INSS Insight No. 769, November 19, 2015

The EU Decision to Indicate the Origin of Products from the Settlements

Oded Eran, Nizan Feldman, and Eran Yashiv

On November 11, 2015, the European Commission approved a document calling on European Union (EU) countries to enforce the labeling of products originating from Jewish settlements beyond the Green Line. According to this legislation, stores will have to label food products (such as fruits, vegetables, wine, and honey) and cosmetics as originating in the settlements. Labeling will not apply to industrial products (such as electrical appliances, for example) originating in those communities. The legislation in question already exists, but until now has not been enforced in most EU countries. However, the UK in 2009, Denmark in 2013, and Belgium in 2014 have issued instructions to this effect. The EU decision is therefore a direct continuation of EU policy, whereby the 1995 association agreement with Israel does not apply to the territories occupied by Israel in 1967. This policy was partly implemented in 2004. Then the EU forced Israel to indicate the exact location of production on certificates of origin for exports from Israel, and to allow European customs authorities to cancel an exemption on duties, granted for products from within Israel's pre-1967 borders.

According to an article in *The Marker* on November 11, 2015, the Israel Ministry of the Economy estimates that the new regulations would apply to some $50 million out of a total of $150-200 million a year in exports from the settlements in the West Bank and the Golan Heights, and that Israeli exports to Europe will not be significantly affected. Data from the Israel Central Bureau of Statistics show that the exports affected are a small proportion of the estimated $27 billion in annual total exports to the EU, and an even small proportion of Israel's $92 billion in exports of goods and services to the world in 2015.

Yet while the macroeconomic consequences of the European measure are negligible, the move signals international willingness to take such steps and is liable to deter companies from expanding their connections with Israel. Since the measure precedes the activities of the BDS movement, it does not give that movement an achievement for which it can take credit. At the same time, the decision is liable to be perceived as such and to create momentum with considerable potential damage.

The main concern aroused by these official measures, which highlight the lack of legitimacy that European governments attribute to business activity in the settlements, is the impetus for the adoption of measures against Israeli companies operating within the Green Line that also conduct business activity in the West Bank. In other words, an official decision to boycott products from the settlements is liable to generate unofficial, and even official, secondary boycotts against Israeli companies linked in one way or another to activity in the West Bank. The formulation of such measures may increase the pressure on sectors and companies with extensive business beyond the Green Line that is easily detectable, such as banks and infrastructure and construction companies. Negative public opinion toward Israel, and the exertion of effective pressure on governments, is also likely to cool their enthusiasm for association with Israeli companies in government tenders.

It is also possible that the financing of projects in the West Bank and the Golan Heights and the provision of financial services to their residents will make Israeli banks a target for punitive measures by financial institutions and governments in Europe. Israeli banks provide banking services, including mortgages, to Israeli citizens living beyond the Green Line, and grant credit to companies operating there. This will make it very easy for boycotters to label them as companies with significant involvement in financial activity in the West Bank. Indeed, over the past two years, several banks and pension funds have announced that they were withdrawing their investment in Israeli banks. For example, in February 2014, Dansk Bank, the largest bank in Denmark, announced that it had included Bank Hapoalim on its black list, because the bank had financed construction of "illegal" Jewish communities in the West Bank. Similar measures were taken by other banks in Scandinavia. In January 2014, PGGM, the largest pension fund in the Netherlands, announced that it was withdrawing investments from all five major Israeli banks. Two years ago, in discussions about Israel's accession to the Horizon 2020 multi-year EU research program, the EU announced that its institutions would conduct no financial activity and grant no contributions or financial assistance to Israeli entities operating in the territories occupied by Israel in 1967.

The economic problem therefore is a possible snowball effect that could turn currently negligible damages into more significant ones. Even if Israel responds to developments of this type, say by increasing exports to East Asia at the expense of Europe, it is not clear that this will be enough to prevent damage. Non-European countries might also adopt the European position. It is difficult, however, to see the United States doing this in the foreseeable future. Indeed, the United States has announced that it regarded the EU decision as a merely "technical measure." Thus, the US State Department did not adopt the approach taken by 36 US senators in a letter to the High Representative of the European Union for Foreign Affairs and Security Policy, Federica Mogherini, which pointed out the political aspect of the decision.

The potential economic damage to various interest groups in Europe and the expected economic and political cost to governments adopting this legislation are not extensive enough to completely rule out the possibility that a dynamic will emerge leading in the future to the formulation of unofficial and official punitive measures against Israel. Past cases and the wealth of academic empirical research on the subject show that one of the important variables, if not the most important, affecting the likelihood that sanctions will be imposed is the political motivation of governments to bring about a change in the policy of other countries. When a government has a clear interest in leading sanctions against another country, its willingness to confront interest groups is greater, and it will even be willing to sustain certain macroeconomic costs.

At the same time, there are numerous economic, political, institutional, and technical constraints that are likely to make it difficult for unofficial and official players in Europe to undertake additional measures that will cause substantial damage to the Israeli economy. These constraints are due mainly to the composition of Israeli exports, and the identity of the companies spearheading Israeli trade and investment. Most of the Israeli goods exported to the EU and other important markets are used as production inputs, and are not consumed by the general public as end-user products. Campaigns calling on consumers to boycott Israeli goods may perhaps detract from exports of agricultural products and processed foods, which account for less than 10 percent of total exports to the EU, but it is more difficult to affect exports of chemical and rubber products, computing, machinery, and optics. These goods, which account for more than 45 percent of total exports to EU countries, are installed in various production stages in numerous industries throughout Europe and other countries.

The identity of the companies exporting from Israel poses another political obstacle to those seeking to enforce significant punitive measures. A substantial proportion of exports from Israel are composed of goods produced by multinational companies that have established manufacturing activity in Israel, or else by Israeli companies with subsidiaries in Europe and other markets. Official restrictions on trade or investment vis-à-vis Israel are liable to wind up damaging the direct interests of those multinational companies, and also detract from their manufacturing activity in other countries.

The struggle of the Israeli government is now moving to the level of the EU member countries, since the EU decision leaves implementation in their hands. A number of governments, headed by Germany, have already announced their opposition to enforcement of the measure. Additional countries will presumably hesitate to engage in confrontation with various groups, including the US Congress, which will take action against implementation of the decision. For its part, the Israeli government must clearly conduct a political campaign against implementation of the decision, but at this stage should refrain from exaggerating its effectiveness and from encouraging its own boycott measures, as this could well enhance any snowball effect. However, the latter effect is a questionable outcome, given the fact that since the EU launched a campaign against Israeli exports from the territories occupied in 1967, the damage has been negligible.