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Israel Needs a Clear Policy on Foreign Involvement in National Infrastructure

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The State Comptroller recently criticized the way Israel operates regarding foreign involvement in national infrastructure. He said that the lack of mandatory consulting by regulators with the advisory committee could lead them to prioritize economic considerations over considerations of national security. The need to implement the State Comptroller's recommendations intensifies as the rivalry between China and the United States heats up, and the US administration exerts pressure on allies to establish or strengthen investment supervisory mechanisms, and carefully weigh the inclusion of Chinese companies in national infrastructure projects. Despite the Israeli government's desire to avoid the establishment of a permanent authoritative agency for assessing foreign investments, and not only as an advisory body, the current reality makes it difficult to continue this policy.

State Comptroller Matanayhau Englman recently assessed the risks of foreign involvement in national infrastructure and the government’s related actions. In a report published on August 3, 2020, he wrote, "Government-owned foreign companies might benefit from their governments' support, and are likely to act according to considerations that are not purely economic and use government resources to gain operational and economic advantages over their competitors from the private market." The State Comptroller criticized extensively the supervisory mechanism for investments, which was delayed for two years before the security cabinet finally established it on October 30, 2019. According to the State Comptroller, the absence of mandatory consulting by regulators with the advisory committee could lead them to prioritize economic considerations over considerations of national security. He therefore recommended emphasizing to the regulators that they must consult with the advisory committee of the supervisory mechanism "before approving a foreign investment that could potentially damage Israel's interests from the standpoint of national security." Although China was not mentioned by name in the State Comptroller's report, the participation of many Chinese companies in infrastructure tenders in Israel underscores the need to implement his recommendations. This is particularly urgent now, as the rivalry between China and the United States heats up, and the US administration exerts pressure on allies to establish or strengthen investment supervision mechanisms and carefully weigh the inclusion of Chinese companies in national infrastructure projects.

Construction of new infrastructure is important for economic growth. An OECD report of March 2018 states that Israel lacks significant infrastructure, which detracts from its economic productivity and the welfare of its population. This shortage is especially acute in land-based transportation, including railway and bus lines; marine transportation, including port capacity; energy, including power stations and production of alternative energy; and desalination. The report states that infrastructure ventures in these spheres are likely to help push the economy forward and encourage productivity. Indeed, in recent years, the government has made considerable effort to narrow gaps by investing much money in improving and upgrading infrastructure. Given the Covid-19 crisis and the anticipated economic slowdown, the need for large-scale public projects has increased even further.

Foreign companies are involved in most of the large infrastructure projects in Israel, and the presence of Chinese companies is especially prominent, mainly due to the economic benefits they entail. Chinese companies have proven knowledge and experience in infrastructure sectors. At the same time, their experience is frequently limited to China, its surrounding area, and developing countries. To penetrate the European market, they are trying to acquire a favorable reputation and experience in European standards within a country like Israel, and are willing to offer a relatively low price for a project. As long as they meet the quality criteria for the work, selecting the cheapest bid makes it possible to maximize the taxpayers' money. In addition to the low price, Chinese companies have succeeded in a considerable number of projects in completing the work before the deadline, thereby saving the country commissioning the work much time and money.

Despite the economic advantages of using Chinese companies in infrastructure projects, this involvement incurs both short and long-term problems. Employing Chinese companies comes at the expense of local companies and workers. The Israel Builders Association claims that Israeli companies and workers are desperate for work and that in the present crisis, it is right for the state to give preference to Israeli labor. Chinese companies, however, tend to rely on their own workers and equipment, and usually operate without an Israeli partner. As a result, the local market is not exposed to new technologies like tunnel-digging equipment and control systems. In the long term, a shortage of know-how and experience among local players may result, and Israel is liable to find itself dependent on foreign parties where these technologies are involved.

Furthermore, like many advanced countries, Israel utilizes a reciprocal procurement mechanism that requires foreign companies to purchase local products on a scale of 20-

35 percent of the amount of the transaction. As a "start-up nation," Israel wants foreign companies to purchase advanced local technologies. In the future, It is expected that this procurement will be a platform for leveraging Israeli technologies for future exports. When Chinese companies are involved, however, there are problems with this reciprocal procurement mechanism. These companies do not always achieve the required volume of procurement, and the procurement that does take place, usually consists of basic products, such as soil and other construction materials, while the companies prefer to bring the advanced technologies with them. The Ministry of Finance opposes the reciprocal procurement requirement and is trying to eliminate it, arguing that it makes tenders more expensive. If the reciprocal procurement obligation is canceled, the result will undoubtedly be further damage to local businesses.

In addition to economic aspects, the State Comptroller advised that regarding the involvement of foreign players in national infrastructure in Israel, geostrategic aspects should also be taken into account. The selection of Chinese companies in several prominent past tenders, such as operating the Haifa Bay port for 25 years, constructing the southern port in Ashdod, digging tunnels for the light rail in Tel Aviv, and acquiring the Alon Tavor power station, has sparked tension between Israel and the United States, which is engaged in a growing rivalry with China. The Trump administration is trying to reduce China’s presence and influence due to concerns about espionage, damage from cyberattacks, technology theft, and political influence. The United States expects its allies to embrace this approach by preventing Chinese investments, with an emphasis on infrastructure and advanced technologies. As a result, the extensive presence of Chinese companies in tenders in Israel has become an issue that can no longer be ignored. For example, in May 2020, a few days before the decision on the tender for construction and operation of the Sorek 2 desalination facility, US Secretary of State Mike Pompeo visited Israel and warned against Chinese investments in critical infrastructure. In the end, the Chinese company was not selected, reportedly for economic reasons.

It is thus clear why the State Comptroller recommended that Israel create a better balance among the considerations for examining and making decisions in future infrastructure tenders. Even if Chinese companies participate in these tenders, Israel should strive to make their participation contribute to the broader interests of Israel's economy, and without jeopardizing its geostrategic interests. For this purpose, the Israeli government should encourage partnership between foreign and local companies in tenders to preserve and improve the know-how and experience of the local companies with new technologies and tools, and to support the local economy. As part of this, lessons should be drawn from experience, in which partnerships with Chinese companies were limited, due to the latter's tendency to purchase little Israeli technology. Partnerships with European companies, on the other hand, were more effective, and later encouraged exports of

Israeli technologies to the European market. Israel can also profit from an enhanced presence of American or European companies in its infrastructure projects through both closer relations with the United States and Europe and a means of diversifying the risks of foreign investment.

Finally, although the Israeli government has preferred to avoid the establishment of a mechanism for assessing foreign investments in order – according to the State Comptroller's report – to avoid diplomatic pressure, the current situation makes it difficult to continue this policy. The risk of a possible confrontation with the United States is growing. Thus, Israel should operate the advisory committee as a permanent, authoritative mechanism, not merely an advisory agency; define criteria that are as clear as possible on the acceptable extent and form of involvement by foreign players in national infrastructure projects; and as the State Comptroller recommended, present these criteria openly already in the early stages of the tender to forestall unnecessary insult or damage among competitors. The government can retain a certain degree of flexibility in decision making, but is entirely justified in designing a clear policy on a matter of national importance that will achieve a proper balance between economic and strategic considerations.

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