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**Israel Needs to Urgently Execute Advanced Contracts in the Framework of American Aid as a Security Solution for Israel's Critical Needs**

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**Israel's Memorandum of Understanding with the United States, which is in its second year, is the largest ever signed between the two countries. However, contracts have not yet been signed for large purchases, such as new platforms and weapons systems, due to previous commitments about purchasing in the past. At the same time, the IDF has a tremendous need for key platforms and systems sold by the United States, including fighter planes, fuel tankers, and heavy helicopters, mainly because most of those it currently has were purchased in the 1960s and 1970s and are reaching the end of their lifespans and require immediate replacement. The solution thus is executing advanced contracts with low financing costs, which will improve the operational capabilities of the State of Israel. Overall, these contracts will provide significant economic and strategic benefits and will promise to reduce shortcomings in operational response capability and advance the defense industry, including establishing an independent maintenance ability for the IDF. They thus benefit the American defense industry and even the United States as a whole, given that a strong Israel is critical for stabilizing the region and for facing the Iranian threat.**

Israel's Memorandum of Understanding (MoU) with the United States, which is in its second year, is the largest ever signed between the two countries. It includes a total of \$38 billion dollars earmarked for military procurement in the United States. However, contracts have not yet been signed for large purchases, such as new platforms and weapons systems. (It should be noted that just before the new MoU was signed and came into effect, a deal was signed to purchase 17 F-35 planes, complementing the existing 50 planes, which will be financed from the MoU funds, as well as a very limited number of new fueler planes). This is due to the relatively high stringency of the aid funds during the first half of the decade-long MoU for previous agreements. At the same time, the IDF has a tremendous need for key platforms sold by the United States, including fighter planes, fuel tankers, and heavy helicopters, mainly because most of those it currently has were purchased in the 1960s and 1970s and are reaching the end of their lifespans and require immediate replacement. There is also the issue of the rising cost of new weapons

systems and the substantial upgrade and adaptation costs of attempting to work with weapons systems whose time has passed.

The incompatibility between existing budget frameworks and the need for immediate large investments in platforms with a long lifespan is not unique to the area of military procurement. The accepted solution for this kind of problem in civilian markets involves using capital markets. In this case, however, the budget in question is that of the government, and the debt framework must be determined in relation to the planned deficit level. Despite this limitation, the government budget in Israel also allows a solution in the form of private-public partnership (PPP)—a collaboration between the government and the private sector. Well-known examples include the paving of Highway 6 and the establishment of water desalination facilities. In the security field, examples include the City of Training Bases and the digital communications base. The purpose of this procurement method is to flatten expenses and equate them to the annual government budget by surplus payment, or in other words, spreading out large procurement expenses so that the budget framework can contain them.

An additional improvement to the military procurement framework (existent to a lesser extent in civilian procurement) is the “availability contract,” in which payment is based on the availability of the service. The best known example is the contract for supplying advanced training flight hours at the IAF flight school. This contract saves the cost of maintaining inventory and prevents issues of returns, contract time, inventory management, and additional issues that exist in military and public procurement. Other examples include maintenance of communication devices, trainers, and more.

At the same time, purchases made in the United States based on American assistance must follow procurement rules and policies. These are determined by the US Department of Defense and are managed and supervised by the Defense Security Cooperation Agency (DSCA)—a body of the Department of Defense (DoD), which in the past did not encourage such methods. Thus, these procurement methods must first be anchored in policy and in the rules of aid determined by the State Department and the DoD. A breakthrough with the DoD and the State Department was made recently when they officially authorized the use of aid money for availability deals.

Transactions that have matching funds to be realized are not new for the Americans. In the past, they authorized large airplane purchases—most recently included a purchase of F-35s from Lockheed Martin (LM), which is still ongoing. This deal was based on a loan taken by the supplier company, LM, which allowed deferral of payments (DPP) of some \$2 billion at relatively low interest as a result of the company's credit rating and the

federal contract, which served as a guarantee. This deal made it possible to move up the provision of the planes and to plan the purchase of additional weapons systems, in accordance with the IDF's operational needs. The scope of the deal exceeded what the aid had made it possible to pay and even went beyond the overall framework of the MoU. This occurred without harming the State of Israel's debt-to-GDP ratio, as will be discussed below.

The sum required to make purchases that meet the IDF's current urgent needs, which should be defined in the new multiyear plan, is expected to exceed more than five billion dollars. These purchases, such as two combat plane squadrons, fueler planes, and heavy cargo helicopters, are also likely to be made from several different companies. Thus, it will be necessary to use a wider variety of advanced transactions, in the framework of an overarching policy.

Another interesting option is to receive a loan from the US government, which could save the high costs of the financing mechanism with supplier companies, as occurred in the DPP deal and was commonplace in the 1970s and that would be repaid as part of the aid funds in later years or by the US government's establishing a credit line. This option would simplify the deals, allow greater certainty in making future financing payments, and require lower mechanism costs than the previous option.

### **The Disadvantages of These Methods for Purchasing Expensive Platforms**

*Diminishing the flexibility of the Ministry of Defense's work plans and budget:* A large budgetary commitment over a long time span (10–15 years) somewhat diminishes the future ability to prioritize and make decisions. This was clearly demonstrated by the argument about purchasing the F-35s instead of making other purchases. The stance of the Ministry of Defense was that the planes offered strategic capabilities, which made it necessary to sign such a large contract, and the advantages outweighed the disadvantage of diminished flexibility.

*Interest costs:* Interest payments are significant and are paid out of Israel's budget in shekels, rather than from the aid, as was the case in the DPP deal. This price includes the cost of establishing a credit line and various fees. A loan from the US government will significantly reduce the cost. Additionally, the recent decrease in the interest curve for medium- and long-term loans will further reduce expected costs.

*Higher lifespan expenses:* New weapons systems are significantly more expensive, given the global rise in costs for major weapons systems. In the cost-benefit analysis, all costs and realistic lifespan of potential alternatives must be considered, as well as the

advantage gained from acquiring operational capabilities that best respond to existing threats. However, this calculation must also account for future price increases of new systems, which are difficult to estimate. One way to reduce price increases is to use advanced technologies to reduce flight hours and maintenance mechanism costs (simulators, advanced engine maintenance, and so forth).

Finally, a word about the debt-to-GDP ratio: This ratio is an important component of Israel's credit rating and one of the most important indicators of its financial stability. In practice, however, transactions of this type have a small, almost negligible impact, when the definition of debt is taken into account—as can be seen in the analysis of the loan in the F-35 purchase.

### **Outstanding Advantages**

*Operational capabilities for facing Israel's principal enemy, Iran:* In the future, a confrontation with Iran will possibly require operational response at the most advanced level. Preemptive acquisition of the necessary equipment in a short time frame, without violating the budget framework, allows preparation for this scenario. Economic advantages to buying new systems are significant, given that the systems that would be replaced are at the end of their lifespan. Replacing them will decrease the time in which old and new systems are in use simultaneously, particularly in relation to training and exercises, and will reduce the need for major investments for “reviving the old systems.” It should also be emphasized that fewer new systems are necessary, which will reduce overhead, manpower and real estate costs.

Large transactions of cutting-edge technologies offer both sides a win-win situation. For the Israeli defense industry, these advantages include offset purchases, which are expected to grow, even though American aid does not require offset purchases of the American industry in Israel. This is because such purchases are determined separately during negotiations over each transaction. Another advantage is the likely inclusion of local industry in manufacturing subsystems for world markets and the various adaptations for Israel's needs, which bring technology and know-how, allow the IDF to develop independent maintenance capabilities. For the American military industry, sales to Israel also enable sales to other Middle Eastern countries, in accordance with US policy of maintaining a qualitative military edge in weapons systems sold to Israel. Increased volume of military sales would certainly uphold President Trump's America First policy, and he is likely to offer support, as will the relevant American weapons lobby. The State Department and the Department of Defense are thus likely to support these transactions in their updated policies.

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