

EU vs. Israel on Trade:

Peace Process Posturing or Commercial Dispute?

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Brief Analysis

The Council of Ministers from European Union (EU) governments is due to meet June 29 to discuss the recommendations of the EU Commission -- the Brussels bureaucracy -- to impose restrictions on trade with Israel. At stake is more than an arcane trade dispute. Because of this matter, Manuel Marin, EU commissioner in charge of relations with Mediterranean countries, says the EU can no longer have dialogue with Israel (Haaretz, May 26; Financial Times, May 27).

The "Rules of Origin" Dispute: In theory, the dispute is about "rules of origin," which govern whether an item can be labeled "Made in Israel." An early round was about Israeli cheating on preferential trade agreements. The EU allows Israel to export a fixed amount of orange juice at low tariff. Because Israel's orange industry has been on decline, Israeli producers have not been able to fill their quota. So in 1995, they exported \$44 million in Brazilian orange juice labeled as Israeli. When caught, their reaction was to claim that everyone does it (an exaggeration) and to allege political persecution (completely untrue). The Brussels bureaucracy was justifiably annoyed at Israeli footdragging, which prevented resolution of the matter until late 1997.

> In May 1998, the EU Commission responded with draft proposals to require Israel not to label as "Made in Israel" products from the Israeli settlements outside of the 1967 boundaries. The clearly stated aim was to reject Israel's claim to any territory not only in the West Bank and Gaza, but in East Jerusalem, too. The dispute has nothing to do with whether the goods in question will enjoy trade privileges, because since 1986, the EU has given products from the West Bank and Gaza the same preferential treatment given products produced in Israel. The only issue at stake is whether the label says "Made in Israel" or "Made in East Jerusalem/West Bank/Gaza/ Golan." On that matter, the Commission has had more than 30 years to act -- 30 years in which it allowed in products from the territories, e.g., wine from the Golan, clearly labeled as such. Raising the issue now, when the final status of the territories is in active negotiation and a "further redeployment" in the West Bank is likely, means that the EU gambit is designed solely for political pressure, not to resolve a trade issue.

The poison pill in the EU's proposal is that it wants to require Israel to provide "settlement-free" certificates with all its exports. This ingenious proposal was immediately picked up by Arab opponents of trade with Israel, who saw the

requirement for "settlement-free" certificates as a wonderful opportunity to block all Israeli exports to Arab lands. And on the Israeli right, the proposal was characterized as a European boycott of Jewish goods, with exaggerated analogies made to Nazi-era practices.

> In its draft proposals, the EU Commission also insisted that Israel separately label all Palestinian products. While that sounds reasonable, it would "hurt both Palestinians and Israel financially," in the words of Palestinian analyst Sa'id Ghazali (Jerusalem Times, May 22). Under the 1994 Paris economic protocol between Israel and the PA, Palestinian producers have the right to sell in Israel; all the quotas that previously restricted Palestinian products were phased out. Because Israel agreed to allow free trade, small Palestinian producers of a specialty crop, like flowers or strawberries, can benefit from Israel's larger market, including its well-developed export network in the EU. Now, along comes the EU to insist that Israeli wholesalers keep separate the products they buy from Palestinian producers. That will drive up the cost of handling Palestinian produce, reducing what the wholesalers will pay for the Palestinian products. Already, because of the fear that the EU may retroactively impose a penalty for Palestinian produce included in shipments from Israel, the huge Israeli wholesaler Agrexco is deducting a 14 percent fee from what it pays for Gaza flowers.

The EU claims it is helping Palestinian producers who should be allowed to export directly to Europe. In fact, the EU has done little to encourage the PA to reach final agreement with Israel on operation of the Gaza airport -- an agreement which, at Israeli insistence, specifies that Israel will have no role in inspecting Palestinian exports (Israel does not want to be held liable in the event a plane is destroyed by terrorism). The PA is not eager to see the airport agreement proceed because that would suggest progress in the peace talks, whereas the PA strategy is to hold all issues hostage to further redeployment. So the PA keeps raising objections to Israeli insistence on security controls over arriving passengers.

Discouraging Arab-Israeli Economic Cooperation: Meanwhile, the EU has also been discouraging joint Arab-Israeli projects by a strict, though legal, application of a crucial practice called "cumulation." Under a typical trade preference agreement such as the EU-Israel or US-Israel accords, a product qualifies for preference only if it meets the test of having a specified minimum of its value produced in the country of origin. That is to prevent scams, like an Israeli sewing a button on a shirt from China and then claiming it is Israeli-made. When the EU has preferential trade agreements with several countries, it usually negotiates agreements that extend the preference to goods partially made in each of the various countries -- that is, it allows the adding up ("cumulation") of the percent of value added in each country. So, for instance, a product partly made in Algeria, partly in Tunisia, and partly in Morocco can be exported to the EU under its preferential trade agreement with any of the three. In this case, the EU has refused to allow cumulation between Israel and its neighbors until Israel gives in on the "rules of origin" issue and until Israel eases conditions for Palestinian trade. That means the EU holds the Israeli-Jordanian and Israeli-Egyptian joint ventures hostage to problems on the Israeli-Palestinian front. Whatever their intentions, the effect of EU actions is to discourage joint Israeli-Arab economic projects.

Israel v. Iran and Iraq: It might seem peculiar for the EU to pick a trade fight with Israel, which in 1997 bought \$14 billion from Europe while selling to Europe only \$7 billion. At the same time, EU governments have done contortions to protect their access to the Iranian and Iraqi markets, when EU sales to neither of those two countries have ever been as high as their current exports to Israel. This fact undermines claims of some in the United States who believe that the EU's behavior in the Middle East is motivated primarily by commercial concerns. The numbers suggest that politics, commerce, is the key factor.

Implications for the United States: The usual commercial practice would be for the U.S. government to take quiet pleasure at the EU's putting at risk its \$14 billion in exports to Israel, to the benefit of U.S. firms which in 1997 only sold \$6 billion to Israel. America has been unhappy to see Israel rely so heavily on EU imports, when the U.S.

supplied Israel with \$10 billion in foreign exchange in 1997 (\$3 billion from aid and \$7 billion from purchasing Israeli exports) compared to \$7 billion from the EU. More important than commercial considerations is the trade dispute's connection to the peace process. Many Europeans feel the way to bring peace to the region is to pressure Israel. They are already positioning themselves to take credit for any agreement on a further redeployment, claiming it was the EU's trade pressure which tipped the balance. That badly misreads Israeli politics (Israeli business leaders often complain that the Likud government pays little attention to their concerns, evidently having written them off as Labor supporters). For Washington, the lesson is that EU involvement in the peace process remains profoundly partisan and generally counterproductive.

>While the EU often complains about Washington's penchant for politicizing trade (e.g., the Iran sanctions dispute), the EU Commission is currently manufacturing trade disputes for the purpose of applying political pressure on Israel. It would behoove both the United States and the EU to recognize openly that trade policy is one of the instruments governments use to advance their diplomatic agendas. When the two disagree about the application of trade pressure, the real cause is a difference over the diplomatic issue at stake, not because one side is principled about keeping politics out of trade.

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