Problems under the EC–Israel Association Agreement: The Export of Goods Produced in the West Bank and the Gaza Strip under the EC–Israel Association Agreement

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Abstract

Where are Israel's borders? This question arose when European customs officers demanded verification of the origin of products declared as Israeli but which originated in the occupied territories. The EC–Israeli Association Treaty grants preferential tariffs to products of Israeli origin. European customs officers abandoned the practice of treating products originating in the occupied territories as Israeli products after the EC concluded an Association Treaty with the PLO. This caused serious irritation on the Israeli side and controversial discussions between the EC and Israel. The issue remains unsolved. The article argues that this issue is directly linked to the question of sovereignty over the disputed areas of Palestine. It discusses several approaches to the solution of the current problem, and examines the possibility of a bilateral, or even regional, cumulation of origin. It concludes that trade agreements and the rules of origin are so closely related to the question of sovereignty that a final solution to the question of origin of products from the occupied territories can only be found after the Israeli–Palestinian conflict has been solved.

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1 Introduction

The conflict between Israel and the Palestinians is as old as the state of Israel, and the most important problems arising from it remain unsolved. The developments since October 2000 have demonstrated that the differences are deeper than commonly believed. Trade and economic relations with both parties are necessary, otherwise attempts to maintain unbiased political relations would be in vain. The legal and economic questions that emerge as a result of these relations, however, can rarely be separated from the political and social issues of the conflict. Moreover, they are influenced by current developments. The particular circumstances of the region create unique problems, which cannot be resolved by means of standard solutions.

On 12 May 1998 the Commission of the European Community (EC) issued a statement declaring that Israel was suspected of breach of treaty for exporting goods into the Community that did not originate in Israel and were thus not subject to preferential treatment.[1] Therein, the Commission referred to products that had been exported as Israeli goods under the free trade agreement (FTA) between the EC and Israel but that originated from the West Bank and the Gaza Strip (WBGS) or the Golan Heights. Consequently, several European customs offices had sent requests to the Israeli authorities to verify Israeli certificates of origin for the products involved. Their responses were not considered satisfactory by the Europeans.

These 'embarrassing questions'[2] were raised after the EC had concluded a free trade agreement with the Palestine Liberation Organization (PLO) in 1996. Suddenly two EU trade partners were claiming responsibility for products originating from the occupied territories.

The EU-Israel Customs Cooperation Committee, the body set up to address this matter, convened for the first time in Jerusalem in July 2001.[3] Predictably, no solution was found. The Israeli side presented its view that products 'coming from places brought under Israeli Administration since 1967', as the Committee put it, enjoy preferential treatment under the Association Agreement, as practised under the 1975 agreement. The European counterpart repeated its interpretation that these territories were not entitled to receive preferential treatment. This first meeting concluded that the matter should be referred to the Association Council, which consisted of members of the Council of the European Union, members of the Commission of the European Communities, and members of the Israeli Government.[4] This next meeting, held on 20 November 2001, brought no solution to the problem. Following the failure of these talks, the EC finally decided that the former practice of accepting goods from the WBGS with Israeli certificates of origin should ultimately be terminated.[5]

Israel considers the European decision to stop this practice as proof of the

[1] Communication by the Commission SEC (98) 695 final.

[2] Jane's Foreign Report 2607, at 4, see also Ha'aretz (English edition) from 24 September 2000, at 4, and Ha'aretz (English edition) 5 November 2000, at 6.

[3] http://europa.eu.int/comm/external_relations/israel/news/ip01_1065.htm.

[4] The procedure is outlined in Article 75 of the Association Agreement.

[5] Notice in OJ 2001 C 328/6, EU Bulletin 11–2001, point 1.6.76.

anti-Israeli mood in Europe.[6] For the Europeans, continuing such practice would contradict its common policy concerning the status of the occupied territories.

This article examines the problem of goods originating in the WBGS and their treatment in the free trade agreements with the European Community. It then discusses some possible solutions to the problem. It appears *prima facie* to be largely a problem of Rules of Origin, i.e., the method used to determine whether a particular product's origin is such that it may benefit from a free trade agreement. However, a more in-depth examination reveals that the political question underlying the problem dominates any approach taken to solve it. The uncertain status of the WBGS under international law impedes their integration into a free trade agreement.

When considering alternative solutions to this problem it should be recalled that the European Union has continually tried to increase its influence in the region by playing the role of a neutral mediator. The EU deemed itself suited to this role in the region, given its presumably more unbiased position than that of the United States, who ever since Camp David have been the main negotiating partner in the conflict. It should thus be of considerable interest to Europe to find an equitable solution to the problem.

The article will first present the framework of the free trade agreements: the treaties between the European Community and Israel, on the one hand, and with the PLO on the other will be outlined. In addition, the agreement regulating economic relations between Israel and the PLO will be described. The different facets of the current problem will then be examined in the light of conclusions of international public law, taking into account economic and political aspects of the question. Some possible solutions will then be proposed and discussed. One possibility would be to amend the current legal documents by introducing a cumulation of origin in the parties' agreements with the EC. Alternatively, application of the European free trade agreement with the PLO with regard to these products could be considered. In addition to these more legal solutions, two diplomatic approaches will be analysed.

The article generally concentrates on agricultural products, although similar problems arise when the origin of other products (such as natural cosmetics) is, according to the current Rules of Origin, determined to be outside the 1967 Israeli borders.

2 The Legal Framework

A *Trade Agreements and Rules of Origin*

The problem dealt with in this article lies within a system of trade agreements. Arranged by grade of integration from lowest to highest, the recognized levels of economic cooperation between states are:

- preferential trade agreement

[6] See, for example, the article in the Israeli newspaper Ma'ariv from 18 May 2001, Globes from 23 May 2001, 'Where does Israel end?'.

- free trade area
- customs union
- common market

In the first two levels, trade is liberalized between states by partial or general abolishment of tariffs and non-tariff barriers on goods entering the market of parties to the agreement. In a customs union, the contracting parties also agree on a common tariff on imports from outside the union. Access to their shared market for goods entering the union from non-member states is therefore the same for all member states. The European Community is a common market, including a customs union. The Association Agreement of 1995 between the EC and Israel established an almost general free trade area.

In contrast to a common market or a customs union, the individual members of a free trade area retain their own external tariff. Thus there is a possibility that goods from non-member countries could enter the market of a high-tariff free trade area member through the country with the lowest tariff. This 'trade deflection' means that a country loses tax revenue, its tariffs are circumvented. Furthermore, products from a non-member of the free trade area benefit from the trade arrangement. To prevent this kind of abuse, there are mechanisms in the system to guarantee that only products originating in a Member State of the free trade area benefit from the trade liberalization. The rules which determine the origin of products are referred to as the Rules of Origin. Their function is to identify goods crossing borders, thereby giving the free trade benefits only to products of the Member States.

Products originate from a state when they are 'wholly obtained' on its territory. If they have been harvested on its territory, determination is easy. The origin of non-processed agricultural goods is therefore rarely a problem in the application of Rules of Origin. Otherwise, the origin of a product is considered as being in the state where the 'last substantial process' or 'sufficient working or processing' is carried out. Three basic methods are used for verification: a) the domestic content of the product, which requires a minimum percentage of the product value originating from that state; b) technical procedures, which describe what specific processing operations can be considered 'sufficient'; c) a change in tariff classification, i.e., the process which the product has undergone changes its tariff heading under the Harmonized Commodity Description System.

As the problem focused on here concerns mainly agricultural products, the specific application of the Rules of Origin need not be discussed in any further detail.

B *The European–Israeli Economic Relationship*

The current EC–Israel Free Trade Agreement is the latest and most advanced in a series of trade agreements established between Europe and Israel. In 1958 Israel was one of the first states to establish relations with the Community. At Israel's request, the first trade agreement with the Community of six[7] was concluded as early as 1964.[8]

[7] Benelux, France, Germany and Italy.

[8] O.J. 1964 L 95/1571.

However, the introduction of the most-favoured-nation clause under the General Agreement on Trade and Tariffs (GATT)[9] extended most preferences to all GATT members, thereby diminishing Israel's special position in relation to the EC. As a result, the agreement lost its significance.

The renewed outbreak of violence in 1967 delayed any further agreement until 1970, when the First Preference Agreement was concluded.[10] This was seen as a transitional solution with the long-term aim of creating a free trade area between the EC and Israel. The agricultural sector was, and still is, a difficult subject for both parties; they regard this sector as important nowadays, probably more for political than for economic reasons.[11] Europe maintains a high level of protectionism in this sector and the Common Agricultural Policy is a constant source of disruption in the EC's foreign relations. Furthermore, agricultural products still constitute a significant share in Israel's exports to the EC.[12]

Not long after this agreement was concluded, the EC changed its general approach to the Mediterranean region. Inspired by a resolution of the European Parliament in 1971, the Council and the Commission began to work on a more global approach towards the Mediterranean. The Paris Summit in October 1972 concluded that all Mediterranean countries, including Jordan, should form a Euro-Mediterranean partnership with the EC, leading eventually to a Free Trade Area. This would promote the development of the Mediterranean countries and create a larger market. It was also hoped that such a partnership would create a more peaceful region on the southern border of the Community, as not only the Palestinian conflict but also the recurrent clashes between Greece and Turkey posed a threat to the region.

The Free Trade Agreement with Israel of 1975 went further than an ordinary free trade arrangement. It included cooperation in scientific matters, with the intention of facilitating the transfer of technological know-how.[13] Some even considered the 1975 agreement to be a first step towards full association.[14] The southern enlargement of the European Community in the 1980s, however, had a strong impact on Israel's benefits. Spain, Portugal and Greece, three Mediterranean states that were directly competing with Israeli agricultural exports (mostly fruits and flowers), became full members of the Common Market. This led to a diminution of Israel's access to the European market for these products. Critics were concerned about the growing Israeli trade deficit towards the Community.[15]

By 1993, the EC devised a long-term schedule to complete a Euro-Mediterranean

[9] Article 1 of the 1947 GATT treaty.

[10] O.J. 1970 L 183/1.

[11] M. Hirsch, E. Inbar, T. Sadeh, *The Future Relations between Israel and the European Communities – Some Alternatives,* Tel Aviv (1996), at 67 explaining the importance of the agricultural sector even in post-industrialized countries on the basis of national interest.

[12] 8.5 % in 1998 (source: Israel Foreign Ministry).

[13] O.J. 1975 L 136/3.

[14] Oppermann, 'Cooperation, Association, Accession: Reflections on the Legal Options for the European-Israeli Economic Relationship', *Tel Aviv University Studies in Law* (1998) 9, at 19.

[15] Malanczuk, 'The Legal Framework of the Economic Relations between Israel and the European Union', in A. E. Kellerman, K. Siehr, and T. Einhorn (eds), *Israel Among Nations,* Tel Aviv (1998) 263, at 277.

Free Trade Area with the Mediterranean partners, leading to the 'Barcelona Process' of Euro-Mediterranean Cooperation. The first step for the Mediterranean partners would be a free trade arrangement or an association with the EC.

Thus, the Association Treaty between Israel and the EC was signed on 20 November 1995, defining the current legal framework.[16] Negotiations and the signing of the treaty took place under the positive development of the peace process between Israel and the Palestinians after the Declaration of Principles in 1993. The treaty intended not only to expand trade between Israel and the EC, but aimed also to use the economic relations as a framework for political dialogue. The Association Council, an annual meeting at ministerial level, monitors implementation of the agreement. This panel is also called upon to resolve disputes relating to application of the treaty. Ratification of the treaty was delayed as a result of the freeze of the Peace Process under the Likud Government, but it eventually entered into force on 1 June 2000.

C *Rules of Origin in the 1995 Association Treaty*

The Fourth Protocol of the association treaty deals with the Rules of Origin for the free trade area. Generally, a product must be 'wholly obtained or produced'[17] in one state. As agricultural goods are the focus of this piece, this general rule is sufficient. A vegetable product is wholly obtained in the state in which it is harvested.

Article 3 introduces a bilateral cumulation of origin. In the event that Israeli producers use materials from the Community, their processed goods are still considered as having originated in Israel. Clearly, however, this bilateral cumulation of origin does not solve the problem of products originating in WBGS.

Generally speaking, products enjoy preferable access to the European market under the 1995 accord if they are indeed of Israeli origin as regulated by the Rules of Origin in the 4th Protocol. The exact meaning of 'Israel' is not defined, as the boundary of a state is usually quite clear. This is not the case in the Middle East, and it is here that the core of the current problem lies.

D *The Agreement between the EC and the Palestinian National Authority*

For trade purposes, the occupied territories of the West Bank and the Gaza Strip (WBGS) were previously *de facto* treated as part of Israel.[18] Theoretically, the exports by Palestinian as well as Israeli producers in the territories could thus benefit from the trade agreements. The elections on 20 January 1996 established the Palestinian National Authority (PA) as a democratically legitimized leadership in the WBGS. The EC therefore quickly concluded negotiations with the PLO to achieve an association

[16] O.J. 2000 L 147/1, in force since June 2000.

[17] Article 2 (2)(a) in Protocol 4 of the Association Treaty.

[18] Kleinman, 'The Economic Provisions of the Agreement between Israel and the PLO', *Israel Law Review* (1994) 347, at 371.

agreement under the Euro-Mediterranean policy.[19] The result was the Euro-Mediterranean Interim Association Agreement with the PLO for the benefit of (on behalf of) the PA.[20] Even though no Palestinian state exists to date, the EC treated the Palestinians as full partner in the Euro-Mediterranean partnership.

The agreement was signed on 24 February 1997 and entered into force on 1 July of the same year. Notwithstanding the fact that the control exercised by the PNA at that time was limited in scope and in territory (only the Gaza Strip and the city of Jericho), the wording of the agreement applies to the whole of the West Bank and the Gaza Strip. Sooner or later, this would result in a territorial differentiation of Israel and the WBGS as trading entities, thus ending the de facto treatment of the Occupied Territories as part of Israel. The agreement generally resembles the EC–Israel Agreement. Access to the Common Market for agricultural products is dealt with in the 1st Protocol, exempting some products fully from the Common Customs Tariff. Generally, under the agreement, Palestinian products have the same access to the European market as Israeli products. The agreement is not based on reciprocity, since its objective lies more in the development of an economy in the WBGS than in opening its market to European products.[21] It gives the Palestinian side advantages that enable them to protect their market to a certain degree.[22] Palestinian exports are treated differently to European imports in Protocols 1 and 2. Considering the weak economy and the low purchasing power in the WBGS, economic gains for the EC may only be expected in the long term.

Conclusion of the agreement was mainly a sign of political goodwill on the part of the Europeans in terms of the goal of Palestinian self-determination. Theoretically, Palestinian exporters could already benefit from the existing Israeli preferential export regime through the economic agreement between the PLO and Israel (see below). Economically, therefore, the EC–PLO agreement did not improve the position of Palestinian exports.

This point is also emphasized by Israel. Even though the Israeli-Palestinian Interim Agreement on the West Bank and the Gaza Strip (Oslo 2 Treaty) allows the PLO to conclude such treaties (Article IX 5.b.(1)), Israel opposes the agreement between the EC and the PLO. It holds that external trade of the PA is covered by the economic agreement between Israel and the PLO (see below). Since the Palestinians already enjoy preferential treatment via the EC–Israel Association Agreement, no further accord is deemed necessary between the EC and the PLO. Most importantly, Israel maintains that in case of contradiction between the two agreements with the PLO, the rules of their agreement with the PLO must prevail.

Nonetheless, the EC–PLO agreement is already used for exports from the Palestinian controlled areas. The success of this agreement is difficult to measure. At least some

[19] The possibility for the PLO to conduct negotiations for the PA was regulated in Article IX 5. b. (1) of the Israeli-Palestinian Interim Agreement on the West Bank and the Gaza Strip (Oslo 2 Treaty) of September 28, 1995.

[20] O.J. 1997 L 187/1.

[21] Statement by the European Parliament (7.4.1997).

[22] For example, Article 7 II of the Interim Agreement.

Palestinian products were exported under the EC–Israel agreement before and no information exists about the Palestinian percentage of the exports from the WBGS before 1997. An increase or decrease in Palestinian exports is therefore hard to determine.

1 Rules of Origin in the EC–PLO Agreement

The Rules of Origin laid down in the 3rd Protocol are similar to the rules in the EC–Israel Agreement, including the bilateral cumulation of origin of European and Palestinian products.

E *The Economic Relationship between the PA and Israel – The Paris Protocol*

The Declaration of Principles of 1993 was the first brick in the building of the legal framework of the peace process. The next step was taken by Israel and the PLO with the Gaza–Jericho Agreement, initiating the transfer of personal, and to a certain degree territorial, autonomy. The so-called Paris Protocol[23] was incorporated as Annex IV and lays down the rules of the economic relationship between Israel and the PLO. According to Article I, it applies only to those areas where self-government arrangements have been made. At that time, this was only the Gaza Strip and the Jericho area, with the rest of the West Bank pending further agreements. Uncertainties remain, however, since the term 'Palestinian jurisdiction', used to delimit the said areas in Article I No. 4, sometimes refers to personal as well as territorial jurisdiction.[24] It can be concluded, however, that the agreement does not include any rules regarding the Israeli settlements in the WBGS.

Apart from specific regulations concerning taxes, monetary issues and insurance rules, the protocol can be characterized as a customs union.[25] Therefore, the Israeli customs regime also applies to the Palestinian territories. Exemptions were made for goods from Jordan, Egypt and other Arab or Muslim countries where an autonomous import policy was granted to the PNA. However, this trade autonomy is limited to a number of goods, chiefly basic food items, and is only for a certain quantity agreed upon by Israel. The internal trade between Israel and the Palestinian territories is basically free and no tariffs exist. Israel continues, though, to apply a rather protective policy with respect to several agricultural products, using quality control and standards as non-tariff barriers (with a view to liberalization).[26]

No restrictions apply to the export of Palestinian agricultural produce to third countries. Furthermore, the PA may grant its own certificates of origin for their

[23] Signed in Paris, April 29, 1994, entered into force with the signature of the Cairo Agreement on May 4, 1994.

[24] Kleinman, *supra* note 18, at 348; Einhorn, 'The need for a Rule-Orientated Israeli–Palestinian Customs', *Netherlands International Law Review* (1997) 315, at 317.

[25] Kleinman, *supra* note 18, at 355.

[26] *Ibid.*, *supra* note 18, at 349, 356.

agricultural products.[27] It is not specified whether they may be granted only to products within the territorial jurisdiction of the PA or in the whole of the West Bank. This poses a certain problem, as in general the territorial scope of the protocol had been restricted to those areas under territorial jurisdiction. At the time of the conclusion of the Paris Protocol the Palestinian areas were mostly urban, so few agricultural goods were grown there. Considering the general uncertainties of the protocol, one might think that personal jurisdiction of the PA is relevant, so that these certificates may be granted only to Palestinian producers. This contradicts the usual determination of origin; it is the origin of the product, not of the producer, that is certified. It thus remains unclear whether the PA may grant certificates for products from all the WBGS. At least the PA is competent to grant certificates of origin for all goods from the territory currently under control of the Palestinian civil authority.

The basic implication of this regulation, and the core of the current problem, is that there are products of Palestinian and of Israeli origin, because 'origin' in the sense of a free trade agreement can only be defined by territorial means. One consequence of the Paris Protocol is that there is Palestinian territory that does not economically belong to Israel. Even if much effort were made not to imply a territorial separation of Israel and the WBGS,[28] the existence of different 'origins' necessarily entails a territorial separation, at least concerning the application of free trade arrangements.

Even though its territorial scope is limited, the Paris Protocol itself gives reason to doubt the 'Israeli' origin of goods produced in the WBGS.

3 The Problem

Questions of international public law, together with the recent development of legal ties between the EC and the parties to the conflict, are the factors that have led to this problem. The application of Rules of Origin, which initiated the problem, is closely related to territorial matters, especially the question of sovereignty over a territory.

A *The Legal Status of the West Bank, the Gaza Strip and the Golan Heights*

The legal status of the WBGS (including East Jerusalem) and the Golan Heights is a much debated issue within international law.[29] While a discussion of all aspects of the issue is outside the scope of this article, suffice it to say that it uses a legal determination of these areas based upon what the author considers to be the conviction of the overwhelming majority.

[27] Article VIII Nr.11 of the Paris Protocol.

[28] Kleinman, *supra* note 18, at 370.

[29] For further literature see Malanczuk, 'Israel: Status, Territory and Occupied Territories', in R. Bernhardt (ed.), *Encyclopaedia of Public International Law* Vol. III, at 1498–1501 and 1506–1508.

Generally, the situation of Palestine both under and after the British mandate was quite unclear. Different plans of separation were submitted to the UN. The proposal for two states in Palestine and a *corpus separatum* for Jerusalem found approval in the General Assembly, but the Arab side rejected it. No solution was implemented when Israel declared its independence on 14 April 1948. The Israeli state was widely recognized by the international community after the ceasefire agreements with its neighbours in 1949. Its border, as recognized by most states, is the 'Green Line', i.e., the pre-1967 border.

The possible former sovereigns of the WBGS are Egypt for the Gaza Strip and Jordan for the West Bank, although the legitimacy of their rule is doubtful. Egypt never integrated the Gaza Strip into its national territory. Jordan did annex the West Bank, but its annexation was never recognized by the majority of states. In any case, both Egypt and Jordan relinquished their claims on the territories in their respective peace treaties with Israel in 1979 and 1994.

Israel has effectively controlled the territories since the Six-Day War in 1967. However, it is only possible to acquire a legal title for territory by means of occupation if that territory has no sovereign, i.e., it belongs to no other state (*terra nullius*). Yet, in the *West Sahara* case, the ICJ clarified that even if only some forms of organized social entities (clans, urban structures) exist on a territory, it cannot be *terra nullius.*[30] Without doubt, such structures existed in the areas that Israel conquered in 1967. By occupation, Israel could therefore not establish a legitimate title to the territories. In his opinion in the *South-West Africa* case, Lord McNair implied that sovereignty is not vested in the mandate power, but remains in abeyance during a mandate and until its inhabitants are eventually recognized as an independent state after the mandate expires.[31] It may be argued that after the end of the Ottoman rule no state exercised legitimate authority over the WBGS, but it was certainly not a *terra nullius.*[32]

Israel's position is that both Israel and the Palestinians have a legitimate claim to the territories and that the final delimitation will be somewhere inside the Green Line. The Palestinians still argue that prior to 1967 the whole of the West Bank was inhabited only by Palestinians and thus their right to self-determination leads to the conclusion that all of the WBGS belongs to the Palestinian people. As long as the PA cannot be regarded as a sovereign authority, however, implying that neither a Palestinian state nor any other solution recognized by the international community has been found, the current status of the WBGS under international law remains unclear.

Some observations can nevertheless be made. If we consider the WBGS without East Jerusalem, the situation is less complicated. Israel never formally annexed these regions nor extended its domestic civil authority to them. Since their occupation during the 1967 War, they have been under a military administration separate from

[30] *Western Sahara Case*, Advisory Opinion ICJ Reports (1975), at 39.

[31] *International Status of South-West Africa – Advisory Opinion*, Separate Opinion of Judge Lord McNair ICJ Reports (1950), at 150.

[32] Malanczuk, 'Israel', *supra* note 29, at 173–174.

the Israeli civil administration.[33] Even a prolonged occupation does not grant any legal territorial title for the occupier under modern international law. Furthermore, Israel never claimed any annexation of these regions as it did with the Golan Heights and East Jerusalem. The inhabitants of Israeli settlements in WBGS, with their legality the subject of strong debate, are treated as Israeli citizens. Yet the territory of the settlements has not been incorporated into the territory of the state of Israel (although some larger settlements (Ariel, Ma'ale Adoumim) have the status of Israeli cities). Consequently, the Israeli territorial sovereignty does not extend to those settlements nor to any other part of the WBGS.

Israel, on the other hand, annexed by domestic enactment the Golan Heights, which had been taken from Syria in the 1967 War, and East Jerusalem.[34] These acts, however, are without effect when analysed under the rules of international law. Firstly, under modern international law the acquisition of territories by force is inadmissible and does not give a legal title to those territories.[35] The UN Declaration on Friendly Relations expressed this view and it has repeatedly been emphasized by the UN Security Council.[36] Israel could thus not unilaterally extend its territorial sovereignty over these regions. On this basis, the European Community asserted the inadmissibility of annexation by force and the right of self-determination of the Palestinians in its Venice Declaration of 13 June 1980 and this document continues to form the centrepiece of the EC position on the region.

Secondly, the annexation of these territories was not recognized by the international community. The annexation was condemned by the Security Council as illegal and as having no effect on the legal status of the area.[37] Israel's annexation can hence be determined as null and void.[38] This position has also been taken by the Commission in statements concerning the present problem.[39]

It can therefore be concluded that neither the Golan Heights, for which Syria remains the rightful sovereign, nor the WBGS including East Jerusalem, form part of the state of Israel.

B *Determination under the Current Regime of Rules of Origin*

The problem arises when Israeli producers, be they settlers or not, wish to export goods that originate from these regions. Article 2 II(a) of the 4th Protocol on Rules of Origin states that for a product to be of Israeli origin it must have been wholly obtained in Israel. Taking into consideration the legal status of these regions as outlined above, such products (if not further processed in Israel) are not of Israeli origin.

Admittedly, these products were previously treated as Israeli products. This had to change, however, with the conclusion of a trade agreement with the PA which

[33] *Ibid.*, *supra* note 29, at 170.
[34] The Golan Heights Act of 12 December 1981, The Jerusalem Law of 30 July 1980.
[35] A. Verdroß, B. Simma, *Universelles Völkerrecht,* 3rd ed., Berlin (1984), at 478, 1163.
[36] GA Res. 2625 (XXV), 1970, SC Res. 242 (1967) and 338 (1973).
[37] SC Res. 497 (1981).
[38] Malanczuk, 'Israel', *supra* note 29, at 175.
[39] Commission Communication from 13 May 1998 in Bulletin (EU) 5–1998, 1.3.85.

accepted the Palestinian leadership as the economic representative of the area. Combined with the position of the EU regarding the legal status of the WBGS, as expressed in the Venice Declaration, this new situation inevitably leads to a separate treatment of Israel and the WBGS, at least in relation to trade. The Commission thus declared that the EC–Israel Agreement does not cover these products.

C *The Added Political Factor – Products from Settlements*

There is unfortunately another issue to be considered, one which poses a major, if not the main, problem in this matter. As the 'normal' Israeli population inside the Green Line (apart from East Jerusalem) is negligible, the disputed goods are mainly produced in Israeli settlements.

The settlement policy, creating Jewish settlements with full infrastructure inside the WBGS, is a remnant of the practice before 1948 aimed at establishing a Jewish population throughout the territory of the Palestine mandate and thus strengthening the Israeli claim to the territory.[40] After 1967, Israel extended its settlement policy on the WBGS, using strategic and security arguments. Continuation of this policy has been heavily criticized and is deemed by the European Union to be contrary to international law.[41] The general line of argument states that the settlement policy is a breach of Article 49 of the Geneva Convention concerning the Protection of Civilian Persons in Time of War. Increasing their conflict potential is the fact that the majority of the settlers are politically of the religious-nationalist spectrum.

The Palestinians argue in particular that settlement products should be regarded as having been illegally acquired. This makes negotiations on the issue even more difficult.

4 Possible Solutions

A *Products from the Golan Heights*

Under the premise that Israel's occupation and annexation of the Syrian territory north-east of the Sea of Galilee (Lake Kinneret) is illegal under international law, no solution is possible for any product originating there. The popular Golan wine and other merchandise from that region cannot be exported to the EC under the EC–Israel Association Agreement.

A hypothetical cumulation of origin between Syria, after incorporation into the system of the Euro-Mediterranean Association Agreements, and Israel seems, for obvious political reasons, to be impossible. In fact, it is most unlikely that integration of Syria into the Mediterranean partnership could occur before the Golan question is solved.

[40] Malanczuk, 'Israel', *supra* note 29, at 151.

[41] Last in a statement of the EU presidency on 22 May 2000 in Bulletin (EU) 5–2000, 1.6.16.

B *Legal Solutions*

1 Cumulation of Origin

As regards the WBGS, including East Jerusalem, the most simple solution for exporters, as well as for Israel, would be for an amendment to be made to the free trade agreements enabling goods to be exported as Israeli products as practised previously.

A cumulation of origin, a method used frequently to alter the Rules of Origin in a free trade agreement, would be necessary. In a free trade agreement, inequalities may exist between member states. A partner whose territory is richer in trade resources (raw materials, labour) is able to produce a wider variety of products and, due to economies of scale, can produce them more cheaply. Because it is not necessary for its producers to use imported materials, the Rules of Origin will declare their output as originating in that country. Therefore, a greater number of products from this state will enjoy preferential treatment. The state with the greater factor endowment benefits more from the free trade agreement.[42] A partner with fewer resources will benefit less from the trade arrangement by comparison as products manufactured with imported materials do not enjoy preferential treatment. Fewer products will be exported by that state. The economy may be able to increase exports in general, but a trade deficit towards the partner to the agreement is likely to increase. This explains the trade deficit between Israel and the EC.

A first compensation is the bilateral cumulation of origin between two partners of a free trade agreement. Each state may use materials originating in the other country. Products using these materials will still be declared as originating in the exporter's country. For example, under the current agreement, an Israeli exporter can use materials with European origin to manufacture products and these may then be exported to Europe as products of Israeli origin using the free trade agreement preferences. This simplest cumulation of origin is frequently used in EC association treaties. It is integrated in the EC agreements with both Israel and the PLO in Article 3 of the respective Protocols on Rules of Origin.[43]

In a system comprising several free trade agreements, a more sophisticated method of cumulation of origin may be applied. Two preferentially adjoining countries may combine their resources in relation to a common trade partner (diagonal cumulation). Furthermore, several states can combine their factor endowment pools to create a region from which producers can use materials (regional cumulation). This is the aim of the EC for the Mediterranean countries. The objective of this method is firstly to compensate for the fact that the EC itself has a vast pool of resources, while the mostly smaller states in the region, e.g. Israel, the WBGS and Jordan, have access to only limited resources. Secondly, the existing bilateral cumulation may not be sufficient. It improves the disadvantageous endowment of the smaller Mediterranean countries

[42] Hirsch, 'Asymmetrical Factor Endowments, Progressive Rules of Origin and Commercial Cooperation in the Middle East', Paper published at the Hebrew University (1999), at 6; M. Hirsch *et al.*, *Future Relations*, *supra* note 11, at 21.

[43] The 4th protocol in the EC–Israel agreement, the 3rd protocol in the EC–PLO agreement.

only minimally, due to the geographical distance between the EC and the Mediterranean non-member countries (MNMC). European producers hardly need Israeli products for their export goods. Israeli producers may use European materials, but the added transport costs for the European materials create a comparative disadvantage in relation to European producers. Thirdly, the possibility of using materials from neighbouring countries in order to benefit from preferential treatment with a third country can lead to stronger economic ties between these countries. This also serves the political aim of the Euro-Mediterranean partnership, namely that growth of trade and mutual dependency in the Mediterranean area will eventually result in a greater interest in maintaining peaceful relations. The idea has certainly succeeded between the former *Erbfeinde* (hereditary enemies) France and Germany. It may well be an opportunity for Israel and its Arab neighbours.

The method of cumulation of origin diagonally or regionally among the MNMCs is already envisaged by the EC. The final objective of the 'Barcelona Process' is to establish a Euro-Mediterranean Free Trade Area by 2010.[44] In this area, a total cumulation of origin would exist as in the EFTA. As a step towards creation of this area, the gradual introduction of diagonal and regional cumulation of origin will be used in the Mashreq and the Maghreb states.[45] Israel is also interested in a regional cumulation of origin with its neighbours because it does not benefit very much from the existing bilateral cumulation.[46] It has proposed the introduction of cumulation of origin between Israel and Jordan. The European side demands the conclusion of a free trade agreement between the respective parties before a cumulation of origin in relation to the Community would be possible.[47]

In our case, Israel would have to conclude a free trade agreement with the PA to benefit from cumulation of origin towards the EC. The Paris Protocol as presented above cannot be characterized as such an agreement. This treaty is not based on reciprocity because the PA is still dependent on Israel's foreign trade policy. In a conventional free trade agreement, Israel would have to accept a more exact territorial delimitation than in the Paris Protocol, which is rather improbable in the current situation. Thus, a 'normal' free trade agreement will not be concluded between Israel and the PA in the foreseeable future. Nonetheless, it has correctly been pointed out by Israeli authors that the requirement of an existing free trade agreement in order to introduce a cumulation of origin is generally 'a case of putting the cart before the horse'.[48] Cumulation of origin is the logical first step towards creating and strengthening trade ties between two countries. The possibility of a free trade

[44] Barcelona Declaration adopted at the Euro-Mediterranean Conference of Foreign Ministers, 27–28 November 1995.

[45] Commission Communications COM (1998) 254 and COM (2000) 497, at 7.

[46] Tovias, 'Israel and the Barcelona Process', Euro-Mediterranean Study Commission (EuroMeSCo), Paper published in the Hebrew University (1998), at 9. The document can also be found under http://www.euromesco.org/euromesco/publi_artigo.asp?cod_artigo=38105.

[47] Declaration by the European Community on cumulation of origin (Article 28), part of the EC–Israel Association Agreement.

[48] Hirsch, 'Asymmetrical Factor Endowments', *supra* note 42, at 23.

agreement lies further down the road. The latter is only of interest if there is an existing trade volume to be freed from tariff borders. A cumulation of origin may increase the trade volume between countries. Moreover, the conclusion of a free trade agreement is a politically bolder and more difficult step than the introduction of cumulation of origin by simple amendment of existing treaties with a third country.

More recently, the EC has linked the introduction of cumulation of origin between Israel and the WBGS to the problem discussed in this article.[49] In the eyes of the EC, the export of goods originating in the WBGS under the EC–Israel Association Agreement is a violation of this treaty. The EC has therefore expressed its view that the current problem must be solved before further developing the rules of origin in the EC–Israel Agreement. The link between the problem and the demand of cumulation of origin implies that it should be solved by other means. Yet no clear statement of this kind exists as yet and cumulation of origin must be taken into account as a possible solution.

The application of this method to the current problem would mean the introduction of a cumulation of origin between Israel and the WBGS (diagonal cumulation). Both are partners in similar trade arrangements with the EC, and these would have to be amended accordingly.

Israel and the Palestinian Entity, together with Jordan, could form the core of the Mashreq group in the Euro-Mediterranean partnership. A regional cumulation of origin between them could create a larger region of economic cooperation and prosperity. With a cumulation of origin between Israel and the PA, both could use materials originating in the other party's territory. Goods originating in the WBGS could be exported under the EC–Israel Agreement. The implementation of cumulation of origin, creating a resource pool for producers in Israel and the WBGS, would be a step towards a Euro-Mediterranean Free Trade Area. Furthermore, the possibility of a cumulation of origin might encourage more trade over the Green Line border, thus strengthening economic ties between the Israelis and Palestinians.

On the other hand, several points make a cumulation of origin at this stage impossible. Two expressions in the last paragraph, 'territory' and 'border', present major problems for the Israeli side. The origin of a product can only be defined by territorial aspects. A cumulation of origin therefore calls for a territorial delimitation in which certificates of origin are granted by Israeli or by Palestinian authorities. The territorial delimitation, however, is the most difficult issue in the peace process itself. From the Israeli point of view, the territorial status of the WBGS is unclear and can only be solved by a final settlement with Palestinian representatives. As concerns the settlements, integrating at least the majority of them into the territory of the state of Israel remains a main objective of the Israeli negotiation team. To treat them as being subject to Palestinian administration would, in their eyes, anticipate the final status. The negotiations about competence to grant certificates of origins would therefore be

[49] Commission Communication from 13.5.1998, Bulletin EU 5–1998, point 1.3.85.

identical to those on the final status. The necessity of defining an economic border leads to a rejection of a cumulation of origin with the PA by Israel.[50]

Moreover, cumulation of origin would not increase trade between Israelis and Palestinians. The cheap cost of labour in the Territories could hypothetically be an incentive for Israeli investors to produce low profile goods in the WBGS. Nonetheless, the frequent closures of the WBGS, which interrupt supply and just-in-time production, discourage investors and prevent Israeli enterprises from using materials originating from within the Green Line to produce their merchandise. More likely, cumulation of origin would only be used to enable the export of Israeli products from the WBGS.

In general, the introduction of cumulation of origin may increase trade between countries and should therefore be used to create the Euro-Mediterranean free trade area. However, the introduction of cumulation of origin between Israel and the WBGS is neither necessary nor useful for this objective.

A cumulation could even prove contradictory to the aim of the EC–PLO agreement. The objective of the EC-Palestinian Association Agreement is not purely economic, but is rather aimed at developing the Palestinian economy and infrastructure. It is not primarily a means to open up the Palestinian market to European products. As explicitly stated by the EC, the economic and social development of the WBGS is of foremost interest.[51] Any action or any amendment of the said agreement should be compatible with this aim.

The Israeli economy is far more advanced and capable than the Palestinian economy, with better infrastructure and superior know-how. Israeli companies stand to gain far more from a possible cumulation than Palestinian producers. The agreement's goal would be satisfied if the Palestinian side were to gain as well, e.g. by an increase in private Israeli investment in the territories or growth in Palestinian private production. A cumulation might at least prove to be a positive sum total; however, the lack of infrastructure and the aforementioned closures of the Territories hinder direct investment.

On the Palestinian side, the only goods that are capable of competing with foreign products, and the only ones suitable for export, are agricultural products. In this field though, a cumulation of origin would not affect Palestinians, as they do not grow crops on Israeli territory. Few major Palestinian companies exist at present, that would benefit from the possibility of using Israeli goods for their exports. The Palestinian economy would therefore gain little from a cumulation of origin.

As the introduction of cumulation of origin would not be beneficial for the Palestinian economy, it would be incompatible with the very aim of the treaty with the PLO.

Seen from a political perspective, the separate agreements of the EC, with Israel on one hand and the PA on the other, are an implementation of the Venice Declaration.

[50] Tovias, 'Israel and the Barcelona Process', *supra* note 46, at 10.

[51] Preamble of the EC–PLO agreement, statement of the European Parliament (7.4.1997) to the conclusion of the EC–PLO agreement.

In this Declaration, the Community adopted for the first time a common and specific position on the Israeli-Palestinian conflict. Based on UN Security Council resolutions 242 (1967) and 338 (1973) its main points were the recognition of a Palestinian right to self-determination (although no Palestinian state is mentioned) and the call to Israel to end the territorial occupation maintained since 1967.

Israel, in the agreements with the PLO, avoided alluding to a territorial separation of the WBGS from Israel. Nonetheless, the EC implies at least economic autonomy when dealing with the PLO.[52] The exclusion of the settlements from the EC–Israel treaty does increase pressure in seeking a final solution for the settlement problem in the WBGS. The EC, even if it may prefer to assume a more important role in the peace process, is not in a position to put direct pressure on the conflicting parties. Competing with the United States in this aspect could even harm the process. Unlike the assumptions of the EU, the parties prefer the power of the US to guarantee the realization of an agreement rather than the possibly higher neutrality of Europe at the negotiating table. The economic pressure of the said exclusion would have the subtlety and indirectness necessary to European actions. It might be effective without major negative diplomatic side effects.

The introduction of cumulation of origin, on the other hand, would harken back to the status quo ante. Besides losing a certain influence on the peace process, Europe would, with the introduction of a cumulation of origin, indirectly give its *placet* to the settlements in the WBGS and contradict its own policy.

2 Export under the EC–PLO Agreement

If, under the current framework, the said products are not of Israeli origin, their actual status in the current framework of trade agreements might be of interest. The Paris Protocol is obviously not applicable to the areas in the WBGS from which the products mainly originate. They are neither under the territorial jurisdiction of the PA, nor under its personal jurisdiction. Nonetheless, when it comes to exempting them from the European tariffs, only community legislation and agreements determine their status. Hence, the EC–PLO agreement might be applicable to them. The application of this agreement is not linked to the actual territorial range of the PA's jurisdiction; instead, the expression 'the West Bank and the Gaza Strip' is used. It can be argued that the agreement, especially the 3rd Protocol on Rules of Origin, applies to the whole WBGS.

If this concept is applied, the concerned products are of Palestinian origin. Since only the origin of the product is relevant to enjoy the benefits of the free trade arrangement, and not the nationality of the exporter, it would be possible to 'use' the EC-PA trade agreement to export these goods. With a Palestinian certificate of origin – the right of the PA to grant such certificates for agricultural products is explicitly given in the Paris Protocol[53] – these products would enjoy the same preferential treatment

[52] Actually the Paris Protocol between Israel and the PLO implies autonomy in economic matters as well.

[53] Article VIII No 11 of the Paris Protocol.

entering the EC as they did before. The only differences for the exporter would be in the declaration of his goods and in the authority granting the certificate of origin for his products.

The first advantage is obviously the fact that no agreement would have to be amended. The current framework would give the exporter the necessary preferential treatment. This would 'outsource' the legal possibilities of the current system of trade agreements.

Cooperation between Israeli producers and the Palestinian authorities would be needed. This is a difficult problem, but it also provides opportunities.

In general, it would give the Palestinian authorities the chance to prove their efficiency and reliance, qualities that up to now have rarely been used when describing the Palestinian administration. An unbiased handling of any Israeli demand would be mandatory. The European side would also observe the performance of the Palestinian authorities. Any illegal denial of a certificate of origin would also be a breach of the EC–PLO agreement, infringing its aim, the promotion of trade.

The fact that most of the products concerned come from Jewish settlements has several distinctive features. If they will not become somehow part of the territory of the State of Israel, the probability of settlers living in a Palestinian governed territory begins to emerge. Even though an improvement in the relations between settlers and Palestinians seems hardly possible under current circumstances, it is highly desirable, and may even prove to be a prerequisite of a final settlement. If this solution were to be chosen, the settlers would have to accept the Palestinian authorities and request certificates of origin from them. The Palestinian Authorities would have to accept the existence of non-Arab settlements in the WBGS and their rightful demands. The contracting parties, i.e. the leadership of Israel, the EC, and the PA could possibly agree upon this solution. It is more than doubtful, however, whether the forced cooperation between settlers and Palestinians would, in the current state of the peace process, decrease tensions. A successful cooperation on this lower civilian level might be a chance to improve relations in a more subtle way, and be a milestone on the way to a political solution of the status of the West Bank. The failure of cooperation leads back to conflict and clashes.

If the concerned products could only benefit from the FTA with a Palestinian certificate of origin, then the possibility to grant or to deny that certificate could be politically used. Like the closures of the territories for the Israelis, it would be a lever in the hands of the PA to put pressure on Israel. Taking this into account, it is wishful thinking to suppose that Israel would agree on this solution.

C *Diplomatic Solutions*

1 'Parallel cumulation of origin'

The unorthodox, apparently Solomon-like solution, to allow Israeli as well as Palestinian certificates of origin for products from the WBGS is improbable but not beyond the scope of a theoretical examination.

Europe could try to find an arrangement with Israel and the PLO whereby the scope

of the FTA between the EC and the PLO is the whole of the WBGS, or at least where Palestinian certificates of origin may be granted to products from anywhere in the WBGS. On the other hand, it could concede to accept Israeli certificates of origin for the same area. For the whole of the WBGS, the EC–PLO as well as the EC–Israel FTA could be used for exports into the EC. In effect, this would be a kind of 'parallel cumulation of origin' as two parties could use materials from the same origin under their agreements.

This solution respects the fact that final territorial limitation would take place between Israel and the Palestinians at some point in the future. The final status of the WBGS would not be anticipated. The somewhat bitter edge that entered into EC–Israel trade relations would be diluted, as Israeli producers could resume their exports to the EC.

On the other hand, Europe would not contradict its policy as stated in the Venice Declaration in such an evident manner. Furthermore, it would promote the implementation of its contested agreement with the PLO. In effect, though, Europe would resume its policy of benign neglect towards the Israeli settlements, evading diplomatic strains with Israel.

The Palestinians would have the benefit of using a parallel trade agreement alongside Israel, implying some 'sovereignty' in the field of trade. In addition, no cooperation between settlers and Palestinian authorities would be necessary.

Accepting certificates of origin from several parties without defining the economic borders, however, would be unprecedented in the practice of rules of origin. The main argument against this approach is that the unsolved problem of a territorial delimitation would be postponed. After the latest developments, the final solution seems farther away than before and is certainly still a long way off. Nonetheless, a final solution is urgently needed, not only for those directly involved in the conflict, but also for those dealing with the region. This means that every possible effort should be made to urge the parties to conclude their struggle. Direct infringement would only harm development. The parties should be reminded, though, that their haggling leads directly to other problems that in turn only do harm upon themselves.

2 'Control' instead of 'sovereignty'

Another rather more political than legal solution would be to determine the scope of Palestinian and Israeli certificates of origin, not by sovereignty, but by control over territory. Usually the territory of application of a FTA is identical to the territory over which the contracting party exercises its sovereignty. On one hand, Israel does not exercise legitimate sovereignty over the territory in question. The recognized scope of Israel's territorial sovereignty is inside the Green Line. The Palestinian Authority, on the other hand, is not a state and not yet a subject of international law,[54] therefore, the PA does not exercise territorial sovereignty over any part of the WBGS.

[54] The PLO is generally considered to be a subject of international law and has, therefore, the capacity to conclude treaties, which is not the case for the PA.

The failure to determine the territorial scope of either the EC–Israel or the EC–PLO trade agreement by classical means, i.e. the extent of the territorial sovereignty of a party, is the root of the problem. To establish the extent of both FTAs until a final solution for the WBGS is implemented, a different approach might be considered. Instead of sovereignty over territory, which neither of the parties actually exercises at present, the control over territory or territorial jurisdiction could be used for determination.

This solution is again easier to implement than to agree upon. The extent of Palestinian control over territory, zones A and B under the current agreement, depends solely on Israeli benevolence to grant this control. On the other hand, the area currently under Israeli control will not necessarily remain so in the future. This solution will gain a positive resonance on the Israeli side, because the territorial scope of the PLO-Israel agreements would thereby be applied to the EC–PLO agreement. Any Palestinian negotiator, however, would strongly oppose such a solution, simply because of the unequal influence of the parties. Israel could influence the EC-Palestinian relationship via the Israel-PLO treaties. The Palestinian side would (once again) be treated like an Israeli appendix.

Even if the wording of such an agreement avoided any anticipation of the final status, and the criterion of control were chosen not to imply any legitimate claim, both parties would see in their commitments, signs that influence the final political outcome. The conflict is too closely related to territory.

5 Conclusion

We have seen that the determination of the origin of products in a free trade agreement is so interlaced with the question of territorial sovereignty, that the current problem cannot be solved unless the final status of the WBGS is determined. At least symbolically, the final result could be anticipated, if either the EC–PLO agreement is applied to the whole of the WBGS or if 'control over territory' is used. The introduction of cumulation of origin into the FTAs leads to further complications. A delimitation would have to be achieved that is identical to the crucial question of the final solution. Additionally, an effective cooperation between Israeli settlers and the Palestinian authorities seems unrealistic. Whichever of the presented solutions is chosen, the question of territorial sovereignty is touched upon.

The European Commission has brought up an issue that was treated until then in contradiction to the European Middle East policy. Most of the member states of the EC would have preferred not to bring up this unpleasant and complicated issue.

In its decision, the EC has not taken sides with either of the conflict's parties. The Community would not venture so far as to declare the Occupied Territories to be Palestinian land. Neither did it act anti-Israeli; all goods that are produced in Israel enjoy the preferential treatment of the Association Agreement. It brought, however, its external trade policy in line with its position towards the Middle East conflict. Based on Security Council Resolutions 242 and 338, and the Venice Declaration, the EC

could not continue its former practice. In particular, the Community's strong words on the settlement policy would have been exposed as hot air.

Someday though, the Israelis producing inside the WBGS will want to export their goods into the EC, enjoying preferential treatment. Economically, the export of products originating in the WBGS is neither of special interest to the EC, nor does it represent a major part of Israeli trade. Even if agricultural products still form an important part of the Israeli exports, the exclusion of products from the WBGS is but a dent in Israel's exports to Europe.

An introduction of cumulation of origin in the agreements would admittedly be the preferred choice. It could even be declared as a success of the Euro-Mediterranean framework, for the cumulation of origin is seen as a step towards the realisation of the Euro-Mediterranean free trade area. On the other hand, the 'parallel cumulation' would avoid the quasi-final status discussions necessary to implement diagonal cumulation of origin.

Nonetheless, both choices evade a problem that remains unsolved, even if its solution is of utmost importance. The occupation and the settlements are a major obstacle in the peace process. No just and lasting solution is possible without solving these questions.