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## **The Defense Budget for 2017-2018**

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In the early morning hours of December 22, 2016, the Knesset approved Israel's state budget for 2017-2018. Within this package, the defense budget component was the product of joint work by the Ministry of Finance and the Ministry of Defense, based on the Kahlon-Ya'alon agreement. Significantly, the defense budget was drafted without the wrangling characteristic of the dynamic between the ministries in previous years.

### **Highlights of the Agreement between the Ministry of Finance and Ministry of Defense**

Improved work relations between the Ministries of Finance and Defense replaced the familiar inter-ministry arguments and dissatisfaction, which peaked with the publication of the Locker Commission report. The most important product of the joint work is the Kahlon-Ya'alon agreement on defense budgets for 2015-2020, followed by additional understandings between the ministries reached in 2016 regarding specific issues in dispute. The principles of the agreement and understandings were adopted by the government.

According to the agreement, the IDF's multi-year Gideon Plan will be fully budgeted. The plan sets clear priorities and includes significant streamlining steps and tools for monitoring and decentralizing the various branches. The agreement sets a clear budget framework for the plan, such that if the budget is increased in one area, it will need to be reduced in another area. Expected streamlining steps include decreasing the number of reservists by 100,000; integrating headquarters; and converting some jobs to civilian positions. In addition, understandings were reached on the service and pensions model, budgets of the Disabled Rehabilitation Division, the Department of Families and Commemoration, and other issues that for years were at the heart of the dispute between the ministries. Certain budget items were taken out of the defense budget altogether. No less important is the mechanism for resolving problems and making changes to the agreement, including a negative incentive for requesting unilateral changes. All of this was done in order to provide stability in the process of drafting the defense budget.

One prominent aspect of the agreement is the new standing army service model, based primarily on the work of the Tishler Committee. The most significant component of the model is the promotion track for officers and the addition of an exit point from the army.

An exit point after 14 years of regular service (meaning after age 35) has been added to the existing exit point after the first seven years of regular service. At this exit point, if an officer is not promoted (to a senior/professional major or lieutenant colonel) he or she is to be released with a grant of up to half a million NIS. Officers who are promoted will retire on average at the age of 43. The current average age of retirement is 48; this is a reversal in the Ministry of Finance's policy, which in the past advocated a later retirement age. The process is meant to reduce significantly the number of officers entitled to a bridging pension, and thus reduce the cost of this pension. In contrast, the target retirement age of NCOs was raised to 53, in order to maximize the utilization of their professional skills, and it was agreed that additional positions in the army would be filled by civilians.

The standing army model is meant to force the IDF to be more selective in choosing its staff. At the same time, it is expected to lead to a transformation of the army over time, including a decline in the level of experience of officers due to shorter terms and/or the fewer tasks undertaken in the standing army. The model's conditions and the periodic changes to service conditions may decrease the attractiveness of enlisting for military service such that the IDF may need additional solutions in order to compete in the job market.

The transparency and monitoring mechanisms are an important issue in the agreement. Since 2005, the auditor at the Ministry of Defense has been appointed by the Ministry of Finance Accountant General. According to the new Defense budget proposal, the Accountant General and her staff have the same access to the budgetary information systems as does the Ministry of Defense budget department. As part of this, "a budget terminal has been made available to the Ministry of Finance that enables it to directly observe the Ministry of Defense's budget in real time." In April 2016, an inter-ministerial transparency regulation was signed that regulates how the information is made available to the Ministry of Finance. This snapshot is somewhat overshadowed by the State Comptroller's report on pension arrangements in Israel published in October 2016, whereby "the IDF Manpower Directorate has made it difficult for the Ministry of Finance to receive the Chief of Staff's policy document on retirement benefits, in violation of the regulation on implementing government decision 4088 on improving monitoring of the IDF and its transparency." According to the Comptroller's report, during 2013-2015 the pension rate increases provided to IDF retirees as part of the "Chief of Staff's supplement" was on average 8.5 percent, while the Ministry of Finance Accountant General was only aware of an average of 6 percent.

### **The Defense Budget for 2017-2018**

According to the budget proposal for 2017-2018 (dated October 2016), the defense budget for 2017 will be 70.7 billion NIS gross and 52.2 billion NIS net. The 18.5 billion NIS

difference is listed as "income-dependent expenditure," almost all of which is United States aid, including: funding of purchases in the US, aid converted into shekels, financing for joint projects, and aid surpluses not utilized in the past. The defense budget for 2018 will be 70.5 billion NIS gross and 54.0 billion NIS net, with a structure similar to the 2017 budget.

Some details worth noting:

*Size of the budget.* For comparison, the defense budget in 2016 (with all of its changes) is estimated at 69.7 billion NIS gross and 61.8 billion NIS net. In gross budget terms, 2016 and 2017 are similar in size, but the net defense budget for 2017 is significantly smaller than the net budget for 2016. The reason for this is technical: starting in 2017 (in accordance with the Kahlon-Ya'alon agreement) all the US aid will be listed under the category "income-dependent expenditure," outside of the net budget and part of the gross budget, while in the past part of the US aid was included in this category and part in the net budget. This change in itself does not affect the resources that the Defense Ministry receives, but it enables distinguishing easily between the portion of the defense budget that is funded by the state (subject to its fiscal policy) and the portion funded through US aid, which is unique to the defense budget. This may contribute somewhat to the management and visibility of the defense budget. Nonetheless, the budget proposal states that the net budget includes VAT on purchases with US aid. Although this is merely an accounting procedure by the Ministry of Finance, which involves allocating state funds for tax purposes and collecting them back once purchases have been made, it would be better to present the net defense budget without this unusual figure.

*The net IDF budget and other expenditures.* According to the budget proposal for 2017, the Ministry of Defense's expenses under the category of non-classified items is 15.4 billion NIS. The main items in this category include retirement benefits – 7.85 billion NIS; Disabled Rehabilitation Division – 3.42 billion NIS; and Department of Families and Commemoration – 1.65 billion NIS. The reduction in expenses in this category out of the total budget shows the size of the budget allocated to the IDF and units in the Ministry of Defense whose budget is classified.

*Unexpected security events.* As in the past, the defense budget does not include the costs of warfare in the course of unexpected security events. For example, the Ministry of Defense received 8.2 billion NIS in compensation for the Second Lebanon War; 2.45 billion NIS for Operation Cast Lead; and 7 billion NIS for Operation Protective Edge.

*Reduction in the share of the defense budget.* According to the Ministry of Finance's forecast, the ratio of defense spending to total government spending (excluding principal and interest payments), which decreased from 23.2 percent in 2010 to 20.4 percent in 2015,

is expected to continue to decline: 19.8 percent in 2016; 19.3 percent in 2017; and 18.9 percent in 2018.

*The new US aid agreement.* Although it does not apply to the 2017-2018 budgets, the US aid agreement for 2019-2028, signed in September 2016, is a challenge that must be prepared for during this period. Moreover, the annual military aid budget will increase, and its composition will substantially change, since the special arrangement that enabled Israel to convert part of the aid to shekels for the purpose of purchasing from local industries and purchasing jet fuel with aid money, will be phased out. In other words, Israel will have to finance purchases in shekels that until now were financed through US aid. This may change the defense budget framework and require new understandings between the Ministry of Finance and the Ministry of Defense.

### **Conclusions and Recommendations**

The significant improvements in the process of drafting the budget are noteworthy and commendable. As a matter of principle, it is important to continue to examine the size of the defense budget within the state budget from a long term perspective, as a function of changing defense and civilian needs. Regarding the agreement, it is important to examine its application. The following issues are especially worthy of attention:

- a. The new pension plan: is it implemented as agreed? Does it affect the quality of manpower in the IDF, and if so, how?
- b. Components of the Gideon Plan implemented within the agreed budget framework: how does the balance principle – whereby if there are increases to the budget in one area, there must be reductions elsewhere – change in face of new threats?
- c. Channeling resources to emergency depots and training of the reserve forces; learning from gaps in the IDF's preparedness in past incidents.
- d. Implementing the transparency regulations, and monitoring their effectiveness.

The major issue since the agreement between the ministries was reached concerns the changes in the conditions of US aid. Since multi-ministerial planning processes in Israel take a long time, and preparation of the 2019 budget is in any case planned for the first quarter of 2018, discussions between the Ministry of Defense and the Ministry of Finance should begin already in early 2017, in order to determine the effect of the aid agreement on the budget, at least for 2019-2020.

