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COMMISSION STAFF WORKING PAPER

European Neighbourhood Policy

Country Report

Israel

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1. INTRODUCTION

1.1. The European Neighbourhood Policy

On 1 May 2004, the enlargement of the European Union took place with the accession of ten new Member States. It has brought changes to the EU's political geography offering new opportunities to deepen existing relations between the Union and its neighbours to the East and to the South. The Union is determined to further develop partnerships with its neighbours to mutual benefit, promoting security as well as stability and prosperity. The EU's external borders will not become new dividing lines but the focus of enhanced co-operation.

The European Neighbourhood Policy sets ambitious objectives for partnership with neighbouring countries based on strong commitments to shared values and political, economic and institutional reforms. Partner countries are invited to enter into closer political, economic and cultural relations with the EU, to enhance cross border co-operation and to share responsibility in conflict prevention and resolution. The Union offers the prospect of a stake in its Internal Market and of further economic integration. The speed and intensity of this process will depend on the will and capability of each partner country to engage in this broad agenda. The policy builds upon and reinforces the existing framework of co-operation.

In the present report, the Commission provides an assessment of bilateral relations between the Union and Israel. It reflects progress under the Association Agreement, and describes the current situation in selected areas of particular interest for this partnership: the development of political institutions based on the values – democracy, the rule of law, human rights - underlined in the Agreement, regional stability and co-operation in justice and home affairs, and economic and social reforms that will create new opportunities for development and modernisation, for further liberalisation of trade and for gradual participation in the Internal Market. The report provides guidance for the preparation of joint action plans, and may also serve as a basis for assessing future progress in the Union's relations with Israel.

1.2. Relations between the European Union and Israel - The existing contractual framework under the Association Agreement

Israel and the European Community first established diplomatic relations in 1959. In 1975 a first co-operation agreement was signed.

The EU-Israel **Association Agreement**, which entered into force in June 2000, now forms the legal basis of EU-Israel relations. It is much more than a free trade agreement and enables continuing dialogue and co-operation between Israel and the EU in a wide variety of fields.

The Agreement foresees regular **political dialogue** at ministerial and senior official levels, and at parliamentary level through contacts between the European Parliament and the Knesset, the Israeli parliament. The Agreement established two main bodies: the EU-Israel Association Council (held at ministerial level) and the EU-Israel Association Committee (held at senior officials' level). Both meet at regular intervals, to discuss political and economic issues as well as bilateral or regional co-operation.

The Agreement refers to the goal of promoting peace, security and regional co-operation, to the need to contribute to the stability and prosperity of the Mediterranean region and to promote understanding and tolerance. Furthermore the agreement includes provisions on freedom of establishment and liberalisation of services, free movement of capital and competition rules, the strengthening of economic co-operation on the widest possible basis and the co-operation on social matters, supplemented by cultural co-operation.

The Agreement confirms the existence of **free trade** in manufactured goods and strengthens the arrangements for free trade in industrial products, which have been in force since the late 1970s. Arrangements for importing Israeli products are more flexible in the new agreement than they were under the 1975 Co-operation Agreement. It also calls for progressive and reciprocal liberalisation of trade for agricultural products. Concerning the latter area, a new agreement entered into force in January 2004, liberalising most of the reciprocal agricultural trade.

A Joint Declaration attached to the agreement stresses the importance both parties attach to the struggle against xenophobia, anti-Semitism and racism.

Israel has been a member of the Euro-Mediterranean Partnership since its establishment in 1995. Due to its relatively high level of economic development, Israel does not benefit from bilateral financial support under MEDA. However, it is eligible for MEDA funds earmarked for **regional co-operation**. While initially Israel participated in a number of projects (notably in the fields of audiovisual issues, cultural heritage, economic and industrial networks, environment), following the outbreak of the second Intifada, it has become increasingly difficult for the country to find partners in the Mediterranean area.

A Framework Agreement, signed in June 2000 between Israel and the **European Investment Bank**, is awaiting ratification by Israel.

Israel participates in Euro-Med programmes such as Euro-Med Youth, which promotes people-to-people contacts and co-operation between actors of civil society, associations and NGOs in the youth field. The same applies to the Euro-Med audiovisual and Euro-Med heritage programmes for co-operation in the audiovisual and cultural sectors. Regarding higher education, Israel is eligible for participation in the Community programmes Erasmus Mundus and, on a self-financing basis, Tempus.

Israel has been one of the around 30 focus countries under the European Initiative for Democracy and Human Rights (EIDHR) for 2002-2004 and has benefited of support amounting to 2,5 ME. The EIDHR supports civil society initiatives that aim to promote democracy and human rights.

In June 2003 the agreement associating Israel to the **6th Framework Programme for Research and Technological Development** (FP6 2003 -2006) was signed in Brussels. The FP6 is a key part of the EU's strategy to create a true European Research Area, an Internal Market for science and knowledge in which Israel plays an active role.

Israel and the Commission initialled in March 2004 the agreement on **Galileo**, Europe's satellite radio navigation programme, paving the way for Israel's active participation in the programme. This agreement provides for co-operative activities on satellite navigation and timing in a wide range of sectors, notably science and technology, industrial manufacturing, service and market development, as well as standardisation, frequencies and certification.

Israel has reacted positively to the **European Neighbourhood Policy**, and has shown interest in the initiative. The November 2003 EU-Israel Association Council discussed inter alia the Neighbourhood Policy and agreed that its broad range of new opportunities and relevant instruments should facilitate Israel's progressive participation in the EU's internal market and in EU policies and programmes, taking into account Israel's strategic goals and priorities. The objective of the exercise is to establish closer relations between the two parties, on the basis of shared values.

2. POLITICAL ISSUES

2.1. Democracy and the rule of law

Israel is a **parliamentary democracy**. The President is the Head of State, elected by the Knesset. The President appoints senior state officials, including the State Comptroller, the Governor of the Bank of Israel, the President and Deputy-President of the Supreme Court and judges, including rabbinical judges and Muslim and Druze *qadis*, members of the Chief Rabbinate Council and other public councils. The President also signs laws, treaties and agreements with foreign countries that have been ratified by the Knesset.

Israel has no written **constitution**; in its place the Declaration of Independence (1948), Supreme Court precedents and a series of Basic Laws are used.

Israel has declared itself a Jewish State. The Declaration of Independence proclaims equality for all citizens, irrespective of religion, race or sex.

Legislative power lies with the Knesset, a unicameral **parliament** with 120 members elected for a four-year term by universal and direct suffrage under a system of proportional representation. Only parties exceeding the minimum threshold of 1.5% qualify for Knesset representation.

The general framework for **elections** is laid down in the Basic Elections Law, according to which the Knesset is to be elected in general, country-wide, direct, equal, secret and proportional elections.

According to the 1992 law on **political parties**, only parties legally registered with the Party Registrar, or a coalition of two or more registered parties, which have decided to run together in the elections, can present a list of candidates and participate in elections. Lists may be excluded from elections for the following reasons: if they act directly or indirectly against the existence of the State of Israel as the state of the Jewish people or against its democratic nature, if they incite racism or support the armed struggle of an enemy state or a terrorist organisation against the State of Israel.

Following the last legislative elections in January 2003, twelve parties are represented in the current Knesset, out of which the Likud (40 seats), the Labour Party (19 seats – main opposition party), the Shinui (15 seats), the Shas (11 seats), the National Religious Party (6 seats), and the National Union (7 seats) have the largest representation.

The executive authority is the **central government**, led by cabinet of ministers under the leadership of the Prime Minister. The President appoints the political leader (usually the leader of the party which has received most votes) considered to have the best chances to form a government enjoying parliamentary support. Within 28 days, the appointed party

leader has to present a list of ministers for Knesset approval, together with a proposed government programme. To date, all governments have been based on coalitions of several parties. The ministers are responsible to the Prime Minister for the fulfilment of their duties and accountable to the Knesset for their actions.

The 30th government of Israel, formed in February 2003, is led by Ariel Sharon (Likud). The government is a coalition formed by four parties: the Likud, the Shinui, the National Religious Party and by the National Union party, controlling 68 of the 120 seats of the Knesset.

The Municipal Corporations Ordinance serves, along with other legal frameworks, as the basis for **local government** structure and its relations with government ministries. The relevant law defines two kinds of local authorities: municipalities and local councils, usually administering towns with a population over 20.000 and 5.000 inhabitants respectively. The number of seats in the councils is determined by their population and the mayors are appointed by direct public vote. The local authorities are led by councils, whose members are elected every five years on the basis of the proportional representation of their political parties.

The local authorities' powers include notably legislation, taxation, financial management and joint activities with other bodies. While not completely independent in any of these areas, a local authority is able to act on behalf of local interests according to the wishes of the elected representatives of the local constituency.

The Ministry of Interior supervises the activities of the local authorities and is primarily responsible in the following areas: the establishment of local authorities, approval of their budgets, provision of a suitable legal framework to fit their needs, examination of their by-laws, and assurance that physical planning and development projects conform to national and regional outline schemes.

The **judicial system** consists of general law courts (divided in three judicial levels), known as civil or regular courts, and tribunals and other authorities with restricted judicial powers, such as Labour courts, Military courts and Religious courts.

The general law courts include the Magistrate's Courts, District Courts and the Supreme Court. Magistrate's Courts are the basic trial courts of the Israeli system. District Courts are the middle level courts. They have jurisdiction in any matter that is not within the sole jurisdiction of another court and hear appeals of judgements of the Magistrate's Courts. The Supreme Court has jurisdiction to hear criminal and civil appeals from judgements of the District Courts as well as on appeals in matters of Knesset elections, rulings of the Civil Service Commission, disciplinary rulings of the Israeli Bar Associations, administrative detentions and prisoners' petitions appealed from the District Court. Furthermore, the Supreme Court sits as the High Court of Justice, acting as a court of first and last instance. The President of the Supreme Court is the head of the entire judicial system in Israel.

The tribunals with limited jurisdiction, such as the military tribunals, labour courts, religious courts and administrative tribunals are supervised by the Supreme Court. Each is comprised of a judicial system with an independent administration and an own appellate system. The Military Courts were established by the Military Justice Law (1955) and are competent to try soldiers for military and civilian offences. In 1969, the Knesset established the Labour Courts, recognizing that labour law requires its own judicial system. It is the Palestine Order in Council (1922) established under the British

Mandate that provides that “jurisdiction in matters of personal status shall be exercised by the courts of the religious communities”.

As regards access to justice, all citizens are entitled to a hearing and legal representation. The Public Defenders Law of 1995 established the Public Defenders Office (PDO) to provide professional legal representation in criminal cases. It is run by the Ministry of Justice and has one national office and five regional offices, and 800 lawyers at its disposal. A specific department of the Ministry of Justice provides legal aid to the less well-to-do in civil cases. The aid is given free of charge except for a participant’s fee. A number of NGOs and universities also operate legal aid clinics.

Judges enjoy both substantive and personal independence. The nine members Judicial Selection Committee selects them by majority vote. Judicial appointments are apolitical, permanent and depend on the professional legal qualification of the candidates. As there are no juries in Israel, the judge is the sole decision-maker in the judicial process. Judicial training per se is not a precondition to judicial appointments. Nevertheless, under the auspices of the Supreme Court, an Institute of Judicial Training for Judges has been established with the aim to invigorate high standards in the judiciary.

The **Civil Service** Commission (CSC) is appointed to implement the government’s policies in the field of management and human resources in the service of the State. The Commission is responsible for approval of the organizational structure and division of responsibilities between Governmental units, qualifying and training employees to improve their level of education and professional expertise, improvement of service to the public, etc.

Israel’s administration relies on a broad and structured base of independent regulatory bodies.

The stated objectives of the economic recovery plan of March 2003 are to improve the efficiency of the public administration and the quality of services it offers, while reducing operating costs. The planned measures include computerisation and reduction of bureaucracy in a number of administrations and the consolidation of smaller local authorities and municipalities.

Israel ranked 21 out of 133 countries in an international **corruption** perception index¹. Corruption in Israel is not perceived to constitute a serious problem for the functioning of the state administration or for Israel’s democratic institutions.

2.2. Human rights and fundamental freedoms

Israel is a democratic state with associated **political rights**, respect for the rule of law and a flourishing **civil society**.

Israel has ratified the core UN Human Rights Conventions, except the two Optional Protocols to the International Covenant on Civil and Political Rights, the Optional Protocol to the Convention on the Elimination of all Forms of Discrimination Against Women and the Optional Protocol to the Convention Against Torture.

¹ Transparency International, Corruption Perception Index, 2003

Israel has ratified most of the ILO's Fundamental Conventions (non-discrimination, child labour, forced labour, trade union rights), except Convention No. 182 on the elimination of the worst forms of child labour.

Certain specific restrictions are governed by the Defence (Emergency) Regulations, established under the British Mandate. These provide for derogations to common law such as administrative detention, restrictions on access to counsel and non-disclosure of full reasons of detention, mainly based on counter-terrorism legislation and regulations. The official justification for keeping the State of Emergency is the severe security situation.

Since 1996, the Basic Law on the Government required that the State of Emergency be reviewed and approved annually. In effect, the renewal has been automatic. Since 1951, unsuccessful attempts have been made to eliminate the regulations.

Israel did not extend Israeli law to the West Bank and Gaza Strip when it occupied them in 1967. Israel does not consider itself as an occupying power in the West Bank and in the Gaza Strip. Therefore, Israel claims that the Fourth Geneva Convention does not apply to its actions in the West Bank and Gaza Strip, which are based on the British Mandatory Emergency (Defence) Regulations (1945). According to Israel, the International Covenant on Civil and Political Rights (ICCPR) does not apply to the West Bank and Gaza Strip. However, the UN consider Israel an occupying power in the West Bank and the Gaza Strip and, the United Nations Committee for Human Rights re-asserted that Israel is responsible under international law for the application of the ICCPR in the occupied territories. In August 2003 the Committee reiterated its concerns at the increasing extent of human rights violations in those territories, particularly through military operations, the obstruction of freedom of movement and house demolitions. The EU recognises Israel's right to protect its citizens from terrorist attacks. It has urged the Government of Israel, in exercising this right, to exert maximum effort to avoid civilian casualties and take no action that aggravates the humanitarian and economic plight of the Palestinian people. It has called on Israel to abstain from any punitive measures which are not in accordance with international law, including extra-judicial killings and destruction of houses.

The Supreme Court has consistently upheld the principle that **freedom of expression** does not only entail the freedom to express the majority's popular opinion, but also the freedom to criticise the government.

Certain forms of expression are explicitly forbidden, e.g. the Prevention of Terrorism Ordinance forbids written or oral publication of praise, support or encouragement of violent acts likely to cause death or injury. The Penal law prohibits the publication of any utterance for the purpose of inciting racism. Public expressions of anti-Israeli sentiment and support for extremist Islamic groups are prohibited. There have also been certain prohibitions on displaying Palestinian political symbols in Jerusalem.

Freedom of association is regulated by the Amutot Law for NGOs (Amutot) and by the Parties Law of 1980 for political parties. The Amutot Law of 1980 empowers the Amutot Registrar to refuse to register an amutah if "one of the purposes is to negate the existence of the State of Israel or its democratic character, or if there are reasonable grounds to conclude that the amutah will serve as a cover for illegal activity". It also empowers the District Courts to order the winding up of an amutah if it, or its purposes, are aimed at the negation of the existence or the democratic character of the State, if it violates the law or

its own by-laws, if it is unable to pay its debts or if “reasons of justice or equity so require”.

Freedom of the press is applied in Israel to all communications media, with security matters only subject to military censorship.

The Press ordinance requires newspapers to be licensed. The authorities are not obliged to prove a reason for refusing to give a licence and can also suspend a licence. Nevertheless, most of the ordinance’s criminal and administrative sanctions on newspapers are no longer in use and their application has been narrowly defined by case law. Under the Defence regulations, the Chief Military Censor has broad powers to oversee print and electronic media publications.

Access to foreign print, electronic media and the internet is unrestricted.

In the territory occupied by Israel in the West Bank and Gaza Strip, reports by foreign journalists must be submitted to the military censors for security issues and the satellite feed used by journalists is monitored. Areas are often closed to journalists, entry permits denied in particular to Palestinian, but on occasions also to Israeli journalists.

The Declaration of Independence simultaneously defines the State of Israel as a home for the Jewish people and guarantees **freedom of religion**. There is no official religion. But the orthodox Jewish law, Halakha, has an important role in Israeli legislation and public life.

Matters of personal status are governed by the religious laws of the parties concerned who have their own courts. The recognised religions for this purpose are Judaism, Islam, ten Christian denominations, Bahai and Druze.

With regard to **torture and ill-treatment**, the Supreme Court has in a judgement of September 1999 invalidated the former governmental guidelines governing the use of “moderate physical pressure” during interrogations and held that the Israeli Security Services have no authority under Israeli law to use physical force during interrogations. This decision represented a significant shift in the interrogation policy of the GSS, and human rights organisations acknowledged that physical force during interrogation was no longer practiced routinely.

However, since the outbreak of the second Intifada, there have been renewed allegations of torture. The UNCHR Special Rapporteur’s report of September 2003 stated his difficulty in assessing the situation, given that he was not granted permission to visit Israeli prisons or detention centres or to meet government officials who might assist in assessing the validity of these allegations.

With regard to **equal opportunities**, Israel presents a high proportion of educated women and their representation in the public administration has increased over the last few years, notably in the top management. Some new measures and legislation were adopted in 2000 by the Government to improve the status of women in Israeli society with a view to promoting equality, such as the amendment to the Equal Rights for Women Law or the Employment of Women Law. An Authority for the Advancement of the Status of Women has also been established, which bears responsibility for the implementation of the Law on the Prevention of Sexual Harassment.

Israel has a diversified **civil society** active in social, cultural, economic, environmental and human rights matters. Israel’s human rights organisations are highly regarded by the

international community both for the accuracy of their reporting and for their advocacy. NGOs supporting peace efforts were prominent at the end of the nineties, but were paralysed after the outbreak of the second Intifada. Grass-roots contacts between Palestinians and Israelis have continued through the Intifada, albeit with a low profile.

Most **trade unions** belong to the Histadruth (General Federation of Labour) which predates the establishment of the State. There is also a much smaller rival federation, the National Federation of Labour. The organisations are independent of the government. Histadruth actively uses its right to strike. Strike leaders, including those organising illegal strikes, are protected by law.

The right of workers and employers to organize in trade unions is firmly entrenched in decisional law and is an underlying presumption of existing collective bargaining legislation Collective Agreements Law 1957. However, it is not yet expressly articulated in the Israeli legislation. Palestinians from the West Bank and Gaza Strip who work in Israel are not able to join Israeli trade unions or organize their own unions in Israel.

The Arab minority, Muslim, Christian and Druze, makes up almost 20% of the Israeli population. Although the Declaration of Independence proclaims **equality for citizens**, Israeli legislation contains laws and regulations that favour the Jewish majority. In this respect, the UNHRC expressed its concern, in its conclusions on Israel's implementation of the "International Covenant on Civil and Political Rights", about the adoption in July 2003 of the "Citizenship and Entry into Israel" Law, in particular, the potentially discriminatory nature of its provisions. As highlighted by an Israeli Commission report presented in 2003 ("Or Commission"), the Arab minority also suffers from discrimination in many areas including budget allocations, official planning, employment, education and health. In July 2001, the High Court ruled on a petition from the Association for Civil Rights in Israel, that Israeli Arabs were entitled to fair and proportionate representation in governmental bodies. The Court also held that the principle of affirmative action should apply to the Lands Council, which is responsible for supervising the Israeli Lands Administration. Currently, only one of 24 members is Arab. The Arab minority is severely affected by the Nationality and Entry into Israel Law of 2003, suspending for a renewable one-year period, the possibility of family reunification, subject to limited exceptions.

About 100.000 Arabs (Bedouins), mostly in the Negev, live in villages considered illegal by the State. The Israeli government announced measures to close the gap between the living conditions of Jews and Bedouins in the Negev and approved a five-year Plan, which consists among other measures of moving villages and destroying others.

In terms of access to justice, problems exist for migrant workers and for activities in the occupied territories. Appeal to the courts is the only recourse for Palestinians, in cases such as deportation, house demolition, damage, injury and land seizure. Although Palestinian residents of the occupied territories have the right to appeal to Israeli courts, access has been severely restricted in recent years. The Torts Law renders the procedure complicated that it prevents them from filing a suit. Closures and curfews, the prohibition on Palestinians entering Israel and the inability of Israeli lawyers to reach them, also severely limits their access to court.

2.3. Regional and global stability

Israel is an active member of the **United Nations** and all the major international organizations. However, it does not belong to any regional body nor is part of any alliance or military organization.

Israel is not part of the **Non-Proliferation** Treaty. The government neither recognises nor denies the existence of nuclear weapons in Israel. Israel has not signed the Ottawa Agreement on Land Mines.

Israel's overall political and economic situation is affected by the continuing conflict with the Palestinians and the state of relations with the Arab world in general. Israel has diplomatic relations with Egypt and Jordan following the conclusion of peace agreements in 1979 and 1994 respectively. The resurgence of suicide bombings since the beginning of the second Intifada in September 2000 - which have targeted Israeli civilians as well as military personnel causing the death of more than 900 people and thousands of wounded - is a matter of the highest security concern for Israel. Some of the measures taken by Israel in response to this situation have been criticised by the UN and the EU as disproportionate or incompatible with its obligations under international law.

The **Quartet Roadmap** (EU, US, UN, RF) for a permanent two-state solution to the Israeli-Palestinian conflict should result in the emergence of an independent, democratic and viable Palestinian state living side by side in peace and security with Israel and its other neighbours. The Roadmap's three-phase plan, which should lead to a comprehensive settlement of the Israeli-Palestinian conflict by 2005, inter alia calls upon the Palestinians to undertake the unconditional cessation of violence and the Israelis to dismantle the settlement outposts erected since March 2001 and freeze all settlement activities.

The EU has recently confirmed its full support of the Roadmap and reiterated its determination to pursue vigorously the course set out in it. Furthermore, the EU stressed that it will not recognise any change to the pre-1967 borders other than those arrived by agreement between parties.

Israel is constructing a separation barrier whose purpose, according to the government, is to protect Israeli population against terrorist attacks. Its construction has been criticised for infringing on occupied Palestinian Territory and for the serious economic and social consequences it has for the Palestinian population, including problems of access to land and services. The separation barrier and various closures and restrictions existing in the West Bank and Gaza, have severely affected the distribution of humanitarian assistance to the Palestinian population. Israel has made some adjustments to the route of the barrier in response to these concerns.

The EU position on these issues was expressed in the conclusions of the Council of March 2004 which states: "The European Council expressed its sympathy for those on all sides who endure the effects of violence or whose lives are disrupted by the conflict. It called on the Palestinian Authority to address the issue of security and combat terrorism and welcomed the Palestinian Authority's announcement of plans for improving Palestinian security performance, stressing the need for full and proper implementation. It noted with particular concern the grievous humanitarian situation in the Occupied Palestinian Territories and called on the Israeli Government to take action to alleviate the suffering of Palestinians by lifting prohibitions on movement, reversing its settlement

policy and dismantling settlements built after March 2001, and reversing the construction of the so-called security fence on Palestinian land”.

2.4. Justice and Home Affairs

The 1950 Law of Return stipulates that Jews immigrating to Israel may be granted the status of *oleh*, which automatically entitles them to citizenship unless the applicant is deemed likely to endanger public health, the security of the State or public welfare, or "the person is engaged in an activity directed against the Jewish people".

The Ministry of Interior has implemented since 1995 a more restrictive approach and the 1950 Law of Return is no longer applied to the non-Jewish spouse of a person who already is an Israeli national: he/she no longer receives the benefits of a Jewish new immigrant, including the automatic right to acquire the Israeli citizenship.

The number of immigrant workers has been steadily increasing over the years. Approximately 60.000 **visa quotations** were delivered in 2003 by the Israeli government to companies. The latter must be registered companies, employ the workers directly and comply with all the conditions set out in the Foreign Worker's law. In the construction and agricultural sectors, the quota among the applicant companies is defined by the Ministry of Labour, Trade and Industry. The visa belongs to the employer and not to the worker and is only indirectly linked to the contract. Should the visa end before the contract or if a worker is dismissed by his employer, the worker becomes an illegal immigrant, leading automatically to deportation. In this respect, cases of maltreatment and exploitation of illegal migrants have been reported by local NGOs. The employment of a foreign worker without a valid work permit may lead to monetary sanctions for the employers and to imprisonment for recidivists.

In 1968, Israel ratified, with some reservations, the 1951 Convention Relating to the Status of Refugees (and its 1967 Protocol). Only in 2001 did the government introduce procedures for dealing with asylum seekers (Ministry of Interior's internal directive "Regulations regarding the treatment of asylum seekers in Israel"). This directive sets the legal foundation for dealing with applications for refugee status in accordance with the Refugees Convention.

The 2002 UNHCR annual report shows a steady increase of the number of **asylum seekers**: 596 applications pending at the beginning of the year and additional 1.319 applications submitted during the year. Most asylum seekers originate from African countries (mainly Ethiopia and Eritrea, followed by Sudan, Congo, Liberia, Ghana, Somalia) and to a lesser extent from Eastern Europe (Serbia-Montenegro Russia, Ukraine, etc.).

Asylum seekers do not receive an appropriate interim status until a decision on their application is taken. No social benefits (including medical services) are granted and they are not allowed to work.

Border controls are carried out by the operational unit for internal security and anti-terrorist duties of the Police Force of Israel. The Israel Police (IP), headed by the Commissioner of Police, has a force of approximately 25.000 officers spread over 80 police stations. Its structure includes a National Headquarters, six districts, several sub-districts and the Border Guard. The Commissioner of Police, appointed by the government upon the recommendation of the Minister of Public Security, directs the IP's subsidiary units through Police district Commanders and the Commanding Officer of the Border Guard, supported by his staff at National Police Headquarters. Other special units

include the Foreign Citizens Liaison Unit assisting the Ministry of Labour and Social Affairs in executing deportation orders issued by the Israeli courts and the Ben Gurion Airport Police Unit (prevention of terrorism against the airport and drug smuggling into the country).

Israel is affected by an increasing **trafficking of human beings** as a country of destination. Most of the victims originate from certain Eastern European countries (Russia, Moldova, and Ukraine). While the Ministry of Justice adopted in 2000 an amendment to the Penal Law foreseeing more stringent sentences, its enforcement remains weak. The establishment of a shelter for trafficking victims, approved in 2003 by the Government, has not been implemented yet.

The **Anti-Drug Authority** of Israel, established in 1988, formulates policy with regard to the prevention of drug abuse, treatment and rehabilitation of drug addicts and enforcement of the laws and penalties pertaining to drug abuse. It also ensures the co-ordination of the activities between government services and between the government and non-governmental bodies. Israel has signed but not yet ratified the "United Nation Convention against illicit traffic in narcotic drugs and psychotropic substances" (1988).

Israeli national policy on drug use and abuse has three distinct dimensions: education and prevention, treatment and legislation. Israel has invested significant resources in prevention, treatment and rehabilitation, in co-operation with certain NGOs. The consumption of synthetic drugs has seen a sharp increase in recent years, while at the same time the age of first use of illicit drugs is steadily falling. Drug-related crimes reportedly represent 75% of the total crimes committed. In this respect, Israel has also developed sophisticated technologies and detection techniques in its fight against drug trafficking.

Since June 2000, when it was identified by the OECD-based Financial Task Force on **Money Laundering** (FATF) as a Non-Co-operative County or Territory (NCCT), Israel adopted legislation and regulations inter alia for the money laundering criminal offence, customer identification, record keeping and reporting requirements. The Israel Money Laundering Prohibition Authority was set-up in January 2002, functioning as a Financial Intelligence Unit (FIU). The concrete improvements achieved by the Israeli administration led the FATF to de-list Israel in June 2002. In 2003, the Israeli Central Bank carried out comprehensive inspections of the major Israeli financial institutions and customer identification procedures.

3. ECONOMIC AND SOCIAL SITUATION

3.1. Macroeconomic and social outlook

3.1.1. Recent economic developments

Once a traditional economy based on agriculture, light industry and labour intensive production, Israel has evolved into a knowledge-based economy, with internationally competitive service and industrial sectors (competitiveness ranking 20 by the World Economic Forum 2003). In 2002 GDP was about US\$ 104 billion, a GDP per capita of US\$ 16,400 given a population of about 6 million. In PPP terms, GDP per capita was about US\$ 20,000 in 2002, compared to an EU average of US\$ 25,000. While falling in 2001 and 2002 owing to the economic recession, per capita incomes remain well above the average for the rest of the Mediterranean region.

Services (2001 data) represent about 60% of GDP with communications services, software production and tourism playing a leading role. Industry accounts for about 30% of GDP, with a comparative advantage in high value-added products, notably high-tech goods (in 2001 57% of Israeli industrial exports were high-tech) and cut and polished diamonds. Until the 2001 global slowdown, the high-tech sector was the engine of the economy, owing to the availability of skilled workers and venture capital funds as well as considerable investment in Research and Development. Agriculture (3% of GDP) is a highly developed sector, but limited by water scarcity.

The Economic Stabilisation Programme adopted in 1985 led to significant progress in macro-economic stabilisation and was accompanied by effective reforms on the structural front. During the 1990s the economy recorded average growth rates of over 5%, sustained by the rapid development of the high-tech sector and progress on the peace front. 2000 was an exceptional year with a 7.5% real growth rate. This positive economic performance was reversed in 2001, due to external and domestic factors, namely the worsening security situation, the crisis in the high tech sector, global economic slowdown and economic policy uncertainties. In 2001 and 2002 real GDP contracted by 0.9% and 1% respectively. The Israeli economy recovered slightly in 2003, with real GDP growth of about 1% owing to some improvement of the global outlook and lower political, economic and security uncertainty. Important factors in this context included the launch of the Economic Recovery Plan (based on structural reforms and fiscal restraint) by the new government in 2003, the rapid conclusion of the war in Iraq and US\$ 9 billion loan guarantees from the USA. Economic performance was also supported by the depreciation of the New Israeli Shekel during 2002 and lower nominal wages. Nevertheless, economic performance in 2003 remained well below potential⁷.

Israel - Selected Economic Indicators, 1997-2003

	1997	1998	1999	2000	2001	2002	prel. 2003
Real GDP growth (in %)	3.3	3	2.6	7.4	-0.9	-1.0	1.0
Unemployment rate	7.7	8.6	8.9	8.8	9.4	10.3	10.6
CPI inflation (average; in %)	9	5.4	5.2	1.1	1.1	5.7	-2.0
Broad money M3 (end of year; % change)	25.3	22.1	21.9	10.1	17.8	2.4	
Central government balance, excl grants (% of GDP)	-5.9	-5.5	-5.1	-3.2	-6.6	-6.4	-8.0
Current account balance (% of GDP)	-3.9	-1.3	-3.2	-1.7	-1.7	-2.1	0.4
Official net international reserves (end of year)							
In millions of US dollars	20	23	23	23	23	24	24
In months of imports of G&NFS	6.6	7.6	6.7	6.0	6.4	6.7	
Public external debt (% of GDP) (end of year)	25.4	26.6	26.6	24.1	24.2	26.3	
Debt service (in % of exports of GNFS)	177.8	178.8	166.4	137.7	162.3	179.8	
Exchange rate (NIS/US dollar) (end of year)	3.54	4.17	4.2	4.0	4.4	4.7	4.4
Real effective exchange rate (annual change in %) ^{1/}	7.0	-3.0	-3.8	8.0	-0.3	-10.0	
Population (million)	5.6	5.8	5.9	6.0	6.2	6.3	

Source: IMF, national sources.

^{1/} A negative sign implies a real depreciation and, therefore, a gain in international competitiveness.

3.1.2. Fiscal management, monetary and exchange policy

The 1985 economic stabilisation programme, allowed the reduction of consumer price inflation (CPI) from the triple-digit figures of the early 1980s to about 5% by the end of the 1990s. Average CPI rose to 5.7% in 2002 (inflation target 3%). This reflected the rapid currency depreciation that took place during the first half of the year. Subsequent rises in interest rates and measures to control the deficit led to a reversal in the inflation trend. CPI was actually negative (2%) in 2003.

Progress with fiscal consolidation stalled in 2001 and the central government deficit widened to 4.6% of GDP (about 6.6% excluding foreign grants). This reflected the deterioration in economic and security conditions (which led to a shortfall in revenues and higher defence spending), but in some cases also higher current expenditures. The government implemented strong fiscal measures in 2002 and 2003. These included cuts in welfare transfers and reductions in public employment and public wages. However, public investments in physical infrastructure and defence spending increased. These budget measures contained the extent of the slippage, although for 2003 the central government deficit is estimated to have risen to 5.5-6% of GDP (about 8% excluding grants) against a target of 3% of GDP. Expenditure cuts in social transfers, as well proposed pension reforms, generated widespread public discontent in 2002 and 2003.

In 2002 central government current revenues stood at about 36% of GDP, of which 30% were revenues from taxation. Israel also received about 3-4% of GDP in foreign grants. Expenditures were about 43% of GDP, mainly devoted to subsidies and transfers (about 15% of GDP), followed by defence (about 10% of GDP) and interest rate payments (6% of GDP). The high and rising level of public debt is an element of fragility. By the end of 2003 gross public debt had reached 106% of GDP, compared to 102% the previous year and 99% in 2001. In 2002 deficit financing was mostly satisfied on the domestic market. With the improvement of the domestic and global outlook, in June 2003 the government successfully completed a US\$ 750 million bond issue.

Although formally committed to respecting an **exchange rate** bound to a USD-dominated basket, since the early 1990s the Bank of Israel regularly announces inflation targets and is strongly committed to maintaining price stability. The Bank has kept rates high in real terms. With falling prices, the average real interest rate in 2003 remained at over 6%.

The exchange rate has exhibited considerable volatility in recent years. In 2002 the NIS depreciated by about 10% against the reference basket and 20% against the euro. In early 2003 it weakened further, reflecting the uncertainty surrounding the general elections and the conflict in Iraq, but subsequently rose with the improvement of the domestic and external environment.

Israel has accepted all the obligations of the IMF's Articles of Agreement, implying the convertibility of its currency for current account transactions. With the abolition in December 2002 of the last ceiling on foreign investments by institutional investors the process of liberalising the currency market was completed.

3.1.3. External situation

Since the mid-1990s the rapid development of Israel's high-tech sector was responsible for substantial inflows of foreign direct and portfolio investments (worth 1.5% and 2.6% of GDP in 2000 respectively). Israel's economic difficulties have weighed on the capital

account balance, although with a lag for FDIs, which actually continued to rise in 2001 before falling in 2002.

There are no immediate concerns about external vulnerability. Total (public and private) gross external debt was about 65% of GDP in 2002, and is expected to have increased to about 67% in 2003. However net foreign debt was negligible at about 2% of GDP, due to substantial public and private foreign assets, and foreign reserves fully cover short-term foreign liabilities. Gross foreign currency reserves were US\$ 24 billion at the end of June 2003.

3.1.4. *Social situation and human development policies*

In 2003 Israel ranked 21st according to the UNDP human development indicators. With the population increasing by over 2% each year, the recession of 2001 and 2002 and the slow recovery of 2003 led to a significant fall in *per capita income* (about 8%). According to the Israeli *poverty* definition, about 14% of the Israeli households were living in poverty in 2001, and the share is expected to have risen in the following years. Figures are higher among the Arab minority (where 45% of the families fell in the poverty category). Under the 1980 Income support law, families that do not earn the minimum income level benefit from income support by the National Insurance Institute (NII).

Israel's workforce is one of the most skilled in the world. Education is compulsory between the age of 5 and 15, and is provided free of charge until 17. The adult literacy rate was over 95% in 2001. At over 7% of GDP, public expenditure on education is above the average of most developed countries.

Unemployment rose to 10.6% by mid 2003, from 10.3% in 2002 and 9.4% in 2001. Youth unemployment was a high 21% in 2002. There has also been an increase in the share of part-time jobs and of long time unemployed. Additional pressure derives from demographic and immigration trends, which lead to increases in the labour force of 3.5% each year. The government took steps to reduce unemployment benefits and tighten eligibility criteria. Limited active labour market policies were also put in place. Foreign workers are mostly concentrated in construction, household and personal care and service sectors.

Israel's labour market is characterised by low rates of participation in the workplace (around 55% in 2001, and 61% for working age men). Raising the rate of participation has been among the main reform priorities of the last few years. Pension reforms, approved in 2003 and proposed for 2004, include a gradual increase in the retirement age and lower benefits. Recent developments indicate a relatively high degree of wage flexibility.

Israel has a well developed **education** system and has an ongoing national investment in education at all levels.

Universities offer under-graduate, graduate and post-graduate studies in the fine arts, humanities, and the sciences. Most basic research in these areas is carried out at the country's eight public universities, while a special focus exists on research in new technologies.

The **pension system** is not compulsory and as a result a large share of the population (about 1 million) does not receive pension benefits. So far, the system has mainly

consisted of pension funds administered by the federation of national trade unions (Histadrut). In mid-2003 the government took over responsibility for the trade unions' pension funds, which had a high unfunded component posing a risk to the sustainability of the pension system. The impact on the budget is expected to be positive in the medium term, as from now on pension funds are required to invest their revenues on the stock market, rather than, as it was the case in the past, in government bonds.

3.2. Structural reforms

3.2.1. State involvement in the economy and privatisation

Historically the government was involved in nearly all sectors of the economy. During the 1990s progress was made towards privatisation. In 2000, state-owned companies accounted for around 8% of exports and 2% of employment. At the end of 2001 there were 101 state-owned companies, of which 43 were commercial enterprises. Privatisation increased in 2003 and was identified as one of the priorities of the Economic Recovery Plan to raise funds to cover the deficit, instil competition in the markets and develop the capital market. Notably, in June 2003 the national airline El Al was privatised through the sale of all the company's shares on the Tel-Aviv Stock Exchange (TASE). Plans were announced regarding privatisations in the banking sector, electricity, shipping and oil refining. In 2003 the government approved the reorganisation of the state-owned Israel Electric Corporation (IEC) in preparation for its future privatisation.

3.2.2. Regulatory framework and private sector development

Prices are mostly liberalised. The government still retains control of some basic products, such as bread, milk and oil. Some government price subsidies also remain for water, telecom services and public transport.

In addition to **privatisation**, the new government also expressed its commitment to breaking up state monopolies. In the telecom sector, mobile telecom services and international telephony have been opened for competition, in 1994 and 1997 respectively. The fixed-line telecom market remains dominated by the company Bezeq, due to the withdrawal of participants to a licensing tender in 2000. However, in late 2003 the government decreased its holding in Bezeq to 49.5%. Since 2001, cable companies have the possibility to provide telephony and other advanced communication services. This is expected to reinvigorate future competition in the fixed line segment. After lengthy negotiations, in early 2003 the restructuring of the Mekorot National Water Company was approved, whereby it will split into five government companies, some of which will be exposed to competition from the private sector. State monopolies in the ports and mail services sectors are also being challenged.

The Israeli economy is mostly diversified and competitive. Regulatory reforms during the 1980s, which were further accelerated during the 1990s, have contributed to the improvement of the business environment.

At the centre of Israel's industrial policy is the 1959 Law for the encouragement of capital investments. The law provides for the extension of financial incentives (including reduced tax rates, tax exemptions for the first period, accelerated depreciation) for "approved enterprises" established in areas of national priority, i.e. mainly the periphery (Negev and Galilee) and in Jewish settlements in West Bank and Gaza and the Golan Heights. Investment incentives are being revisited in order to avoid market distortions and discrimination against domestic investors.

Competition is regulated by the Restrictive Business Practices Law of 1988, which forbids restrictive arrangements, but allows companies to request an exemption. The law requires advance notification of mergers and acquisitions under certain circumstances, including when the aggregate market share exceeds 50%, or when one of the merging parties is a monopoly. A monopoly is defined as an entity enjoying over 50% of sales or purchases in a relevant market. Monopolies are prohibited by law from abusing their market position. The Israeli Antitrust Authority (IAA) is in charge of the civil and criminal enforcement of the Competition Law. The IAA is strong and active, and despite being formally under the authority of the Minister of Industry and Trade, it is de facto separated from the ministry, with an independent budget and legal powers, including the authority to conduct criminal investigations and bring prosecutions in court. Since 1994, the Jerusalem District Court acts as Israel's Restrictive Business Practices Court. It hears appeals against IAA decisions and deals with criminal dimensions of competition cases. There is currently no uniform **state aid** surveillance or control regime.

The government subsidy programme to the business sector accounted for about 0.7% of GDP in 2002. The government also extended capital grants to the business sector in the order of 1% of GDP in 2002.

3.2.3. Financial sector

The **financial sector** is highly developed by regional and international standards. The banking sector is rather concentrated, with three institutions accounting for about 80% of assets. The state still holds shares in two of the largest banks but it does not exercise management control and is planning to sell its participation. Foreign banks are allowed to operate in Israel but their presence is small. Financial intermediation appears relatively efficient, as indicated by a low and declining interest rate spread between average lending and deposit rates (3.9 percentage points in 2002). The recession in 2001 and 2002 led to a worsening of the credit quality and to a rise in problem loans. However there are no immediate threats to the banking system or to financial stability. Bank supervision reacted quickly and supplementary credit provisions and on-site examinations were successful in containing problem loans at a low level (3.5% of total credit in 2000-2002). An IMF Financial Sector Stability Assessment was conducted in 2000-2001. Among the recommendations made was the introduction of a deposit insurance scheme, which appears particularly important in light of the declining profitability of banks.

Israeli Banking supervision is ensured by a supervisor of banks appointed by the Bank of Israel. There are no restrictions on the establishment of locally incorporated banking firms or on their acquisition by foreign residents, provided that prudential requirements laid down by the Supervisor of Banks, regarding ownership and management of Israeli banks, are adhered to. There are also no restrictions on the opening of Israeli branches of foreign banks. In accordance with its obligations under GATS, Israel does not limit activities of foreign service-providers.

There are five large institutions in the insurance sector, accounting for 80% of the insurance market, and particularly for 93% of the life insurance segment. New insurance companies are gaining market shares, while foreign ones are relatively small. The sector is regulated by the Commissioner for Insurance under the supervision of the Ministry of Finance.

The insurance sector is regulated by the Commissioner of Insurance, who is a treasury official empowered with certain statutory authority. Israel's insurance law permits

foreign ownership of insurance companies. A foreign insurer must be financially sound in accordance with the requirements of the Ministry of Finance. It must also commit itself to keep certain prescribed amounts in the country before a licence is granted. Foreign presence remains limited in this sector.

The capital market is dominated by provident, pension and mutual funds, as well as insurance companies, whose assets represented about two-thirds of the capital market in 1997. The capital market is characterised by a degree of government intervention and subsidisation, notably through the issue of guaranteed-rate state bonds. Israel also has a very strong venture capital market, channelling resources mainly to early-stage companies, particularly start-ups in sectors based on ICT and biotechnology. The Israeli government has played an active role in the development of Israeli venture capital markets, most effectively through financing hybrid (public/private) venture capital funds to leverage private capital from foreign investors. Over time, the role of the government in these funds has declined to almost zero.

3.2.4. Sustainable Development

A Government Decision on **sustainable development** was adopted in 2003. All Ministries need to prepare sector specific strategies, which will be updated every three years. A National Commission for Sustainable Development is under consideration.

3.3. Trade, market and regulatory reform

Israel is an open economy, with merchandise trade of about 60% of GDP, or 80% if services are included. More than 80% of Israeli trade is covered by free trade agreements. Among them, the EU-Israel Association Agreement signed in 1995 (in force since 2000) provides for free trade in industrial products and reciprocal concessions in agricultural trade. Negotiations for a package of new trade concessions for certain agricultural products were concluded in July 2003. The only remaining non-tariff barrier on Israeli agricultural imports is that applying to non-Kosher food.

A country with scarce natural resources, notably energy, Israel has traditionally displayed a negative trade balance in merchandise trade. In 2002 the balance of trade in goods stood at about 8% of GDP, with exports representing over 25% of GDP and imports (including defence) about 35%. Industrial goods and diamonds are the main export items. The performance of the service balance is mainly determined by the tourism and software sectors: The service balance turned slightly negative in 2001-2002. Substantial foreign grants (about 3-4% of GDP between 1999 and 2000) and other transfers have traditionally allowed containment of the current account deficit (about 2% of GDP in 2002). Trade data up to October 2003 reveal a narrowing of the trade deficit in 2003, brought about by the recovery in exports supported by the real depreciation of the NIS in 2002. Together with larger transfers, the recovery of sales in technology services and lower net factor payments, this should have allowed for a current account with a small surplus.

Regarding **sanitary and phytosanitary issues**, the veterinary legislative framework consists of six major laws covering animal diseases, export of live animals and animal products, veterinarians, animal protection and business licensing. The main activities and authority of the Israeli State Veterinary Services (VS) derive from these laws, with competent central and regionalised centres. Israel lacks an updated phyto-sanitary legislation and this causes disruption to trade flows. The Plant Protection Law dates from 1956. The Plant Protection and Inspection Services (PPIS) are the enforcement authority

of the Ministry of Agriculture in the field of plant health, safety and quality and operate according to international standards. Their main activities are opening export markets for Israeli products by mutual agreements with other countries.

On **customs**, the Israeli Customs & VAT Department, a Ministry of Finance body, is responsible for customs collection, enforcing foreign trade laws including on the prevention of drug trafficking, money laundering and IPR regulations, for enforcing regulations and facilitating the movement of goods between Israel and other countries. A reform of the Ministry of Finance is currently taking place to increase efficiency and reduce personnel.

The Israeli Customs adhere to the Harmonisation System. There is one unified form for imports and one for exports. All customs clearance procedures are fully computerised, and the Department's IT system is being upgraded to reach paperless procedures by 2006. Information in Hebrew and partly in English is available on the web. Customs services are free of charge. A system of binding tariff information is in place (BTI).

Israel has a "Qualified Industrial Zone" agreement, allowing for specific rules of origin for duty and quota-free exports to the United States of products manufactured partly in Israel, partly in certain areas of Jordan and then exported from Jordan. Israel and Jordan requested a similar arrangement with the European Community.

Israel, as a partner to the Barcelona Process, endorsed on 7 July 2003 the new Protocol on rules of origin allowing the extension of the Pan-European system of cumulation of origin to the Barcelona Partners. The next stage aims at amending the origin protocol in the relevant Euro-mediterranean Agreement in order to insert the changes necessary for the application of diagonal cumulation. This could help fostering economic integration and allow for a better use of the complementarities and the economics of scale in the Euro-mediterranean area. Nevertheless, the EU has made clear that it is not in a position to proceed with the amendment of the present Protocol until the bilateral issue on rules of origin, i.e. products originating from the settlements and exported to the EU under the EC-Israel Agreement, has not found a suitable arrangement between the parties. Discussions are still going on in this regard.

Concerning **taxation**, the Ministry of Finance is currently undergoing a reform, to increase efficiency and to reduce personnel.

The main types of taxation in Israel are personal income tax, capital gains tax, corporate income tax and value added tax. VAT was raised in mid-2002 from 17% to 18%.

Foreign investment, venture capital and expenditure on research and development are eligible for tax exemptions, as part of the Capital Investment Encouragement Law. Goods purchased in Eilat are exempt from VAT in order to encourage the development of the city. The Israeli government also grants income tax benefits for people residing in the periphery: the Negev, the Galilee and the settlements and promotes investments (only in industry and tourism) in the priority zones by means of grants or tax benefits (60%). For this purpose the country has been divided into priority zones A and B.

Israel has signed double taxation treaties with 18 Member States.

In the area of **technical regulations and standards for industrial products**, Israel applies legislation requiring the adoption of international or European standards. The non-governmental Standards Institution of Israel (SII) carries out standardisation, testing,

certification and training activities and prepares and publishes Israeli standards. A standards commissioner exists, with responsibility for enforcement of standards; some ministries are involved in developing and enforcing standards. The Israel Laboratory Accreditation Authority (ISRAC) is a member of the International Laboratory Accreditation Cooperation (ILAC).

Intellectual and industrial property is covered by three main pieces of legislation: the 1967 Patent Act protects regular patents for 20 years, the 1972 Trademarks offers (renewable) protection for an initial period of seven years, whilst the Copyright Law regulates the protection of original literary, musical, artistic and dramatic works, and computer programmes; providing protection for the lifetime of the creator plus 50 years for musical and artistic works and 70 years for literary and dramatic works. Data exclusivity is a sensitive problem, particularly in the pharmaceutical sector. Israel's efforts to ensure conformity with the TRIPS Agreement include enforcement measures such as the establishment of a specialised police unit, judicial training and improvements to inter-ministerial co-ordination.

In the area of **public procurement**, Israel is party (with developing country status) to the WTO's Government Procurement Agreement (GPA). Its WTO obligations are reflected in the Mandatory Tenders Law of 1992 and related regulations. The GPA does not apply to defence establishments and Israel benefits from "offset" arrangements up to 35% of the contract (to downsize to 20% in 2005). According to the *Mandatory Tenders Regulation of 1995*, contracting authorities must follow an offset policy. This is designed to promote national manufacturers, whereby industrial co-operation with Israeli entities is required up to 35% of the contract's value. Israel's procurement law also provides for exemptions from mandatory public tendering. In some tenders domestic suppliers also receive price preferences. In 1997 Israel and the EU signed two procurement agreements going beyond the GPA. The first agreement commits Israel to further opening in urban transport services, medical equipment and sub-central government procurement, such as municipal and state agencies. The second facilitates telecommunications procurement.

As regards **provision of services** (other than financial services) and **right of establishment**, the latter is regulated by the Company Ordinance and by the Company Law of 1999. According to the Law, every person, Israeli and non-Israeli, is entitled to establish a firm in Israel, provided that the goals of the company are not illegal, immoral or against the State of Israel. The formal procedures include registering with the Registrar of Companies, waiting for approval and payment of fees. The Law also regulates bankruptcy of companies. The Law for Encouragement of Capital Investments (the Investment Law) regulates investments and established the Israel Investment Centre (ICC), the main responsibility of which is to encourage the development of industry and tourism in Israel. Israel has signed Investment Promotion and Protection Agreements with a number of foreign countries.

With the exception of investments in the defence sectors and the acquisition of rights to land use, the business regime is generally non-discriminatory for foreign direct investments. 100% foreign-owned companies are allowed, provided they register with the government. The Israeli Investment Promotion Centre was set up as a one-stop shop for foreign investors. Financial incentives (grants or tax reductions) may also be provided, notably to investments in the high-tech sector. In 2002 after a full examination of its foreign direct investment policies, Israel was invited to join the OECD "Declaration on International Investment and Multinational Enterprises" in view of its general

openness to foreign direct investment and liberal orientation of its macro-economic and structural policies.

3.4. Transport, energy, information society, environment and research and innovation

The Ministry of Transport (MoT) pursues a sustainable **transport policy** focusing in particular on the development of an integrated intermodal public transport system. Israel also pursues a very ambitious railway policy “Railways 2000”, aimed at making railways a major transportation service by 2010. The plan for rail service development encompasses the twin areas of passengers and goods. In the road sector, the promotion of road safety is an important policy goal (including the further development of technical safety regulations). The Road Safety Administration, an inter-ministerial agency, coordinates the activities of the various ministries involved in traffic accident prevention.

The Civil Aviation Administration of the MoT is responsible for all matters related to civil aviation in Israel and has a wide range of competences, including inter alia the formulation of a comprehensive policy for domestic and international civil aviation, and supervising the enforcement of aviation legislation, regulations and standards. In international aviation, bilateral air services agreements between Israel and the Member States of the European Union do not include Community designation and are not in line with Community law. Israel has concluded bilateral aviation safety agreements with some Member States in the field of mutual recognition of the acceptance of airworthiness certification findings. Israel has high standards of aviation security and has deployed “sky marshals” (armed law enforcement officers) for many years. The Israel Airports Authority is responsible for running and developing the airports and the civil air transport systems.

The maritime sector is regulated by the MoT through the Shipping and Ports Administration. The latter is responsible inter alia for policy regarding the merchant shipping industry, covering subjects of safety, maritime manpower, and international maritime convention. The Ports Authority is responsible for planning, building, developing, managing, maintaining and operating Israel’s three state-owned ports (Haifa, Ashdod and Eilat).

Concerning **energy**, Israel is almost exclusively dependent on imports, but has indigenous resources (natural gas, oil and non-exploited oil shale). It is a major actor in and user of solar technology. Exploration activities offshore regarding recently discovered natural gas are a high priority. Energy and notably electricity demand is growing rapidly inter alia resulting from population growth, desalinisation and the use of air-conditioning. Israel is developing an Energy Plan which will aim at diversification through an enhanced move towards gas; and at further improving energy efficiency and increasing the use of renewable energy sources.

The electricity sector is dominated by the vertically integrated state-owned Israel Electric Company (IEC). The Electricity Sector Law, amended in 2003, provides the legal framework in this field and established an independent regulator, the Public Utility Authority-Electricity. Independent power production is currently limited. The electricity sector is being reformed and plans include the unbundling of IEC’s production, transmission and distribution activities.

The enhanced use of natural gas will impact considerably on the further development of the electricity sector. The 2001 Natural Gas Industry Act regulates the sector and

establishes a regulator, the Natural Gas Authority. In January 2004 the first quantities of domestic (offshore) gas were delivered at the power station in Ashdod. Israel is developing its gas networks both offshore and onshore. It is generally interested to enhance energy cooperation in the region as regards demand management and renewable energy sources and to develop network interconnections. A number of proposals have been discussed, including the possibility of constructing a Combined Heat and Power Plant with the PA and regional interconnections of the gas network with neighbouring countries. In this context the various energy agreements signed between Israel and the Palestinian Authority during the Euro-Med energy process on gas, electricity, energy demand management and renewable energy, supported by the EU, are noteworthy.

Stepping up efforts on energy efficiency and renewable energy sources are key elements of Israeli energy policy. Israel is, for the indication of the efficiency performance of certain household appliances, using a labelling system comparable to EU acquis. Israel has set itself a target that by 2007 at least 2% and by 2016 at least 5% of electricity be produced from renewable energy sources.

Regarding **Information Society**, the Ministry of Communications (MoC) is responsible for policy, legislation and regulations, managing the radio-spectrum and implementing market liberalisation. The MoC supervises Bezeq, the dominant operator of the fixed network and other network operators and approves telecoms and cable television tariffs.

The telecommunications and broadcasting law was amended in 2001 and includes the legal instruments for the liberalisation process, for interconnection and rights of way for new operators. The MoC introduced a licensing regime for the provision of fixed voice telephony, data communications and broadband Internet access. There are more than 70 Internet service providers.

In September 2003, the MoC set a policy to ensure fair competition and to decrease the barriers for new market entrants. The major policy objectives are: Establishment of a National Communication Authority, a new framework for broadcasting services, and the complete privatization of the incumbent operator Bezeq. Domestic fixed telephony is exclusively provided by Bezeq, while three operators are offering international telephony services. Three of the four cable TV operators will merge, and a joint "Hot Telecom" will start in September 2004 to provide domestic fixed telephony in competition to Bezeq. There are four GSM operators, and three 3G mobile communications licences are expected to be operational in 2004.

As regards **environment**, a set of environment policy guidelines were formulated by the Ministry of Environment in 2000. These include prudent use of environmental resources, integrated environmental management, the polluter pays principle, treatment at source, public participation, regional and international co-operation. The 2003 Government Decision on sustainable development includes specific environment protection, social and economic development tasks to be carried out by various Israeli Ministries.

Israel's environmental legislation encompasses laws for the protection of nature and natural resources (air, water and soil), for the abatement and prevention of environmental nuisances (prevention of air, water and marine pollution, waste and noise), and for safe treatment of contaminants (hazardous and radioactive substances, and waste). The Ministry of Environment was set up in 1988 to succeed the Environment Protection Service established in 1973. Other Ministries are also responsible for environment-related matters, such as the Ministry of Health, Ministry of Interior and the Ministry of Infrastructure. Israel is a beneficiary of Community support under SMAP and 'LIFE-

Third Countries programmes'. Israel has ratified relevant international and regional conventions to which it is signatory (including the Kyoto Protocol), with the exception of amendments to the Barcelona Convention and its new and revised Protocols.

Regarding **Research and Development** Israel is the only non-EU country fully associated with EU's Framework Programmes since 1996. The renewal of the S&T Co-operation Agreement between EU and Israel was approved by the Council and the European Parliament and concluded by Israeli Government in March 2004, but the provisional application of this agreement allowed to Israeli research entities to participate in the 6th RTD Framework Programme activities from the beginning.

The impact of this S&T co-operation agreement is expected to be at the same level that it was during the 5th RTD Framework Programme, in which Israel has been involved in a total of 623 projects, 149 of them being coordinated by Israeli partners.

In 2003, which was the first year of the 6th Framework Programme on Research and Technological Development, 831 legal bodies registered in Israel have participated in various call for proposals under the Programme.