

ISRAEL

Overview

The two major factors influencing Israel's economy since 1990 are the influx of nearly 600,000 immigrants from the former Soviet Union and the Middle East peace process. Both have been positive influences, leading to an average annual growth rate since 1990 of approximately 5 percent. GDP growth in 1996 is expected to reach between 4.5-5 percent, on the heels of 7 percent GDP growth in 1994.

Israel's economic growth continues to be primarily export-led. The almost frenetic double-digit growth in exports which characterized the past few years as Israel took advantage of the erosion of the Arab boycott to penetrate new markets in Asia and East Europe is expected to slow in 1995-1996. Bilateral trade between the U.S. and Israel is slightly over \$10 billion, with the balance in Israel's favor.

The current positive trends in Israel's economy are expected to continue through the year 2000, as Israel's benefits from the fruits of peace, extensive investment in infrastructure and education and new immigrants continue their assimilation into Israel's economy. Maintaining discipline in public sector spending, continuing economic deregulation and reducing the current balance of payments gap will be crucial to Israel's achievement of sustainable growth over the long run. The current trend of strong growth rates provide a wide variety of dual-use and defense trade opportunities for U.S. firms.

Defense Industry Environment

Israel's \$6.8 billion defense budget accounted for ten percent of GDP. Approximately twenty five percent of the annual defense budget is spent on procurement. In addition, the U.S. in 1995 provided \$1.8 billion of which \$1.325 billion must be spent on purchases from the U.S. The balance of \$475 million was authorized for use for defense procurements within Israel.

Because Israel's three main defense industries (Rafael, IAI, and TAAS) are government-owned, their research and development facilities are used by the Ministry of Defense (MOD) R&D Office. This office also uses the Technion and Soreq Institutes as research and development facilities.

Following are short profiles of Israel's major defense firms:

Rafael Armament Development Authority (Rafael): Rafael provides services to the MOD, manufacturing guided and unguided weapon systems, electro-optics, military electronics, and image systems for the Israel Defense Forces (IDF) as well as for export. The company employs 5,000 with sales of approximately \$420 million of which \$150 million is derived from exports. The authority is known for its sophisticated R&D facilities.

Israel Aircraft Industries, Ltd. (IAI): IAI employs over 17,000 with sales of approximately \$1.6 billion, seventy five percent of which is derived from exports. IAI manufactures aircraft, patrol boats, armored cars, and missile systems.

TAAS Israel Industries, Ltd. (TAAS): TAAS is the country's oldest defense company, established in 1933. Employing 6000, TAAS generated sales of \$500 million, 90 percent of which is derived from exports. The company's core business are advanced weapons and ammunition systems, missiles, rocket motors, and aviation equipment. Its commercial activities include electro-mechanic and electronic systems, metal construction, and engineering.

These companies grew dramatically in the decade following the 1973 war, during a period that the Government of Israel (GOI) found it necessary to achieve its own production capabilities in order to provide for its own defense. As a result, large budgets (25.2 percent of GNP in 1980) were transferred to these industries, including as much as one-half of the nation's entire R&D budget. Cost-plus contracts were widely utilized, and highly advanced weapons and control systems were developed by an industry characterized by high costs for salaries and advanced materials. In order to amortize development costs, achieve economies of scale in production, and earn export income, Israel developed an extensive program of defense exports, which by 1994 had reached 38 percent of defense sales and 20 percent of national industrial exports.

Since the mid-1980s, the high cost of weapons and support systems, combined with a smaller market, created the same competitive pressures faced by U.S. defense firms. Faced with large operating deficits, Israel's major defense firms have searched for ways to trim personnel costs and adapt military technologies for use in new civilian applications. To date, neither effort has been completely successful. Formal recovery plans, designed to lead IAI and TAAS toward privatization, were implemented in the early 1990's, but have not been successful. The GOI plans to institute a similar plan for Rafael in 1995.

The labor force in the defense sector has been strongly protected by the National Labor Organization, and industry management has been reluctant to undertake the necessary economic and market analyses to compete in civilian markets. Instead, the three government-owned defense industries have argued that it is in the national interest for Israel to protect and support the defense industry rather than force it into diversification and make it subject to international markets.

Major U.S. suppliers of defense equipment to Israel include McDonnell Douglas, Martin Marietta, Loral Vought Systems, Raytheon, and Sikorsky.

Defense Opportunities

Based on recent acquisitions and receipt of excess equipment, the Israeli Defense Force (IDF) has requirements for spare parts and upgrades as needed for of their F-16 aircraft, Apache, Cobra, and Blackhawk helicopters, Patriot missile systems, and overhaul of their M-60 tanks.

Two recent major FMS purchases of the Multiple Launch Rocket Systems (MLRS) and F-

15 aircraft will require the IDF to contract support for maintenance and possibly spares parts. The purchase of these systems will upgrade both the ground Corps and the Air Force. The Army will also continue domestic production of the Merkava 4 Tank. In addition, emphasis will be placed on theater ballistic defense with systems such as the Arrow which is being jointly developed with the U.S.

Defense Procurement Process

The procurement of defense equipment by the Israeli Government in the U.S. is handled by the Ministry of Defense (MOD) which maintains a 200-person purchasing mission in New York. The mission handles all purchases of U.S. equipment including direct commercial contracts paid by FMS funds. The Israeli MOD also operates a much smaller purchasing mission in Paris.

Procurements are advertised in the Commerce Business Daily (CBD) and in advertisements placed by the New York mission in newspapers across the U.S. The New York mission directly places and executes defense contracts. Most negotiations on large dollar value contracts usually include an offset arrangement. Contracts advertised and executed in Israel are subject to Israeli law.

U.S. firms must realize that they are competing against Israeli industries as well as European companies on most contracts. There is a free trade agreement between Israel and the European community, which allows importation of raw materials without duty. Full implementation of the U.S.-Israel Free Trade Area occurred on January 1, 1995. This agreement eliminated all the remaining duties on U.S. products. Most Israeli defense industries are in a difficult financial situation, having to dismiss thousands of workers. Therefore, the MOD will give preference to offers from local industry and to foreign companies offering local content in their products. The Ministry of Defense has exclusive jurisdiction over defense trade.

Israeli Points of Contact:

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Ministry of Defense
Deputy Head for Economic Affairs

Directorate of Procurement and Production
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Diversification/Commercialization Opportunities

Israel's growing economy and high technology sectors offer many dual-use opportunities for U.S. firms. Described below are industry sectors deemed "best prospects" for U.S. exports by the Commerce Department's Foreign Commercial Service in Tel Aviv.

Electrical Power Systems

Two factors assure the growth of the market for electrical power systems: Israel Electric Corporation (IEC) continues to invest \$1 billion annually in generation, transmission and distribution systems; the Ministry of Energy and Infrastructure plans to issue international tenders for the involvement of IPP's in electricity generation. Although European companies are making inroads in this sector, U.S. companies still hold the lead in the market, having supplied IEC since the company's establishment. As of May 1995, IEC has accessed \$970 million of the \$10 billion U.S. loan guarantees available to the State of Israel.

Pollution Control Equipment

The Ministry of Environment (MOE) with support from the Ministry of Finance is providing grants to promote investment in the local environmental industry. The use of EPA standards for air quality control, the high regard for U.S. technologies and services in the market, coupled with a lack of expertise and experience of the local companies provide U.S. environmental firms with a good market opportunity.

Medical Equipment and Supplies

Israel has absorbed 600,000 immigrants since 1990 and its population is continuing to grow at an annual rate of 2.7 percent. On January 1, 1995, the National Health Insurance Law came into effect under which all citizens are entitled to universal medical care. The medical sector will continue to expand to meet demands for medical services to those who were not previously insured and of the elderly who now comprise nine percent of the population. As a result, there is a growing demand for high-quality medical equipment. American equipment is highly regarded, but U.S. suppliers continue to compete against a growing presence of European manufacturers.

Computer Software

U.S. products encounter fierce competition from the local production of computer software. The Israeli high technology industries have developed significantly in the past three years and computer software has become a leading industry. Best prospect markets for U.S. products are the multimedia field, which is growing at a startling pace, due to the Ministry of Education's large investments in the automation of all education systems.

Electronic Components

Consumption of components manufactured under strict military specifications represent over 50 percent of the total market. Other leading sectors include civil communication (17%), and computers and peripherals (22%). This market profile allows relatively small manufacturers to capture market share quickly if they can respond effectively to market demand. The wide range and broad basis of the Israeli electronics industry, combined with fast growing export markets for the local electronics industry, provide electronic components with a buffer against a downturn in demand in any single end-user industry. Price reductions in many electronic product areas, combined with presence of most world manufacturers render the Israeli component market highly competitive.

Machine Tools/Metalworking Equipment

The domestic metalworking industry employs over 70,000 people and constitutes 22% of Israel's industrial output and 25 percent of its exports. Growth in this market will be driven by demand for automation equipment and advanced machinery in high-technology defense industries and sophisticated export-oriented businesses. Israel has a strong requirement to remain in the technological forefront in the fields of metallurgy, missile systems, armor and avionics. As a result, there is a receptive audience among users of metalworking equipment for all types of advanced devices and systems. Germany, Italy and Japan are the strongest third country competitors. There are no special regulations affecting imports.

Telecommunications

Israel's telecommunications market offers good opportunities with the ongoing expansion of the national CATV network, the introduction of a second cellular telephone operator and the liberalization of the international calls market, in which two new operators will be licensed this year. The elimination of the remaining 10-15 percent duty on January 1, 1995 made U.S. telecommunications products even more competitive.

Automotive Parts and Service Equipment

There is a growing demand for U.S.-manufactured cars and accessories due to their high safety standards and the reduction of the purchase tax levied on automobiles with large engines. The increased sales of U.S. cars has resulted in growing market potential for U.S.-made

accessories and spare parts. However, U.S. manufacturers face stiff competition from Europe and the Far East. The increasing number of vehicles over the past few years has created a strong demand for service equipment.

Computers & Peripherals

U.S.-made computers and peripherals account for over 30 percent of the import market in this sector. Israeli consumers have a preference for U.S. brand-name computers. Defense related establishments prefer U.S.-made computers, as they can be purchased with FMS funds. However, this is a very competitive market and the presence of European firms and East Asian manufacturers is strengthening every year.

Defense Conversion

The Ministry of Defense and the Ministry of Industry and Trade are promoting defense conversion and the commercialization of dual use technologies. They have provided the following list of major defense firms interested in exploring defense conversion projects as investors or joint venture partners.

Israel Aircraft Industries Ltd.
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Israel Military Industries
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Rafael
Dr. Aviel Brosh
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Tadiran, Ltd.
Mr. Shlomo Yariv
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Fax: 011-972-3-557-3282

Elbit, Ltd.
Mr. Arie Tal
Tel: 011-972-3-695-7558
Fax: 011-972-3-695-6615

El-OP Electro-Optics Industries, Ltd.
Dr. Moshe Oron
Tel: 011-972-8-386-302
Fax: 011-972-8-386-826

Opgal Optronics Industries, Ltd.
Mr. Jacob Lichter
Tel: 011-972-4-995-3902
Fax: 011-972-4-995-3900

Privatization

Since its election in 1992, the current Government has talked frequently of privatizing elements of the government-owned defense companies. However, no concrete plans or time-table to sell the government interests to private investors have been developed. Consequently, opportunities for U.S. investors to take equity positions in these three major companies do not exist. The GOI has announced plans to sell off most of its holdings in government companies, including government shares in commercial banks. Privatization plans, however, proceed slowly. El-Al (the national airline), Zim Maritime (national shipping company), Bezek (national telecommunications company), Tahal (national water planning company), Israel Electric Company (IEC) and the country's three leading banks are all still owned by the government. There has been steady liberalization of the capital and foreign exchange markets.

Throughout the 1970's and 1980's, Israel's high-technology companies had their R&D costs largely financed by defense contracts, and many of the leading companies still rely on the Israeli Ministry of Defense to finance their research programs. However, many of these firms recognize the need to adapt defense technologies to civilian market applications, and are actively seeking strategic partners to help them with prototype testing and refinement, and eventually production and marketing. Key areas include adapting night vision and protective wear for the law enforcement market, developing interference resistant RF and DSP telecommunications devices, and medical/diagnostic and civilian engineering applications of laser products. Some companies, such as Elscint and Scitex have established themselves as technology and market leaders.

U.S. firms should expect stiff competition from Israeli companies if they decide to enter the market with their own products and technologies. Many of the Israeli companies are developing products designed for U.S. and European markets, and all depend on export markets. Because of the need for capital to scale-up their production and to penetrate new markets, U.S. firms will find Israeli companies eager for joint venture arrangements and technology and production licensing agreements.

Doing Business in Israel

Israel has a professional and westernized business environment in which most U.S. business people will feel comfortable. Israelis arrive well-prepared for meetings, come straight to

the point, and are very direct. Appointments can be made on fairly short notice, but punctuality is desired. Business cards are recommended. Business suits are appropriate for meetings with private sector companies and government officials, but business travelers will find business dress in both the private sector and government offices to be much less formal than in the United States, especially from April to October. English is widely spoken in the business community and in government offices.

Israeli business people understand that, given the size of the domestic market, they must operate internationally to survive. As a result, they generally are very accessible to U.S. companies and their representatives. A work week is usually five days, from Sunday through Thursday, with office hours generally from 8:00 am - 5:00 pm. Some businesses are open on Friday from 8:00 am - 1:00 pm.

Israel has a well-developed and modern banking system, which provides all banking and credit services. The leading banks operate subsidiaries in the U.S. and maintain correspondent relationships with U.S. banks.

Export Control

The U.S. Department of Commerce requires a validated license for the export of certain controlled technologies to Israel. In general, licenses are issued after completion of an export control check performed by the commercial section of the U.S. Embassy. The export of Israeli commercial technologies derived from defense-related technologies is subject to approval by the Israeli Ministry of Industry and Trade, after having received initial approval from the MOD.

Buy-Israel regulations require GOI entities to award a tender to an Israeli firm if the local firm's bid is up to 15 percent higher than the foreign proposal. If a local company is located in a so called priority area, it receives an additional 15 percent advantage. If Israel's GATT or other international obligations conflict with the Buy-Israel rules, the international obligations will take precedence. Sales to GOI entities are usually subject to offset regulations, requiring a foreign company to purchase local products or use local content of up to 35 percent of the cost of the awarded contract.

There is no restriction on foreign competition. However, many government tenders are selective (i.e. not issued publicly), but addressed to a small number of prequalified suppliers.

Local Agent/Distributor

Although there is no general requirement for a foreign company to appoint a local representative, in many cases, when after-sales service may be required or local stock kept, a local representation is an advantage. It is advisable for a U.S. company to contract a competent Israeli agent/distributor who knows how to operate within the local bureaucracy. There are no general restrictions on foreign ownership of local enterprises or joint ventures, and no requirements for Israeli participation in foreign-owned enterprises. Foreign investment capital and profits can be freely repatriated, provided the funds are channeled through authorized banks.

Intellectual Property Rights

Israel is a member of the Paris convention for the protection of industrial property and of the Berne Union and the Universal Copyright Convention. Patents are regulated by the Patent Act of 1967, though new patent legislation is currently in the works. Recently, the Israeli courts have imposed harsher punishments on intellectual property right offenses.

U.S. Government Points of Contact:

The following is a list of helpful contacts for U.S. firms interested in the Israeli market.

U.S. Embassy

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Chamber of Commerce:

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