



# The Defense Budget Debate, Yet Once More

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In early August 2005 the government approved the state budget, which it will submit to the Knesset for approval in the coming weeks. The outlines of all ministry budgets have been drawn. Although some changes are expected in the budget following the change in finance ministers, no changes are expected in the manner of drafting the budget or in its underlying principles.

There are two leading operative objectives in a budget that furthers a broad economic policy: a budget deficit not exceeding 3 percent of the GDP (the estimated increase for 2006 is approximately NIS 17 billion)<sup>1</sup> and a maximum increase in government expenses of 1 percent (approximately NIS 2.2 billion). This budget policy, therefore, dictates a "cutback" that has sparked a public debate on the question of who should be saddled with the higher cutbacks. In recent years, defense has usually been at a disadvantage in this debate, despite general agreement that defense is a supreme priority. Hence the changes in the defense budget over recent years (table 1).

**F**irst of all it must be clear that the overall cutback is a reduction in the budget increase, and not an actual reduction compared with last year.<sup>2</sup> Reduced is the amount of last year's budget, with the addition of two other types of expenses: first, the "automatic pilot" – those expenses that increased last year's total spending and that are expected to persist in the current budget year; the second is a supplement of 1 percent of

last year's budget expenses. The 2006 budget, approved by the government, comprises the following figures: total expenses, which include last year's budget plus the "automatic pilot" and the allowable supplement, amounting to NIS 217.4 billion; estimated revenues for the budget year of approximately NIS 196.7 billion; and a deficit resulting from the difference between revenues and expenses amounting to NIS 20.7 billion. The acceptable deficit based on the tabulation above totals NIS 17.2 billion. Therefore, there must be a "cutback" of NIS 3.5 billion.

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**Table 1. The Defense Budget, 1999-2005**

Year	Updated budget in NIS billion
1999	29.4
2000	30.5
2001	32.5
2002	35.2
2003	33.1
2004	32.4
2005	30.8

Source: State comptroller's report for 2005. All figures represent the sum total of expenses in shekels from local sources, without conversions from US military aid funds. The 2005 figure is taken from the 2005 budget principles as proposed by the Ministry of Finance.

Of the sum intended as a cutback, NIS 1.6 billion has been foisted directly on the defense budget, while the rest has been divided among the various ministries, including defense. The debate over reductions in the budgets of all the ministries is fundamentally similar, though it enlists different arguments in the different ministries. The sum approved for the defense cutback was reduced following demands by the defense establishment and a ruling by the prime minister, and was set at NIS 650 million in direct cuts. Yet while government deliberations

over the budget have concluded, it is likely that until the final approval of the budget, some changes will be made. Still, it should be remembered that planning for the year 2006 has already begun within the defense establishment and other ministries, and the working assumptions of each minis-

try include the government's decision plus suppositions regarding the final arrangements that will be approved over the coming months.<sup>3</sup>

This article presents the highlights of the debate over the defense budget before it is to be presented to the Knesset.<sup>4</sup> The defense budget is the

largest of government budgets, but the political support it enjoys in the Knesset rests on the power of the defense minister, with the prime minister wielding his influence according to changing considerations. There is no significant defense lobby in the Knesset.<sup>5</sup>

## The Treasury vs. the Defense Ministry

*Four central issues are raised by the Ministry of Finance regarding the defense budget that the Ministry of Defense is called on to address:*

### ↳ Practicality

The defense budget is the largest among the various ministries, constituting approximately 18 percent of the overall budget.<sup>6</sup> Barring a cutback in defense, it would not be possible to arrive at the necessary budget reduction without striking a mortal blow to other ministries. In addition, a cutback in defense reduces political and professional opposition to general cutbacks.

In response, the defense establishment argues that the defense budget must be removed from the political debate. In addition, a distinction must be made between the defense budget and the budgets of other ministries, according to their relative importance. As long as defense deals with the state's very survival, its present size must be regarded as a necessary condition for existence. The budgets of the other ministries, however, define conditions of existence, and therefore have more room for flexibility.

The practical consideration is of great importance for negotiations over determining the budget. Some of the agreements achieved rely on the possibility, by no means assured, of changing the original budget allocation during the course of the year. This process gained media coverage following the state comptroller's report.

### ⬅ National Priorities

As part of its role, the Ministry of Finance considers itself obliged to set national priorities. It serves as the government's professional branch for allocating resources and examining the efficacy of their use. Exercising this responsibility, the Treasury generally prefers expenditures on health, education, and various social welfare expenditures.<sup>7</sup>

Defense's response to this argument refers back to the previous argument, with the added claim that short range administration of policy must be

avoided as far as the defense budget is concerned, because planning for this budget is normally long range. Yearly changes result in waste and in planning difficulties.

The dispute between the ministries of finance and defense raises the broader question, relevant to all ministries: who determines the priorities for national expenditures and on what basis? Which body is the appropriate branch to consider assessments and risks of all types, including hidden risks, according to priorities? Who determines the order of importance for allocating budgets, whether marginal or primary? Can the Treasury's budget department, staffed by outstanding professionals who are working towards the realization of economic objectives on the deficit and the size of overall spending, also serve as the group making recommendations to the government on how to allocate budgets, based on evaluating risks from an overall national perspective, and not only those in the field of economic policy?<sup>8</sup>

The complementary argument to the issue of national priorities is the Treasury's determination that economic growth engines lie in the fields of civic investment, exports, and private consumption. Defense spending does not contribute to sustainable or desired growth. The defense establishment, however, counters by asserting the contribution of defense spending to technology and its development, exports, foreign relations, and the like.

The fundamental issue that emerges from this debate is: does defense spending impact negatively on the economy's growth? Seemingly, defense spending increases translate into reduced spending on growth engines, i.e., civic investments, export, and private consumption. The notion that this is the sole relationship is so prevalent that the option of developing defense as a growth engine is rejected outright. But is this indeed the case? Professional literature and experts grappling with this issue express doubts regarding a necessarily negative relationship between the two. For example, there is sufficiently broad agreement that technological education plays an important part in the building of future growth engines for the economy. The capabilities of the military system, by way of public resources, have given rise to technologies whose conversion to the civilian market have greatly contributed to an increase in exports and other growth engines.

## Military-Strategic Considerations

An additional argument raised by the Ministry of Finance is that Israel's strategic situation has changed, allowing for cutbacks in the defense budget. Examples include the changes in Iraq, the collapse of the so-called eastern front, and the ongoing presence of the American army in the region. Given the change in these strategic circumstances, the presumption is that the budget for 2006 must be adjusted. Since most of the disengagement budget is not included within the defense budget, it will be possible to cut the defense budget, despite the issue of the removal of settlements and the army's involvement.

The defense establishment disagrees with the Treasury's assessment of the situation and rejects its conclusions, insisting that the authorized and responsible party for performing a national situation assessment is not the Ministry of Finance. More fundamentally, however, the debate focuses on the essential issue – does a change in the assessment of the strategic situation oblige a budgetary change?

In fact, a change in the assessment of the strategic situation does not necessarily mandate a change in the defense budget. The immediate expected change is in force buildup and planning its use. Changes in force buildup do not warrant budget changes; rather, they point primarily to a change in how to employ existing power, for which no additional ex-

pense is required, unless it is not possible to adjust spending sufficiently or if the change in buildup demands new acquisitions.

Thus, the strategic changes occurring in the world and the Middle East do not necessarily require an immediate change in the size of the budget; therefore, linking the situation in Iraq with the cutback in the defense budget is not a forgone conclusion. Also, statements that the Gaza disengagement would lead to a cutback in security needs are not substantiated. Altering the defense budget as an outcome of changes in the strategic environment would be appropriate only as part of an overall analysis of the force needed for the new strategic situation. Only through such an analysis can budget needs and expenditures over time be determined.

Force buildup and planning its use are not marginal activities of subtracting or adding budgets and inventories following a solitary change. They deal with the existing inventory of capabilities and ensuring its comprehensive operability under new conditions. Sometimes a budget supplement is needed, and sometimes not. This issue must be examined within a specific context. Thus, the differences between the defense and finance ministries in assessing required changes in the defense budget stem from differences in their manners of analysis. The assessment of risks performed by the two ministries is totally different; and they diverge in their understanding of force buildup methodologies, which represent separate organizational interests.

## → Management of National Resources

It is the Treasury's responsibility to examine how effectively budgets were used by the various government ministries. Since the Ministry of Finance's ability to investigate and control the defense budget is relatively low compared with its ability to oversee the budgets of other ministries, it has chosen a method to provide a response to this relative weakness. In other words, the Treasury maintains that the defense budget must be cut persistently so that the defense leadership will seek the best and most efficient way of providing the required level of security within the framework of ever-decreasing resources.

Over the last years, mainly coinciding with its ability to know more details of the defense budget, the Treasury has begun to demand specific changes beyond the continuous cutbacks, contrary to past recommendations and proposals.<sup>9</sup> Generally, however, the defense establishment's response to demands for increased internal efficiency calls for the Treasury not to intervene, since it interferes with multi-year planning processes and has no understanding of the issues that it proposes to solve. Moreover, a division of responsibility exists under which increasing internal efficiency is the responsibility of the defense leadership, not to mention the fact that the leadership itself is interested in this, without the need for the Ministry of Finance's intervention or encouragement.

Here too, a fundamental question arises on how to set in motion increased efficiency within the defense establishment. The differences of opinion between the ministries are a product of different administrative outlooks and the partisan objectives of each ministry.

What is meant by "efficiency" requires clarification, since this is a concept understood differently by different people. Here, efficiency is defined as the relation between an objective's value, or the expected benefit, and the cost of resources having alternative uses that have been invested in attaining the objective. This definition enables the formulation of two processes. The first points to the notion that the more that is achieved from an objective through a smaller use of economic resources, the more efficiency rises, i.e., "maximum bang for the buck." This is an accepted mindset within the military for those seeking to achieve maximum military strength and security within the budget at their disposal. The second process describes the increase of efficiency as the process whereby fewer economic resources are used in order to achieve the objective, resulting in a rise in efficiency, i.e., "minimizing the cost per unit of output." This is a mindset characteristic of economists and budgeters interested in arriving at a designated security level (military strength) at minimum expense.

Setting into motion processes of increased efficiency in the defense establishment is perceived differently by the two ministries. The defense

establishment tends to view the first process as preferable, which allows it to plan for maximum security over time, even when a budget increase is required for a particular year. The Treasury, driven by macroeconomic considerations, prefers to administrate budgets on a yearly basis, while permitting, with limitations, a multi-year purchasing process. This dimension of the debate will decline if the Treasury moves to allocating multi-year budgets.

### Recommendations

The inter-ministry debate is based on differing situation assessments, varying risk evaluation methodologies, different work cultures, and a lack of trust that has accrued over the years. Settling the budget debate will not only contribute to a more pleasant public arena, but also to the ef-

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ficiency of processes in government ministries, the government, and the Knesset. Thus, notwithstanding the chasm between the ministries, there

are some potential measures to bridge the divide:

■ **Setting up an advisory staff for the government and the prime minister.** The advisory staff will focus on evaluating national risks, not only military ones, and prioritize the urgency and importance of handling them. The staff will deal with evaluating military, social, environmental, and health risks, basing itself on work done in the various ministries. The staff's work will enable the Treasury to focus on its designated role, macroeconomic policy, allowing another group to examine economic objectives and dimensions against social or other objectives and dimensions. The staff must act solely as an advisory body, with authority for decisions remaining, as today, with the government and the prime minister.

### Does a change in the assessment of the strategic situation oblige a budgetary change?

■ **Linking budget clauses and policy objectives.** Familiar spending budgets must change and reflect the objectives that the organization or ministry strives to achieve. A multi-year budget focused on placing a price tag on objectives would serve as a fitting index for the measure of success at various ministries in achieving their goals; this in contrast with the current situation where the budget presents a collection of expense clauses whose linkage with any task

or objective requires special work. In most cases this is not feasible.

Creating the option of assigning a price tag to objectives obliges designing budgetary tools for the long-range and short-range administration of tasks of the defense economy. Yearly budgets cannot provide a fitting solution for the cost of multi-year tasks; the tools needed include: budgeting tasks, multi-year budgets, involving Treasury staff in discussions of work programs at the Ministry of Defense (and at other ministries), and identifying working techniques that transform strategic objectives as the focus at all echelons.

■ **Optimizing institutional control mechanisms over the defense budget.** The Knesset and the Ministry of Finance are the two official bodies that control the defense budget. The Ministry of Finance checks the level of the budget and the fulfillment of its clauses, while the Knesset is mandated to inspect and approve decisions and the use of the budget towards their realization. Neither of these bodies employs techniques for reviewing the fulfillment of tasks, except for checking isolated expense clauses. Designing appropriate tools, some of which also serve to link budget clauses and policy objectives, will improve ability to control the defense budget.

■ **Increasing efficiency as an ongoing process in the defense establishment.** Increasing efficiency in the defense sector is not a onetime move, but rather an ongoing process whose necessity must be recognized by the heads of this sector. In creating such

awareness, the Ministry of Finance plays a fundamental, though not exclusive, role. The concrete process must be coordinated between the two

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ministries, while allowing the option of planning to the defense system and the granting of appropriate funding to the Treasury.<sup>10</sup>

■ **Seeing defense spending as a growth engine.** The defense budget for research and development must be increased for fields that private business organizations avoid due to business risk. Spending on technological education within the defense system should be increased as well as resources directed to the development of technologies that can be used by both the military and civilian sectors. The given fact that defense spending will accompany the economy for many years to come, and in significant sums, justifies the search for a way to build a defense budget that contributes to other sectors, instead of acting solely as a competitor for national resources.

■ **Creating analytical information systems for the defense establish-**

**ment.** Defining objectives and goals, evaluating policy, analyzing outcomes, and designing savings plans are just some of the decisions that require information originating exclusively from the defense sector. The preparation of data that can be publicized and used for analytical goals is a condition for achieving trust among decision-makers and the public. Moreover, only reliable information that is publicly distributed can, over time, generate credibility for information that flows out of the defense establishment, and even more so, support the legitimacy of the system within the country's social system.<sup>11</sup>

### **Settling the budget debate will contribute to the efficiency of processes in government ministries, the government, and the Knesset.**

## **Conclusion**

Only a change in the budget model and a change in the government's working method can neutralize the more important hubs of the debate between the budgeted body and the body responsible for determining the budget, in this case the ministries of defense and finance, and thereby improve the allocation process. If no change is effected in the rules of the game, i.e., enlarging the circle of participants in discussions over determin-

ing the defense budget with increased transparency; increased cooperation between the Ministry of Finance and the Ministry of Defense in discussions over work plans; and a refinement of external supervision over the determination and administration of the budget, distortions in the resource allocation process will continue to grow in the Israeli economy. Without these measures, dialogue between the Treasury and government ministries – the defense ministry chief among them – and even more so the public debate within and outside the Knesset will not be founded on reliable information and structured thinking and will not proceed along more efficient and reasonable lines.

## **Notes**

1. In general there is no debate on the level of the overall reduction. The "economic formula" by which the allowable deficit for the state budget is set at approximately 3 percent of the GDP is customary and accepted, although its scientific validity is debatable. Still, it is worth noting that even more than this formula is perceived as a valid technique, it is seen as proof of determination and consistency in the administration of government policy. At the same time, there is no overriding need to sanctify the number 3 as the key to good policy administration.
2. The possibility that expenditures will fall in comparison with the previous year exists, for example, when government income does not increase as a result of lowering tax rates; or if in the previous budget year, a one-time expense was approved on a scale exceeding the approved percentage increase in expenses.
3. All government ministries also take into account the possibility of a change in the budget during the working year. Usually benefiting from changes during the year is the Ministry of Defense, which can demonstrate needs that must be fulfilled and the ability to purchase. The final outcome of changes during the year does not alter the overall picture of the budget and the underlying macro-evaluations.
4. Changes in ministry budgets during the year are another issue that will not be discussed here. Suffice it to mention that this represents an administrative tool in the hands of the Treasury for regulating shortages and surpluses in the operations of the various ministries and in the general budget.
5. Members of the Knesset with military backgrounds and almost certain sympathy for the defense establishment understand that their political bases do not reside within the army; therefore their support for the system's demands is not automatic.
6. The weight of budget spending on defense within unfixed expenses is growing. The relative size of the defense budget represents a decisive parameter in cutback considerations.
7. It is not any way the intention here to discredit Treasury officials, who are not politically suspect. The political apparatus influences their decisions by way of the finance minister, who is a political figure.
8. The conceptual decision for efficient allocation is "simple": when marginal utility (the change in utility following a small increase in the budget) is equal among all ministries, allocation is "efficient." Due to the inability to actually measure marginal utility within various ministries, it is not possible to employ this simple model for creating an objective tool for efficient distribution. It is therefore obvious that when there is no possibility to finalize amounts for allocation, the decision becomes

political-administrative (Treasury), and the process of fashioning and approving the defense budget is one of debate, with argumentative reasoning intended to convince the other side.

9. Required changes in the defense budget according to the Treasury's understanding include: continued reduction of the budget, reduction of workforce expenses, civilianization of tasks, project reviews, downsized delegations sent abroad, and unification of headquarters. The Treasury has also suggested shortening compulsory service, although the committee appointed by the minister of defense has not yet formulated its recommendations. The Treasury is prepared to lend assistance via additional budgets for fulfilling structural revision programs in the defense establishment.
10. The reorganization that will lead to continued savings in resources lies within three fields:
  - *Defense production* (including force buildup and activation during a conflict), especially: power buildup based on lifecycle costs of components; capabilities, buildup with flexibility that enables response to a variety of con-

flict situations; and response creation through comparing expected damage from the realization of the danger with the cost of the response. Note that insurance against all risks is expensive and inefficient, and includes evaluations regarding risks for which it would be wrong to initiate an early response.

- *Management of defense resources* (the defense economy), with an emphasis on subordination of economic decisions to the establishment's strategic objectives. Objectives must be determined "top down," with the achievement of overriding objectives taking preference over all others. Decisions must be made according to long-range parameters and subordinate to system objectives. A single price mechanism must be installed by which decisions will be reached at all levels of the system – the price mechanism – to enable putting a price tag on activities within the system (including regular soldiers who constitute the central hub of inefficiency in the defense system). There should be trans-organizational joint action programs; exchange of ownership of assets for outsourcing; coop-

eration with the business sector, relying on a division of labor such that the defense sector specializes in security production (a focus on core pursuits), and on the competence of the business sector; and transparency and accountability towards other sectors.

- *Acquisitions system* (connecting between the defense sector and other sections of the national economy), mainly: an organizational structure supporting efficient acquisition decisions (chiefly shortening the acquisition channel); optimization of performance, costs, and time (by formulating substitution rates between the three); acquisition of systems based on lifecycle cost; timing decisions – administrative delay causes increased acquisition prices; and continuous study and updates of best practice procedures existing in the field of purchasing organizations in Israel and the world.
- 11. Establishing an analytical research body within the defense establishment that will act as an evaluation and analysis center alongside decision-makers will also contribute to increasing the credibility of information flowing from the defense establishment.