A Review of the Negotiations on the 2016 US-Israel MOU on Military Assistance

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The opening of US Fiscal Year 2019 on October 1, 2018 marked the beginning of the implementation of the US-Israel Memorandum of Understanding (MOU) on military assistance. Signed in September 2016 in the final months of the Obama Administration, and building on the previous 10-year MOU, it marked a major milestone in the US-Israel defense partnership.

Over 10 years, the MOU will provide Israel with a guaranteed $38 billion in military assistance, the largest package ever provided by the United States to any country. It represents a fulfillment of the commitment to Israel's qualitative military edge (QME), reaffirmed by presidents of both parties, which ensures Israel's ability to acquire the most sophisticated US defense technology.

At the time the MOU was signed, some critics in both countries argued that its $38 billion total, which included both Foreign Military Financing (FMF) and Ballistic Missile Defense (BMD) accounts, was smaller than Israel's needs required. Some accused the Obama Administration of shortchanging Israel's defense needs. Others argued that Prime Minister Benjamin Netanyahu had squandered the opportunity to obtain a significantly higher sum by stoking tensions with the Obama Administration during the disagreement over the Iran nuclear deal, including with his speech in Congress in March 2015.

But those criticisms are based on a misunderstanding of the process that led to the MOU, and the considerations that went into its various elements.

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It is worth recounting that history and the MOU's key provisions, while underscoring that at no time, even at the height of US-Israel tensions, was there any interruption or diminution of the broad defense and intelligence cooperation shared by the two countries.

The MOU Negotiations

The decision by President Barack Obama and Prime Minister Netanyahu to open negotiations toward a new, multi-year MOU was originally announced by the two leaders during Obama's visit to Israel in March 2013 – some five years before the expiration of the previous MOU. Later that year, the two sides assembled teams that met on several occasions. The US side was led by White House Middle East Coordinator Phil Gordon and the Israeli side by Deputy National Security Adviser Jacob Nagel. The Israeli side provided briefings at an unprecedented level of detail about the IDF's force structure, order of battle, budgeting, manpower, threat analysis, and planning. These formed the basis of the discussion of weapons systems that Israel sought to acquire to meet its defense needs. The American side provided detailed explanations of its budget process and competing considerations in Foreign Military Financing and Ballistic Missile Defense.

These talks continued well into 2014, but were put on hold as attention turned to the Iran nuclear deal. Tensions between the two governments over the Iran negotiations were only part of the reason for putting the MOU talks to the side. It also became clear at a certain stage that both sides would need to take into account the impact of an Iran nuclear deal, or the collapse of those negotiations, on the regional strategic picture and Israel's defense requirements in order to develop an up-to-date MOU. Finally, following the announcement of the Lausanne Understandings in April 2015 that formed the outline of the final nuclear deal (the Joint Comprehensive Plan of Action or JCPOA), in a phone call President Obama told Prime Minister Netanyahu that the United States was prepared either to accelerate the MOU talks during the final stage of the JCPOA talks or to wait until after the deal was completed and had passed its Congressional review. He left the choice to Netanyahu, who chose the latter option.

When the two leaders met at the White House in November 2015, following completion of the JCPOA's Congressional review and as the deal was beginning to be implemented, they agreed to relaunch talks to try to complete the MOU during Obama's final year in office. Yael Lempert, Senior Director for the Middle East at the National Security Council, was appointed to lead the American side, with the deep involvement of US Ambassador to Israel Daniel Shapiro, while Nagel, by this time Israel's National Security Adviser, led the Israeli side with the support of Israeli Ambassador to the US Ron Dermer and the head of the IDF's Planning Division, Gen. Amikam Norkin. These talks opened in December 2015, and continued intensively until the signing of the MOU in September 2016.

There were four primary issues that dominated the negotiations during those months: the top line of the MOU; whether it should include Ballistic Missile Defense funding; the use of FMF to purchase fuel; and Off-Shore Procurement, the provision that permitted Israel to use a portion of its FMF to purchase equipment from Israeli rather than American firms. Each issue warrants its own discussion.

The Top Line

Without revealing details of the negotiations, it is widely known that Israel sought a higher total for the MOU than the $38 billion that was eventually agreed. Its envoys laid out Israel's defense needs and documented their analysis of the funding levels required to fill them in detailed presentations. They argued that a significant increase in FMF was required to keep up with inflation and make up for the declining purchasing power of FMF dollars.

The US position was that the United States was fully committed to meeting Israel's defense needs, including via an increase in funding from the previous $30 billion MOU. But, the American side explained, it also needed to take into account certain budget realities. These included the overall pressure on the US budget which resulted each year in large deficits, the declining level of funding for FMF provided by Congress each year, and the increasing Israeli share of the FMF budget. At $3.1 billion (the closing level of FMF in the previous MOU), the Israeli share of the global FMF budget stood at roughly 40 percent. Two of the three next largest recipients of FMF were Egypt and Jordan, Israel's two Arab peace partners. The American side explained that there would be no way to increase FMF to Israel to certain levels without cutting deeply into the Egyptian and Jordanian programs, and likely eliminating altogether a number of smaller programs in other countries.

The Israeli side faced a dilemma about whether to proceed toward completion of the MOU in 2016 at lower levels than it preferred, or to put the negotiations on hold in 2016 and take them up with the new US administration in 2017. Some advised Israel that it might be able to expect a marginally higher top line in negotiations with a Hillary Clinton Administration, although many of the same budget pressures would be relevant, and some of the same US officials might be involved. As it became clear that Donald Trump would be the Republican nominee, the prospect of negotiating with a Trump Administration was difficult to predict. While he projected a friendly attitude toward Israel, he was disparaging of foreign aid in general and US expenditures in the Middle East in particular, and it was difficult to forecast who would serve on his national security team.

One thing was clear: by not completing the MOU in 2016, the delay would be at least a year, while a new administration appointed its senior officials and negotiations were relaunched from the beginning. That time pressure became an important factor in the Israeli decision. The IDF leadership was eager to complete the MOU in 2016, even at lower levels than Israel sought, to facilitate moving forward with their long-range planning and key acquisitions. In particular, the IDF felt it needed the certainty of a signed MOU to implement its five-year Gideon Plan for the defense budget, and to proceed with the purchase of 31 additional F-35s, beyond the original purchase of 19, allowing the Israeli Air Force to field two complete squadrons of 25 aircraft. While it was possible that, in certain scenarios, the next US administration would agree to a higher top line, the likelihood was that the increase would not be dramatic, and would not make up for the lost time in allowing the IDF to advance on these key steps.

With all of these considerations in play, the two sides struggled over both the top line and whether it should be provided at a flat rate of funding or in a phased increase, as the previous MOU had done. The agreement that was reached provided for a flat rate of $3.3 billion in FMF funding a year for 10 years, an increase of $200 million a year over the closing rate of the previous MOU.

Ballistic Missile Defense

The previous MOU had covered only FMF, an account controlled by the State Department. In parallel, Israel requested and received funds each year from a separate account controlled by the Defense Department to fund its Ballistic Missile Defense (BMD) programs (Iron Dome, David's Sling, and Arrow 3). The typical pattern was that the Administration would call for a certain BMD funding level from Congress that was less than the Israeli request, knowing that Congress would respond by increasing the number, sometimes by a factor of two or three. Israeli planners had gotten used to this "plus-up" process, as well as additional opportunities for funding in supplemental appropriations bills, which resulted in annual funding levels anywhere from $350 million to over $700 million.

This pattern created a degree of uncertainty on both sides. For Israeli planners, it meant difficulty in predicting any given year's funding level. For Pentagon planners, it meant concern for the funding stability of US BMD programs, from which the funds for Israel were drawn and which were struggling to make progress in addressing North Korean ballistic missile threats. They also raised questions about the absorptive capacity of the Israeli programs.

The final MOU included a flat rate of $500 million per year for Israeli BMD programs for 10 years. While that figure was lower than Israel had received via Congressional plus-ups in some previous years, for the first time it provided a stable, predictable level of funding that both sides could plan for, and represented the first long-term commitment, not subject to the ups and downs of annual negotiations with the administration and Congress, to Israeli BMD programs. The Israeli side explained that these funds would permit the buildup of the inventory of interceptor missiles for all three systems, as well as the development of new batteries for Arrow 3 and David's Sling to confront the most pressing threat of missiles from Lebanese Hezbollah, Syria, and Iran.

Fuel

In previous years, Israel had spent in the range of $300-400 million of its FMF grant on fuel, primarily for aircraft. The American position in the negotiations was that spending FMF dollars on fuel was an inefficiency that should be corrected. They argued that FMF should be used for those systems that the United States has the unique ability to provide, while Israel should budget its own national funds to purchase fuel. They pointed out that the amount spent on fuel each year was equivalent to the cost of two to three F-35s, meaning those were dollars not spent on unique American defense capabilities and job-creating orders from US defense contractors.

The Israeli side countered that its budgeting had long assumed flexibility to purchase fuel with FMF dollars, and making the adjustment to purchase fuel exclusively with Israeli national funds would require painful cuts elsewhere. But the US position was firm, and its negotiators further argued that Israel would have two years from the signing of the MOU until the beginning of its implementation to make the necessary budget adjustments. The final MOU says that "both sides understand that FMF is not intended for the purchase fuel or other consumables."

Off-Shore Procurement

Off-Shore Procurement (OSP) was one of the most contentious issues in the negotiations, and the last one to be resolved. Israel was unique among countries receiving FMF in that it was permitted to spend a portion of those funds in shekels to buy from Israeli defense firms. The figure had been set for many years at 26.3 percent of the total US package.

When OSP was launched in the 1980s, its intent was to help build up and sustain Israel's young defense industry which was considered a critical part of Israel's national security. Some three decades later, the United States' view was that the Israeli defense industry was now mature, competitive, and had customers around the world — in some markets even competing with US companies — and therefore OSP had outlived its original purpose. Therefore, the US position was that Israel's FMF program could now return to normal, to be run as FMF was in all other countries.

The Israeli position was that eliminating OSP could have a negative impact on its defense industry. Israel argued that it would cause budgetary chaos, as it had already made commitments to some companies, and would certainly lead to a loss of jobs, weakening the industry. The US side was sympathetic to these concerns, but did not feel that the United States had an obligation to maintain OSP as a permanent Israeli jobs program, especially in light of the maturity of the Israeli economy. The Israeli side then proposed a reduction, rather than full elimination of OSP, but the US position was firm – OSP needed to end by the final year of the MOU.

The US side did show flexibility on the terms for the phase-out. The two sides developed a creative phase-out formula that reached the US goal of zero OSP, but softened the impact in the first five years with a very gradual decline from $815.3 million to $775.3 million. It was understood that those years would give the Israeli government and industry time to plan, prepare, and adjust for the more significant changes that occurred in the much steeper slide from $725.3 million to zero in the second five years.

Final Issues

The MOU also contains an agreement that both sides would respect the terms of the MOU, that is, they would not seek to change the terms without the consent of the other side. Specifically, that means that Administration budget requests to Congress should reflect the levels in the MOU, and Israel will not go to Congress on its own to request increases above the MOU levels – particularly on BMD funding, which had been the practice in the past. These provisions provide a significant degree of certainty and predictability to both sides, and strengthen the agreement. Of course, the MOU can always be revisited by the mutual consent of both sides. With respect to BMD funding, the MOU explicitly states that if the two governments jointly agree on the need for a change in light of "exceptional circumstances" – "such as in the event of a major armed conflict involving Israel" – they could jointly approach Congress to advocate for such funds.

Since President Trump took office, there have been rumors that Israel will try to renegotiate various provisions of the MOU – the top line, the decision not to allow the use of FMF for fuel, and most of all, the phase-out of OSP. Israel is clearly within its rights to request such a renegotiation, and anything that they can agree on with the Trump Administration is fair game. But so far, such efforts have not advanced, at least not with any public notice.

Given Trump's commitment to US jobs, there are serious questions about whether he would support depriving the US defense industry of over $2.5 billion over the next decade – which would be the effect of canceling the phase-out of OSP. If such a proposal were raised, US defense contractors would certainly make their views known to Members of Congress, citing the jobs that could be at stake in their districts. Some media reports have cited Members of Knesset raising concerns about the Israeli jobs that will be lost if OSP is phased out, which again raises the question about whether US taxpayers, who have been very generous to Israel for many years and continue to support its foreign aid program, should be obligated to fund a permanent Israeli jobs-support program. If Israel were to advocate for such a change, it would have to weigh whether restoring OSP and the Israeli jobs it supports would be worth the potential decrease in support for Israel's foreign aid from parts of the American public, particularly in key areas of the US where many defense contractors are located.