

Politics prevails – Israel’s trade relations with the European Union

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The European Union’s trade relations with Israel are asymmetrical, but the overall volume of their trade in goods and services has been growing rapidly. The EU is Israel’s top partner in this field, while Israel ranks outside the top 30 of the EU’s biggest partners; the EU has a positive trade balance with this country. This state of affairs has turned trade into a potential political instrument, but its assertive use by the EU with respect to the Palestinian issue has failed to bring about any change in Israel’s policy towards the occupied territories. Instead, Israel’s resistance to the EU’s policy on this issue has led to a freeze in the institutional development of trade relations, especially in the services and investment sectors. The EU and especially Israel could benefit from a further liberalisation in bilateral relations and its extension to their partners in the region, but political factors are hampering this process. Therefore, a breakthrough in the form of launching negotiations on an agreement to create a deep and comprehensive free trade area appears unlikely in the foreseeable future.

The EU as Israel’s top trade partner

The European Union is Israel’s largest trading partner: in 2022, 32% of Israeli imports came from the EU, while 25.6% of its exports went to the EU member states. By contrast, Israel is only a significant partner for the EU when compared to other Mediterranean countries. In 2020, it ranked 24th on the list of its trade partners, accounting for 0.9% of the EU’s trade with the world. However, two years later it dropped to 34th and its share fell to 0.6%. In the area of trade in goods, the main categories are machinery and transport equipment, chemicals, agricultural goods and raw materials. Trade has reached €46.7 billion a year, with a positive trade balance for the EU (+€11.7 billion; see chart below). The EU’s exports of goods to Israel (€29.2 billion) are worth almost twice as much as its imports from this country (€17.5 billion). The value of bilateral trade in services is about €16.7 billion and here too the balance is positive for the EU (+€2.9 billion).¹ Furthermore, the Israeli market is heavily dependent on imports from the EU while Israeli companies operate with a focus on exports to the bloc. This stems from the limitations of Israel’s internal market, the size of the EU market and its geographic proximity, as well as the significant costs of domestic production, which local manufacturers can only offset by

¹ ‘EU trade relations with Israel. Facts, figures and latest developments’, European Commission, ec.europa.eu; ‘European Union, Trade in goods with Israel’, European Commission, 19 April 2023, ec.europa.eu.



selling their products to Western countries at high prices. Israel's dependence can be seen especially in the food, automotive and pharmaceutical sectors.²

Israel's trade with the EU has been growing considerably from year to year, a trend that has remained unchanged despite Britain's exit from the EU. Although the British market appeared to be the main recipient of Israeli products imported by the EU, in reality the bulk of these goods were only transferred through British ports; after Brexit this stream was redirected to ports on the continent (the so-called Rotterdam and Antwerp effect). Israeli investors are eagerly buying shares in companies listed on the European exchanges, while European investors are increasingly interested in the Israeli market, especially its high-tech companies. Since 2019, the European Institute of Innovation and Technology has operated in Israel, focusing particularly on the promotion of investments in small and medium-sized enterprises.³ Apart from the activity of private entities, it is also worth noting that Israel has benefited from the European Investment Bank's lending mechanisms. Agreements totalling more than €2.2 billion have been concluded so far and these funds have allowed Israel to build facilities such as seawater desalination plants and solar power plants.⁴

The history of trade liberalisation between Israel and the EU dates back to 1975, when an agreement was signed to create a free trade

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zone for industrial goods by 1989 and to grant preferences (with limitations) for Israeli agricultural exports. The so-called Association Agreement was concluded in 1995 and came into force five years later, and extended these arrangements. An agreement on good laboratory practices designed to increase trust in the trade of cosmetics, industrial chemicals, pharmaceuticals and food additives has also been in effect since 2000. Another qualitative change came in 2004 with the creation of the European Neighbourhood Policy and the introduction of an individualised partnership, which made it possible to tailor mechanisms of cooperation to Israel's high level of economic development.⁵

In the following years, trade liberalisation was expanded to include new categories of agricultural goods and processed foods. In 2022, talks began on updating the facilitation measures for organic foods and extending their period of validity. In 2012, an agreement was reached on the removal of trade barriers and on the mutual recognition of certificates authorising the marketing of pharmaceuticals. The development of trade relations, primarily tourism services, has also been facilitated indirectly by the 'open skies' agreement that has been in effect since 2018. This allows Israeli carriers to use all international airports in Europe with European operators able to use airports in Israel.

Political determinants and trade relations

An important determinant of the EU's trade policy towards Israel is its position on the Israeli-Palestinian conflict based on support for the so-called two-state solution; this reflects the views of the EU's individual member states. The EU opposes the construction of Jewish settlements in the occupied West Bank.⁶ The foundations of its policy have remained unchanged since the 1980s, although the instruments used have been evolving in response to developments in these territories. In 2008,

² N. Munin, 'Israel's Trade Alliances Strategy: Enjoying the Best of All Worlds', *International Journal of Law and Public Administration*, Vol. 4, No. 2; December 2021, via: ijlpa.redfame.com.

³ Based on an interview conducted online on 7 June 2023 with Małgorzata Kowalczyk, counsellor, head of the Trade and Economic Section at the European Union Delegation to the State of Israel.

⁴ 'Financed projects (Israel)', *European Investment Bank*, eib.org.

⁵ A. Tovias, 'EU Foreign Policy on the Israeli-Palestinian Conflict: A Reevaluation', *Israel Journal of Foreign Affairs* 2021, Vol. 15, No. 2, s. 201-216, via: tandfonline.com.

⁶ K. Zielińska, 'Israel's Palestinian challenges. The state's identity, a leadership crisis and the "new" Middle East', *OSW*, Warsaw 2021, osw.waw.pl.

in the context of advanced peace negotiations at the time, the EU's Foreign Affairs Council adopted resolutions that made any deepening of cooperation with Israel conditional on significant progress in Israeli-Palestinian talks. This linkage policy has been in place since 2009 and it has effectively frozen EU-Israel relations following the failure of these negotiations. It was later reinforced by the Foreign Affairs Council's conclusions from 2013 which were intended to support the peace efforts of US mediator John Kerry. In exchange for a peace agreement, the EU offered both Israel and Palestine an upgrade in their relations to a special privileged partnership. This is the highest possible for non-member states and would also involve measures to facilitate trade worth billions of euros, including access to the European market and investments. A further incentive to peace would be a broad assistance package.⁷

The offer remains on the table, but the prospects of it being taken up are remote amid the stalled peace process. For conflict-related reasons, the EU-Israel Association

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Council, the body responsible for making directional decisions on the development of relations at the political level, did not meet for a decade. It was suspended in 2013 after the European Commission (EC) issued new recommendations, acting on a series of documents consistently adopted by the Foreign Affairs Council that outlined the member states' unequivocal position on the conflict. According to these recommendations, agreements that the EU or its individual member states conclude with Israel should include provisions that preclude their application in the occupied territories; nor should private entities from the EU should engage in such cooperation.⁸ This prompted Israel to cancel a meeting of the Association Council. The attitude of the Israeli government is related to the fundamental dispute over the legality of the settlement activity. The vast majority of the international community, including the EU, holds the view that the West Bank and East Jerusalem are occupied territories and that therefore it is illegal for Israeli civilians to settle there. In contrast, the Israeli government insists that these areas are disputed territories and that the status of the settlements and the Israelis who live there will only be determined as part of a solution to the conflict. Nevertheless, the Israeli-EU subcommittees that were formed in 2005, including those that can affect trade (on trade and services, customs and taxation, agriculture and fisheries), have continued to meet. Their work helps to keep relations intact, but they do not have the authority to raise relations to a higher level.

In the area of trade, political restrictions also stem from the EU's introduction of the principle of differential treatment for goods manufactured within Israel's borders prior to the 1967 Six-Day War and those made in Jewish settlements in the occupied territories. The rules of preferential trade do not apply to the latter, which makes them more expensive as they are subject to the EU's import duties. The basis for this policy of differentiation is provided by the interpretation of the provisions of the EU-Israel Association Agreement that the EC adopted in 1998, which is based on United Nations resolutions on the same issues and states that the agreement applies to Israel's territory within its pre-1967 borders.⁹ This approach allowed the EU to use trade issues as an instrument of political

⁷ B. Ravid, 'EU Set to Offer Massive Aid to Israel, Palestinians for Peace Deal', *Haaretz*, 13 December 2013, haaretz.com; 'Council conclusions on the Middle East Peace Process', *Council of the European Union*, 16 December 2013, consilium.europa.eu.

⁸ 'Guidelines on the eligibility of Israeli entities and their activities in the territories occupied by Israel since June 1967 for grants, prizes and financial instruments funded by the EU from 2014 onwards', *Official Journal of the European Union* C 205, Vol. 56, 19 July 2013, pp. 9–11, eur-lex.europa.eu.

⁹ N. Gordon, S. Pardo, 'The European Union and Israel's Occupation: Using Technical Customs Rules as Instruments of Foreign Policy', *Middle East Journal*, Vol. 69, No. 1 (2015), pp. 74–90, via: jstor.org; 'EU – Israel: Implementation of the interim agreement in the framework of a strengthened regional cooperation', *European Commission*, 13 May 1998, ec.europa.eu.

pressure. In 2004, Israel agreed to introduce postcode-based labels that allow the EU's customs authorities to identify the origin of goods. At the same time, it launched a compensation scheme for duty-affected manufacturers.

However, the tensions proved impossible to contain. In 2015, the EU recommended that its member states assign separate

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labels to food products from settlements in the occupied territories. In 2010 and 2019, the EU Court of Justice tightened the labelling requirements for these products when it ruled in two cases that were brought by private parties. In practice, individual EU member states rarely apply the rules for differentiating labels based on the origin of goods, because products from the occupied territories represent a negligible share of Israeli exports to the EU (according to estimates that are difficult to verify, it is only about 1.5% as these products are mainly destined for the domestic market)¹⁰ and their identification generates a considerable amount of work for the customs authorities.¹¹ In an effort to tighten the system, in May 2023 the EC issued recommendations that importers should be required to provide additional labels of origin for products in electronic customs declarations.¹² There have also been discussions within the EU whether to further tighten its policy of differentiation in response to possible Israeli actions that would be fundamentally detrimental to the idea of creating a Palestinian state, such as the annexation of parts of the occupied territories.¹³

The government of Naftali Bennett and Yair Lapid (June 2021–December 2022), which was dominated by forces that support the two-state solution, succeeded in reviving the Association Council – in October 2022 it held its first meeting since 2012. However, one consequence of the fact that relations at the highest level were *de facto* frozen for a decade was observed in the outdated bilateral framework of treaties and institutions. Since 2016, the other six Southern Mediterranean countries and the EU have pursued cooperation through the so-called partnership priorities, a short- and medium-term instrument that replaced the earlier action plans. Unlike those ‘plans’, the ‘priorities’ are usually less focused on political reform and more concerned with economic cooperation. Israel does not have such a document. The old ‘action plan’, which was agreed back in 2004, has been extended until 2025. The resumption of the Association Council’s meetings has created momentum for talks on ‘partnership priorities’, but these are still at a very early stage.¹⁴

Prospects for the development of relations

Other factors that reduce the attractiveness of mutual trade include the small size of Israel’s domestic market, the local bureaucracy, and restrictive rules for importing goods under Israel’s policy of protecting its own market. In an effort to tackle the rising cost of living for households, the Bennett-Lapid government adopted a standardisation reform. It abolished the requirement to obtain certification from the Standards Institution of Israel for some 500 categories of imported industrial products and 97 of the 127 categories of food products, as long as these goods meet the international requirements accepted by the Israeli side, including primarily EU requirements (in principle, approval for sale in

¹⁰ N. Munin, ‘Israel’s Trade...’, *op. cit.*

¹¹ M. Sion Tzidkiyahu, S. Hirsch, ‘The Differences between the EU’s Differentiation Policy and the BDS Movement’, The Israeli Institute for Regional Foreign Policies (MITVIM), July 2020, mitvim.org.il.

¹² ‘New code Y864 for goods imported into the EU with preferential origin from Israel as from 16 May 2023’, European Commission, ec.europa.eu.

¹³ H. Lovatt, ‘The end of Oslo: A new European strategy on Israel-Palestine’, European Council on Foreign Relations, 9 December 2020, ecfr.eu.

¹⁴ M. Sion-Tzidkiyahu, ‘The Significance of Convening the European Union – Israel Association Council’, MITVIM, August 2022, mitvim.org.il; M. Sion Tzidkiyahu, J. Brause, ‘Partnership Priorities with the EU – What (If Anything) Is Israel Missing?’, MITVIM, October 2022, mitvim.org.il.

the EU market is sufficient). The government also adopted the EU's energy efficiency standards for electrical appliances. The standardisation reform, which came into effect for industrial products on 1 June 2022 and for foodstuffs on 1 January 2023, was welcomed by the EU, but its impact on the volume of Israeli imports from Europe is still difficult to estimate. Moreover, work began in 2023 on recognising the EU's standards for imported electronics.¹⁵

Disputes that are yet to be resolved include: Israel's discrimination against exporters of medical products from the so-called new

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member states (Israel has cited a 'lack of confidence' in their quality); the need for Israel to extend intellectual property protection to producers of biological medicines; and discrimination in the Israeli market against European producers of non-kosher meat (only this kind of meat can be exported to Israel, whereas domestic production of such meat is permitted).¹⁶ For Israeli exporters, the EU's introduction of a carbon tax poses a problem. Since Israel does not have a similar mechanism in place, this will translate into lower price competitiveness for Israeli exports in the European market by 2026.¹⁷

As a result of the political determinants, preferential treatment in bilateral relations still applies only to goods that are listed in the Association Agreement. Any significant enhancement of cooperation (such as extending the existing free trade agreements to the areas of the trade in services, investment protection and energy through an agreement to create the so-called Deep and Comprehensive Free Trade Area – DCFTA) would require Israel to meet the conditions arising from the EU's linkage policy.¹⁸ The absence of such an agreement greatly limits the scope of the relationship, especially since 70% of Israel's GDP (in the EU this figure is 65%) and almost 80% of its jobs are in fact generated by the services sector. However, trade in services also suffers from impediments on the Israeli side that are separate from the unresolved Palestinian issue, such as: the complicated business registration process; barriers to the movement of people of non-Jewish origin and their acquisition of land rights; and the lack of agreements on the recognition of qualifications.¹⁹ Therefore, Israel would have to make fundamental legislative changes in order to sign the DCFTA, but this would require its legislature to act consistently given the highly controversial nature of such reforms. Regardless of the slim chances that the Israeli-Palestinian conflict will be resolved or that the EU will abandon its linkage policy, and despite the potentially significant economic benefits (particularly for Israel), this indicates that the EU-Israeli relationship is unlikely to be upgraded in the foreseeable future. Meanwhile, the EU has already started DCFTA negotiations with Morocco and Tunisia.²⁰

The EU-Israeli trade relationship is also influenced by many Israelis perceiving the EU single market as still highly diverse in terms of regulations, cultures and languages, as well as the attractiveness of the US market.²¹ Another issue is the political controversy within Israel around relations with the EU. A large proportion of Israeli citizens do not fully understand the essence of the EU and opinion polls indicate that they view it more often as Israel's enemy (43% in 2020) than an ally (29%).²²

¹⁵ See footnote 3; 'Review of the New Import Reform in Israel', Federation of Israeli Chambers of Commerce, chamber.org.il; 'Relations with Israel – European Union's position for the Association Council's 12th meeting', Council of the European Union, 3 October 2022, consilium.europa.eu.

¹⁶ 'Relations with Israel...', Council of the European Union, *op. cit.*

¹⁷ E. Ofer, 'Europe's New Climate Tax Will Affect Israeli Companies', Lexology, 21 June 2023, lexology.com.

¹⁸ See footnote 3.

¹⁹ M. Luban, 'Improving access to the EU's market for services', MITVIM, June 2021, mitvim.org.il.

²⁰ 'Joint Communication to the European Parliament, the Council, the European Economic and Social Committee and the Committee of the Regions. Renewed partnership with the Southern Neighbourhood. A new Agenda for the Mediterranean', European Commission, 9 February 2021, eur-lex.europa.eu.

²¹ See footnote 3.

²² 'Principles and Recommendations for Israel's Foreign Policy towards the EU', MITVIM, April 2021, mitvim.org.il.

The issue of labelling products from settlements in the occupied territories, which is often confused or deliberately misrepresented in public discourse as synonymous with the demands of the movement calling for a boycott of Israel, arouses strong emotions in Israel. However, Israel (not only in its relations with the EU) has so far always pragmatically favoured the development of trade relations and tactically yielded on these issues without giving way in disputes on fundamental matters; the alternative would be to give up trade preferences altogether and have customs duties extended to all Israeli exports destined for these partners.²³ Moreover, the perceived discriminatory treatment of Israel often appears in the domestic discourse, as cooperation does not extend to settlements in the occupied territories, whereas these rules do not apply to a number of third countries that hold disputed territories. For example, the EU makes no such differentiation with regard to Morocco and occupied Western Sahara (in the case of Israel, however, the EU's policy is determined by the parallel existence of a free trade agreement with the Palestinian Authority).²⁴

The expansion of trade relations with third countries, mainly in Asia, under Benjamin Netanyahu's government in 2009–2021 was

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designed as a way to make Israel independent from the EU in terms of trade, but this proved to be impossible.²⁵ Meanwhile, Israeli proponents of deepening cooperation (that is, politicians, analysts and businessmen who represent the centre and left side of the political spectrum) point out that the reliance of the national income on export revenues makes the partnership with the EU necessary. Therefore, in their opinion Israel should strive to conclude the DCFTA as it will benefit from the adoption of EU standards, including in terms of market development and the quality of services provided domestically.²⁶

In the regional dimension, the EU sees the development of trade and investment as an opportunity to unlock the potential of the countries in its southern neighbourhood. It currently lists the removal of non-trade barriers and the reduction of trade costs as its priorities. The EU also supports the development of infrastructural connectivity between its partner countries (for example, the expansion of the King Hussein Bridge crossing that links Jordan, the Palestinian Authority and Israel) and expects the Israeli side to facilitate the exports of Palestinian products to the EU.²⁷ In addition, multilateral economic cooperation between the countries of the region and also between them and the EU is supported through the mechanism of the Euro-Mediterranean cumulation of rules of origin, which is based on a network of bilateral free trade agreements.

Conclusions

The current state of EU-Israel trade relations does not meet their potential. Political obstacles are standing in the way of a substantial acceleration of their development and they are unlikely to be overcome in the foreseeable future. The core problem is the unresolved Israeli-Palestinian conflict, while structural constraints include Israel's protectionist policies and its reluctance to be dependent on external partners. Nevertheless, the bilateral relationship continues to develop to some extent, which is demonstrated by the growing trade. This development could be fostered by a better political climate, which would improve the partners' perceptions of each other as well as their knowledge

²³ M. Sion Tzidkiyahu, S. Hirsch, 'The Differences...', *op. cit.*

²⁴ R. Frid de Vries, 'Judgments by the Court of Justice of the EU on the EU's Trade with Israel's Disputed Territories', MITVIM, December 2021, mitvim.org.il.

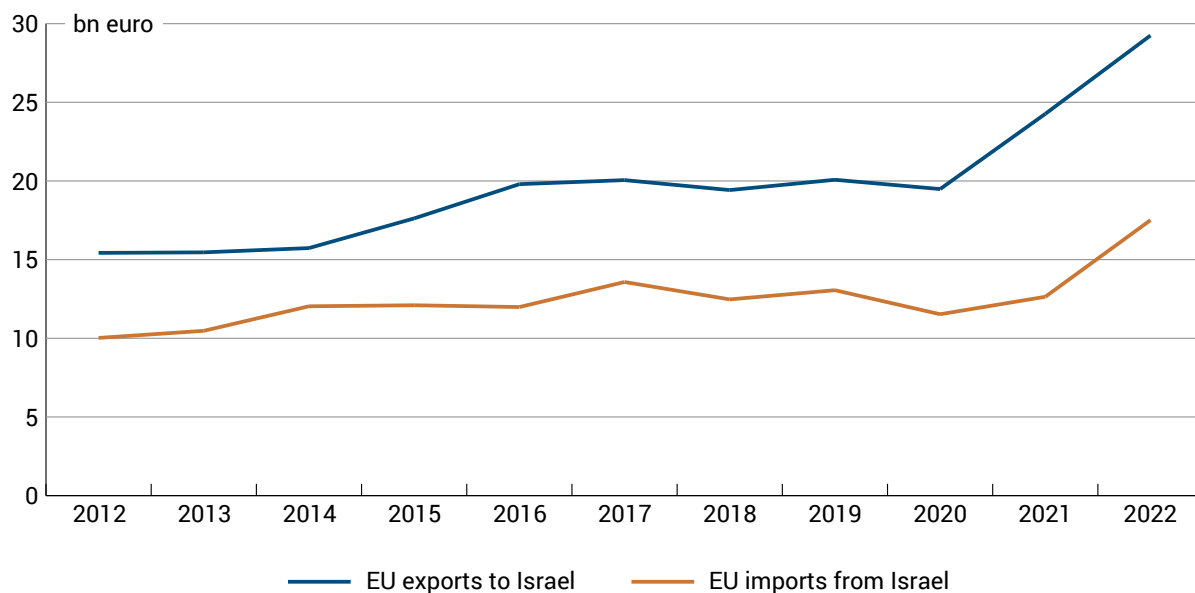
²⁵ N. Munin, 'Israel's Trade...', *op. cit.*

²⁶ 'Principles...', MITVIM, *op. cit.*

²⁷ 'Joint Communication...', European Commission, *op. cit.*; 'Relations with Israel...', Council of the European Union, *op. cit.*

about the benefits that have already been achieved, the available mechanisms of cooperation and its future potential. However, the coalition that has held power in Israel since December 2022 contains prominent groups that are essentially hostile to the EU as an institution and averse to the values it represents; they also actively support the expansion of Jewish settlements in the West Bank and violence by radical settlers against the Palestinians. Their actions carry significant potential to damage the EU's relationship with Israel, including in trade.

Chart. The EU's trade in goods with Israel in 2012–2022



Source: 'European Union, Trade in goods with Israel', European Commission, 19 April 2023, ec.europa.eu.