ISRAEL

TRADE SUMMARY

The U.S. trade deficit with Israel was $5.3 billion in 2004, a decrease of $548 million from $5.9 billion in 2003. U.S. goods exports in 2004 were $9.2 billion, up 33.5 percent from the previous year. Corresponding U.S. imports from Israel were $14.5 billion, up 13.8 percent. Israel is currently the 19th largest export market for U.S. goods.

U.S. exports of private commercial services (i.e., excluding military and government) to Israel were $2.3 billion in 2003 (latest data available), and U.S. imports were $1.8 billion.

The stock of U.S. foreign direct investment (FDI) in Israel in 2003 was $6.2 billion, up from $5.6 billion in 2002. U.S. FDI in Israel is concentrated largely in the manufacturing sector.

The United States-Israel Free Trade Area Agreement

Under the United States-Israel Free Trade Area Agreement (FTA), signed in 1985, the United States and Israel agreed to phased tariff reductions culminating in the complete elimination of duties on all products by 1995. In practice, most tariffs between the United States and Israel have been eliminated as agreed, although tariff and non-tariff barriers continue to affect a certain portion of U.S. agricultural exports.

Israel continues to restrict market access for certain U.S. agricultural products. To temporarily and partially address the differing views between the two countries over how the U.S.-Israel FTA applies to trade in agricultural products, in 1996 the United States and Israel signed an Agreement on Trade in Agricultural Products (ATAP), establishing a program of gradual and steady market access liberalization for food and agricultural products effective through December 31, 2001. Negotiation and implementation of a new ATAP was successfully completed in 2004. The new agreement is effective through December 31, 2008, and provides improved access to selected U.S. agricultural products. The agreement provides U.S. food and agricultural products access to the Israeli market under one of three different categories: unlimited duty-free access; duty-free tariff-rate quotas (TRQs); or preferential tariffs, which are set at least 10 percent below Israel's most-favored nation (MFN) rates. The ATAP also provides for annual increases in TRQs.

IMPORT POLICIES

Tariffs

Under the 1985 FTA, the United States and Israel agreed to eliminate duties on all products by January 1, 1995, the end of the implementation period. Israel removed duties on U.S. non-

agricultural products according to the FTA schedule, but substantial tariffs remain on some U.S. agricultural products.

Agriculture

Approximately 90 percent of U.S. agricultural exports (by value) enter Israel duty- and quota-free as a result of Israel's implementation of commitments under the WTO, the FTA, and the new ATAP. However, remaining U.S. agricultural exports consisting largely of consumer-oriented goods face restrictions such as a complicated tariff-rate quota system and high tariffs. In addition, the ability of U.S. exporters to utilize available quota volumes can be hampered by problems with the administration and transparency of Israel's TRQs. TRQ-related problems include lack of data on quota fill rates and license allocation issues such as small non-commercially viable quota quantities and difficulties in obtaining licenses for within-quota imports. The Israeli government has committed to taking steps to improve the administration of TRQs, including engaging in regular bilateral consultations through a review mechanism created by the new ATAP.

U.S. agricultural exports without free access to Israel primarily consist of high value goods which are important to the Israeli agricultural sector such as dairy products, fresh fruits, fresh vegetables, almonds, wine, and some processed foods. According to industry estimates, elimination of levies on processed foods could result in increased sales by U.S. companies in the range of $25 million to $50 million (with appropriate market development efforts). Removal of quotas and levies on dried fruits could result in increases in sales by U.S. exporters of up to $10 million. U.S. growers of apples, pears, cherries and stone fruits estimate that elimination of Israeli trade barriers would lead to an increase of $5 million to $25 million in export sales of these products. It is estimated that free trade in agriculture could result in U.S. almond exports growing by as much as $10 million.

Labeling Requirements

Imported food products face rigid labeling requirements. For many products, the labeling required by Israel is far more detailed than that required in the United States. The cost of additional labeling has acted as a deterrent for many U.S. companies who have considered marketing their products in Israel. The loss of sales of American products is difficult to estimate due to the variety of products affected by these regulations.

Customs Procedures

Some U.S. exporters have reported difficulties in claiming preferences under the U.S.-Israel Free Trade Agreement. Israeli concerns about the U.S. methods for issuing certificates of origin have sometimes delayed entry of, or delayed preferential tariff treatment to, U.S. goods going into Israel.

Meat Imports and Kosher Certification

Israel prohibits the importation of any meat or meat product that is not certified as kosher by Israel's chief rabbinate, a policy that presents significant challenges for U.S. meat exporters. There is strong demand in Israel for quality kosher beef. However, the process for granting kosher certificates is expensive and complex. In 2002 the U.S. meat industry and the two governments attempted, but were unable to develop, steps to facilitate U.S. compliance with Israel's kosher requirements. Industry estimates that kosher certification for U.S. meat could result in an annual increase in U.S. meat exports of $15 million in the medium term and more than $25 million in the long-term. In addition, work on an agreement on veterinary certificates of health for live animal imports was suspended after the announcement of the discovery of a single U.S. case of BSE involving an imported animal.

Israel permits the domestic production and marketing of non-kosher meat, but bans its importation. The ban on the import of non-kosher meat raises questions in terms of the 1985 FTA requirement that any religious-based restrictions be applied in accordance with the principle of national treatment. U.S. firms estimate that elimination of the prohibition on non-kosher imports could result in increased sales of less than $10 million.

Wine Imports

The 2004 Agreement on Trade in Agricultural Products for the first time grants U.S. wine exporters an annual tariff-rate quota of 200,000 liters of wine, with preferences over Israel's MFN rate for exports over and beyond that level. However, other impediments to U.S. wine exports remain. Wine importers also note that the government of Israel does not require Israeli wine producers to follow the detailed labeling requirements of the official Israel Standard for Wine, while these rules are strictly enforced on imported wines.

Rabbinical regulations for kosher certification also pose challenges for the wine industry. For example, rabbinical regulations do not permit use of the same company name on kosher and non-kosher wines. To keep their kosher certification, importers of kosher wines are not permitted to import non-kosher wines. Kosher wines cannot be stored in the same warehouse as non-kosher wines.

Sales of U.S. wines to Israel are about $700,000 per year. The industry estimates that the elimination of trade barriers could result in increased exports worth up to $10 million per year.

Purchase Taxes

In February 2004, the GOI announced a series of cuts in purchase taxes as part of a wide-ranging plan to reduce taxes to help benefit weak sectors in the economy. This included reducing taxes on televisions, videos, and DVDs from 45 percent to 15 percent, and reducing taxes from 15

percent to 5 percent on household appliances, such as refrigerators, ovens, dishwashers, washing machines, and dryers. In April 2004, purchase taxes on raw materials and building materials were eliminated. In December 2004, the Ministry of Finance announced a tax increase on cigarettes.

Textiles

Israel restricts imports of used clothing, and bans the importation of seconds fabrics. There has been an increased enforcement effort by the Israeli Customs Authority regarding its inspection of textile products entering Israel under the auspices of the U.S.-Israeli FTA. For apparel shipped from, but assembled outside, the United States, the Customs Authority requires a statement from the U.S. exporter with a complete breakdown of the value for each type of item in the shipment by design, cutting, assembly, etc., to determine whether the goods qualify to enter Israel under the FTA rules of origin.

STANDARDS, TESTING, LABELING AND CERTIFICATION

Technical standards are increasingly becoming a prominent non-tariff barrier limiting U.S. exporters' access to the Israeli market. Since 1999, Israeli law mandates that the Standards Institution of Israel (SII) adopt multiple international technical standards whenever possible. However, the SII has not implemented this concept. In addition, SII's formal process for adopting or developing technical standards appears to be a significant market-access obstacle to U.S. exporters despite concerted U.S. Government efforts to address the underlying issues of access and transparency. Moreover, each government ministry may adopt mandatory new regulations that can prevent the importation of U.S.-made products and services to Israel. This procedure has also created difficulties for U.S. exporters who contend that transparency and due process are frequently lacking, most notably for food imports. In addition, industry has said that requirements for technical standards are often not uniformly enforced. In some instances, domestic products appear to have an advantage over imports because enforcement of standards on domestic producers has been inconsistent, while standards requirements are more strictly applied to imported goods. U.S. companies that have been doing business in Israel for many years have increasingly been confronted by new, often EU-based, standards. In addition, the SII does not recognize U.S. testing or accreditation of electrical components and products without the product undergoing additional and often costly tests in Israel.

GOVERNMENT PROCUREMENT

Israel is a signatory to the WTO Agreement on Government Procurement (GPA), which covers most Israeli government entities and government-owned corporations. Most of the country's open international public tenders are published in the local press. However, government-owned corporations make extensive use of selective tendering procedures. In addition, the lack of transparency in the public procurement process discourages U.S. companies from participating in major projects and disadvantages those that choose to compete. Enforcement of the public

procurement laws and regulations is not consistent. Poor design and unfair management of public tenders discourages U.S. bidders.

In accordance with the Israel public tendering law, all international public tenders with a value of at least $500,000 contain requirements for "industrial cooperation" (IC) with Israeli entities. Under the IC agreements, foreign companies offset their income from Israel by agreeing to invest in local industry, co-develop or co-produce, subcontract to local companies, or purchase from Israeli industry. The current IC offset percentage for industries covered under the WTO GPA is 30% of the value of the contract; for industries excluded from the GPA, including most military procurements and El Al, it is 35%. U.S. suppliers have found the size and nature of their IC proposals to be a decisive factor in tight tender competitions, despite a court decision that prohibits the use of offset proposals in determining award of a bid. Small and medium-size U.S. exporters are often reluctant to commit to make purchases in Israel in order to comply with the IC requirements and refrain from participation in GOI tenders. At Israel's request, the WTO Committee on Government Procurement granted Israel an additional year (until the end of 2005) to reduce the level of its offsets from 30 percent to 20 percent. Israel is now required to reduce the level of its offsets to 20 percent by January 1, 2006.

In addition, the inclusion of unlimited liability clauses in many government tenders discourages American firms from competing. When faced with the possibility of millions of dollars in legal costs for unforeseeable problems resulting from a government contract, most American firms are forced to insure against the risk, which raises their overall bid price, and reduces their competitiveness.

For civilian local currency procurement by the Ministry of Defense (MOD), a U.S.-Israeli Memorandum of Understanding (MOU), extended in 1997, gives U.S. competitors equal status with domestic suppliers. This MOU applies to procurements that are not connected with U.S. military assistance programs. Despite this MOU, U.S. suppliers have expressed concern about the lack of transparency and apparent lack of justification for excluding U.S. suppliers from MOD tendering opportunities. The MOU, which has had a favorable effect on the Israeli defense industries by opening up the U.S. market to their products, has not resulted in an open market for U.S. suppliers competing on MOD's local currency procurements. Efforts by U.S. manufacturers or their agents to win military tenders for food have invariably met with failure.

INTELLECTUAL PROPERTY RIGHTS (IPR) PROTECTION

Israel is a member of the World Trade Organization (WTO) and the World Intellectual Property Organization (WIPO). It is a signatory to the Berne Convention for the Protection of Literary and Artistic Works, the Universal Copyright Convention, the Paris Convention for the Protection of Industrial Property, and the Patent Cooperation Treaty. Israel was fully obligated to implement the WTO Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS) in 2000. The United States would like to see Israel accede to the WIPO Copyright Treaty and the WIPO Performance and Phonograms Treaty (commonly known as the WIPO

Internet Treaties), particularly in view of the importance of Israel's high-technology software and telecommunication industries.

Although Israel has been obligated since January 1, 2000 to protect undisclosed test data from unfair commercial use, it has failed to do so. This lack of protection places it at odds with other OECD-level economies and many of its neighbors that have met their TRIPS Article 39.3 obligations. Israel does not deny that it relies, or allows a third party without authorization to rely, on data submitted by U.S. pharmaceutical firms when approving marketing applications from domestic generic competitors of U.S. innovator firms. The impact of Israel’s failure to provide data protection is already being felt within the country. Research and development, as well as clinical trial expenditures made by international pharmaceutical companies, have fallen in recent years as these companies have moved these activities to countries with more favorable data protection regimes. The U.S. Government has urged the Israeli government and the Knesset to enact TRIPS-consistent legislation that will provide a reasonable period of non-reliance on confidential data similar to that granted in OECD countries and many neighboring countries. In March 2004, an inter-ministerial Israeli government commission issued findings that support the adoption of protection for confidential test data in Israel; however, legislation submitted by the Israeli Government for Knesset consideration in December would fall short of providing adequate data protection. At U.S. urging, the Israeli Government in early 2005 withdrew the legislation from consideration to allow the two sides additional time to seek a resolution of the data protection issue.

At the same time, Israel has increased its budgetary, educational, police, and judicial resources devoted to the enforcement of the country’s copyright and trademark laws. In addition, Israel passed amendments to its copyright laws that should make it easier for law enforcement officials, prosecutors, and judges to pursue, prosecute, and punish copyright crimes. In 2003, the U.S. Trade Representative (USTR) recognized the country’s efforts by moving Israel from the Special 301 Priority Watch List to the Watch List. While noting Israel’s efforts, USTR said that it is essential that progress continue to be made in copyright and trademark enforcement, such as providing the Israeli police, prosecutors and courts with sufficient resources to fully meet enforcement requirements. In 2004, U.S. industry estimates the loss due to inadequate intellectual property protection $113 million.

In 2004, the government of Israel prepared new draft legislation intended to update and consolidate the country’s copyright laws. This draft may exclude end-user piracy from criminal liability, a step that may lead to weaker protection for business software. In addition, a separate law concerning writable media threatens to legalize the downloading of protected content from the Internet, and compensating rights holders through a tax on the media itself.

In October 2004, the government of Israel assured the United States that it would continue to provide U.S. music rights-holders' with national treatment protection.

SERVICES BARRIERS

Audiovisual and Communications Services

Israel has made progress in liberalizing its telecommunications sector. Foreign companies are now able to participate in joint ventures providing cellular and international telephone service, DBS satellite broadcasts, cable television, and Internet service. Israel officially opened domestic telephone service to domestic and foreign competition in 2000.

The State of Israel now owns less than 50 percent of Bezeq, the telephone parastatal, after it sold off shares of the company in July and November 2003. Privatization of the remainder of Bezeq is moving ahead, with an information room opened for potential bidders in November 2004 and the Government Companies Authority monitoring the tender process.

In 2001, Bezeq received a license to provide high speed Internet service with the condition that it permits other Internet service providers to have access to its infrastructure. The Knesset amended the telecommunications law to permit cable television providers (including firms with U.S. ownership) to provide fast Internet and other telecommunications services.

The international telephone market expanded in 2004 with two of the Internet companies, Netvision and Internet Gold Lines, receiving licenses to provide international telephone service.

Only selected private Israeli television channels are allowed to air advertising. These channels received broadcast licenses and the advertising privilege in exchange for certain investment commitments. Israeli law largely prohibits other channels, both public and private, from airing advertising. The government funds the country's public channels, whereas the remaining private channels generate revenues via subscription fees. In 2002, the Israeli government developed regulations that allow foreign channels aired through the country's cable and satellite networks to broadcast a limited amount of advertising aimed at a domestic Israeli audience. Currently, the regulations allow foreign channels to use up to 25 percent of their total advertising time to target the Israeli market. The regulations allow a foreign channel to apply for more than 25 percent advertising time if the channel can prove that it has a sizable viewing audience outside of Israel. The U.S. Government worries that any restrictions on advertising might inhibit the economic viability of U.S. firms' participating in the Israeli broadcasting sector.

INVESTMENT BARRIERS

The Israeli government actively solicits foreign private investment, including joint ventures, especially in industries involving exports, tourism, telecommunications, and high technology. Foreign firms are accorded national treatment in terms of taxation and labor relations, and are eligible for incentives for designated "approved" investments in priority development zones. There are generally no ownership restrictions, but the foreign entity must be registered in Israel.

Profits, dividends, and rents generally can be repatriated without difficulty through a licensed bank.

Over 750 U.S. companies have subsidiaries in Israel. Estimates for the number of Israeli companies with subsidiaries in the United States range from 300 to 500. Investment in regulated sectors, including electronic commerce, banking, insurance, and defense industries, requires prior government approval. Israel is a member of the International Centre for Settlement of Investment Disputes (ICSID) and a party to the 1958 New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards.

In an attempt to increase competition in the very concentrated banking sector and prevent conflicts of interest, the Government approved the Bachar capital market recommendations in November 2004. The two largest banks, Hapoalim and Leumi, control 61% of the banking sector's assets, and the 5 largest banks control 95% of the banking sector's assets.

The main aspects of the Bachar reforms include removing from the banks' ownership and management the Provident funds, which are private retirement funds, and mutual funds. This is to be done gradually over the next few years. In return, banks will be able to enter the insurance market, and sell life insurance. However, these reforms require Knesset approval.

ELECTRONIC COMMERCE

Israel generally supports U.S. efforts to ensure that electronic transmissions will not be subject to tariffs. U.S. industry has not reported any barriers to electronic commerce in Israel. Israel still lacks a clear body of regulations and tax laws covering electronic commerce-specific transactions. As a disincentive to online businesses, loopholes in the laws dictate that a consumer can decline to pay for any merchandise for which they did not physically sign. In August 2000, an Electronic Signature Bill was passed to regulate signatures on electronic media. The Ministry of Justice maintains a register of authorizing entities to issue electronic certificates attesting to the signature of the sender of an electronic message. Also under their jurisdiction is the Registrar of Data Bases, which by law must issue licenses to any firm or individual holding a client database. This measure is designed to protect client information from unwanted third party intrusion. It remains to be seen how the bill is being enforced, and whether businesses and consumers have increased confidence in electric commerce due to these measures.