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PROBABLE ECONOMIC EFFECT OF PROVIDING DUTY-FREE TREATMENT FOR IMPORTS FROM ISRAEL

Report to the President
Investigation No. 332-180

Original Classified by

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United States Trade Representative
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PREFACE

On January 30, 1984, the Commission received a request from the United States Trade Representative (USTR), at the direction of the President, to investigate and provide advice as to the probable economic effects on domestic industries and on consumers of providing duty-free treatment for imports from Israel. 1/ The USTR indicated the request stemmed from a recent agreement between the President and the Prime Minister of Israel that the Governments of their respective countries would enter into negotiations with a view to the establishment of a free-trade area between the United States and Israel. 2/ The President has requested Commission advice to assist in making a judgment as to the impact of such a free-trade area on the U.S. economy.

In response to the USTR request, the Commission initiated investigation No. 332-180 on February 8, 1984. The study provides the requested advice on a broad sector basis and for each commodity area or domestic industry the Commission identified as being likely to experience a significant adverse effect due to the provision of duty-free treatment to imports from Israel. For purposes of this investigation, a "significant" adverse effect is one in which increased imports resulting from the proposed free-trade agreement will cause at least a significant proportion of U.S. workers to become unemployed, declines in output, and the departure of firms.

The information provided in the report is based on testimony provided at a public hearing, staff contact with U.S. producing and trading interests, previous Government and academic studies, trade literature, and U.S. and

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1/ The USTR request and Commission public notice related to this investigation are contained in app. A.

2/ Actual negotiations on the proposed free-trade agreement began on Jan. 17, 1984.

United Nations trade data. The U.S. International Trade Commission's Trade Monitoring Information Support System (TMISS) provided an appropriate basis for the analysis of imports from Israel, since it permitted the ready comparison of import levels with U.S. consumption levels in approximately 650 different commodity/industry areas. 1/ Appendix B contains the basic background information on each of the 650 commodity/industry areas, including the level of imports from Israel in each area.

A public hearing in connection with the investigation was held in the Commission Hearing Room, 701 E Street NW., Washington, D.C. 20436, on April 10-11, 1984. 2/ All interested parties were afforded an opportunity to appear by counsel or in person, to produce evidence, and to be heard. Transcripts of the hearing and copies of briefs submitted by interested parties in connection with the investigation are attached.

1/ The TMISS consists of a comprehensive and standardized data base designed to provide the Commission with the basic data required in its analytical and monitoring responsibilities and to serve as a starting point for more detailed trade analysis. The basic component of the system is the tailor made trade tables, which consist of computer-generated import/export tables for key commodity areas or aggregations.

The tailor made trade tables serve as the vehicle for a Commission trade-monitoring or early-warning system, which can alert the Commission to shifts in trade patterns and focus on areas for further Commission study. The tailor made trade tables are automatically tested quarterly and annually by computer against predetermined criteria or "gates" designed to detect aberrant trade behavior.

The TMISS, constructed in 1980, currently has a complete data base for 1978-82. Trade data are available for 1983, but U.S. consumption data cannot currently be estimated with a reasonable degree of accuracy beyond 1982 due to the erratic behavior of commodity markets during 1983 and the lack of 1983 production data at a detailed commodity/industry level at this time.

2/ A listing of the witnesses appearing at the Commission hearing is contained in app. C.

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EXECUTIVE SUMMARY

Israel, a country of 4 million people, had a gross national product of approximately $22 billion in 1982--equivalent to roughly 0.7 percent of the U.S. output. The agricultural and industrial sectors together accounted for roughly 21 percent of Israel's output, with agriculture contributing slightly over one-fifth of this amount. Israel's industrial sector is widely diversified; however, major concentrations of output are found in food processing, textiles and apparel, chemicals, metal products, electronics, and diamonds. Since the 1970's, there has been a gradual structural shift from the more basic, labor-intensive industries such as food processing and textiles into higher technology products such as electronics, computers, telecommunications, pharmaceuticals, and military equipment. The high educational level of Israel's population and the availability of capital for development of high-technology industry are generally believed to give it a greater comparative advantage in world markets for these advanced products than for the more labor-intensive products, where low wage rates are so critical. Israel's hourly wages in manufacturing were equivalent to roughly 40 percent of those in the United States in 1982; they were nonetheless high relative to those of many other developing countries such as Taiwan, which had wages averaging only 13 percent of the U.S. level.

As a result of limited natural resources, Israel imports a large part of its fuel, machinery, and raw materials for processing. Israel's merchandise trade balance is consistently negative, having exceeded $3 billion annually over 1979-82. The pressure for foreign exchange has made exports a necessity and helps explain the Government emphasis on a structural shift in industry to the high-technology products in which Israel can compete more successfully in world markets. 1/

The major findings of the study regarding Israel export trade and the probable impact on U.S. producers of a United States-Israel free-trade area follow:

- Total Israel exports to the world rose from $4.6 billion in 1979 to $5.3 billion in 1982, or by 15 percent. 2/

Israel exports are concentrated in the minerals and metals sector, primarily cut diamonds, (35 percent of exports), followed by the chemicals sector (18 percent), machinery and equipment (16 percent), agriculture (15 percent), textiles and apparel (9 percent), miscellaneous manufactures (7 percent), and forest products (1 percent). In recent years the most significant growth in exports on a sector basis has been seen in the machinery and equipment sector which includes Israel exports such as aircraft, electrical articles, computers, telecommunications apparatus, and office machines. Agricultural exports as a share of total exports are on a downward trend.

Trade does not exist between Israel and its immediate neighbors because of its geopolitical situation. Instead Israel has found its major export markets in the European Community (EC) and the United States. Israel's

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1/ Israel's Government assistance efforts and the existing export subsidies of concern to the United States in the free-trade area negotiations are briefly discussed in app. D.

2/ App. E contains detailed information on Israel's exports on a two-digit SITC basis and to specific countries.

largest market, the EC, accounted for 33 percent of Israel's exports in 1982. Despite a free-trade area agreement with the EC in 1975 providing for the elimination of duties on industrial products and a lowering of duties on most agricultural products, the portion of Israel's exports going to the EC has declined since 1975, when it amounted to 39 percent. Israel's second largest and growing market, the United States, accounted for 22 percent of Israel's exports in 1982, up from 16 percent in 1975. The decline in the EC market share and concurrent rise in the U.S. market share have been generally attributed to a variety of factors such as the strength of the U.S. dollar against European currencies, a faster economic recovery in the United States, restrictive EC trade policies on nontariff issues, and the influence of the U.S. Generalized System of Preferences (GSP) program. Other important export markets for Israel include Japan, Hong Kong, Switzerland, the Republic of South Africa, and Australia.

o <u>Israel's exports to the United States were valued at $1.25 billion in 1983, having risen at an annual rate of approximately 13 percent from a level of $0.75 billion in 1979 (table 1)</u>.

U.S. imports from Israel have increased despite Israel's industrial product price inflation which exceeded 100 percent per year since 1979. A roughly comparable devaluation of the Israel shekel has kept the unit value of Israel's exports in U.S. dollars relatively level over the period. Overall however, imports from Israel accounted for less than 0.5 percent of total U.S. imports from all sources throughout the period; Israel ranked 34th in 1983 in terms of U.S. import suppliers. As shown in table 1, the minerals and metals sector, primarily diamonds, accounted for the highest level of imports in 1983 (44 percent), followed by the machinery and equipment sector (19 percent),

Table 1.--U.S. shipments, imports for consumption, exports of domestic merchandise, and apparent consumption, by specified sectors, 1979-83

Sector	Producers' shipments	Imports: Total	Imports: From Israel	Exports	Apparent consumption	Ratio of--: Imports from Israel to total imports	Ratio of--: Total imports to consumption	Ratio of--: Imports from Israel to consumption
	Million dollars					Percent		
Agricultural products:								
1979	275,567	19,399	26	34,835	260,131	0.1	7.5	1/
1980	301,707	20,023	25	40,733	280,997	.1	7.1	1/
1981	319,382	20,261	35	43,679	295,964	.2	6.8	1/
1982	314,765	19,038	49	37,142	296,661	.3	6.4	1/
1983	324,729	20,545	50	36,523	308,751	.2	6.6	1/
Forest products:								
1979	172,700	9,699	8	7,806	174,593	.1	5.6	1/
1980	183,700	9,252	6	9,609	183,343	.1	5.0	1/
1981	196,600	9,647	6	9,218	197,029	.1	4.9	1/
1982	187,500	9,021	5	8,482	188,039	.1	4.8	1/
1983	205,300	10,808	5	8,358	207,750	1/	5.2	1/
Textiles, apparel, and footwear:								
1979	105,550	11,015	26	7,190	109,375	.2	10.1	1/
1980	111,122	12,039	18	8,845	114,316	.2	10.5	1/
1981	119,536	13,984	19	8,348	125,172	.1	11.2	1/
1982	113,421	14,704	19	6,639	121,486	.1	12.1	1/
1983	122,098	17,279	24	5,855	133,522	.1	12.9	1/
Energy and chemicals:								
1979	422,126	71,040	73	25,023	468,142	.1	15.2	1/
1980	530,181	90,867	89	31,333	589,716	.1	15.4	1/
1981	611,375	93,843	121	33,942	671,276	.1	14.0	1/
1982	591,552	78,062	130	34,891	634,723	.2	12.3	1/
1983	650,707	72,144	123	31,615	691,236	.2	10.4	1/
Minerals and metals:								
1979	234,919	27,156	378	19,530	242,545	1.4	11.2	.2
1980	227,635	31,751	521	25,090	234,296	1.6	13.6	.2
1981	233,035	34,386	626	19,953	247,468	1.8	13.9	.3
1982	199,020	29,247	490	14,760	213,507	1.7	13.7	.2
1983	214,485	29,333	551	13,682	230,136	1.9	12.8	.2
Machinery and equipment:								
1979	401,674	53,630	132	70,260	385,044	.2	13.9	1/
1980	413,785	60,078	173	84,307	389,556	.3	15.4	1/
1981	445,533	68,542	253	95,536	418,539	.4	16.4	.1

miscellaneous manufactures (16 percent), chemicals (11 percent), agriculture (4 percent), and textiles and apparel (2 percent). Because of rising imports of jewelry, the largest relative increase on a sector basis in recent years has been in the miscellaneous manufactures sector. Major concentrations of imports in 1983 were in individual products such as cut diamonds and emeralds, jewelry, X-ray apparatus and parts, fertilizers, airplanes and parts, telephonic apparatus, electromedical apparatus, office machines, pneumatic tires, and processed tomatoes.

- <u>During 1983, approximately 95 percent of imports from Israel entered the United States free of duty under either the GSP or a most-favored-nation column 1 rate of free (table 2)</u>.

Dutiable imports have been concentrated--73 percent in 1983--in agricultural, textiles, and apparel products such as tomato products, olives, oranges, wine, women's knit apparel, cotton towels, and manmade fiber yarns. During 1983, duties collected on imports from Israel amounted to approximately $10 million. As a group, the dutiable imports grew more slowly over the period than the duty-free imports, by 39 and 68 percent, respectively, over the period. The proposed United States-Israel free-trade area could potentially affect both dutiable and GSP imports--the dutiable imports because of the elimination of duties and the GSP imports due to the elimination of competitive-need limits on free imports and the temporary nature of the GSP.

- <u>Imports from Israel represented less than 0.1 percent of U.S. consumption over the period, accounting for no more than 0.2 percent in any major sector (table 1)</u>.

Individual product areas where imports from Israel are a more significant part of U.S. consumption include products such as cut diamonds (23 percent of U.S. consumption in 1982), cut emeralds (4 percent), precious metal jewelry

United States-Israel free-trade agreement, by specified sectors

Sector	U.S. exports to Israel	U.S. imports from Israel	Share of U.S. imports from Israel entering--2/ Duty-free under GSP	Duty-free under col. 1	Dutiable under col. 1	Major import items from Israel and share of sector imports from Israel, 1979-83	Commodity groups likely to experience significant adverse effects from proposed United States-Israel free-trade agreeme
	--Million dollars----		------------Percent------------				
Agricultural products:							
1979	320	26	41	12	47	Processed tomatoes (41%)	Certain dehy. vegetables.
1980	300	25	43	21	36	Biscuits (6%)	Processed tomatoes.
1981	345	35	29	22	49	Dried vegetables (4%)	Processed olives.
1982	243	49	33	12	55	Licorice extract (4%)	Citrus fruit juices.
1983	311	50	35	9	56	Candy (4%)	Fresh cut roses.
Forest products:							
1979	35	8	54	46	1/	Miscellaneous books (61%)	None.
1980	33	6	24	75	1/	Postage stamps (11%)	
1981	44	6	24	76	1	Misc. wood articles (6%)	
1982	40	5	21	78	1	Social cards (4%)	
1983	43	5	20	80	1/		
Textiles, apparel, and footwear:							
1979	49	26	9	1/	91	Wearing apparel (48%)	None.
1980	41	18	14	1	85	Home furnishings (24%)	
1981	61	19	17	1/	83	Manmade-fiber yarns (9%)	
1982	49	19	17	1/	83		
1983	32	24	11	1/	89		
Energy and chemicals:							
1979	86	73	58	36	6	Fertilizers (49%)	Certain bromine compounds.
1980	84	89	42	53	5	Pneumatic tires (11%)	
1981	79	121	44	52	4	Non benzenoid org. chem. (7%)	
1982	87	130	44	52	4	Rubber and plastic prod. (7%)	
1983	81	133	53	43	4	Synthetic org. pesticides (7%)	
Minerals and metals:							
1979	109	378	8	91	1	Cut diamonds (86%)	None.
1980	115	521	6	92	1	Cut emeralds (3%)	
1981	117	626	7	91	2		
1982	91	490	8	90	1		
1983	109	551	8	92	1/		
Machinery and equipment:							
1979	815	132	87	9	4	Airplanes and parts (16%)	None.
1980	706	173	42	54	4	Telephone apparatus (14%)	
1981	748	253	40	57	3	Office machines (7%)	
1982	808	260	49	48	3	Civil aircraft parts (4%)	

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(3 percent), X-ray apparatus (3 percent), water heaters (2 percent), and olives (2 percent).

- Duty-free treatment for U.S. imports from Israel is not expected to have a significant adverse effect at the aggregate level for any of the major sectors examined; however, at the less aggregated commodity level, significant adverse effects are likely in seven different areas, as indicated in the following summaries of probable effects, by sectors (table 2). 1/

Agricultural, animal, and vegetable products sector.--During 1979-83, U.S. imports from Israel increased from $26 million to $50 million. The ratio of such imports to total U.S. imports in the sector was less than 0.5 percent each year.

The major concentrations of imports from Israel in this sector occurred in processed tomatoes (41 percent of sector imports from Israel in 1983), biscuits (6 percent), dried vegetables (4 percent), licorice extract (4 percent), and candy (4 percent). During 1983, approximately 44 percent of all agricultural imports from Israel entered the United States under tariff items which were either eligible for the GSP or had a most-favored-nation duty rate of free.

Imports from Israel accounted for less than 0.05 percent of apparent U.S. consumption in the sector. The most significant areas of market penetration by Israel include olives (2 percent of U.S. consumption in 1982) and processed vegetables (1 percent).

1/ App. F contains an explanation of the probable economic effects codes used in the sector writeups appearing in the main body of the report.

Considering the current and potential production of Israel, current levels of exports to the United States and other markets, the amount of duty reduction, the potential for transshipment of third-country agricultural products through Israel, and the competitiveness of the U.S. industry, duty-free treatment for all imports from Israel is expected to result in a significant adverse impact on U.S. producers of dehydrated vegetables, processed tomatoes, processed olives, citrus fruit juices, and fresh cut roses.

Forest products sector.--During 1979-83, U.S. imports from Israel decreased from $8 million to $5 million; the ratio of such imports to total U.S. imports in the sector remained at approximately 0.1 percent.

The major concentrations of imports from Israel in this sector occurred in miscellaneous books (61 percent of sector imports from Israel in 1983), postage and revenue stamps (11 percent), miscellaneous articles of wood (6 percent), social and gift cards (4 percent), and miscellaneous building boards (2 percent). During 1983 over 99 percent of all forest product imports from Israel entered the United States under tariff items which were either eligible for the GSP or had a most-favored-nation duty rate of free.

Imports from Israel accounted for less than 0.05 percent of apparent U.S. consumption in the sector. During 1982, market penetration by Israel was less than 0.5 percent of U.S. consumption for all individual products within the sector.

Considering the current and potential production of Israel and the competitiveness of the U.S. industry, duty-free treatment for all imports from Israel is not expected to result in a significant adverse impact on U.S. producers in this sector.

Textiles, apparel, and footwear sector.--U.S. imports from Israel, after declining from $26 million in 1979 to $18 million in 1980, increased annually to $24 million in 1983. The ratio of such imports to total U.S. imports in the sector averaged less than 0.2 percent during 1979-83.

The major concentrations of imports from Israel in this sector occurred in wearing apparel (48 percent of sector imports from Israel in 1983), especially women's swimwear, pantyhose, and other knit apparel; textile home furnishings (24 percent), mostly towels; and manmade-fiber yarns (9 percent). During 1983, approximately 11 percent of all sector imports from Israel entered the United States under tariff items which were either eligible for the GSP or had a most-favored-nation duty rate of free; they consisted primarily of GSP-eligible fur apparel and coated fabrics.

Imports from Israel accounted for less than 0.05 percent of apparent U.S. consumption in the sector during 1979-83. The most significant areas of market penetration by Israel include women's, girls', and infants' swimwear (1.1 percent of U.S. consumption in 1982) and pantyhose (0.4 percent).

Considering the current and potential production of Israel and the high level of duty reduction, duty-free treatment for all imports from Israel is expected to result in a significant increase in imports from their currently low levels but not enough to adversely affect the U.S. industry.

Chemicals, coal, petroleum, natural gas, and related products sector.--During 1979-83, U.S. imports from Israel increased from $73 million to $133 million. The ratio of such imports to total U.S. imports in the sector rose from 0.1 to 0.2 percent during the period.

The major concentrations of imports from Isrcel in this sector occurred in fertilizers (49 percent of sector imports from Israel in 1983), pneumatic tires (11 percent), miscellaneous nonbenzenoid organic compounds (7 percent), fabricated rubber and plastics products (7 percent), and synthetic organic pesticides (7 percent). During 1983, approximately 96 percent of all chemical imports from Israel entered the United States under tariff items which were either eligible for the GSP or had a most-favored-nation duty rate of free.

Imports from Israel accounted for less than 0.05 percent of apparent U.S. consumption in the sector. The most significant areas of market penetration by Israel include fertilizers (1.1 percent of U.S. consumption in 1982), drugs (0.4 percent), and synthetic organic pesticides (0.3 percent).

Considering the current and potential production of Israel, current levels of exports to the United States and other markets, and the competitiveness of the U.S. industry, duty-free treatment for all imports from Israel is expected to result in a significant adverse impact only on U.S. producers of some bromine compounds.

Minerals and metals sector.--During 1979-83, U.S. imports from Israel increased from $378 million to $551 million. The ratio of such imports to total U.S. imports in the sector rose from 1.4 percent in 1979 to 1.9 percent in 1983.

The major concentrations of imports from Israel in this sector occurred in cut diamonds (86 percent of sector imports from Israel in 1983), cut emeralds (3 percent), cutting tools (1 percent), and aluminum bars, plates, sheet, and strip (1 percent). During 1983, approximately 99 percent of all minerals and metals imports from Israel entered the United States under tariff items which were either eligible for the GSP or had a most-favored-nation duty rate of free.

Imports from Israel accounted for approximately 0.2 percent of apparent U.S. consumption in the sector. The most significant areas of market penetration by Israel include cut diamonds (23 percent of U.S. consumption in 1982) and cut emeralds (4 percent).

Considering the current and potential production of Israel, current levels of exports to the United States and other markets, the amount of duty reduction, and the competitiveness of the U.S. industry, duty-free treatment for all imports from Israel is not expected to result in a significant adverse impact on U.S. producers in this sector.

Machinery and equipment sector.--During 1979-83, U.S. imports from Israel increased from $132 million to $241 million; the ratio of such imports to total U.S. imports in the sector remained at approximately 0.3 percent.

The major concentrations of imports from Israel in this sector occurred in airplanes and parts (16 percent of sector imports from Israel in 1983), telephone apparatus (14 percent), office machines (7 percent), civil aircraft parts (4 percent), and vehicle chassis and parts (4 percent). During 1983, approximately 96 percent of all machinery and equipment imports from Israel entered the United States under tariff items which were either eligible for the GSP or had a most-favored-nation duty rate of free.

Imports from Israel accounted for less than 0.1 percent of apparent U.S. consumption in the sector. The most significant areas of market penetration by Israel include water heaters (2 pe ent of U.S. consumption in 1982) and fixed resistors (1 percent).

Considering the current and potential production of Israel, current levels of exports to the United States and other markets, the amount of duty reduction, and the competitiveness of the U.S. industry, duty-free treatment for all imports from Israel is not expected to result in a significant adverse impact on U.S. producers in this sector.

Miscellaneous manufactures sector.--During 1979-83, U.S. imports from Israel increased from $85 million to $205 million, and the ratio of such imports to total U.S. imports in the sector increased from 0.8 to 1.3 percent.

The major concentrations of imports from Israel in this sector occurred in precious metal jewelry (45 percent of sector imports from Israel in 1983), X-ray apparatus and parts (21 percent), electromedical apparatus and parts (4 percent), furniture (3 percent), and small arms (2 percent). During 1983, virtually all miscellaneous manufactures imports from Israel entered the United States under tariff items which were either eligible for the GSP or had a most-favored-nation duty rate of free.

Imports from Israel accounted for approximately 0 2 percent of apparent U.S. consumption in the sector. The most significant areas of market penetration by Israel include X-ray apparatus and parts (3.2 percent of U.S. consumption in 1982), precious metal jewelry (2.6 percent), small arms (0.7 percent), and electromedical apparatus and parts (0.6 percent).

Considering the current and potential production of Israel, current levels of exports to the United States and other markets, the amount of duty reduction, and the competitiveness of the U.S. industry, duty-free treatment for all imports from Israel is expected to result in a significant adverse impact only on U.S. producers of precious metal chain.

o <u>A significant potential for the transshipment of third country goods through Israel to the United States to avoid U.S. duties, with resultant adverse effects on U.S. industry, is seen in only one industry area</u>.

During the course of the investigation, a frequently mentioned concern of domestic interests was the possibility that goods originating in third countries would benefit from the agreement, to the detriment of U.S. industry, by being transshipped through Israel to the United States with only limited processing actually taking place in Israel. The Commission, operating under the assumption that the proposed agreement would incorporate rules of origin similar to those in the U.S. GSP or Caribbean Basin Economic Recovery Act, identified only one product area where this particular practice would likely affect a U.S. industry adversely--citrus fruit juices.

AGRICULTURAL, ANIMAL, AND VEGETABLE PRODUCTS 1/

U.S. Sector Profile and Conditions of Competition

The agricultural product sector includes the industries engaged in the production of raw agricultural products (such as live animals, grains, fruits and vegetables, cut flowers, live plants, tobacco, and oilseeds) and processed agricultural products (such as meat, fish and shellfish, dairy products, animal and vegetable fats and oils, and alcoholic beverages). The number of workers in the agricultural sector averaged about 5 million annually during 1979-83; shipments of the sector increased during the period. There were approximately 2.4 million operating farms in 1979 and 1983, with an average size of 429 acres per farm during the period. In general, the production of raw and processed agricultural products in the United States is capital rather than labor intensive and is very efficient, thus allowing U.S. producers to compete throughout the world. As evidence of the competitive strength of U.S. agriculture, a positive balance of trade has been maintained in the sector, although it declined by about $7.4 billion from 1981 to 1983. This decline reflected a number of factors, including the worldwide recession, mounting world grain supplies, and the relative strength of the dollar exerting a downward pressure on exports.

During 1979-83, the value of producers' shipments in this sector increased irregularly from $276 billion to $325 billion (table 3), or by an average annual rate of about 4 percent. Processed agricultural products

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1/ Included here are the commodities classified in schedule 1 of the Tariff Schedules of the United States: Animal and vegetable products.