1991, to US$3,602 million in 1992 and to more than US$5,000 million in 1993. This gap may be attributed also to some obstacles to Israeli exports to the EEC.

That is one of the reasons why Israel and the EEC are now engaged in a thorough examination of the agreement with the aim of improving the relationship between them. Among the issues being discussed are also technical aspects such as a possible extension of the agreement to the field of services; a revision of the rules of origin, which are rather complex; a system of mutual recognition of standards testing; R&D cooperation and the lack of dispute settlement procedure.

3.2 Free Trade Agreement with the United States

This convention was signed in 1985. Its duration is not limited.

The Agreement recognizes that Israel's economy is still in a process of development.

The agreement covers goods, including fresh and processed agricultural products, intellectual property rights, and trade related investment requirements. The agreement aims also at including services in the future.

The rules of origin are as follows: the product must be wholly manufactured in the territory of the exporting party, or if made of imported inputs, it must be a new or different article that has been grown, produced or manufactured in the exporting country with at least 35 per cent of the local content having been added. Also, it must be imported directly from one party into the other.

Both parties agreed to phase out all duties within 10 years in four stages based on the sensitivity of products to imports. For the majority of products, duties were immediately eliminated. There are still a limited number of products that benefit from GSP treatment and from which duties will be definitely eliminated in 1995. The agreement enables import restrictions on agricultural products, provided that such restrictions are not duties, if they are based on agricultural policy considerations.

Israel is allowed to levy duties to protect infant industries under specific circumstances. Both parties may impose temporary restrictions for a 150-day period in the event of serious balance-of-payments difficulties.

A Joint Committee is responsible for the implementation and the annual review of the agreement.

The agreement provides mechanisms for dispute settlement: the parties may refer to the Joint committee and if necessary, to a three member conciliation panel whose findings are not binding.

The trade flows between the two countries weigh between 18 and 31 per cent of the Israeli trade (1992). The balance is positive for Israel, and the expansion of the trade is satisfactory: Between 1988 and 1993, the exports from Israel grew from US$2,987 million to US$4,200 million and the imports to Israel grew from US$2,153 million to US$3,600 million; obviously the importance of the agreement in the future is very great.

3.3 Free Trade Agreement with EFTA countries

The European Free Trade Association (EFTA) comprising Finland, Iceland, Norway, Sweden, Switzerland, Austria and Liechtenstein, is a free trade area that has developed a close cooperation with the EEC. Consequently, the Free Trade Agreement between Israel and EFTA is a natural complement to the existing agreement with Israel and enlarging the Free Trade Agreement to all the territories of Western Europe.

In January 1993, all duties on industrial goods imports were abolished. The only exceptions are processed foods that are classified as agricultural products. Whereas regarding agricultural goods and semi-processed food, some duties were eliminated on 1 January 1993, others have been reduced.

This treaty is similar in principle to that with the EEC, but it includes the field of intellectual property and the rules of origin are more detailed.

A number of additional trading agreements are being negotiated with various countries

4. Other bilateral agreements

The objective of the other bilateral agreements is to ease economic relations between countries, preventing obstacles or giving incentives.

Israel has signed treaties for the prevention of double taxation with sixteen countries: Austria, Belgium, Canada, Denmark, Finland, France, Germany, Italy, Jamaica, Holland, Norway, Poland, Singapore, South Africa, Sweden and United Kingdom. Similar treaties are on the way with other countries. Treaties that are limited to the taxation of aviation and shipping enterprises have been signed with Argentina, Greece, Switzerland and Uruguay.

Treaties for the promotion and reciprocal Protection of Investments have been signed with several European countries, and additional ones are being negotiated. In the field of industrial research and development, agreements have been signed with Canada, France, Holland and Spain, whereas a binational Industrial Research and Development Foundation has been created with the US in order to support the advancement of scientific collaboration between business groups from both countries.

IV. THE IMPLEMENTATION OF TRADE POLICIES

a. Trade Policy Measures

Israeli foreign trade was highly concentrated on the EEC and the US markets, as a result of the FTA agreements and for known political reasons. The share of East Asia, Latin America, Africa and Eastern Europe in world trade is becoming significant only in the last years. In this context, Israel decided to open the economy to imports from those countries. The purpose of the programme was to prevent distortions in resource allocation resulting from differentials in effective exchange rates, since protective tariffs induce investments on products whose profitability is relatively low. A governmental decision in April 1991 started the liberalization process that began eventually on 1 September 1991.

This programme provides a predetermined path for removal of trade barriers with countries besides the EEC, EFTA and the US. The first stage of this programme was implemented in September 1991, when administrative restrictions on imports from these countries were replaced by tariffication, the tariffs to be lowered at a predetermined rate. For the first three years of the programme, licences were required for certain imports such as textiles, clothing, footwear, fertilizers, plywood. These licenses are issued mostly automatically. For very sensitive products, high tariffs are levied at the beginning, to be gradually reduced during a 5 to 9 year period, at the end of which customs tariffs will be down to 8 per cent for raw materials, and 12 per cent for finished and semi-processed products. In the wood and textile branches, maximum rates of 110 per cent were levied. They were reduced to 75 per cent on 1 September 1993 and to 60 per cent on 1 January 1994. The programme is implemented gradually, to soften the impact on firms and sectors which may suffer from new competing imports.

This programme includes all kinds of goods. No doubt the implementation of this programme will bring about a real opening of the Israeli economy to the entire world. In September 1992, 1993 and 1994, tariffs were lowered as scheduled.

The import liberalization is characterized by the increasing importance of the value added tax (V.A.T) and the reduced share of the purchase tax. In 1992 V.A.T was 62 per cent of the revenue of the Customs Division, while it was 30 per cent the year after the V.A.T law came into force in July 1976. In recent years, purchase tax on 400 items was reduced and it is under way to be abolished totally.

1. Tariffs and duties

Aside from customs duties, the other taxes imposed on imports are some additional levies on a limited list of agricultural products, the Value Added Tax and the Purchase Tax. Israel has no import deposits, no tariff quotas, and the Peace of Galilee surcharge has been abolished.

1.1 Customs duties

Since 1 January 1988, the classification of commodities that serves the Customs has been based on the new international Harmonized System. The simplification of the structure of import charges in Israel is under review, and will come into effect thanks to the liberalization programme of 1991. The Customs Administration is also planning a radical simplification in customs procedures and it is under implementation now.

Customs duties are based on the CIF value of imports. Duties have been subject to specific reductions in the FTA agreements: most of the tariffs have been abolished and the remaining part will be definitely abolished by 1995.

As a result, customs duties apply only to countries not under FTA agreements. Even for those imports, the main part is free from duties: in 1992, 63.5 per cent of imports from those countries were free from duties.

The influence of FTA agreements on customs revenues has been particularly visible since 1989, when most products became free of tariffs within the Israel-United States Free Trade Area and all tariffs were cancelled within the Israel-EEC Free Trade Area: Customs revenues fell by 56 per cent in real terms. Since then, the real annual increases have not compensated for this reduction. In 1992, the real growth of the revenues stood at 18.7 per cent, (a higher rate than that of the growth of imports) due to a change in the composition of imports, with an increase in imports of durable goods, especially cars. The change in the customs legislation did not have a significant influence on the data.

1.2 Purchase tax

The Purchase Tax is one of the most important tools in achieving fiscal aims. This tax is levied on consumer and durable goods, both imported products and domestic production. In both cases, the tax is calculated on the basis of the wholesale price.

The structure of the purchase tax has been modified many times from the beginning of the 1980s, up to 1993. In order to ensure equal treatment between local and imported items, since January 1989, there has been an option for registered importers, to use the actual mark-up and the actual wholesale price as part of the basis for taxation instead of using TAMA, which is the administrative evaluation price for imported goods. In addition, the third supplement was cancelled in January 1993. The trend is to lower the rate of the tax and reduce its field of implementation.

Since 1987 the number of different rates of purchase tax has been reduced to five major groups: 10 per cent and 20 per cent for common items, 30 per cent for electrical appliances refrigerators, washing machines, 45 per cent for construction intermediaries and 65 per cent for electronic goods, i.e. TV sets, VCRs etc. In 1990 the rate for constructions input was reduced and the purchase tax on cars was reformed and unified so that in August 1993 the tax was at the unique rate of 95 per cent. In January 1991, TAMA was cancelled on commodities that are not produced in Israel, such as televisions, VCRs, and cameras, and in 1993 the purchase tax on textiles, clothing and shoes was phased out.

1.3 Value added tax

The rate of the value added tax is 17 per cent.

In 1992, the V.A.T accounted for 62 per cent of all the indirect taxation, while the purchase tax accounted for only 19 per cent.

1.4 General import levy

The General Import Levy (Peace of Galilee Duty) was based on the CIF value of imports. Since the Lebanon war, this duty has been levied at a rate of 3 per cent, on all imported goods, including those which were duty free. The Israeli Government promised GATT to lower the rate to 1 per cent in 1995, but it decided to accelerate the process, and eliminated the tax in 1993.

2. Rules of origin

These are autonomous or contractual rules of origin. As regards the first category, in order to confer Israel origin on the goods, Israel must have been the place where the last substantial transformation occurred.

Contractual rules of origin are provided by the FTA agreements, since they govern the definition of a product originating in one of the parties that is eligible for tariff reduction or complete tariff-free entry. The rules of origin as specified in the Israel - US Agreement and those which result from the Israel - EEC Agreement are different.

According to the Israel - US Agreement, in order to receive the benefits of the free trade agreement, a product must meet the following requirements:

- it must be wholly the growth, product or manufacture of the exporting country, or if it is made of imported materials;

- it must be a new or different article that has been grown, produced or manufactured in the exporting country;

- it must be imported directly from one country to the other and at least 35 per cent of the local content (and not the cost) of the product must have been added in the exporting country.

According to the Israel - EEC Agreement, to be eligible to benefit from the agreement, a product must either wholly originate within the territory of one of the parties, or be a product manufactured from other components that do not fall into the above category, but in the making of which sufficient work or processing has taken place, so that the final product receives a different tariff classification from the classification of the component parts.

Special attention should be paid to the different definitions of 'origin'. The agreement with the EEC states that the origin is the country where the last substantial process or operation that is economically justified has taken place, so that the final product receives a different tariff classification from the classification of the component parts, whereas the agreements with the United States and EFTA countries provides that the place of origin is where at least 35 per cent of the local content of the product has been added.

Israel is interested in a set of similar rules of origin, since the different definitions bring about difficulties in foreign trade.

3. Quantitative restrictions, import licensing and quotas

Quantitative restrictions are currently limited to agricultural products, petroleum, gold and gold coins, chemicals covered by the Montreal Protocol, weapons and explosives, and narcotics.

Agricultural products are subject to import restrictions based on agricultural policy considerations.

The Free Import Ordinance - 1978, states that the import of commodities is free but in a limited number of exceptions a licence is required. This law applies only to countries that are not parties of FTA agreements. Following the liberalization programme, it was decided at the administrative level that those licences that are required have to be automatically delivered within a 14-day period, a lack of answer within the aforesaid period is considered as an approval.

4. Health regulations

Health regulations are aimed at the protection of public health. The Food Department at the Ministry of Health is in charge of testing the goods before issuing the import permit. The composition of the product is checked to ensure that it complies with standards of public health and of quality.

5. Customs valuation

Custom valuations are applied to the CIF value of the imported goods. The Customs Administration may refer to the value as it appears in the sale contract, if this value reflects the real price of the imported good, as defined in the Customs Ordinance.

6. State-trading entities

Israel has a single State-trading entity, the Government Trade Administration, which deals only with import of meat. The possibility of liberalization in this sector is under consideration and currently the import of kosher beef meat is fully privatized and free.

7. Tariff concession arrangements

A draw-back for export is given on the taxes levied on inputs to manufacture exported products and for all indirect domestic taxes that were paid. The draw-back is granted only on those inputs physically used in the manufacturing of the exported product.

8. Import prohibitions

There are no import prohibitions, except for dangerous items, such as drugs in accordance with the Dangerous Drugs Ordinance - 1973, weapons, etc. Dangerous items are specified in an appendix of the Free Import Ordinance.

9. Import and export cartels

There is a general law whose purpose is to dismantle existing cartels and prevent the emergence of new cartels or monopolies if the monopoly endangers free trade. The General Restrictive Trade Law, 1988, provides a framework for implementing the law and a Controller of Restrictive Trade and a Restrictive Practice Trade Court. The Law states that mergers have to be checked to prevent situations of monopolies.

10. Government assistance

The Encouragement of the Capital Investments Law - 1959, is aimed at developing the productive capacity of the economy and promoting regional industrial development. Various incentives are offered to enterprises - including foreign enterprises registered in Israel - which are approved by the Government Investment Center in accordance with specific criteria. Some of these criteria are the value added, increase in employment, development of remote areas, innovative technologies and volume of the project. The status of "Approved Enterprise" requires the recommendation of the relevant economic department of the Ministry of Industry and Trade responsible for the field of activity in which the enterprise will be involved. The benefits may be investment grants, tax exemptions or accelerated depreciation, and loan guarantees. Encouragements for investments to "Capital Intensive Companies" are provided by the Law for the Encouragement of Investments - 1990.

The government assistance policy is also characterized by encouragement to small entrepreneurs and support for research and development.

There is a Small Business Encouragement Fund, to grant loans and credit facilities to new entrepreneurs and immigrants who cannot benefit from the Encouragement of Capital Investment Law. This measure is also aimed at reducing unemployment, since it is assumed that small sized enterprises create new jobs.

The Law for the Encouragement of Industrial Research and Development - 1965, aims to foster research and development in industry and to facilitate the absorption of scientific manpower. The Chief Scientist of the Ministry of Industry and Trade participates in research and development expenses of approved projects by giving grants. There are also different programmes, such as venture capital funds and incubators (start-up enterprises), for approved scientific projects.

11. Safeguard, anti-dumping and countervailing actions

11.1 Safeguard duties

Safeguard duties are regulated by the Trade Levies Law - 1991. Safeguard levies may be imposed by order of the Minister of Trade and Industry, if the Minister considers that the levy is needed in order to achieve a limited number of objectives, which are specified in the law. It must be stressed that the Minister has to specify in his order for which purpose the levy is needed. An example of one of the objectives is to offset cost differentials of agricultural components in processed food products in domestic and imported prices. Measures may also be taken in order to adopt economic countermeasures against any country which violates an agreement or arrangement with Israel and to prevent import from any country that prohibits or restricts trade with Israel or takes discriminatory steps against Israel.

An Advisory Committee whose composition and proceedings are defined by the law and operates like a judiciary institution has to examine complaints. In addition to the powers of the Committee over the parties, the committee advises the Minister in his decision making. The Minister must take into account the benefits derived from imports, as well as the state of the trade relations between Israel and foreign countries.

In fact, very few cases of safeguard actions have occurred: In the past, petitions for import relief have been filed and temporary measures were taken concerning imports of flat glass sheets and

glass containers imported from the EEC. Currently, the only import relief measure in existence is an import quota for plywood from the US.

11.2 Anti-dumping and countervailing measures

These measures are enacted in the Trade Levies Law. A special feature of this law should be noted: both anti-dumping and countervailing duties may be established for a maximum three-year period. This may be extended, but only after a review of the case.

Two conditions have to be met: goods have been imported or are about to be imported under conditions of dumped or subsidized imports and material injury has been or is liable to be caused by the dumped or subsidized imports, provided that each concept is defined by the law.

The Advisory Committee which is responsible for the determination of the dumping level and of the existence of injury and causality as a result of dumping or the subsidy level, is chaired by an independent public representative who has to be a lawyer.

Investigation is carried out by a government official, the Commissioner. According to the law, when deciding about imposition of anti-dumping measures upon advice of the Advisory Committee, the Minister is also expected to take into consideration international economic relations. Therefore, he may impose a lower duty than advised by the Committee.

The Law also determines a time table for carrying out investigations and reaching decisions in order to avoid a lengthy investigation, while giving all interested parties the opportunity to present all the required evidence.

Although several complaints have been filed, only few of them have given rise to investigations. In only one case an anti-dumping duty was imposed, for a period of two years until May 1993. Currently three investigations and one review are in process. In two cases provisional securities on imports have been required.

12. Government procurement

Israel has signed the GATT Government Procurement Code and accordingly, thirteen public agencies opened their tenders above US$150,000 to foreign suppliers.

13. Technical standards

The regulations governing the Standards Institute of Israel show that one of the main features of the policy is participation in international organizations. Its purpose is to enable national authorities to accept the results of tests and inspections performed in other participating countries on a reciprocal basis and to harmonize standards when they differ. The Standards Institute of Israel represents Israel in the two international standardization organizations: ISO and IEC. This includes participation in several committees of these organizations.

The other main aim of the policy is to ensure transparency of national activities and procedures in regard to the elaboration and notification of technical requirements. The Standards Institute of Israel provides all available information on Israeli standards in Israel and abroad.

The Standards Institute provides a high quality of elaboration and testing of standards, thanks to different laboratories specialized in various disciplines. The Institute tests the degree to which the products comply with Israeli Standards or Official Israel standards and issues test certificates. It also issues permits to manufacturers to mark their products with a standard mark and supervises the manufacture and the quality of these products.

14. Free trade zones

The Free Port Areas Act (Haifa, Ashdod, Eilat) - 1969, enables investors to enjoy special privileges, a large measure of independence, exemption from taxes, and freedom from administrative limitations. Israeli companies, as well as foreign companies registered in Israel, which have obtained the qualification of approved enterprises benefit from various tax exemptions. Enterprises in free trade zones enjoy all the benefits provided by the Law for the Encouragement of Capital Investments, those deriving from the Free Port Areas Act.

General benefits not specifically related to the Law for the Encouragement of Capital Investments are granted in the Eilat area in accordance with the Eilat Free Port Areas Act. It relates to investors in and residents of the Eilat region and allow grants and tax concessions. Direct and indirect tax benefits are granted to ventures endorsed as 'authorized enterprises' in accordance with the Free Port Areas Act, as well as to 'approved enterprises' in the Eilat area.

15. Foreign exchange controls

The Currency Control Law - 1978, provides details on what is prohibited and permitted in the area of foreign currency transactions. An Israeli resident is subject to the general prohibition on the purchase and transfer of foreign currency overseas. The regulations restrict the offset of foreign currency liabilities against receivables, since it is only permissible with respect to goods transactions, or if special approval is granted by the Controller of Foreign Exchange at the Bank of Israel.

Foreign exchanges, including capital movements transactions have been deregulated since 1987. The object is to offer a wider and more accessible range of foreign exchange transactions, thus strengthening the ties between foreign and domestic financial markets. Residents are also allowed to carry out direct investments abroad and non-residents are encouraged to invest in Israel. The liberalization of capital movements reduces the cost of borrowing abroad and increases the yield on foreign assets.

Short-term capital movements have been deregulated: the minimum term for direct foreign credit was first reduced in 1989 and 1990 and abolished in 1991, when premature repayment was permitted. In April 1991, forward transactions were extended to include securities trade abroad as a hedge for foreign exchange assets and liabilities. As a result, investment abroad by residents grew and net investments in Israel by non-residents also went up. In 1992 Israel's residents were permitted to buy foreign shares and bonds abroad. The total investments of Israeli residents abroad accounted for US$2.7 billion in 1992, compared to US$1.5 billion in 1991 and US$350 million in 1990.

The liberalization extended the possibilities of foreign investments of companies: in November 1991, the permitted ratio for direct investment abroad was increased from 20 to 40 per cent of equity. In December 1992, it was decided that enterprises of which 75 per cent of the capital is owned by foreign residents may lend up to 40 per cent of the capital to their shareholders. The levy on transfer payments was abolished in 1993.

PART TWO: RELEVANT BACKGROUND OF THE TRADE POLICY

I. WIDER ECONOMIC AND DEVELOPMENTAL NEEDS, POLICIES AND OBJECTIVES

a. The Aim of the Policy

The aim of the ongoing economic policy is to increase employment by stimulating economic growth through a strong and competitive private sector. The structural changes to improve the efficiency of the private sector are as follows:

1. Encouraging the business sector, and making it more competitive through confrontation with foreign competitors.

2. Providing economic agents with a reliable planning horizon: predictable rates in the fields of inflation, exchange, customs, and global predictions in the pluri-annual State budget.

3. Reducing the State involvement in the economy; lowering taxes and duties, selling off public enterprises, curbing the deficit of the public sector.

4. Increasing investment in infrastructure and education.

A stable macroeconomic environment to strengthen confidence in the economy has been reinforced by the peace process and through US loan guarantees. At the end of 1992, the US Government agreed to grant the Israel Government a US$2 billion first guarantee as part of a total guarantee of US$5 billion over a 5-year period.

b. Developments During the Period under Review

1. Principal economic measures

A full range of transformations has occurred in Israeli trade policy during the last three years, due to the continuation of a coherent policy of liberalization. Measure have been taken in the domestic as well as in the external market. The law for the Encouragement of the Private Sector - 1991, provides incentives for the integration of additional employees, but it is no longer operative.

State involvement in the economy has been decreased by reduction of the budget deficit, reduction of taxes, and privatization.

The budget deficit must be cancelled by 1995, since a special law was passed to this effect. Following the surpluses in the public sector accounts after the 1985 stabilization programme, the economy began to accumulate domestic debt. In 1988 and 1989 the deficit increased as a result of the influence of the recession on tax revenues. From 1989 the deficit was linked to higher expenditures on immigrant absorption. Nevertheless, there is a real trend to downward the domestic deficit, which, from 7.3 per cent of the GNP in 1991, went down to 5.7 per cent in 1992, whereas the total deficit (domestic and foreign) shifted from 4.3 per cent down to 2.4 per cent of the GNP.

There has been a substantial change in the composition of taxes. In order to encourage private initiative, direct taxation has been reduced. Between 1986 and 1992, the marginal income tax rate

on individuals was reduced from 60 to 48 per cent, the corporate tax from 61 to 40 per cent and the rate of national insurance from 21 to 13 per cent. The taxes/GDP ratio fell to 39 per cent, compared to 45 per cent in 1986. Tax provisions for 1993 took into account an additional reduction in tax revenues totalling US$180.8 million. The reductions, which came into effect on 1 January 1993, include the elimination of the travel tax, the levy on imported services, the reduction of the purchase tax on imports, tariffs reductions according to the bilateral agreements, and a 1 per cent reduction in the Value Added Tax. In addition, during the next four years, corporate taxes will be reduced 1 per cent a year from 40 to 36 per cent.

During the six years prior to December 1992, 22 companies were wholly or partially privatized. The Government is accelerating the privatization process: it appointed a Government Companies Authority (a body responsible for implementing privatization), allocated higher resources, and submitted to the Knesset a draft law authorizing the Government Companies Authority to use sanctions to deal with uncooperative directors of State-owned companies. In addition, the Government is selling off bank shares. The involvement of the Government in the banks is a consequence of the 1983 crisis, when the bank share value collapsed and the Government provided securities to shareholders by issuing alternative government debt. A complete restructuring of the banking system is on the way. Its purposes are to increase competition in the banking sector, to prevent potential conflict of interest within various banking activities, and to reduce the centralization in the economy and in the banking sector. Governmental resolutions dealt with this matter in May 1993 and stated for example, that the management of the banks should be separated from that of the provident funds, reducing permitted holdings by banks in non-banking companies. This ongoing step is due to have tremendous consequences on the economy as a whole, since banks represent a highly concentrated institution, consisting not only of financial institutes, but also industrial companies. On the other hand, the present transformation of the financial actors is a prerequisite to the establishment of foreign banks in Israel.

2. The present situation

Economic developments in the past three years have been shaped by the most important immigration wave that Israel has experienced since the 1950s. As a result, the need for investments in productive projects is particularly high. The ongoing opening of the entire economy is aimed at ensuring the competitiveness of the projects on a mondial level and at attracting foreign investors.

The main features of the Israeli economy are a high rate of growth despite an unfavourable external environment and a rate of inflation that fell to under 10 per cent per year, versus a high rate of unemployment and a persistent deficit of the commercial balance.

Israel's economy is industrialized and diversified. In 1992 the GDP totalled 161,279 million NIS and grew by 6.6 per cent in real terms.

The industrial sector improved its profitability in 1992; the cost of labour per unit of output declined by 3 per cent, after a previous decline by 2.2 per cent in 1991. Productivity improved by 3 per cent after a similar increase in 1991 and 6 per cent growth in 1990. The rate of increase in industrial investments was 10 per cent in 1992 and is forecasted as 15 per cent in 1993. The investment/capital ratio was 17 per cent in 1992, against 14 per cent in the last half of the 1980s. The high profitability of the industrial sector has contributed to increased activity of the Tel Aviv Stock Exchange, where the capital collected grew by 320 per cent, while the capital collected in the American stock exchange by Israeli companies grew by 135 per cent.

The increase in industrial production has been high since the influx of immigrants in 1989: 6 per cent at the beginning and 8.8 per cent in 1992. In 1991, the expansion of the business sector product was largely due to the impressive expansion in the construction industry: 40.5 per cent against 13.7 per cent in the previous years, and 2.6 per cent in 1992. But at the end of this transitional phenomenon, which influenced the general rate of growth, the economic expansion went on. Domestic demand initiated the expansion at the beginning of the period, while in 1992, half of the increase resulted from exports.

Services make up the largest portion of the GDP, while manufacturing and construction account for another 40 per cent and agriculture accounts for only 3 per cent. The composition of foreign trade shows that exports are primarily made up of manufactured goods, while imports are comprised mostly of raw materials and intermediate items. Israel's commercial balance reflects a structural surplus of imports.

The per capita income is comparable to that of Portugal or Ireland and stood in 1992 at 64 per cent of the G7 average GNP per capita. The rapid evolution in this field should be stressed, since the ratio was 56 per cent in 1990 and only 37 per cent in 1984.

The specificity of Israel (as aforesaid) is high skilled manpower; scientists, engineers and technicians constitute more than 17 per cent of the manufacturing working force. Israel has the highest proportion of any industrialized country of science and engineering graduates and holders of post-graduate degrees.

The present massive immigration is another salient feature of Israel's economy. 470,000 new immigrants arrived from 1989 to 1993, a population growth of more than 10 per cent over the natural increase. Within a short period, Israel's population will increase by nearly a third. This wave of immigration, represents a heavy burden in the short run, increasing unemployment and the budget deficit (in addition to the already high burden of defense). Immigrant absorption expenditures amounted to NIS16.6 billion, that is about 10 per cent of the 1992 budget. Immigration is mainly responsible for the very high rate of unemployment that has prevailed for the three past years: 11.2 per cent in 1992, an average of 10.5 per cent between 1990 and 1993. The situation began to get better in the first quarter of 1994. Average rate of unemployment is expected to be 10.2 per cent.

Out of the 470,000 new immigrants who have arrived since 1989, 123,000 of the 164,000 immigrants who are in the labour market are employed (fourth quarter of 1992 data). It should be stressed that more than 70 per cent of the newly employed during the four last years joined the business sector.

The purpose of the policy concerning unemployment is not only the absorption of the additional work force, but also the optimal exploitation of the highly skilled new immigrants.

The inflation rate dropped from 18 per cent in 1991 to 9.4 per cent in 1992 but increased to 11 per cent in 1993. This rate has to be compared with the very high levels of inflation in the beginning of the 1980's. The improvement in this field is the consequence of drastic measures that were implemented in 1985 and also of the new exchange rate system.

The economic growth that prevails in Israel - 6 per cent of the GNP in recent years, is a good performance, if compared with that of the developed world in the present period of economic crisis. This growth is closely connected with the massive immigration but also with the improvement of export performances. Whereas in 1991, most of the growth occurred in industries producing for housing

construction, in 1992, the expansion was due equally to internal demand and exports. In 1993 the expansion will continue due to the increase in exports to recently opened markets. Imports of investments goods have been 12 per cent higher in the first third of 1993 than that of the correspondent period in 1992.

The 1993 budget as adopted by the Knesset reduces the budget deficit (excluding net credits) from US$3.7 billion to US$2.25 billion and tax receipts by US$297.7 million, and increases investment in education and infrastructure by approximately US$343.5 million. The total infrastructure investment during 1993-1995 is expected to reach US$7.09 billion. This is the most important investment in years.

3. Historic background

During the first decades of the State, Israel erected high import barriers to protect its infant economy. Yet, soon, in the early sixties, Israel initiated a new economic policy, whose purpose was to allow imports to compete with local production.

This policy of trade liberalization gave the impetus for bilateral negotiations, which ended in agreements, with the EEC in 1975, the US in 1985 and EFTA in 1992. Restrictive measures on imports shifted from quantitative and administrative barriers to price and tariff barriers that are being gradually reduced.

In this context, a major change occurred in October 1977, when Israel moved from a fixed to a floating exchange rate system, which was modified again in the late 1980s and again at a later date.

These measures were part of a global policy towards a free trade system. In 1985, with the implementation of a stabilization programme aimed at lowering inflation, the trend was strengthened through commitments to deregulation, promotion of the private sector, reduction of income tax, industrial subsidies, removal of State involvement in marketing, importing and pricing agricultural products and breaking monopolies and cartels. The transport and communication branch organization is under review, in order to increase competition within the sector, in aircraft, as in telecommunication.

It should be noticed that the liberalization line has been steadily pursued, despite the enormous burden of the integration. For example, the Government refused to intervene directly on the labour market, limiting its action to creating an improved environment to allow enterprises to create jobs. This shows that radical choices have been made and it is in this context of liberalization, that the principal goals of the economic policy should be understood. They are improving the situation in the labour market, enlarging the investment in the industrial sector and in the infrastructure, and expanding foreign commercial relations, not only for exports, since most imports are required for the production process.

II. THE EXTERNAL ECONOMIC ENVIRONMENT

Exports accounted for 33.4 per cent and 33 per cent of GDP in 1992 and 1993, while civilian imports accounted for 41.8 per cent and 41.5 per cent in 1992 and 1993. Both imports and exports are essential to ensure the continuation of Israel's economic growth, since the main part of imports are integrated in the industrial process and since the smallness of the internal market turns the external market into an essential outlet for Israeli products and services.

External trade has been aimed towards Europe and North America markets, but dramatic changes in the global political situation provided a good opportunity for opening the rest of the world to Israeli trade. In past years, the economic relations between Israel and underdeveloped countries consisted of cooperation, Israel sending teams of experts to provide assistance in agriculture and development fields. The liberalization plan provides conditions for a turning point in this field. Trade relations with underdeveloped countries have already increased (mainly in South East Asia) and will grow in accordance with the implementation of the new programme, the dramatic political changes, and the peace process.

a. Major Trends in Imports and Exports

1. Exports

Expanding exports, breaking through to new markets, diversifying both the commodities and the geographical patterns of its foreign trade are a main target for Israel and the only way to pursue the ongoing economic growth process.

Exports of goods and services increased very slowly in 1990 and 1991 (3 per cent annually not including diamonds) due to the Gulf crisis and the international recession. The growth of exports in 1992 at a rate of 14 per cent has been higher than that of the Gross Domestic Product. This growth is partly explained as compensation for the slowdown of 1991, due to the Gulf War. Yet, in 1991 and 1992, the share of Israeli exports in the world's exports increased by an average 4 per cent whereas Israeli exports (without diamonds and capital services) grew by an average 8 per cent.

Export of services contributed significantly to the surge in 1992 exports. Services exports (without capital) grew by 24.4 per cent in volume and within the services sector, tourism exports increased by 39 per cent in volume.

Industrial goods account for the bulk of Israel's exports, the leading industries being metals, machinery, electronics (together: US$4 billion), diamonds (US$3.1 billion) chemicals (US$1.5 billion), textile and clothing (US$950 million). This rate is composed of a growth of 11 per cent for industrial products and a very high expansion in tourism - 60 per cent.

The expansion of industrial exports is partly explained by enhanced productivity, which resulted from a cheaper work force and by a drop in financing costs. But it is also connected to an unusual know-how in development-related infrastructure technologies and products, in agriculture, water use, telecommunications and health care, and a strong high-tech industry.

Whereas diamonds constitute the largest export sector in value, in terms of value added the leading sector is electronics, which reached US$2.2 billion in 1990 and 1991, US$1.4 billion in 1992 and US$2 billion in 1993.

The composition of Israeli exports is changing. There is a slow-down in fresh and processed food, mining, quarrying and in military equipment, and an increase in electronics and communications, medical and healthcare technologies and agricultural inputs. The chemicals and plastics industries as well as textiles and clothing are increasing their share in Israeli exports.

There has been an increase in exports of products resulting from high research and development investment, such as in electronics and precision instruments. Electronics and metal exports rose by a quarter in 1992, mainly due to sales to new markets such as India, Chinese Taipei, Singapore and

South Korea. The growth in electronics exports was also related to an additional demand from external markets, that induced in particular an increase in the production of electronic materials for scientific and medical purposes. Exports in electronics are partly for civil and partly for military uses, but in 1992, in line with the declining demand in defense materials, the increase was in civilian electronic goods.

Textile exports are steadily rising: on a base of 100 in 1988, the exports volume was 134.6 in 1992. This evolution was the outcome of rationalization by firms and the transition to the manufacture of non-standard items. The reduction of import tariffs by the United States as part of its free trade agreement with Israel was an additional incentive for the branch, while the rise in textile and fashion exports is linked to manufacturing contracts with major retail chains in the United States and Europe.

The main export destinations are Europe, accounting for 42 per cent in 1992, compared to 45 per cent in 1991 and 1990, the United States, accounting for 29 per cent in 1992 and 1991 and the 'rest of the world' - mainly Eastern Europe and South East Asia, which grew from 27 per cent in 1990-91 to 30 per cent in 1992, no major changes in 1993.

The change in export destinations between 1991 and 1992 shows that exports to countries with which Israel has no bilateral agreement expanded by approximately 25 per cent, whereas the increase to the EEC and EFTA accounted for only 2 per cent and to the United States 12 per cent, thanks to the recovery of demand there. 60 per cent of added exports in 1992 were to markets that accounted for only 24 per cent in the previous year. This growth is particularly significant in South East Asia. This trend is not specific to Israel, since it occurred in American and European foreign trade in the 1980s. It is due to recent new developments in the world, such as the dismantling of the communist world and the peace process. These new developments are also the result of the new economic policy aimed at breaking through to new markets, to compensate for the slowdown in the western world and to expand the range of markets open to Israeli exports.

2. Imports

Increasing the import of goods and in particular of capital goods, raw materials and intermediates, and diversifying the trading partners, is the only way for Israel to strengthen its industry and to provide employment for the new immigrants.

Imports grew at the rate of 13 per cent in 1992 and 9.4 per cent in 1993. This impressive growth is the result of the increase in domestic demand in particular for durable goods connected with the immigration and the general increase of production, which depends on imports of inputs. The increased demand for imports has also been stimulated by the persistent decline in the relative price of imports, in line with the improvement in the terms of trade. For example, the price of imported capital goods rose by 21 per cent between 1990 and 1992, while that of production costs rose by 45 per cent.

As a result, from 1990 and onwards, all imports grew: consumer goods, investment items and intermediates.

The rate of production inputs in the total imports of goods (without diamonds) was 65 per cent in 1992. The percentage of capital goods was 20 and of consumer items 15. This breakdown was almost the same in the previous year. After remaining unchanged in 1988 and 1989, demand for

machinery and equipment rose by 23 per cent in 1990, 30 per cent in 1991 and only by 4.5 per cent in 1992.

Merchandise imports for private consumption increased by 20 per cent in 1991 and 1992. The rate of durable goods imports growth was even higher: 28 per cent in 1990, 30 per cent in 1991 and 27 per cent in 1992.

The principal countries from which Israeli imports originate are the EEC, accounting for 54 per cent of the total in 1992, almost the same rate as over the five previous years. The US accounting for 21 per cent in 1992, which has also remained stable over the last years, while the 'rest of the world' share remained unchanged, with 25 per cent in 1992.

The geographic breakdown of imports in 1992 shows that growth from the EEC, the US and Japan is similar to the global growth of imports, whereas the increase of imports from the EFTA countries is much more important - 26 per cent. There was a slowdown in imports from the rest of the world, because of the high tariffs which characterized the beginning of the liberalization programme.

The prospects for the future are based on a continuation of rapid export growth, and a sustained import increase, maintaining an import surplus around US$1 billion per year.

b. Developments in the Terms of Trade and Commodity Prices

Commodity prices are affected, among other factors, by the exchange rate policy and the interest rate policy. Both of these were aimed at encouraging the business sector. In 1992 the marginal interest rate went down, from 15 per cent in the two previous years, to 11.5 per cent.

The Consumer Price Index (CPI) rose by 18 per cent in 1991, a rate similar to the annual inflation prevailing in Israel since the economic stabilization programme in July 1985.

In 1992 the CPI rose by only 9 per cent and by 11 per cent in 1993. The slowdown in inflation may be understood in the context of unemployment - with decreasing wages, the fiscal policy, public budget deficit reduction, and of decreasing international prices.

A difficulty arose from the persistent disparity in price increases between Israel and its trading partners. This phenomenon induced pressures on the exchange rates and created waves of speculation against which the Government initiated changes in the exchange trade system (see next paragraph). The Israeli's financial authorities have reaffirmed their commitment to the new exchange system, with a diagonal exchange rate band, which contributed to economic stability.

In the last quarter of 1992, the Shekel was in fact devaluated against the currency basket by 5.3 per cent, while its value against the dollar went down by 10.3 per cent. These devaluations did not induce a significant rise in prices. The terms of trade of Israel, defined as the price index of exports divided by the price index of imports is improving slowly: on the basis 100 in 1988, it went up to 106.1 in 1991, and 106.9 in 1992. This general trend masks sharp variations from year to year.

c. Trends in the Balance of Payments, Reserves, Debt, Exchange and Interest Rates

The commercial balance of Israel has always be in deficit. The coverage of imports by exports improved in 1988 and 1989, when the deficit went down from US$3,254 million in 1987, to US$2,842 million in 1988 and US$2,358 in 1989, but this trend was reversed in 1990, as a result of the burden

of immigration. In 1992 the commercial balance was characterized by a significant increase in exports, along with a strong expansion of imports, which began in 1990. Import surplus accounted for US$7.6 billion in 1993 compared to US$6.1 billion in 1992 and US$5.4 billion in 1991.

Israel was improving the commercial balance by reducing the civilian import surplus, which fell from US$3,225 million to US$2,665 million in 1989, when the needs of immigration put an end to the process.

In 1992 the balance of payment current account did not reflect the deficit of the commercial balance, thanks to unilateral transfers to the Government and the private sector that accounted for US$7 billion in 1992. Thus, the deficit in the current account has been cut by US$400 million and turned into a surplus of US$100 million. This may be explained also by a reduction in the civilian import surplus in 1992: US$100 million against US$1.6 billion in 1991. So, the conditions of the current balance are similar to those which prevailed in 1990 and 1991, where there was a surplus of US$0.6 and US$1.2 billion.

Despite the high cost of absorbing the wave of immigration, the net foreign debt remained at approximately US$15 billion per year in each of the past three years. Its percentage of the GNP was reduced from 7.7 per cent in 1985 to 3.3 per cent in 1992. The reduction of the external debt burden is connected with the relative stability of the exchange rate and the growth of the domestic product. The increasing foreign investments in the economy, along with the US guarantees are easing the current deficit financing. In 1992, the external debt declined by US$400 million.

Eighty-four per cent of the external debt is a governmental debt. The external debt is made up of the following: direct debt to the American Government - 21 per cent, debts converted into fully guaranteed Israel government bonds tradable in the American capital market - 29 per cent, State of Israel Bonds and certificates - 34 per cent.

The ratio of net debt servicing to GNP steadily declined in the last years, from 12 per cent in 1986 down to 5 per cent in 1991. The softening of interest rates abroad reduced the cost of net borrowing. The interest on loans to the private sector was reduced more than interest on loans to the Government. There was relative stability in the reserves and the external debt, as well as in the interest rate spread, showing that there was no change in Israel's risk standing. In 1991, the average level of foreign reserves rose slightly and grew in terms of import months, from 3.4 in 1990 to 3.6 in 1991. This trend went on in the first half of 1992, whereas in the second semester the level of reserves was cut from US$6.7 billion down to US$5.3 billion, equivalent to only 2.6 of import months in the last quarter of 1992. This development brought the reserves ratio beyond the minimum, as recognized at an international level, but since the enlargement of the imports was in line with an increase in exports, the equilibrium was preserved.

The exchange rate is determined by supply and demand conditions. The foreign exchange rate system has been altered several times since 1976. From 1954, the exchange rate was linked to the US dollar. As a result, Israeli currency was affected by all the fluctuations of the US dollar on international markets. So, in 1986 the shekel was linked to a basket of five weighted currencies according to their respective use in the Israeli foreign trade, and subject to the fluctuations of the value of each currency on the world market. There was a fixed rate and periodic devaluations intended to correct the erosion of the real exchange rate. The disadvantage of the system was that it induced speculations, and thus, sharp fluctuations in foreign exchange reserves and interest rates. With the currency liberalization of October 1977 the exchange rate became a floating one. Since July 1985,

the exchange rate policy has been aimed at maintaining the rate at a stable level. In 1989, a band was introduced, with a midpoint rate, so that the exchange rate could move in accordance with market forces within a specific range on either side of the midpoint rate; changes in the midpoint did not entail a rise in the exchange rate. The purpose of this was to permit a flexible response to short term capital fluctuations in order to moderate speculation. The permitted range of variation was 3 per cent in each direction in 1989 and this was extended to 5 per cent after the devaluation of March 1990.

In December 1991, there was a new change with the introduction of a diagonal band, instead of the original horizontal one; the midpoint rate rises daily at a rate which adds up to 9 per cent over the year. This second innovation provides a preset path for the exchange rate, and thus reduces uncertainty and opportunities for speculation in capital movements, since the rate of change of the exchange rate is predetermined.

The slope of the diagonal band is principally determined by the difference between the domestic inflation rate attainable in the coming years and predicted inflation abroad.

Between 1987 and 1990 the exchange rate rose at an average annual rate of 11 per cent. From September 1990 to March 1991 the exchange rate remained close to the lower boundary of the band as a result of capital imports. At the beginning of March 1991, the midpoint rate was raised by 6 per cent. In mid-December, within the new mechanism, the midpoint rate was raised by 3 per cent.

The exchange rate against the foreign currency basket rose by 15 per cent in 1992, compared to 11 per cent in the previous years. The devaluation rate during 1992 totalled 16.3 per cent against the basket and 21.1 per cent against the dollar. The persistence of the devaluation rate, in a context of low interest rates and prices, induced increased revenue from foreign currency assets and consequently, acquisitions of foreign currencies, and in return, pressure to increase the real interest rate.

This may endanger the economic growth in the long run. The monetary policy did not impede the devaluation process, but prevented the increase of interest rates. To achieve this goal, the public sector reduced its deficit along with the rate of public funds collection. The local debt of the public sector (Government and Jewish agency) accounted for 4.9 per cent of the GNP in 1992 against 6.5 per cent in 1991.

High interest rates prevailed in 1987 - 1988, as part of a stabilization programme. A turnabout occurred at the end of 1988, with realignments of the exchange rates associated with a new cost of living adjustment pact that neutralized the direct effect of devaluation on prices.

Nominal and unindexed local currency interest rates remained in 1991 at the 1990 level, whereas there was a decline in nominal rates in 1992. In particular in 1992, there was a rapid enlargement of bank credit to the public and of public assets, and a decline in foreign exchange liabilities of the Bank of Israel. Whereas the interest on middle and long term borrowings remained at the same level as the 1991 average.

The high level of interest rates led to an increased debt servicing burden on the business sector and in the rural sector, many farmers faced financial difficulties. The number of bankruptcies increased.

Among the steps taken in the liberalization of the capital and money markets, there was a further reduction in reserve ratios on deposits, some deregulation of indexed transactions, simplification of tax procedures, unification of tax rates on financial assets and removal of more restrictions on investments

abroad by Israelis and in Israel by foreigners. These measures are part of a global policy, aimed at opening up Israel's financial market and increasing the funds available for investment.

Future prospects are based on a continuation of a rapid export growth and a sustained import increase, maintaining an import surplus around US$1 billion per year.

d. International Macroeconomic Situation Affecting the External Sector

Each of the salient great events of the recent years have had a significant impact on Israel's external trade. The collapse of the Soviet Union brought about waves of immigrants to Israel, allowed the peace process to take off and opened a wide range of new markets to Israel's foreign trade. The unification of the Economic Community market should induce improved efficiency of the exports to the EEC, since administrative rules are simplified, but on the other hand competition inside the EEC may become much harder. The increasing role of southeastern countries in international trade is already reflected in Israeli foreign trade figures. This influence is growing and the expected effect is a reduction of import costs.

The pace of change in trading routes is higher than in the past decades and constitutes a challenge, as well as a danger for international trade stability. The growth deceleration in the west lowers the increase of Israeli foreign trade with its traditional markets, the US and the EEC. Hence, Israel invested great efforts to penetrate new markets, in South East Asia, Latin America, Eastern Europe. Those new markets are characterized by high financial and political risks.

Entering countries that have just opened up their markets, induces additional costs, in time and money, due to the extremely complicated bureaucracy that prevails. This new trend cannot yet be analyzed in its effects, but it may induce a reorganization in the composition of external trade in accordance with economic considerations.

The above prospects are very uncertain (considering the uncertainty that prevails in many fields). It may be asserted that the actual general trend favours the application of GATT principles, since many new countries are entering into the international trade flows after the dismantling of the communist world. On the other hand, the war for trade markets has now replaced the late cold war, bringing about the possible emergence of new protectionism, with managed trade replacing free trade. Paradoxically the main commercial countries are also those which may put themselves out of the free trade system, whereas small countries such as Israel have the greatest interest in the preservation of GATT rules.

In line with the opening of a large part of the world to international trade, Israel widened its trading flows and diversified its markets.

In addition to the worldwide trading developments, Israeli as well as Arab professionals, are planning the possible development of a mutual economic relationship.

e. Problems in External Markets

The export oriented economic policy of Israel has been pursued up to now despite a slowdown in world trade and a trend toward regional integration in different parts of the world. Those two phenomena may impede the international exchanges in general and the new policy of Israel in particular.

The latest events on the international scene have direct effects on the Israeli economy. The Gulf War had direct consequences on the Israeli economy, lowering its exports and reducing tourism by dramatic proportions. The world recession held back the growth of world trade, which went down from 7 per cent in 1989 to 5 per cent in 1990 and 3 per cent in 1991. The economic crisis lowered the demand from Israel's principal markets, while regionalism impeded the expansion of exports. For example, growing competition on the European market exacerbated the situation of agriculture in the mid-1980s and citrus exports have suffered. These difficulties initiated a major change in the foreign economic policy of Israel, with a breakthrough into new markets, such as South Asia.

Exports of metals, machinery and electronics have been affected by a decline in world demand for weapons. This phenomenon has led to the continued diversion of production from military to civilian purposes, especially in electronics.

Israeli exports are affected by non-tariff barriers that prevail in some of its trading partners, i.e. Japan, by difficult access to public procurement in the US and by bureaucracy in newly opened markets.

As for trade relations between Israel and the EEC, the question of semi-processed food has to be reviewed, since there is a lack of reciprocity in the present situation, when agricultural inputs are granted protection in the EEC, through variable taxes and refunds, in accordance with the Common Agricultural Policy, while the Agreement does not grant to Israel an equivalent right to variable levies on processed food products from the EEC.

In addition to the problems related to the world economic crisis, external Israeli trade faces specific issues. Indeed, the Arab boycott prevented many international companies from trading with, or investing in Israel and constituted a serious obstacle to Israeli exports. The economic damage to Israel, in terms of lost trade and investments, has been estimated at US$40 billion.

Some of the main economic partners of Israel used to link commercial considerations to political ones, impeding significantly the harmonious development of the trade flows of Israel.

f. Prospects

A rather optimistic outlook is based on many factors. Among them, the high degree of education of the immigrants. Whereas up to now these talents have not been fully used, their exploitation will bring about a sustainable increase in GDP, and additional growth potential, since science, technology and know-how will make the difference in the world of tomorrow.

The trends result from the following assumptions: 120,000 or perhaps only 60-80,000 immigrants per year, starting in 1994; the pursuit of the on-going policy favouring liberalization; competition; improving infrastructure; an average 5 per cent growth rate in world trade in the next three years. The share of investment in GNP will remain high; it will account for 20 per cent in 1994 (non-residential investments), exports will expand by 9 per cent per year, this very high level is based on the assumption that the breakthrough to new markets will go on successfully. The business product should grow at an annual rate of 7.3 per cent, the unemployment rate will decline to 8 per cent. The import surplus will persist, the forecast deficit being approximately US$1 billion.

Prospects for the long term should take into account the possible developments of trade between Israel and the Arab world. Indeed, some major Arab countries have already appealed to put an end to the boycott of Israel and obviously commercial relations between Israel and its neighbours will benefit

all the parties. These kind of relations should be gradual, because of the great disparities in production structures and social organization. The outcome will be shaped by inflows of foreign investments that will be brought about by peace. Estimates state that trade between Israel and its Arab neighbours could reach billions of dollars. Israel could export foodstuffs, fertilizers, rubber, textile, clothing, tools, machinery, and high-tech items.

APPENDIX 1

LIST OF COMMODITY AGREEMENTS IN WHICH ISRAEL PARTICIPATED

1. International Agreement on Olive Oil - 1956, as amended by the protocol of 3.4.1958.
   Israel's accession: 10.9 1958.

2. International Coffee Agreement - 1962.
   Israel's accession: 11.10.1967.

3. International Coffee Agreement - 1968.
   Israel's ratification: 26.9.1968.

4. International Coffee Agreement - 1975.
   Israel's ratification: 29.3.1977 and on 28.9.1979: Notification of intention to continue participation.

5. International Wheat Agreement - 1986.
   Israel's accession: 21.11.1988.

6. International Agreement on Olive Oils and Table Olives - 1986.
   Israel's accession: 31.12.1992.

7. Protocol of the Extension of the International Olive Oil Agreement.
   Israel's ratification: 21.11.1967.

8. International Tin Agreement - 1954.
   Israel's accession: 15.10.1956.

9. International Sugar Agreement - 1958.
   Israel's ratification: 29.10.1959.

10. International Grains Arrangement - 1967, Wheat Convention.
    Israel's ratification: 12.6.1968.

APPENDIX 2

Convention establishing the World Intellectual Property Organization; the Paris Convention for the Protection of Industrial Property; the Madrid Agreement for the Repression of False or Deceptive Indications of Source on Goods; the Nice Agreement concerning the International Classification of Goods and Services for the Purpose of the Registration of Marks; the Lisbon Agreement for the Protection of Appellations of Origin and their International Registration; the Strasbourg Agreement concerning the International Patent Classification; the International Convention for the Protection of New Varieties of Plants; the European Convention relating to the Formalities Required for Patent Applications; the Berne Convention for the Protection of the Literary and Artistic Works; the Convention for the Protection of Phonograms against Unauthorized Duplication of their Phonograms; Universal Copyright Convention.