2000 Country Reports on Economic Policy and Trade Practices
Released by the Bureau of Economic and Business Affairs
U.S. Department of State, March 2001

ISRAEL

Key Economic Indicators

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

	1998	1999	2000 1/
Income, Production and Employment:			
Nominal GDP	100.7	100.8	107
Real GDP Growth (in percent)	2.2	2.3	5.0
GDP by Sector:			
Agriculture	1.9	1.9	1.8
Manufacturing	19.7	19.6	20.9
Construction	7.0	6.0	6.0
Services	41.3	42.9	47.2
Public Sector	33.2	32.7	34.0
Per Capita GDP (US$)	16,870	16,470	17,200
Labor Force (000s) 2/	2,266	2,345	2,500
Unemployment Rate (pct) 2/	8.5	8.9	8.5
Money and Prices (annual percentage growth):			
Money Growth (M2) (pct) 3/	17.5	24.3	17.0
Consumer Inflation (pct) 3/	8.6	1.3	0.9
Exchange Rate (NIS/US$) 2/	3.80	4.14	4.06
Balance of Payments and Trade:			
Total Exports FOB	21.3	23.6	28.3
Exports to U.S.	8.3	9.2	11.7
Total Imports CIF 4/	27.0	30.6	34.3
Imports from U.S. 4/	5.4	6.3	6.7
Trade Balance 4/	-5.7	-7.0	-6.0
Balance with U.S. 4/	2.9	2.9	5.0
External Public Debt (gross)	27.4	27.4	27.9
Fiscal Deficit/GDP (pct)	2.4	2.2	1.0
Current Account Deficit/GDP (pct)	0.9	2.6	1.5
Debt Service/GDP (pct)	4.2	4.1	3.9
Gold and Foreign Exchange Reserves 5/	23.3	22.4	23.5
Aid from U.S.	3.0	2.9	2.8
Aid from Other Countries	0	0	0

1/ 2000 indicators estimated using partial-year data.

2/ Annual average.
3/ December to December.
4/ Excludes defense imports.
5/ At end of year.

1. General Policy Framework

Israel is an open economy, increasingly competitive internationally in such high technology sectors as telecommunications, software, pharmaceuticals, and biomedical equipment. The economy is expected to grow between 4.5 and 5 percent in 2000, although some economists project a lower figure due to concern about the effects of violence in parts of Israel, the West Bank and Gaza in late 2000.

The inflation-adjusted central government budget deficit for 2000 should drop to 1.5 percent of GDP or lower, well within its 2.5 percent of GDP target this year, on the back of a strong revenue intake and fiscal restraint. The 2001 budget calls for a fiscal deficit target of 1.75 percent of GDP, falling to 1.25 percent of GDP by 2003. However, Israel officially reports only the central government fiscal deficit and not the conventional overall fiscal deficit, which is much higher. Defense spending remains the largest single component of the Israeli budget, but the most rapidly growing portions of the budget have been in the area of social services, such as health care, education, and direct payments to individuals and institutions.

The Bank of Israel has maintained a relatively strict monetary policy over the last two years. The result has been very little inflation. The inflation rate in 2000 is expected to fall below one percent. The inflation rate in 1999 was 1.3 percent, the lowest level in more than 30 years. The Israeli shekel remained strong through most of 2000, although it appeared to weaken later in the year due to political uncertainty. Israel's official inflation target for 2001 is 2.5 to 3.5 percent.

Taxes in Israel remain high, with marginal tax rates (including payments for social security insurance) reaching 60 percent. The government tried, but failed, to push through a far-reaching income tax reform package that would have eliminated most exemptions and lowered marginal rates. The government plans to resubmit a more limited tax reform program by the end of 2000, but passage will be difficult amidst political uncertainty. The government would like to reduce taxes on working income and raise taxes on certain capital gains. The reform, if passed, would also equalize tax treatment of domestic and foreign investments. One positive tax development was the decision, taken in mid-2000, to eliminate or reduce purchase taxes on more than 600 items, including imported products like color televisions, refrigerators, VCRs, dishwashers and cosmetics.

2. Exchange Rate Policy

The shekel floats within a pre-defined target zone against a basket of currencies: the dollar, yen, euro, and pound sterling. As a matter of policy, the Bank of Israel does not intervene in the foreign exchange markets as long as the shekel remains within the target zone, although it is obligated to do so once the limits of the zone are reached.

Israel has ended almost all of its remaining capital controls, except for limits on Israeli institutions' foreign investments. The government decided in 2000 to allow insurance companies to invest up to five percent of their assets overseas for the first time.

3. Structural Policies

Over the past decade, Israel has gradually reduced the degree of government involvement in and control over the economy while increasing the influence of domestic and international competition. Israel signed a Free Trade Agreement with the United States in 1985 and has similar agreements with the EU, the EFTA, Mexico, and other countries. This policy of increasing exposure to international competition has led to a significant restructuring of Israeli industry.

The government is continuing efforts begun several years ago to bring competition and privatization to the telecommunications sector. In September 2000 the government announced rules for permitting competition in the provision of domestic telephone service. The government expects to announce tenders for the sale of wireless broadband frequencies, an additional commercial television station, and another wireless telephone service provider. Early in 2001, it expects to sell off its remaining shares of Bezeq, the primary domestic telephone service provider. Competition already exists in international long distance service. The government's plan to permit competitive broadband internet services has sparked intense rivalry among telephone, cable television, and other telecommunications providers. The government is continuing to revise regulations covering the telecommunications sector. The government sold its remaining shares in Bank Hapoalim in 2000. It is hoping to move ahead in 2001 with plans to sell the state airline, El Al, and the state shipping company, Zim.

The state power company, Israel Electric (IEC), dominates electricity generation and distribution in Israel. Under current law, independent producers can generate up to ten percent of Israel's electricity; another ten percent of Israel's power needs could be met by imports. Both areas could provide opportunities for U.S. companies. Progress towards opening up the electricity market to competition has been very slow.

4. Debt Management Policies

Israel's gross public debt totaled $27.9 billion as of mid-2000. Israel's total gross foreign debt (including both public and private debt) was $60 billion. After netting out foreign assets of $50.3 billion, the country's net debt fell $1.1 billion from the beginning of the year, and stood at $9.7 billion.

5. Aid

U.S. assistance to Israel for fiscal year 2001 includes $1.98 billion in military aid (of which over $1.4 billion was earmarked for procurement from the United States) and economic assistance totaling $840 million. Israel also received various forms of support for military research and development, notably for missile defense.

6. Significant Barriers to U.S. Exports

With the exception of some categories of agricultural products and processed foods, all duties on products from the United States were eliminated under the 1985 United States-Israel Free Trade Area Agreement (FTAA) by January 1, 1995. In late 1996 the United States and Israel agreed on a five-year program of agricultural market liberalization. The agreement covers all agricultural products, and provides for increased access during each year of the agreement via tariff rate quotas (TRQ) and tariff reductions. This agreement will be renegotiated in 2001. In 2000, for the first time, Israel met its commitment to publish TRQs for the following year by October 31.

Israel calculates import value according to the Brussels Definition of Value (BDV), a method that tolerates uplifts of invoice prices. A uniquely Israeli form of protection is called "TAMA." TAMA is a post-duty uplift designed to convert the CIF value plus duty to an equivalent wholesale price for purposes of imposing purchase tax. Coefficients for calculation of the TAMA vary from industry to industry and from product to product. There is no TAMA on food or beverages other than spirits.

In addition, purchase taxes from 25 to 95 percent are applied to many goods. Israel eliminated or reduced purchase taxes on over 600 products in 2000, including consumer electronics, household appliances, building inputs, and office equipment. The purchase taxes on automobiles, fuel and alcoholic beverages were not reduced. Where remaining, purchase taxes apply to both local and foreign products.

Although Israel agreed in 1990 to harmonize standards treatment, either by dropping health and safety standards applied only to imports or making them mandatory for all products, implementation of this promise has been slow. Enforcement of mandatory standards on domestic producers can be spotty, and in some cases (e.g., refrigerators, auto headlights, plywood, and carpets) standards are written so that domestic goods meet requirements more easily than do imports. Israel has agreed to notify the United States of proposed new mandatory standards to be recorded under the WTO.

The Standards Institution of Israel is proposing a bilateral Mutual Recognition Agreement of Laboratory Accreditation with the United States that could result in the acceptance of U.S.-developed test data in Israel. The proposed program would eliminate the need for redundant testing of U.S. products in Israel to ensure compliance with mandatory product requirements. The Israeli cabinet decided in August 1999 that official Israeli standards could incorporate in their entirety more than one foreign standard. The government's delay in developing implementing regulations, however, has caused difficulties for a few U.S. manufacturers.

Israeli policies in high tech sectors are evolving. Recent developments have raised concerns for the United States in the areas of information technology (the right of cable companies to offer internet services) and advertising (proposed Israeli government regulations on advertising on foreign cable TV channels directed at the Israeli market). The U.S. government is closely following these sectors.

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

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

Israel is a member of the WTO. It is a signatory to the Uruguay Round Procurement Code, intended to enable more open and transparent international tendering procedures for a wide range of government entities. However, while some government entities notify the U.S. government of tenders valued at over $50,000, many do not, and the notices that are received frequently carry short deadlines and are often only in Hebrew. Complex technical specifications and kosher certification requirements discourage foreign participation in government tenders for food.

The government frequently seeks offsets (subcontracts to Israeli firms) of up to 35 percent of total contract value for purchases by ministries, state-owned enterprises, and municipal authorities. Failure to enter into or fulfill such industrial cooperation agreements (which may involve investment, co-development, co-production, subcontracting, or purchase from Israeli industry) may disadvantage a foreign company in government awards. Although Israel pledged to relax offset requests on civilian purchases under the FTAA, Israeli law continues to require such offsets.

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

In addition to its WTO multilateral trade commitments and its FTAA with the United States, Israel has free trade agreements with the European Union, Canada, the Czech Republic, Slovakia, Turkey, Hungary, Poland, Slovenia, Mexico, and the EFTA states. It also has a preferential trade agreement with Jordan. Israel's import liberalization program and negotiation of new free trade agreements have diluted U.S. advantages under the bilateral FTAA.

7. Export Subsidy Policies

Israel has eliminated virtually all of its export subsidy programs. It retains a mechanism to extend long-term export credits, but the volumes involved are small, roughly $250 million. Israel has been a member of the WTO/GATT Subsidies Code since 1985.

8. Protection of U.S. Intellectual Property

Israel's legal system provides for protection of IPR, but enforcement of IPR laws is not adequate. The U.S. Trade Representative placed Israel on the "Special 301" Priority Watch List in 2000 due in large part to U.S. concern over continuing illegal copying and sale of video and audio recordings. USTR noted that the government of Israel had taken important steps to improve its IPR record, including the establishment of a special IPR unit in the police and passage of legislation to implement the Trade Related Aspects of Intellectual Property (TRIPS) agreement. Nevertheless, enforcement of IPR laws remains weak and punishments for IPR violations are insufficient. In addition, concerns remain over possible TRIPS deficiencies, such as failure to protect adequately confidential test data and to provide criminal penalties for unauthorized end-user copying of computer software.

Israel passed legislation in December 1999 intended to bring it into compliance with its commitments under the WTO TRIPS Agreement. The Israeli government is also developing amendments to its copyright law that would make it easier for Israeli prosecutors to bring charges against copyright violators, and establish a royalty judge to adjudicate among rival royalty claimants.

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

In September 2000 a law went into effect that allows the parallel import of pharmaceutical products. Several pharmaceuticals companies have challenged this law in court, but a trial has not yet taken place.

9. Worker Rights

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

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

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

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

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

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

Extent of U.S. Investment in Selected Industries—U.S. Direct Investment Position Abroad on an Historical Cost Basis—1999

(Millions of U.S. dollars)

Category		Amount
Petroleum		4
Total Manufacturing		2,168
Food & Kindred Products	78	
Chemicals & Allied Products	14	
Primary & Fabricated Metals	7	
Industrial Machinery and Equipment	14	
Electric & Electronic Equipment	1,534	
Transportation Equipment	6	
Other Manufacturing	514	
Wholesale Trade		130
Banking		0
Finance/Insurance/Real Estate		405
Services		381
Other Industries		111
TOTAL ALL INDUSTRIES		3,199

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