

CRS Report for Congress

Israel: Background and Relations with the United States

Updated January 31, 2007

Carol Migdalovitz
Specialist in Middle Eastern Affairs
Foreign Affairs, Defense, and Trade Division



Prepared for Members and
Committees of Congress

Israel: Background and Relations with the United States

Summary

On May 14, 1948, the State of Israel declared its independence and was immediately engaged in a war with all of its neighbors. Armed conflict has marked every decade of Israel's existence. Despite its unstable regional environment, Israel has developed a vibrant parliamentary democracy, albeit with relatively fragile governments. The Kadima Party placed first in the March 28, 2006, Knesset (parliament) election; Prime Minister Ehud Olmert formed a four-party coalition government that has been enlarged to include one more. Israel has an advanced industrial, market economy in which the government plays a substantial role.

Israel's foreign policy is focused largely on its region, Europe, and the United States. The government views Iran as an existential threat due to its nuclear ambitions and support for anti-Israel terrorists. Israel concluded peace treaties with Egypt in 1979 and Jordan in 1994 but never achieved accords with Syria and Lebanon. It negotiated a series of agreements with the Palestinians in the 1990s, but the Oslo peace process ended in 2000, with the *intifadah* or uprising against Israeli occupation. Israeli and Palestinian officials have accepted but have not implemented the "Roadmap," the international framework for achieving a two-state solution to their conflict. Israel unilaterally disengaged from Gaza in summer 2005 and is constructing a security barrier in the West Bank to separate from the Palestinians. The victory of the Hamas terrorist group in the January 2006 Palestinian parliamentary elections has complicated Israeli-Palestinian relations. On June 25, the Hamas military wing kidnaped an Israeli soldier, provoking an Israeli military offensive to force his release. Israel unilaterally withdrew from southern Lebanon in 2000; Hezbollah occupied the area and continued to fire rockets from it into northern Israel. Hezbollah sparked a war when it kidnaped two Israel soldiers on July 12; a cease-fire took effect on August 14. European countries collectively are Israel's second largest trading partner, and the EU participates in the peace process.

Since 1948, the United States and Israel have developed a close friendship based on common democratic values, religious affinities, and security interests. U.S.-Israeli bilateral relations are multidimensional. The United States is the principal proponent of the Arab-Israeli peace process, but U.S. and Israeli views have differed on various issues, such as the fate of the Golan Heights, Jerusalem, and Israeli settlements. The United States and Israel concluded a free-trade agreement in 1985, and the United States is Israel's largest trading partner. Israel is a prominent recipient of U.S. foreign aid. The two countries also have close security relations. Other issues in U.S.-Israeli relations include Israel's military sales to China, inadequate Israeli protection of U.S. intellectual property, and espionage-related cases. This report will be updated as developments warrant. See also CRS Report RL33530, *Israeli-Arab Negotiations: Background, Conflicts, and U.S. Policy*, CRS Report RL33566, *Lebanon: The Israel-Hamas-Hezbollah Conflict*, and CRS Report RL33222, *U.S. Foreign Aid to Israel*.

Contents

| | |
|--|----|
| Most Recent Developments | 1 |
| Aftermath of War | 1 |
| Scandals | 2 |
| Iran | 3 |
| Historical Overview of Israel | 4 |
| Government and Politics | 4 |
| Overview | 4 |
| Recent Political Developments | 5 |
| Current Government and Politics | 7 |
| Economy | 8 |
| Overview | 8 |
| Current Issues | 9 |
| Foreign Policy | 10 |
| Middle East | 10 |
| Iran | 10 |
| Palestinian Authority | 12 |
| Egypt | 13 |
| Jordan | 14 |
| Syria | 14 |
| Lebanon | 15 |
| Other | 16 |
| European Union | 16 |
| Relations with the United States | 17 |
| Overview | 17 |
| Issues | 17 |
| Peace Process | 17 |
| Trade and Investment | 19 |
| Aid | 20 |
| Security Cooperation | 21 |
| Other Current Issues | 22 |
| Military Sales | 22 |
| Espionage-Related Cases | 23 |
| Intellectual Property Protection | 24 |
| U.S. Interest Groups | 24 |

List of Figures

| | |
|-------------------------------|----|
| Figure 1. Map of Israel | 26 |
|-------------------------------|----|

List of Tables

| | |
|---------------------------------------|---|
| Table 1. Parties in the Knesset | 7 |
|---------------------------------------|---|

Israel: Background and Relations with the United States

Most Recent Developments

Aftermath of War

Israel engaged in a two-front war against U.S.-designated terrorist groups in response to the June 25, 2006, kidnaping of an Israeli soldier by Hamas and others near Gaza and the July 12 abduction of two Israeli soldiers from northern Israel by Hezbollah.¹ The Israeli public, press, and parliament supported the war in Lebanon as a legitimate response to an attack on sovereign Israeli territory and a long overdue reaction to Hezbollah rocket attacks on northern Israel, but they questioned its prosecution. Charges levied against the government and military leaders included hesitant decision-making; poor intelligence concerning Hezbollah locations, arms, tactics, and capabilities; deficient training and equipment for mobilized reservists; tactics unsuitable for terrain and enemy; excessive reliance on air power; ill-prepared home front defenses; and inadequate presentation of the Israeli view to international audiences.

Israelis have been debating the war since it was concluded. Critics note that the kidnaped soldiers remain in captivity and that Hezbollah is rearming and has been strengthened politically. The government claims success in forcing Hezbollah from the border and in degrading its arms, particularly in destroying its long-range rockets, and in pressuring the Lebanese government, aided by international forces, to assert itself in south Lebanon. Israeli officials took Hezbollah leader Shaykh Hassan Nasrallah's admission that he would not have authorized the July 12 action if he had known how strongly Israel would react as confirmation that the group had been weakened and that Israel's deterrence had been strengthened.²

Nonetheless, public opinion polls indicate stark lack of support for Prime Minister Ehud Olmert, head of the Kadima Party, and his main coalition partner, Defense Minister Amir Peretz, head of the Labor Party, while support for the rightist

¹ For additional coverage of these developments, see CRS Report RL33530, *Israeli-Arab Negotiations: Background, Conflicts, and U.S. Policy*, by Carol Migdalovitz and CRS Report RL33566, *Lebanon: the Israel-Hamas-Hezbollah Conflict*, coordinated by Jeremy M. Sharp.

² Nasrallah's August 27, 2006, interview with Lebanon television, cited by Joshua Mitnick, "Hezbollah Says Its War with Israel Was a Mistake," *Washington Times*, Aug. 28, 2006, among others.

Likud and its leader, Benjamin Netanyahu, has increased.³ Yet, elections are not imminent. Members of the Knesset are unlikely to vote no confidence in the government when many would either lose their seats in an early vote or prefer to wait as their parties' chances improve with further decline in the coalition's support. The government could be reconfigured without elections if Members of the Knesset or parties shift their loyalties, but that, too, is not yet in the offing.

The incumbents have no plans to resign. Olmert has not yet been challenged as leader of his Kadima Party, although Foreign Minister Tzipi Livni has suggested that she might do so, and Ministers Meir Shitrit, Avi Dichter, and Shaul Mofaz are known to want the post.⁴ Peretz's hold on Labor's helm may be more tenuous; his competition includes former Shin Bet (Israeli Counterintelligence and Internal Security Service) head Ami Ayalon, former Prime Minister Ehud Barak, former Minister Ophir Pines-Paz, and former Mossad (Institute for Intelligence and Special Operations) chief Danny Yatom. The next Labor leadership primary is scheduled for May 28, 2007. Some view Peretz's selection of Raled Majadele to be Israel's first Arab minister, without portfolio, in January as part of a re-election campaign.

In October 2006, Olmert broadened the coalition in order to stabilize it, bringing in Yisrael Beiteinu and increasing the government's strength in the Knesset to 78 out of 120 seats. Yisrael Beiteinu leader Lieberman became Deputy Prime Minister and Minister for Strategic Threats. Only (Labor) Minister of Culture and Sport Ophir Pines-Paz resigned from the government to protest the inclusion of what he labeled a party with "racist characteristics," i.e., Yisrael Beiteinu.

The fall-out from the war with Hezbollah continued with the resignation of Chief of Staff Lt. Gen. Dan Halutz on January 17, 2007. Retired Maj. Gen. Gabi Askenazi, Director General of the Defense Ministry and a former infantry commander, was named to succeed Halutz and be promoted to lieutenant general. He will assume his post on February 14. Additional ramifications are expected after the report of the Winograd Commission investigating the war effort is submitted.

Scandals

On October 15, 2006, police recommended that the Attorney General indict President Moshe Katzav on charges of rape, sexual harassment, and obstruction of justice, and on January 23, 2007, the Attorney General announced his intention to do so. Prime Minister Olmert and members of his government and of the Knesset have called on Katzav to resign. Instead, the President denied the charges and requested that he be declared temporarily incapacitated for three months or until after presenting his case in a hearing with the Attorney General before charges are filed.

³ Yossi Verter, "Kadima's Approval Rating Plummets Under Olmert," Jan. 12, 2007, [<http://www.haaretz.com>], cites an early January poll indicating an approval rating of 14% for Olmert and 10% for Peretz. Also, Attila Somfalvi, "Poll: Likud Back in Lead," *Ynet*, Jan. 30, 2007, reports a Smith Institute poll showing Netanyahu will a large lead over his possible competitors and Likud potentially winning 32 seats in the Knesset.

⁴ Interview by Ari Shavit, *Ha'aretz*, Dec. 29, 2006, Open Source Document GMP2006 1229746001.

The Knesset House Committee approved Katzav's leave request on January 25, and Speaker of the Knesset Dalia Itzik became Acting President. Katzav, who is immune from trial while holding office, has said that he will resign if indicted. A Knesset committee has begun to discuss removing the President from office.

The President's seven-year term expires in July 2007. If and when he resigns, the Knesset will have 45 days to elect a successor. Itzik has declared that she does not intend to run. Olmert is backing Vice Premier Shimon Peres, who lost the 2000 election to Katzav. Popular Former Speaker Reuven (Ruby) Rivlin is expected to be Likud's candidate for president.

Prime Minister Olmert also is functioning under a cloud. The State Comptroller has accused him of making illegal appointments to the Small Business Authority when he was Minister of Industry and has turned the case file over to the Attorney General. Olmert's bureau director and other officials are under house arrest for their alleged roles in the appointments. The police also have opened a criminal investigation into allegations that, as Finance Minister, Olmert tried to steer the sale of a controlling interest in a government-controlled bank toward a close personal associate. In addition, Olmert's sale of his Jerusalem home for significantly above market price is under investigation.

Finally, on January 31, former (Kadima) Justice Minister Haim Ramon was convicted of an indecent act in assaulting a female soldier. Ramon is appealing the verdict, but it is still expected to trigger changes in the cabinet.

Iran

Israel appears to be heightening its focus on Iran's nuclear ambitions. Minister of Strategic Threats Avigdor Lieberman has indicated that he views confronting the Iranian threat as a major part of his portfolio. (The creation of his Ministry and its potential to impinge on the Minister of Defense Peretz's turf is producing tension between the two ministers.) On January 24, 2007, Prime Minister Olmert gave a speech on the status of the Iranian threat, which he said preoccupies him "incessantly." He stated his continuing preference for a diplomatic solution and observed that Iran is "very vulnerable" to international pressure. He added, "Although the Iranian threat is grave, Israel does not face an imminent danger of a nuclear attack" and said that there is still time to frustrate Iran's intentions to become a nuclear power.⁵ (See also "Foreign Policy/Middle East/Iran," below.)

⁵ Verbatim text of speech to the Herziliyya Conference, reported by Israeli Defense Forces Radio, BBC Monitoring Middle East, Jan. 25, 2007.

Historical Overview of Israel⁶

The quest for a modern Jewish homeland was launched with the publication of Theodore Herzl's *The Jewish State* in 1896. The following year, Herzl described his vision at the first Zionist Congress, which encouraged Jewish settlement in Palestine, a land that had been the Biblical home of the Jews and was later part of the Ottoman Empire. In 1917, the British government issued the Balfour Declaration, supporting the "establishment in Palestine (which had become a British mandate after World War I) of a national home for the Jewish people." Britain also made conflicting promises to the Arabs concerning the fate of Palestine, which had an overwhelmingly Arab populace. Nonetheless, Jews immigrated to Palestine in ever greater numbers and, following World War II, the plight of Jewish survivors of the Nazi holocaust gave the demand for a Jewish home greater poignancy and urgency.

In 1947, the U.N. developed a partition plan to divide Palestine into Jewish and Arab states, with Jerusalem under U.N. administration. The Arab states rejected the plan. On May 14, 1948, the State of Israel proclaimed its independence and was immediately invaded by Arab armies. The conflict ended with armistice agreements between Israel and its neighbors: Egypt, Jordan, Lebanon, and Syria. Israel engaged in armed conflict with some or all of these countries in 1948, 1956, 1967, 1973, and 1982. Since the late 1960s, Israel also has dealt with the threat of Palestinian terrorism. In 1979, Israel concluded a peace treaty with Egypt, thus making another multi-front war unlikely. Israel's current relations with its neighbors are discussed in "Foreign Policy" below.

Government and Politics

Overview

Israel is a parliamentary democracy in which the President is head of state and the Prime Minister is head of government. The unicameral parliament (the Knesset) elects a president for a seven-year term. The Prime Minister is the leader of the party with the most seats in parliament. The political spectrum is highly fragmented, with small parties exercising disproportionate power due to the low vote threshold for entry into parliament and the need for their numbers to form coalition governments. In the March 2006, election, the threshold to enter parliament was raised from 1% to 2% — an action intended to bar some smaller parties from parliament but that spurred some parties to join together simply to overcome the threshold. National elections must be held at least every four years, but are often held earlier due to difficulties in holding coalitions together. The average life span of an Israeli government is 22 months. The peace process, the role of religion in the state, and political scandals have caused coalitions to break apart or produced early elections.

⁶ For more, see Howard M. Sachar, *A History of Israel: From the Rise of Zionism to Our Time*, New York, Knopf, 1996.

Israel does not have a constitution. Instead, 11 Basic Laws lay down the rules of government and enumerate fundamental rights; two new Basic Laws are under consideration.⁷ On February 2, 2006, the Knesset's Constitution, Law, and Justice Committee approved a draft constitution encompassing existing Basic Laws and a chapter of human rights and basic principles. However, the coalition agreement of the government that took power in April promised the ultra-orthodox Shas Party that Basic Laws would not be changed (i.e., transformed into a Constitution) without its approval. Israel has an independent judiciary, with a system of magistrates courts and district courts topped by a Supreme Court.

There is an active civil society. Some political pressure groups are especially concerned with the peace process, including the Council of Judea, Samaria, and Gaza (Yesha Council), which represents local settler councils and opposes any withdrawal from occupied Arab territories, and Peace Now, which opposes settlements, the security barrier in the West Bank, and seeks territorial compromise. Both groups have U.S. supporters.

Recent Political Developments

Israel's domestic politics have been troubled in recent years. Prime Minister Ariel Sharon's plan to disengage from the Gaza Strip and four small West Bank settlements split his Likud Party. In November 2005, Histadrut labor federation head Amir Peretz defeated acting party leader Shimon Peres and former Infrastructure Minister Benjamin Ben Eliezer in a Labor Party leadership primary. Peretz emphasized the party's need to champion socioeconomic goals, which it had subordinated for the sake of joining Sharon's coalition. On November 20, Labor voted to withdraw from the coalition government, depriving Sharon of his parliamentary majority.

On November 21, Sharon said that he was no longer willing to deal with Likud rebels, resigned from the party, and founded a new "centrist" party, Kadima (Forward). He asked President Katzav to dissolve parliament and schedule an early election. Some 18 Likud Members of the Knesset (parliament) (MKs), including several ministers, the chairman of the Likud Central Committee, several Labor Knesset members, players in other political parties, and prominent personalities joined Kadima. Former Labor leader Peres supported Sharon. Kadima's platform or Action Plan stated that, in order to secure a Jewish majority in a democratic Jewish State of Israel, part of the Land of Israel (defined by some Israelis as the area between the Jordan River and the Mediterranean Sea) would have to be ceded. It affirmed a commitment to the Roadmap, the international framework for achieving a two-state solution to the Israeli-Palestinian conflict. Israel would keep settlement blocs, the security barrier, and a united Jerusalem, while demarcating permanent borders.⁸

Former Prime Minister and Finance Minister Benjamin Netanyahu won a Likud primary to replace Sharon as leader of Likud on December 19. Netanyahu called for

⁷ For Basic Laws, see [<http://www.mfa.gov.il/mfa/government/law/basic%20laws/>].

⁸ For Kadima's Action Plan, see [<http://kadimasharon.co.il/15-en/Kadima.aspx>].

“defensible walls” against Hamas and borders that would include the Jordan Valley, the Golan Heights, an undivided Jerusalem, settlement blocs, and hilltops, and moving the security barrier eastward.

On January 4, 2006, Sharon suffered an incapacitating stroke. In a peaceful transition under the terms of Basic Law Article 16 (b), Deputy Prime Minister Olmert became Acting Prime Minister. On January 16, Olmert became acting chairman of Kadima.

The Hamas victory in the January 25 Palestinian parliamentary elections rapidly became an Israeli election issue, even though all parties agreed that Israel should not negotiate with Hamas. On March 8, Olmert revealed plans for further unilateral withdrawals from the West Bank and said that he would reallocate funds from settlements to the Negev, the Galilee, and Jerusalem. Although Olmert declared that he prefers negotiations, if they do not develop in a “reasonable time,” then he would proceed with what he called “convergence,” or merging of settlements east of the security barrier with large settlement blocs that will be west of the barrier.⁹ Netanyahu charged that the unreciprocated, unilateral withdrawal from Gaza had rewarded terrorists and contributed to the Hamas win. He criticized Olmert’s plan as another unilateral concession that would endanger Israel. Peretz proposed that Israel continue a dialogue with moderate Palestinians, not Hamas.

The March 28, 2006, Knesset election results were surprising in many respects. The voter turnout of 63.2% was the lowest ever. The contest was widely viewed as a referendum on Kadima’s plans to disengage from the West Bank, but it also proved to be a vote on economic policies that many believed had harmed the disadvantaged. Kadima came in first, but by a smaller margin than polls had predicted. Labor, emphasizing socioeconomic issues, came in a respectable second. Kadima drew supporters from Likud, which lost 75% of its votes from 2003. Likud’s decline also was attributed personally to Netanyahu, whose policies as Finance Minister were blamed for social distress and whose opposition to unilateral disengagement proved to be unpopular with an increasingly pragmatic, non-ideological electorate.

The Shas campaign specifically aimed at restoring child allowances for the large families of its constituents. Although it opposes disengagements, the party’s spiritual leader has made rulings in the past that might allow Shas to accommodate Kadima’s plans for the territories. Yisrael Beiteinu (Israel Our Home), a secular party appealing to Russian-speakers, wants borders that exclude Israeli Arabs and their land and include settlements; it opposes unilateral disengagement and the Roadmap. The rightist NU/NRP drew support from settlers; it opposes all withdrawals from the West Bank, where it believes Jews have a biblical right to settle. The new Pensioners’ Party (GIL) was supported by voters harmed by Netanyahu’s policies as well as young protest voters. It did not elaborate its positions on other issues. The ultra-orthodox United Torah Judaism was part of the last Sharon government; it seeks increased child allowances and deferments for religious school students from the military and, despite protracted negotiations, did not strike a deal to join the

⁹ During his May 2006 meeting with President Bush at the White House, Olmert used “realignment” and not “convergence” as the English translation for his plan.

government. United Arab List, Hadash, and Balad — Israeli Arab parties — are not part of the government but are expected to passively support any future disengagements.

Current Government and Politics

On May 4, 2006, the Knesset (parliament) approved a four-party coalition government of Prime Minister Ehud Olmert's Kadima Party, the Labor Party, the Pensioners' Party, and the ultra-orthodox Shas Party. It controlled 67 out of 120 seats in the Knesset, with 25 cabinet ministers, and Dalia Itzik of Kadima as the first woman Speaker of the Knesset. The government's guidelines call for shaping permanent borders for a democratic state with a Jewish majority.¹⁰ They state that the government will strive to negotiate with the Palestinians, but it will act in the absence of negotiations. The guidelines also promise to narrow the social gap. Labor wants Olmert to negotiate with Palestinian President Mahmud Abbas before deciding on a unilateral move. Shas joined the coalition without agreeing to evacuate West Bank settlements as specified in the guidelines and will decide on the issue when it is on the government agenda.

Table 1. Parties in the Knesset

| Seats | Party | Orientation |
|-------|---|---|
| 29 | Kadima | Centrist, Pro-disengagement |
| 19 | Labor | Leftist, Social-democrat |
| 12 | Likud | Rightist, Anti-disengagement |
| 12 | Shas | Sephardi Ultra-orthodox |
| 11 | Yisrael Beiteinu (Our Home Israel) | Russian-speakers, Nationalist, Secular, Against unilateral withdrawals, but for exchange of populations and territories to create 2 homogenous states |
| 9 | National Union (NU)/ National Religious Party (NRP) | Nationalist, Ashkenazi Orthodox, Seeks to annex the West Bank (Land of Israel) and transfer Palestinians to Jordan |
| 7 | Pensioners' (GIL) | Single-issue: guaranteed pensions for all; Supports unilateral withdrawal from West Bank |
| 6 | United Torah Judaism (UTJ) | Ashkenazi Orthodox, Anti-withdrawals |
| 5 | Meretz/Yahad | Leftist, Anti-occupation, Civil libertarian |
| 4 | United Arab List/Ta'al | Israeli-Arab, Islamist |
| 3 | Hadash | Israeli-Arab, Communist |
| 3 | Balad | Israeli-Arab |

¹⁰ For the entire text of the government guidelines, see [<http://www.mfa.gov.il/MFA/Government/Current+Government+of+Israel/Basic%20Guidelines%20of%20the%201st%20Government%20of%20Israel>].

Several scandals involving prominent politicians, including President Katzav, Prime Minister Olmert, and former Justice Minister Haim Ramon, exacerbate the decline in the government's standing and national morale. The Chairman of the Knesset Foreign Affairs and Defense Committee, Kadima Knesset Member Tsahi Hanegbi, also has been indicted for illegal conduct during his tenure as Environment Minister from 2001-2003.

Key Cabinet Officers

| | | |
|-------------------|---|------------------|
| Ehud Olmert | Prime Minister; Minister of Social Welfare | Kadima |
| Tzipi Livni | Vice Prime Minister; Minister of Foreign Affairs | Kadima |
| Shimon Peres | Vice Prime Minister; Negev and Galilee Development | Kadima |
| Amir Peretz | Deputy Prime Minister; Minister of Defense | Labor |
| Avigdor Lieberman | Deputy Prime Minister; Minister of Strategic Threats | Yisrael Beiteinu |
| Daniel Friedman | Minister of Justice | Kadima |
| Avi Dichter | Public Security | Kadima |
| Shaul Mofaz | Deputy Prime Minister; Minister of Transportation* | Kadima |
| Roni Bar-On | Minister of Interior | Kadima |
| Yuli Tamir | Minister of Education | Labor |
| Eli Yishai | Deputy Prime Minister; Minister of Industry, Trade, and Labor | Shas |

*Also in charge of strategic dialogue with the United States.

Economy

Overview

Israel has an advanced industrial, market economy in which the government plays a substantial role. Most people enjoy a middle class standard of living. Per capita income is on par with some European Union members. Despite limited natural resources, the agricultural and industrial sectors are well developed. An advanced high tech sector includes aviation, communications, computer-aided design and manufactures, medical electronics, and fiber optics. Israel greatly depends on foreign aid and loans and contributions from the Jewish diaspora. After economic declines in 2001 and 2002 due to the effects of the Palestinian *intifadah* (uprising) on tourism and to the bursting of the global high-tech bubble, Israel's economy recovered. In early 2006, most economic indicators were positive: inflation low, employment and wages rising, and the standard of living rising.

Basic Facts

| | |
|------------------------|---|
| Population | 6,352,117 (2006 est.) |
| Population Growth Rate | 1.18% (2006 est.) |
| Ethnic Groups | — Jewish 80.1% (1996) — non-Jewish (mostly Arab) 19.9% (1996)* |
| GDP Growth Rate | 5% (2006 est.) |
| GDP Per Capita | \$26,200 (2006 est.) |
| Inflation Rate | 1.9% (2006 est.) |
| Unemployment Rate | 8.5% (2006 est.) |
| Ratio of debt to GDP | 91% (2006 est.) |
| Foreign Debt | \$81.98 billion (June 2006 est.) |
| Imports | crude oil, grains, raw materials, military equipment |
| Exports | cut diamonds, high-technology equipment, fruits and vegetables |
| Main Trading Partners | United States, Belgium, Germany, United Kingdom |

Sources: CIA, *The World Factbook*, January 2007; and the Israeli government.

*Within 1967 borders.

Under Former Finance Minister Netanyahu, the government attempted to liberalize the economy by controlling government spending, reducing taxes, and resuming privatization of state enterprises. The chronic budget deficit decreased, while the country's international credit rating was raised, enabling a drop in interest rates. However, Netanyahu's critics suggested that cuts in social spending widened the national income gap and increased the underclass. According to Israel's National Insurance Institute, 20% of all Israelis and 30% of Israeli children live below the poverty line.

Israel has a budget deficit target of 3% of gross domestic product, and the government is allowed by law to raise the annual budget by only 1.7%. Olmert vowed not to increase the deficit while lessening the social gap. The coalition agreement calls for raising the minimum wage to \$1,000 a month by the end of the Knesset session, canceling a 1.5% pension cut of the Netanyahu era, guaranteeing a pension for all workers, and increasing spending on health care, child allowances, daycare, and other socioeconomic programs.

Current Issues

The 2006 budget was not approved before the dissolution of the last parliament; therefore spending remained at 2005 levels from January through May and a budget surplus accrued due to the low expenditures and higher than expected tax revenues. The surplus was expected to enable the new government to spend more on social programs. Finance Minister Hirschson proposed a budget cut of 1 billion New Israeli Shekels (NIS) (U.S.\$224 million) for 2006, of which NIS 510 million (U.S.\$114

million) was to be taken from defense and none from social programs. The Knesset passed the budget on June 7, 2006, by a vote of 53 to 22, with 45 abstentions.

In the end, the defense budget was not cut due to military expenditures for the war in Lebanon. On August 31, the Knesset Finance Committee passed a 6% across-the-board cut (totaling about \$450 million) for all ministries, except defense and social welfare. Hirschson estimated the cost of the war to be about \$3.5 billion due economic losses resulting from the closure of industrial plants in northern Israel, inability to work on agriculture in that region, attendant business, property, and tax losses, and the loss of tourism revenues. In the first half of 2006, the economy grew at a 5.9% rate; second half growth fell to 2.9%. At year's end, government economists were very pleased with the economy's performance, which resulted in a balance of payments surplus of \$3.9 billion and a cut in the government deficit to 1.2%, half of the previous year.¹¹

On September 12, the cabinet approved the 2007 budget. Only Shas voted against it. Labor Leader Peretz abstained over a minimum wage issue, but other Labor ministers disagreed with his assessment and voted for the budget.

On January 29, 2007, Hirschson presented plans to decrease poverty and correct the mal-distribution of wealth in the country during the period from 2007 to 2010. They include mandatory pensions, increased taxes on employee vehicles, negative income tax for low-income earners, and lower-middle-class income taxes.

Foreign Policy

Middle East

Iran. Israeli officials state that Iran will pose an existential threat to Israel if it achieves nuclear capability. Ayatollah Khomeini, founder of Iran's Islamic revolution, decreed that the elimination of Israel is a religious duty. President Mahmud Ahmadinejad quoted Khomeini when he called for Israel to be "wiped off the map," has described the Holocaust as a "myth" used as a pretext to create an "artificial Zionist regime," and suggested that Europe, the United States, or Canada donate land for a Jewish state. He repeatedly makes virulently anti-Israel statements. The Iranian Shahab-3 missile is capable of delivering a warhead to Israel. Israeli officials have called on the international community to thwart Iran's nuclear ambitions in order to avert the need for Israel to act as it did against Iraq's reactor at Osirak in 1981.

When U.S. Vice President Dick Cheney warned in early 2005 that Israel might act pre-emptively against Iran, Israel's then Defense Minister Shaul Mofaz countered, urging a U.S. pre-emptive strike. Because Israel is presumed to have nuclear weapons, the prospect of a counterattack is seen by many as a deterrent against an Iranian attack. On January 17, 2006, then Acting Prime Minister Olmert said,

¹¹ Sharon Wrobel, "2006 GDP Growth Tops Forecasts," *Jerusalem Post*, Jan. 1, 2007, citing the Israeli Central Bureau of Statistics' preliminary figures.

“Under no circumstances ... will Israel permit anyone who harbors evil intentions against us to possess destructive weapons that can threaten our existence.” He added, “Israel acted, and will continue to act, in cooperation and consultation with ... international elements.”¹² On April 23, he told the cabinet, “our position has always been that it would not be correct to focus on us as the spearhead of the global struggle as if it were our local, individual problem and not a problem for the entire international community. The international struggle must be led and managed by — first and foremost — the U.S., Europe, and the U.N. institutions. We are not ignoring our need to take ... steps in order to be prepared for any eventuality.”¹³ On November 13, Olmert told the U.S. “Today Show” that he would find acceptable any compromise that President Bush does to stop Iran from acquiring nuclear capabilities.

Israeli estimates of when Iran might have a nuclear weapon differ from those of the United States. On May 23, 2006, then Chief of Staff Dan Halutz said that, according to intelligence estimates, Iran would be in possession of nuclear weapons by 2008-2010 and noted that U.S. assessments predicted a 2010-2015 time frame. He asserted, however, that Israel must prepare for a possibly more imminent threat.¹⁴ On December 17, Mossad (Institute for Intelligence and Special Operations) Chief Meir Dagan told a Knesset committee that if there were no sanctions on Iran and no technological delays, then Iran would have 25 kilograms of enriched uranium by 2008 and nuclear warheads by 2009-2010.¹⁵ In January 2007, Maj. Gen. Amos Yadlin, head of military intelligence, said that, barring delays, Iran would have a nuclear bomb in two and a half years. If it could reduce the time needed to procure fissile material, it might even have one before mid-2009.¹⁶

Iran also provides financial, political, and/or military support to the Lebanese Hezbollah as well as to Hamas, Palestinian Islamic Jihad (PIJ), the Al Aqsa Martyrs’ Brigades, and the Popular Front for the Liberation of Palestine-General Command — Palestinian terrorist groups seeking to obstruct the peace process and destroy Israel. In January 2006, then Defense Minister Mofaz charged that Iran had financed a PIJ suicide bombing in Tel Aviv and Israeli officials blamed Iran for Hezbollah’s attack on northern Israel in July 2006.

Prime Minister Olmert has called upon moderate Sunni leaders to form a coalition against Iran, Hezbollah, and other regional radicals. The Sunnis are seeking a revived Israeli-Palestinian peace process.

¹² “PM Olmert, President Qatzav Discuss Iran, Peace Process During News Conference,” Open Source Center Document FEA20060117017385, Jan. 17, 2006.

¹³ “23 Apr Cabinet Session; Daily Says Olmert Ready for ‘Swift’ Convergence,” Open Source Center, Document GMP20060424621005, Jerusalem Government Press Office, Apr. 23, 2006.

¹⁴ *Ha’aretz* report, May 24, 2006.

¹⁵ Sheera Claire Frenkel, “Dagan: Syria more Willing Now than Ever to Attack Israel,” *Jerusalem Post*, Dec. 18, 2006.

¹⁶ “Israeli MI Chief: Iran to have Bomb in 2.5 Years,” *Voice of Israel*, Jan. 9, 2007, Open Source Center, Document GMP20070109739002.

Palestinian Authority. During the Oslo peace process of the 1990's, Israelis and Palestinians negotiated a series of agreements that resulted in the creation of a Palestinian Authority (PA) with territorial control over parts of the West Bank and the Gaza Strip. Israel refused to deal with the late Palestinian leader Yasir Arafat after Sharon came to power and during the *intifadah* or Palestinian uprising against Israeli occupation. Israel's relations with the PA and its leaders improved somewhat after Arafat's death in November 2004 and the election of Mahmud Abbas as President of the PA in January 2005. Sharon and Abbas met at a summit in Sharm al Shaykh, Egypt, in February, and promised to end violence and to take other measures. Israel made some goodwill gestures toward the PA, and President Abbas and 13 Palestinian factions agreed to an informal truce. However, Sharon and Abbas did not meet for a long time after June 2005. Although Israeli officials described the disengagement from the Gaza Strip as unilateral, they met with Palestinian counterparts to coordinate security and disposition of assets.

Israel still has 242 settlements, other civilian land use sites, and 124 unauthorized settlement outposts in the West Bank and 29 settlements in East Jerusalem — all areas that the Palestinians view as part of their future state. Israel retains military control over the West Bank and is building a security barrier on West Bank territory to separate Israelis and Palestinians and prevent terrorists from entering Israel. Palestinians object to the barrier being built on their territory. The barrier is taking the form of a future border between Israel and Palestine and will cut Palestinians off from East Jerusalem and, in some places, from each other and some of their land.

The Israeli government accepted the Roadmap, the framework for a peace process leading to a two-state solution developed by the United States, European Union, U.N., and Russia, reluctantly and with many conditions. Sharon contended that the Roadmap requires that the PA first fight terror, by which he meant disarm militants and dismantle their infrastructure. (It also required Israel to cease settlement activity in the first phase.) Abbas preferred to include terrorist groups such as Hamas in the political system and refused to disarm them prior to January 2006 parliamentary elections. Hamas's victory in those elections created policy dilemmas for Abbas, Israel, and the international community. Israel demanded that Hamas abrogate its Covenant that calls for the destruction of Israel, recognize Israel, disarm and disavow terrorism, and accept all prior agreements with Israel as preconditions for relations with a Hamas-led PA.

Israel officially refuses to negotiate with Hamas for the return of the Israeli soldier kidnaped from a post at Kerem Shalom, Israel, near the Gaza Strip on June 25, 2006. Since the kidnaping, Israel has arrested many members of the Hamas-led PA government and legislature for participating in a terrorist group, and Israeli forces have conducted military operations against Hamas and other militant groups in the Gaza Strip as well as in the West Bank. Egyptian officials are attempting to mediate a resolution that would involve a prisoner exchange. Analysts believe that this effort is complicated by the need for the approval of Hamas political bureau head Khalid Mish'al, who is based in Damascus and subject to influence by the Syrian and Iranian governments.

The Israeli government has shelved plans for unilateral disengagement from the West Bank. Many Israelis believe that unilateral disengagements from the south Lebanon and the Gaza Strip had enabled the transformation of those regions into terrorist bases for Hezbollah and Hamas and led to war.

Egypt. After fighting four wars in as many decades, Israel and Egypt signed a peace treaty in 1979. In 1982, Israel withdrew from the Sinai Peninsula, which it had taken in the 1967 war. Egypt and Israel established diplomatic relations, although Egypt withdrew its ambassador during the four years of the second *intifadah*, 2001-2005, because it objected to Israel's "excessive" use of force against the Palestinians. Some Israelis refer to their ties with Egypt as a "cold peace" because full normalization of relations, such as enhanced trade, bilateral tourism, and educational exchanges, has not materialized. Egyptian President Hosni Mubarak has visited Israel only once — for the funeral of former Israeli Prime Minister Yitzhak Rabin. Outreach is often one way, from Israel to Egypt. Egyptians say that they are reluctant to engage because of Israel's continuing occupation of Arab lands. Israelis are upset by some Egyptian media and religious figures' anti-Israeli and occasionally anti-Semitic rhetoric. Nonetheless, the Egyptian government often plays a constructive role in the Arab-Israeli peace process, hosting meetings and acting as a liaison. In March 2005, it helped secure an informal Palestinian truce and later helped prevent it from breaking down due to violence between Palestinian factions and Israel and between Palestinian security forces and factions. After the January 2006 Hamas election victory in the Palestinian territories, Egyptian officials unsuccessfully urged the group to accept a 2002 Arab League declaration that offers Israel recognition within its 1967 borders. Egyptian intelligence chief Omar Sulayman has tried to gain the release of an Israeli soldier kidnaped by Hamas and others in exchange for Palestinian prisoners.

On June 4, 2006, President Mubarak and Prime Minister Olmert had a very cordial meeting. Mubarak praised Olmert as a man of "vision and credibility," while Olmert reciprocated with compliments and pledged to work closely with Mubarak to advance the peace process.

Egypt deployed 750 border guards to secure the Gaza-Egyptian border (Rafah) after Israel's disengagement from Gaza. Israel refused an Egyptian request to deploy military border guards, instead of police, for greater control of smuggling along the entire border in Sinai, which some Israelis argue would require a change in the military appendix of the 1979 peace treaty. Israeli officials have repeatedly expressed frustration with Egypt's failure to control arms-smuggling into Gaza. However, in November 2006, Prime Minister Olmert said that Israel wanted to make the border agreement more effective and not to change it.

In December 2004, Egypt and Israel signed a Qualified Industrial Zone (QIZ) Agreement under which jointly produced goods enter the U.S. market duty free as part of the U.S.-Israeli Free Trade Agreement (FTA). As a result of the QIZ, Israeli exports to Egypt grew 110% in 2005. On June 30, 2005, Israel signed a memorandum of understanding to buy 1.7 billion cubic feet of Egyptian natural gas for an estimated U.S.\$2.5 billion over 15 years, fulfilling a commitment made in an addendum to the 1979 peace treaty. The deal includes cooperation in construction of the infrastructure and may expand to other energy areas. Gas is not expected to

flow before 2007.¹⁷ An initial agreement for the deal was signed on December 11, 2006. It will serve as a framework for negotiations leading to a final accord.

Jordan. Israel and Jordan signed a peace treaty in October 1994 and exchanged ambassadors, although Jordan did not have an ambassador in Israel during most of the *intifadah*. Relations have developed with trade, cultural exchanges, and water-sharing agreements. Since 1997, Jordan and Israel have collaborated in creating 13 qualified industrial zones (QIZs) to export jointly produced goods to the United States duty-free under the U.S.-Israel Free Trade Agreement (FTA), although Jordanian companies are now said to prefer arrangements under the U.S.-Jordan FTA over the QIZ. Normalization of ties is not popular with the Jordanian people, over half of whom are of Palestinian origin, although King Abdullah II has attempted to control media and organizations opposed to normalization.

Believing that a two-state solution to the Israeli-Palestinian conflict would contribute to regional stability, the King is very supportive of the peace process, wants the Roadmap to be implemented, and has hosted meetings between Israeli and Palestinian leaders.¹⁸ Abdullah met Olmert in Jordan on June 8 and December 19, 2006, and has urged a resumption of Israeli-Palestinian negotiations. In January 2007, Jordan joined Egypt, Saudi Arabia, and Palestinian President Abbas in advocating an agreement on the “end game” before following the Roadmap. The King is opposed to possible unilateral Israeli steps in the West Bank, fearing that they would strengthen Palestinian radicals who could destabilize the region and undermine his regime.

Syria. Israel and Syria have fought several wars but, except for rare breaches, have maintained a military truce along their border for many years. Yet, they failed to reach a peace agreement in negotiations that ended in 2000. Since 1967, Israel has occupied Syria’s Golan Heights and, in December 1981, effectively annexed it by applying Israeli law there. There are 42 Israeli settlements on the Golan. Syrian President Bashar al Asad has said that he wants to hold peace talks with Israel, but Israeli officials demand that he first cease supporting the Lebanese Hezbollah militia, which attacks Israeli forces in the disputed Shib’a Farms area of Lebanon and communities in northern Israel and aids Palestinian terrorist groups. They also want Asad to expel Palestinian rejectionist groups (i.e., those who reject an Israeli-Palestinian peace process). Sharon said that the Golan is essential for Israel’s security and discussion of withdrawal would be a mistake.¹⁹

After Syria was implicated in the February 2005 assassination of former Lebanese Prime Minister Rafiq Hariri, international pressure on the Asad regime mounted. Israeli officials have said that Israel is not interested in the fall of the

¹⁷ See also CRS Report RL33003, *Egypt: Background and U.S. Relations*, by Jeremy Sharp.

¹⁸ See also CRS Report RL33546, *Jordan: U.S. Relations and Bilateral Issues*, by Alfred Prados and Jeremy M. Sharp; and CRS Report RS22002, *Qualifying Industrial Zones in Jordan: A Model for Promoting Peace and Development in the Middle East?* by Mary Jane Bolle, et al.

¹⁹ See also CRS Report RL33487, *Syria: U.S. Relations and Bilateral Issues*, by Alfred Prados.

regime, only in changing its policies. Some reportedly fear that anarchy or extreme Islamist elements might follow Asad and prefer him to stay in power in a weakened state. On December 1, 2005, Sharon said that nothing should be done to ease U.S. and French pressure on Syria, implying that Syrian-Israeli peace talks would do that. His successor, Olmert has indicated that talks with Syria are not on his agenda and has blamed Damascus for Palestinian terror attacks in Israel.

Syria hosts Hamas political bureau chief Khalid Mish'al and supplies Hezbollah with Syrian and Iranian weapons. After the June 25, 2006, Palestinian attack on Israeli forces and kidnaping of an Israeli soldier, Israeli officials specifically requested the United States to exert pressure on President Asad to induce him to expel Mish'al, whom they believed was responsible for the operation. After Hezbollah abducted two Israeli soldiers from northern Israel on July 12, sparking a major Israeli military campaign against Hezbollah in Lebanon, some rightwing Israeli politicians demanded that it be expanded to include Syria. However, the government and military did not want to open a third front. U.S. officials demanded that Syria exert its influence on Hezbollah to end the conflict; Syrian officials unsuccessfully sought a broader resolution that would include a revival of a peace process to produce the return of the Golan Heights.

Lebanon.²⁰ Israeli forces invaded Lebanon in 1982 to prevent Palestinian attacks on northern Israel. The forces gradually withdrew to a self-declared nine-mile "security zone," north of the Israeli border. Peace talks in the 1990's failed to produce a peace treaty, mainly because of Syria's insistence that it reach an accord with Israel first. Israel unilaterally withdrew from southern Lebanon on May 25, 2000. Lebanon insists that the Israeli withdrawal is incomplete because of the continuing presence of Israeli forces in the Shib'a Farms area, in the region where Lebanon, Syria, and Israel meet. The U.N. said that Israel's withdrawal from Lebanon was complete and treats the Shib'a Farms as part of Syria's Golan Heights occupied by Israel. Syria verbally recognizes that Shib'a is part of Lebanon, but will not demarcate the border officially as long as the Israeli occupation continues. Hezbollah took control of the former "security zone" after Israeli forces left and attacked Israeli forces in Shib'a and northern Israeli communities. The Lebanese government considers Hezbollah to be a legitimate resistance group and a political party represented in parliament. Israel views it as a terrorist group.

Hezbollah's kidnaping of two Israeli soldiers on July 12, 2006, provoked Israel to launch a major military campaign against Hezbollah in Lebanon. In a July 17 speech to the Knesset, Prime Minister Olmert said that military operations would end with the return of the kidnaped soldiers, the end to Hezbollah rocket attacks into northern Israel, and the deployment of the Lebanese army along the Israeli-Lebanese border to replace Hezbollah units. Hezbollah demanded a prisoner swap, i.e., that the Israeli soldiers be exchanged for Lebanese and other Arab prisoners in Israel. The war ended with a cessation of hostilities on August 14. Israeli forces withdrew as their positions were assumed by the Lebanese army and an enlarged U.N. Interim

²⁰ See also CRS Report RL33509, *Lebanon*; and CRS Report RL31078, *The Shib'a Farms Dispute and Its Implications*, both by Alfred Prados.

Forces in Lebanon (UNIFIL). Hezbollah has maintained the cease-fire, but has not released the abducted soldiers.

Other. Aside from Egypt and Jordan, Israel has diplomatic relations with the majority-Muslim governments of Mauritania and Turkey and has had interest or trade offices in Morocco, Tunisia, Oman, and Qatar. The latter four suspended relations with Israel during the *intifadah*. Former Foreign Minister Silvan Shalom had predicted that relations with Arab and Muslim countries would improve due to Israel's disengagement from Gaza. The first diplomatic breakthrough was his September 1, 2005, meeting in Istanbul with the Pakistani foreign minister, although Pakistani officials have asserted that they will not recognize Israel until an independent Palestinian state is established. On September 14, Pakistan's President Pervez Musharraf shook Prime Minister Sharon's hand in a "chance" meeting at the U.N. General Assembly opening session in New York. In October, Pakistan agreed to accept Israeli humanitarian aid after a devastating earthquake. Shalom also met the Indonesian, Qatari, Algerian, Moroccan, and Tunisian foreign ministers at the U.N. Also that September, Bahrain ended its economic boycott of Israel, a move required by the World Trade Organization and the Bahrain-U.S. Free Trade Agreement, but it has vowed not to normalize relations. Tunisian President Zine El Abidine Ben Ali sent a personal letter to Sharon, praising his "courageous" withdrawal from Gaza. Shalom attended the World Summit on the Information Society in Tunisia in November 2005.

In September 2006, Foreign Minister Livni was said to have met at the U.N. with 10 Arab and Muslim foreign ministers, including the Omani foreign minister. On January 30, 2007, Vice Premier Shimon Peres met the Emir of Qatar, Shaykh Hamad bin Khalifa al Thani, in Doha.

Israel also has developed good relations with the predominantly Muslim former Soviet republic of Azerbaijan, which supplies about one-sixth of Israel's oil needs.

European Union

Israel has complex relations with the European Union (EU). Many Europeans believe that the Israeli-Palestinian conflict is a root cause of terrorism and Islamist extremism among their own Muslim populations and want it addressed urgently. The EU has ambitions to exert greater influence in the Middle East peace process. The EU is a member of the "Quartet," with the United States, U.N., and Russia, which developed the Roadmap. EU officials appeared to share Palestinian suspicions that Sharon's disengagement plan meant "Gaza first, Gaza only" and would not lead to the Roadmap process. They observed with concern Israel's ongoing settlement activity and construction of the security barrier in the West Bank, which, according to the Europeans, contravene the Roadmap and prejudice negotiations on borders.

Israel has been cool to EU overtures because it views many Europeans as biased in favor of the Palestinians and hears some Europeans increasingly question the legitimacy of the State of Israel. Some Israelis contend that the basis of such views is an underlying European anti-Semitism. Nonetheless, in November 2005, Israel agreed to allow the EU to maintain a Border Assistance Mission (EU-BAM) to monitor the reopened Rafah crossing between the Gaza Strip and Egypt. In

November 2006, the mission was extended for another six months despite European complaints about Israeli restrictions. After the war in Lebanon, Israel also urged and welcomed the strong participation of European countries in the peacekeeping force there.

To Israel's dismay, some EU representatives met local Hamas leaders elected in December 2004 in order to oversee EU-funded local projects. The EU also authorized its monitoring mission for the January 2006 Palestinian parliamentary elections to contact the full range of candidates, including Hamas, in order to carry out its task. EU officials have said, however, that Hamas will remain on the EU terror list until it commits to using nonviolent means to solve the Israeli-Palestinian conflict. The EU agrees with the Quartet's preconditions for relations with the Hamas-led government: disavowal of violence, recognition of Israel, and acceptance of prior Israeli-Palestinian accords. The EU has developed, at the Quartet's request, a temporary international mechanism to aid the Palestinian people directly while bypassing the government.

Israel also demands that the EU include Hezbollah on its list of terrorist organizations and has protested meetings between European ambassadors and the Hezbollah ministers in the Lebanese cabinet.

Israel participates in the EU's Euro-Mediterranean Partnership Initiative, otherwise known as the Barcelona Process, and in the European Neighborhood Policy (ENP). And EU countries combined are Israel's second trading partner, but the EU bans imports from Israeli settlements in the occupied territories.²¹

Relations with the United States

Overview

On May 14, 1948, the United States became the first country to extend de facto recognition to the State of Israel. Over the years, the United States and Israel have developed a close friendship based on common democratic values, religious affinities, and security interests. Relations have evolved through legislation; memorandums of understanding; economic, scientific, military agreements; and trade.

Issues

Peace Process. The United States has been the principal international proponent of the Arab-Israeli peace process. President Jimmy Carter mediated the Israeli-Egyptian talks at Camp David which resulted in the 1979 peace treaty. President George H.W. Bush together with Soviet President Mikhail Gorbachev convened the peace conference in Madrid in 1990 that inaugurated a decade of

²¹ See CRS Report RL31956, *European Views and Policies Toward the Middle East*, by Kristin Archick.

unprecedented negotiations between Israel, Jordan, Syria, Lebanon, and the Palestinians. President Clinton continued U.S. activism throughout his tenure in office, facilitated a series of agreements between Israel and the Palestinians as well as the Israeli-Jordanian peace treaty in 1994, hosted the Israeli-Palestinian summit at Camp David in 2000 that failed to reach a peace settlement, and sought unsuccessfully to mediate between Israel and Syria during the same year.

In June 2002, President George Bush outlined his vision of a democratic Palestine to be created alongside Israel in a three-year process.²² U.S., European Union, Russian, and U.N. representatives built on this vision to develop the international Roadmap to a Permanent Two-State Solution to the Israeli Palestinian Conflict. The Administration remains committed to the Roadmap process despite the parties' failure to implement it.²³

Secretary of State Condoleezza Rice has not named a Special Middle East Envoy and said that she would not get involved in direct Israeli-Palestinian negotiations of issues and preferred to have the Israelis and Palestinians work together. However, she has traveled to the region several times and personally mediated an accord to secure the reopening of the Rafah crossing between Gaza and Egypt in November 2005. The Administration had supported Israel's disengagement from Gaza mainly as a way to return to the Roadmap. Some Israelis criticized U.S. insistence that the Palestinian elections proceed in January 2006, with Hamas participating, which produced a Hamas-led government. The Administration agrees with Israel's preconditions for dealing with that government. During a January 2007 visit to the region, Secretary Rice said that she planned to convene a meeting with Olmert and Abbas to discuss a political horizon for the Palestinians in order to accelerate the Roadmap. No date has been set for the meeting.

All recent U.S. Administrations have disapproved of Israel's settlement activity as prejudging final status issues and possibly preventing the emergence of a contiguous Palestinian state. On April 14, 2004, however President Bush noted the need to take into account changed "realities on the ground, including already existing major Israeli population centers" (i.e., settlements), asserting "it is unrealistic to expect that the outcome of final status negotiations will be full and complete return to the armistice lines of 1949."²⁴ He later emphasized that it was a subject for negotiations between the parties.

The Bush Administration also has insisted that U.N. Security Council resolutions be "balanced," by criticizing Palestinian as well as Israeli violence and has vetoed resolutions which do not meet that standard.

Since taking East Jerusalem in the 1967 war, Israel has maintained that Jerusalem is its indivisible, eternal capital. Few countries agree with this position.

²² See [<http://www.whitehouse.gov/news/releases/2002/06/20020624-3.html>] for text of President's speech.

²³ See [<http://www.state.gov/r/pa/prs/ps/2003/20062.htm>]for text of Roadmap.

²⁴ For text of Bush letter to Sharon, see [<http://www.whitehouse.gov>].

The U.N.'s 1947 partition plan called for the internationalization of Jerusalem, while the Declaration of Principles signed by Israel and the Palestine Liberation Organization in September 1993 says that it is a subject for permanent status negotiations. U.S. Administrations have recognized that Jerusalem's status is unresolved by keeping the U.S. Embassy in Tel Aviv. In 1995, Congress mandated that the embassy be moved to Jerusalem,²⁵ but a series of presidential waivers of penalties for non-compliance have delayed the move. U.S. legislation has granted Jerusalem status as a capital in particular instances and sought to prevent U.S. official recognition of Palestinian claims to the city. The failure of the State Department to follow congressional guidance on Jerusalem prompted a response in H.R. 2601, the Foreign Relations Authorization bill, passed in the House on July 20, 2005.²⁶ The Senate did not pass an authorization bill, and it did not become law.²⁷

The United States has never recognized Israel's annexation of the Golan Heights, which it views as a violation of international law. However, the current administration has not attempted to revive Israeli-Syrian peace talks. Olmert and the Bush Administration appear to agree on isolating Damascus until it ends its relations with terrorists and Iran. Yet, some in the Israeli coalition, Knesset, and press want their government to engage Damascus in peace talks in order to remove it from an alliance that enhances the Iranian threat to the Jewish State.

Some Israeli officials have questioned possible unintended consequences of the U.S. democratization policy in the Middle East, believing that it is aiding extremist organizations to gain power positions and to be legitimized. Alarmed, they cite the examples of Hezbollah in Lebanon, Hamas in the Palestinian Authority, and the Muslim Brotherhood in Egypt.²⁸

Trade and Investment. Israel and the United States concluded a Free Trade Agreement in 1985, and all customs duties between the two trading partners have since been eliminated. The FTA includes provisions that protect both countries' more sensitive agricultural sub-sectors with non-tariff barriers, including import bans, quotas, and fees. Israeli exports to the United States have grown 200% since the FTA became effective. As noted above, qualified industrial zones in Jordan and Egypt are considered to be part of the U.S.-Israeli free trade area. The United States

²⁵ P.L. 109-102, Nov. 14, 2005.

²⁶ H.R. 2601 (d) requires that "accurate entries be made on request of citizen." Specifically, for the purpose of the issuance of a passport to a U.S. citizen born in Jerusalem, the Secretary of State shall upon the request of the citizen or the citizen's legal guardian, record the place of birth as Israel. See also CRS Report RL33530, *Israeli-Arab Negotiations: Background, Conflicts, and U.S. Policy*, by Carol Migdalovitz; and CRS Report RL33000, *Foreign Relations Authorization, FY2006 and FY2007: An Overview*, coordinated by Susan Epstein.

²⁷ In August 2006, El Salvador notified the Israeli Foreign Ministry that it was moving its embassy from Jerusalem to Tel Aviv. When that happens, no country that has diplomatic relations with Israel will have an embassy in Jerusalem.

²⁸ For example, head of military intelligence, Maj. Gen. Amos Yadlin, in Ahiya Raved, "Intelligence Chief: Strategic Threats on Israeli Rising," *Ynetnews*, June 20, 2006, Open Source Center Document GMP20060621746004.

is Israel's main trading partner, while Israel ranks about 20th among U.S. trading partners. In 2005, the United States imported \$23.8 million in goods from Israel and exported \$27.1 million in goods to Israel.

U.S. companies have made large investments in Israel. In July 2005, the U.S. microchip manufacturer Intel announced that it would invest \$4.6 billion in its Israeli branch; Israel provided a grant of 15% of an investment of up to \$3.5 billion or \$525 million to secure the deal. In May 2006, prominent U.S. investor Warren Buffet announced that he was buying 80% of Iscar, a major Israeli metalworks, for \$4 billion.

On July 26, the House passed H.R. 2730, the United States-Israel Energy Cooperation Act. It would have authorized a grant program of \$20 million for each of fiscal years 2006 through 2012 to fund joint ventures between U.S. and Israeli businesses and academics for research, development, or commercialization of alternative energy, improved energy efficiency, or renewable energy sources. S. 1862, the Senate version of the bill, was referred to the Senate Foreign Relations Committee on October 7, 2005. The Senate did not vote on it before the 109th Congress adjourned.

Aid. Israel was the largest recipient of U.S. foreign aid after 1976 and until Iraq supplanted it after 2003. In 1998, Israeli, congressional, and Administration officials agreed to reduce U.S. \$1.2 billion in Economic Support Funds (ESF) to zero over ten years, while increasing Foreign Military Financing (FMF) from \$1.8 billion to \$2.4 billion. The process began in FY1999, with P.L. 105-277, October 21, 1998. Separately from the scheduled ESF cuts, Israeli received an extra \$1.2 billion to fund implementation of the Wye agreement (part of the Israeli-Palestinian peace process) in FY2000, \$200 million in anti-terror assistance in FY2002, and \$1 billion in FMF in the supplemental appropriations bill for FY2003. P.L. 109-102, November 14, 2005, the Foreign Operations Appropriations Act, 2006, provided \$240 million in ESF, \$2.28 billion in FMF, and \$40 million for the settlement of migrants to Israel. H.R. 5522, the Foreign Operations Appropriations bill, FY2007, passed in the House on June 9, 2006, appropriates \$120 million in ESF, \$40 million for migration and refugee assistance, and \$2.34 billion in FMF (of which \$610 million may be spent for defense acquisitions in Israel), for Israel. The Senate did not pass a bill. Foreign Operations programs are operating under continuing appropriations resolutions that provide funding at the FY2006 level or the House-passed FY2007 level, whichever is less. The House FY2007 bill has fewer funds for Israel than FY2006.

On July 14, 2006, during Israel's war against Hezbollah in Lebanon, the Pentagon notified Congress that it planned to sell up to \$210 million in jet fuel to Israel. On July 22, it was reported that the Administration was expediting the delivery of precision-guided bombs that had been ordered by Israel in 2005.

Congress has legislated other special provisions regarding aid to Israel. Since the 1980s, ESF and FMF have been provided as all grant cash transfers, not designated for particular projects, and have been transferred as a lump sum in the first month of the fiscal year, instead of in periodic increments. Israel is allowed to spend about one-quarter of the military aid for the procurement in Israel of defense articles and services, including research and development, rather than in the United States.

Finally, to help Israel out of its economic slump, P.L. 108-11, April 16, 2003, provided \$9 billion in loan guarantees (for commercial loans) over three years. As of September 2006, \$4.5 billion of the guarantees was unexpended.²⁹ P.L. 109-472, January 11, 2007, extends the period for which the guarantees are to be provided for a second time until September 30, 2011.

As of December 31, 2005, Israel's total debt to the U.S. government was \$1.2089 billion.

Security Cooperation. Although Israel is frequently referred to as an ally of the United States, the two countries do not have a mutual defense agreement. Even though there is no treaty obligation, President Bush has said several times that the United States would defend Israel militarily in the event of an attack.³⁰

On November 30, 1981, U.S. Secretary of Defense Caspar Weinberger and Israeli Minister of Defense Ariel Sharon signed a memorandum of understanding (MOU), establishing a framework for continued consultation and cooperation to enhance the national security of both countries. In November 1983, the two sides formed a Joint Political Military Group, (JPMG) which meets twice a year, to implement most provisions of the MOU. Joint air and sea military exercises began in June 1984, and the United States has constructed facilities to stockpile military equipment in Israel. In 2001, an annual interagency strategic dialogue, including representatives of diplomatic, defense, and intelligence establishments, was created to discuss long-term issues.

In 2003, reportedly at the U.S. initiative due to bilateral tensions related to Israeli arms sales to China, the talks were suspended. (See *Military Sales*, below.) After the issue was resolved, the talks resumed at the State Department on November 28, 2005, and reportedly focused on Syria and democratization in the Arab world. On January 11, 2006, the JPMG convened in Tel Aviv also for the first time since 2003. On January 21, 2007, U.S. Under Secretary of State Nicholas Burns and Deputy Secretary of Defense Gordon Englund headed a U.S. delegation to Tel Aviv for the annual talks, reportedly focused on Iran. Minister of Transportation Shaul Mofaz and Director General of the Defense Ministry (soon to be Chief of Staff) Gabi Ashkenazi led the Israeli delegation. After the meeting, Mofaz said that the Americans want to increase the number of dialogue sessions to four a year.

On May 6, 1986, Israel and the United States signed an agreement (the contents of which are secret) for Israeli participation in the Strategic Defense Initiative (SDI/"Star Wars"). Under SDI, Israel is developing the "Arrow" anti-ballistic missile with a total U.S. financial contribution so far of more than \$1 billion, increasing annually. The system became operational in 2000 in Israel and has been tested successfully, most recently on December 2, 2005, when it shot down a missile

²⁹ See also CRS Report RL33222, *U.S. Foreign Aid to Israel*, by Jeremy Sharp.

³⁰ Interview with Reuters, cited in Glenn Kessler, "Bush Says U.S. Would Defend Israel Militarily," *Washington Post*, Feb. 2, 2006. See also [<http://www.whitehouse.gov/news/releases/2006/05/20060523-9.html>] for transcript of joint Bush-Olmert news conference in May 2006.

simulating an Iranian Shahab-3 that can be armed with nuclear warheads and reach Israel. The Defense Appropriations Act for FY2007, P.L. 109-289, September 29, 2006 appropriates \$137,894,000 for the Arrow program. Of this amount, \$53,000,000 is for producing missile components in the United States and missile components and missiles in Israel to meet Israel's defense requirements, and \$20,400,000 is for a joint feasibility study of the Short Range Ballistic Missile Defense (SRBMD) initiative, a missile interceptor designed to thwart missiles and rockets from 40 to 200 kilometers that is not expected to be operational before 2011.

In 1988, under the terms of Sec. 517 of the Foreign Assistance Act of 1961, as amended, Israel was designated a "major non-NATO ally," affording it preferential treatment in bidding for U.S. defense contracts and access to expanded weapons systems at lower prices. Israel participates in NATO's Mediterranean Dialogue, its Istanbul Cooperative Initiative, and in Operation Active Endeavor monitoring the Mediterranean Sea to thwart terrorism. On October 16, 2006, Israel signed an Individual Cooperation Program (ICP) with NATO, providing for cooperation in such fields as counter-terrorism, intelligence sharing, disaster preparedness, etc.

After the war against Hezbollah in Lebanon ended in August 2006, the State Department Office of Defense Trade Controls began to investigate whether Israel's use of U.S.-made cluster bombs in the war had violated the Arms Export Control Act, which restricts use of the weapons to military targets. On January 28, 2007, the State Department informed Congress of preliminary findings that Israel may have violated agreements by using cluster bombs against civilian populated areas. A final determination has not yet been made. Israel has denied violating agreements, saying that it had acted in self-defense. The U.N. has reported that 30 deaths and 180 injuries in southern Lebanon from the weapons since the war ended.³¹

Other Current Issues

Military Sales. In 2006, Israel earned \$4.4 billion from defense sales. India was Israel's biggest customer, with purchases totaling \$1.5 billion.

The United States and Israel have regularly discussed Israel's sale of sensitive security equipment and technology to various countries, especially China. Israel reportedly is China's second major arms supplier, after Russia.³² U.S. administrations believe that such sales are potentially harmful to the security of U.S. forces in Asia. In 2000, the United States persuaded Israel to cancel the sale of the Phalcon, an advanced, airborne early-warning system, to China. More recently, Israel's agreement to upgrade Harpy Killer unmanned aerial vehicles (UAVs) that it sold to China in 1999 angered the Department of Defense (DOD). China tested the weapon over the Taiwan Strait in 2004. DOD suspended technological cooperation with the Israel Air Force on the future F-35 Joint Strike Fighter (JSF) aircraft as well as several other

³¹ David S. Cloud and Greg Myre, "Israel May Have Violated Arms Pact, U.S. Officials Say," *New York Times*, Jan. 28, 2007.

³² Ron Kampeas, "Israel-U.S. Dispute on Arms Sales to China Threatens to Snowball," *Jewish Telegraphic Agency*, June 8, 2005, citing a U.S.-China Economic and Security Review 2004 report.

cooperative programs, held up shipments of some military equipment, and refused to communicate with the Israeli Defense Ministry Director General, whom Pentagon officials believed had misled them about the Harpy deal.

On August 17, 2005, the U.S. DOD and the Israeli Ministry of Defense issued a joint press statement reporting that they had signed an understanding “designed to remedy problems of the past that seriously affected the technology security relationship and to restore confidence in the technology security area. In the coming months additional steps will be taken to restore confidence fully.”³³ According to the Israeli newspaper *Ha’aretz*, Israel will continue to voluntarily adhere to the Wassenaar Arrangement on Export Controls for Conventional Arms and Dual-Use Goods and Technologies, without actually being a party to it. On November 4, in Washington, Defense Minister Mofaz announced that Israel would again participate in the F-35 JSF project and that the crisis in relations was over. In March 2006, the new Defense Ministry Director General Jacob Toren said that an interagency process had begun approving marketing licenses for Israeli firms to sell selected dual-use items and services to China, primarily for the 2008 Olympic Games, on a case-by-case basis.

On October 21, 2005, it was reported that Israel would freeze or cancel a deal to upgrade 22 Venezuelan Air Force F-16 fighter jets, with some U.S. parts and technology. The Israeli government had requested U.S. permission to proceed, but it was not granted.

Espionage-Related Cases. In November 1985, Jonathan Pollard, a civilian U.S. naval intelligence employee, and his wife were charged with selling classified documents to Israel. Four Israeli officials also were indicted. The Israeli government claimed that it was a rogue operation. Pollard was sentenced to life in prison and his wife to two consecutive five-year terms. She was released in 1990, moved to Israel, and divorced Pollard. Israelis complain that Pollard received an excessively harsh sentence. Israel granted him citizenship in 1996, and he remains a cause celebre in Israel. Israeli officials repeatedly raise the Pollard case with U.S. counterparts, but no formal request for clemency is pending.³⁴ Pollard’s Mossad handler Rafi Eitan, now 79 years old, is head of the Pensioners’ Party and a member of the current government. On June 8, 2006, the Israeli High Court of Justice refused to intervene in efforts to obtain Pollard release.

On June 13, 2005, U.S. Department of Defense analyst Lawrence Franklin was indicted for the unauthorized disclosure of classified information (about Iran) to a foreign diplomat. Press reports named Na’or Gil’on, a political counselor at the Israeli Embassy in Washington, as the diplomat. Gil’on has not been accused of wrongdoing and returned to Israel. Then Foreign Minister Silvan Shalom strongly denied that Israel was involved in any activity that could harm the United States, and Israel’s Ambassador to the United States declared that “Israel does not spy on the United

³³ “U.S. Israel Agree to Consult on Future Israeli Weapons Sales - Nations Affirm Joint Commitment to Address Global Security Challenges,” U.S. State Department Press Release, Aug. 17, 2005.

³⁴ See CRS Report RS20001, *Jonathan Pollard: Background and Considerations for Presidential Clemency*, by Richard Best and Clyde Mark.

States.” Franklin had been charged earlier on related counts of conspiracy to communicate and disclose national defense information to “persons” not entitled to receive it. On August 4, 2005, two former officials of the American Israel Political Action Committee (AIPAC), Steven J. Rosen and Keith Weissman, whom AIPAC fired in April 2005, were identified as the “persons” and indicted for their parts in the conspiracy. Both denied wrongdoing. On October 24, their attorneys asked the court to summon Israeli diplomats to Washington for testimony. On January 20, 2006, Franklin was sentenced to 12 years, 7 months in prison.

Rosen and Weissman are the first nongovernment employees ever to be indicted under the 1917 Espionage Act for receiving classified information orally; they argue that they were exercising protected free speech and the law was designed to punish government officials. In August, a judge ruled that “the rights protected by the First Amendment must at times yield to the need for national security.” However, he required the government to establish that national security is genuinely at risk and that those who wrongly disclosed the information knew that disclosure could harm the nation. A trial may begin in May 2007.

Intellectual Property Protection. The “Special 301” provisions of the Trade Act of 1974, as amended, require the U.S. Trade Representative (USTR) to identify countries which deny adequate and effective protection of intellectual property rights. In April 2005, the USTR elevated Israel from its “Watch List” to the “Priority Watch List” because it had an “inadequate data protection regime” and intended to pass legislation to reduce patent term extensions. The USTR singled out for concern U.S. biotechnology firms’ problems in Israel and a persistent piracy affecting the U.S. copyright industry. In November 2005, U.S. Ambassador to Israel Richard H. Jones urged the Knesset to put Israel in line with Organizations for Economic Cooperation and Development (OECD) countries with copyright law. (Joining the OECD is an important Israeli foreign policy goal.) On December 15, then-Minister of Industry Olmert and then-USTR Rob Portman agreed to negotiations on the issue. On April 28, 2006, however, the USTR decided to keep Israel on the Priority Watch List due to continuing concern about copyright matters and about legislation Israel passed in December 2005 that weakened protections for U.S. pharmaceutical companies.³⁵ As they had in 2005, Israeli officials criticized the USTR decision as discriminatory.

U.S. Interest Groups

An array of interest groups has varying views regarding Israel and the peace process. Some are noted below with links to their websites for information on their policy positions.

American Israel Public Affairs Committee: [<http://www.aipac.org/>]

American Jewish Committee:
[<http://www.ajc.org/site/c.ijITI2PHKoG/b.685761/k.CB97/Home.htm>]

³⁵ For U.S. government explanation of Israel’s listing on the Priority Watch List, see *Full Version of the 2006 Special 301 Report*, Apr. 28, 2006, accessible at [<http://www.ustr.gov>]

American Jewish Congress: [<http://www.ajcongress.org/>]

Americans for Peace Now: [<http://www.peacenow.org/>]

Anti-Defamation League: [<http://www.adl.org/>]

Conference of Presidents of Major Jewish Organizations:
[<http://www.conferenceofpresidents.org/>]

The Israel Project:
[<http://www.theisraelproject.org/site/c.hsJPK0PIJpH/b.672581/k.CB99/Home.htm>]

Israel Policy Forum: [<http://www.israelpolicyforum.org/>]

New Israel Fund: [<http://www.nif.org/>]

Zionist Organization of America: [<http://www.zoa.org/>]

Figure 1. Map of Israel



Source: Map Resources. Adapted by CRS.