



**Economic and Strategic  
Ramifications of American  
Assistance to Israel**

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# **Economic and Strategic Ramifications of American Assistance to Israel**

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The debate surrounding the moratorium on building in the settlements of Judea and Samaria exposed the problematic nature of America's aid to Israel and its impact on the public agenda. Whether one's opinion is that a settlement freeze would be contrary to Israel's best interest or not, major policy decisions of this kind should not be based on a sense of reciprocity, such as compensation Israel might seek from the United States in return for freezing construction. Yet a great many people do not appreciate the real costs of America's assistance to Israel. This paper presents the ramifications of this aid on Israel's economy, followed by an examination from a strategic perspective.

### **Background**

Israel has received over 110 billion dollars in American financial assistance since its establishment as a state, an amount which does not include guarantees or American military emergency equipment stored in Israel.<sup>1</sup> Unlike American assistance to other countries which is paid in installments throughout the year, assistance to Israel is transferred in the first month of the financial year, allowing Israel to benefit from accrued interest as well. In 2011, American assistance will comprise some 24% of Israel's security budget, 4% of the country's total budget and approximately 1.5% of the GDP.<sup>2</sup>

According to the most recent bilateral agreement, signed in 2007, Israel is expected to receive some three billion dollars in annual military assistance for the next decade, ending in 2018. All American assistance to Israel, as of 2008, is military in nature. This is the case since the agreement signed by the first Netanyahu government and the Clinton administration in the 1990's, in which the US Government ceased providing civilian assistance to Israel. Seventy five per-cent of this military assistance must be allocated to US-based purchases and the remainder may be designated toward acquisitions in Israel or from other countries.

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<sup>1</sup> Sharp, Jeremy. *US Foreign Aid to Israel*, Washington: Congressional Research Service 2010, p. 24.

<sup>2</sup> Based on Ministry of Finance projections and budget proposal.

### **Economic Ramifications of American Aid**

While on the face of it, three billion dollars of annual assistance seems fully advantageous, a closer look reveals not a few shortcomings.

#### **Assessing Actual Value**

To begin with, the total figure of this assistance does not represent its actual value to the defense establishment, due to the stipulation allocating much of the package toward US acquisitions. Were Israel's defense establishment free in selecting all its purchases, no doubt many would be made in the USA, but it is highly unlikely that they would amount to the total required seventy-five percent, 2.25 billion dollars. Less expensive equipment of perhaps even higher quality might be available in Israel or in other countries. But with the US-purchase budget so ample, and the shekel budget so limited, there is little leeway but to buy in the USA. In this sense, the cost of this equipment does not reflect its real value, since many of the same items could have been purchased at a lower price.

In an interview several years ago, Shomron Dasht, Deputy CEO of Israel's Military Industries, told researcher Erez Raphaeli that "The cost of the (American) raw materials is double that of the options available in Israel or Europe, upping the final cost by 20%."<sup>3</sup> Raphaeli also cited former IDF Chief of Staff Dan Halutz, who claimed:

The shift to US products on the basis of currency rather than economic considerations is wasteful and works to Israel's disadvantage. We're buying equipment of lower quality than we could get in Israel and at a higher price. One example is the American "attack pod." Despite the fact that Rafael [Rafael Advanced Defense Systems Ltd.] offers a pod which is more suited to our needs and is cheaper (by half), without the shekel-currency budget, there was no option but to buy the US product.<sup>4</sup>

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<sup>3</sup> Raphaeli, Erez. "American Security Assistance to Israel: A New Discussion and Assessment," (position paper, unpublished).

<sup>4</sup> Ibid.

The full actual value of American assistance to Israel's defense establishment is difficult to assess, yet Raphaeli pointed to a statement by former Minister of Defense Moshe Arens in 2001, that some 50% of the assistance would be spent outside of the United States were it possible. In other words, about one-third of Israel's defense acquisitions in the US, some \$750 million annually, is not economically justifiable. Raphaeli brought an additional assessment from David Vaish, former economic advisor to the Ministry of Defense, who estimated that in 2001, the IDF would have elected to make some \$400 million of its military product purchases within Israel, but that these potential acquisitions were tabled due to the requirement to purchase US-made products – translating into a \$400 million loss for the Israeli economy. Since then, the value of those same products is 50% higher, equivalent to some \$600 million in today's terms.<sup>5</sup>

### **Hidden Costs**

With the Camp David accords, the United States inaugurated an assistance package to Egypt, linking it to Israel's, making the countries the two major recipients of US assistance over the years. Egypt's military and economic assistance has maintained a consistent rate of 66 cents for every dollar Israel receives.<sup>6</sup> The reduction of aid to Israel in the 1990's brought a reduction of US aid to Egypt by a commensurate amount.<sup>7</sup> History and experience point to the likelihood of a continued correlation between aid to the two countries, although no guarantee to this effect was ever signed.

Jordan receives significant assistance from the US as well, with a projected \$700 million in grants to the Hashemite Kingdom projected for 2011. This assistance dates back to the Jordan-Israel peace treaty and while it is not at the level of US assistance to either Israel or Egypt, it is one of the largest US aid packages granted to any foreign country. Grants to Egypt and Jordan are not all designated as military, in contrast to Israel. Yet in effect, this difference is immaterial, since designating funds for civilian use frees available allocations toward military purposes.

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<sup>5</sup> Nominal calculation.

<sup>6</sup> Sharp, *US Foreign Aid to Israel*, p. 22.

<sup>7</sup> Sharp, Jeremy, *US Foreign Assistance to the Middle East: Historical Background, Recent Trends and the FY 2011 Request*, Washington; Congressional Research Service, 2010, p. 5.

Israel's peace treaties with Egypt and Jordan lower the likelihood of war between them, yet the IDF must nevertheless invest considerable resources in maintaining battle readiness in the event of an outbreak of hostilities. The "cold peace" with Egypt, coupled with the fact that it borders no country other than Israel which has a strong army, has left Egypt free to develop its modern efficient army. In addition, the great uncertainty regarding the country's foreign policy in the aftermath of the Mubarak era means that the IDF must be prepared for any eventuality – even one of very low probability – of a defensive war on either the Egyptian or the Jordanian front.

The stronger Egypt's and Jordan's armies become, the more resources Israel must direct toward countering the potential threat. With Israel's comparative disadvantage in terms of relative population (over ten Egyptians for every Israeli), maintaining a qualitative advantage in equipment and weaponry is critical. Therefore, for every military purchase of Egypt's, Israel must spend a greater amount in order to maintain the balance of power.

Raphaeli estimated in 2005 that for each dollar of military aid to Egypt, Israel must spend between 1.6 and 2.1 dollars in order to maintain its qualitative military advantage, yet receives only 1.5 dollars for every dollar invested in Egypt. Some of the resources invested in order to stave off a potential Egyptian threat are deployed on other fronts as well. Raphaeli estimated that for every dollar of American aid to neighboring countries which translates into support for their armies, Israel needs to spend between 1.3 and 1.4 dollars in order to preserve the balance. In this sense, Israel has a lower return on investment than Egypt for every dollar spent, due to the greater amount of military goods it must acquire. Not only does American assistance *not* provide Israel with an economic advantage, it requires Israel to expend additional amounts from its own internal security reserves.

The benefits of Israel's grant are thus greatly diminished, and perhaps canceled out altogether, if weighed beside the costs which accompany America's aid to Israel's neighbors.

### **Undercutting Israel's Military Industry**

Israel is among the leading arms manufacturers in the world, with arms exports forming an important component of its economy. Collaboration between Israel and the United States contributed to the growth of Israel's arms industry, yet American assistance to Israel undercuts its success.

As noted above, a large proportion of America's assistance must be spent on American weapons, so that Israel cannot base its choices solely upon cost or quality. Whereas American equipment is purchased as part of the assistance package budget, Israeli-made arms are purchased from a separate pocket, that of the Israeli tax payer. This acts against Israel's arms industry on a number of levels:

To begin, as inferred earlier, Israel's arms industry loses out on valuable contracts with the IDF, which must opt for purchasing equivalent goods from the US. Second, according to Dasht, Israeli arms suppliers are required to purchase raw materials in the US as well, which are more expensive, thus raising the costs of the end product and making it difficult for Israeli industry to compete with foreign manufacturers. Third, due to Israel's reputation as a military power, any acquisition choice of Israel's will instantly increase the demand for that product on the international market. When a foreign country contemplates a purchase from an Israeli arms manufacturer, the question of whether Israel's own army uses that product often plays into the decision. Accordingly, every time Israel opts for an American-made product over one of its own is a strike against the added value which its industry's reputation would have gained had it supplied the item to the IDF.

This is not to say that the Israel Defense Forces ought to purchase Israeli products in order to boost the local economy or the industry's image. The IDF's role is to defend the State of Israel, and should purchase the highest quality and most effective equipment in order to fulfill that mission. However, when arms purchase decisions are made not on the

basis of quality or cost effectiveness but on external constraints, there is a negative fallout effect on local industry.

Further, the United States places restrictions on Israel when it comes to its exports to other countries. Large scale business deals have been cancelled or scuttled due to American pressure on Israel not to sell arms to countries which the US considers to be adversaries. The best known such case was Israel's "Falcon" deal with China in 2000. Israel was forced to cancel a deal worth hundreds of millions of dollars – in addition to paying damages to China – following threats of aid cuts from the US Congress. The establishment of a "consultation" process with the United States in the aftermath of the Falcon affair, further compromised Israel's independence in arms exports. In the absence of American assistance, America might not have leaned so hard on Israel not to sell arms to China; Israel might have given in regardless, in its desire to safeguard its relationship with its important ally. In either case, however, American assistance places pressure on Israel in this area, with the resulting economic loss.

### **Perpetuating Irresponsible Israeli Economic Policy**

America's assistance to Israel comes independent of fluctuations in the Israeli economy. One might say that it forms the most reliable source of all State revenues. This fact led Roni Bart of the Institute for National Security Research to claim that "the defense establishment rightly views this financial assistance as the single most permanent long term item in its budget planning, a factor which is immune to political disruption, and is therefore best left alone."<sup>8</sup> This situation leaves the system with no incentive to become more efficient. As former Prime Minister Ehud Olmert noted in December 2010, "We can and should decrease our defense budget and this would have no negative effect on any of the objectives with which the State of Israel needs to content in order to protect Israel's vital interests, including facing the most hostile of our enemies."<sup>9</sup> But when a

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<sup>8</sup> Bart, Roni, "American Aid to Israel: A Reevaluation," *Strategic Update*, Institute for National Security Studies, Tel Aviv (June, 2007), [http://www.inss.org.il/upload/\(FILE\)1193575818.pdf](http://www.inss.org.il/upload/(FILE)1193575818.pdf) .

<sup>9</sup> *Calcalist* December 9, 2010, <http://www.calcalist.co.il/money/articles/0.7340.L-4335001.00.html?dcRef=ynet>

great proportion of this budget comes from a foreign source, the incentive to increase efficiency drops.

When a government wishes to increase its budget, it must advance reforms to encourage economic growth and which, in turn, will increase the tax base and tax revenues. The alternative, raising taxes without broadening the tax base, is not sustainable in a competitive global economy. Such growth-incentive reforms generally need to overcome opposition that is either political or institutionally-based. Politicians will generally opt for relying on foreign assistance over the prospect of political turbulence.

### **Harming the Private Sector**

As noted, American assistance is not linked to the Israeli market and is granted to the public sector. Without this aid, it stands to reason that the government would be forced to reduce the public sector in size, through defense budget cuts, restructuring and increased efficiency in other frameworks. This would direct many more resources toward the private sector, which would be motivated to seek creative and growth-oriented solutions, involving personnel, financing, as well as land and other resources currently held by the government.

These challenges and opportunities would pass to private sector hands were it not for American assistance. Instead of helping advance the Israeli market, it acts to obstruct economic growth and promotes its stagnation.

### **Strategic Implications**

The above illustrates that Israel's economy would grow were it to go without American assistance grants, or at the very least, would not suffer any significant damage. Examining this issue from a strategic standpoint brings equally illuminating observations.

### **Limiting Israel's Diplomatic Freedom**

As we have seen, American assistance to Israel is not unconditional and comes with numerous strings attached. One such string is that by accepting this aid, Israel identifies

itself with America's foreign policy and limits Israel's ability to pursue alliances with other countries. The Falcon episode with China forms an excellent case study. In addition to the financial cost of cancelling the deal, this move damaged Israel-Sino relations. China's growing role as a superpower, not to mention its veto privileges in the UN Security Council, bring it great strategic importance from Israel's perspective. Israel, a small country, cannot affect the policies of a superpower like China's on its own. If and when it was to ask China for its assistance, China would not be likely to overlook the Falcon incident. Although Israel might well refrain from selling arms to a given country due to US pressure even without the American aid package, the US would nevertheless have less leverage to employ, leaving Israel with somewhat greater flexibility in cultivating new alliances.

Likewise, Israel votes in automatic step with American positions on all issues in the United Nations and other international bodies. Israel thus has found itself among practically the only countries in the world which votes with the US in favor of sanctions on Cuba, for example. On top of the ever-present hostility to which Israel is subjected due to the Arab-Israeli conflict, these ties draw added anti-American sentiment prevalent in many regions, including the Middle East. Here too, ending American aid would not necessarily mean the end of Israel's support for US positions, but it would mark an essential step toward independence.

### **Strengthening Neighboring Autocracies**

As already noted, military aid to Israel comes as part of an aid package to Egypt and Jordan. In addition to the economic burden this foists on Israel, the aid to these neighboring countries causes it long term strategic damage.

Unlike Israel, the Egyptian regime uses the army to maintain its hold on power, abusing human rights and oppressing opposition movements in the process. Since having the Moslem Brotherhood opposition in power is thought to be worse for Israel than the Mubarak regime, Israel is said to be better off favoring the regime's survival. Yet Mubarak, through the army, has quashed liberal opposition movements, leaving the Moslem

Brotherhood as the main opposition movement. In addition, the theory that Egypt can be “enticed” to maintain its peace agreement with Israel over time is far from certain; there is always a looming chance that it will act otherwise in accordance with its perceived geopolitical interests.

### **Creating an Image of Weakness**

American aid fosters the image of a weak Israel vis à vis its neighbors. Leaders of the Zionist movement from both sides of the political map emphasized how vital it is that Israel have the ability to defend itself on its own. In his famous article on the “iron wall,” referring to Jewish determination and resolve, Vladimir Ze’ev Jabotinsky claimed that “as long as the Arabs have even the slightest hope of eliminating us, they will not give up that hope” unless and until “they see not a single crack in the iron wall.” Moshe Beilinson, a founder of the left-wing newspaper *Davar*, expressed a similar viewpoint when he wrote,

Until when, they say, until when? Until the time that Israel’s strength will overcome any enemy attack, whatever its source; until the most driven and the most daring of all the enemy camps, wherever they are, will know: There is nothing that can break Israel’s strength within its land, for the imperative and the truth of life is on our side, and they can do nothing but make peace with that knowledge. That is the objective of this campaign.<sup>10</sup>

America’s aid to Israel may not form a tipping point in the balance of power in the Middle East, yet the impression of Israel as dependent upon it encourages radical elements, or “cracks” in the “iron wall.” As long as hostile elements have hope that the end of that aid would provide a decisive advantage for them against Israel, they will do everything to drive a wedge between Israel and the United States by portraying Israel as an entity state whose actions run contrary to American values and interests. If they were to see Israel defend itself fully on its own, without reliance on foreign assistance, their incentive to do so would lessen.

In addition, as US leaders make a point of noting from time to time, American aid is considered an expression of America’s commitment to Israel’s security and that this

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<sup>10</sup> Beilinson, Moshe, “The Goal of this Campaign,” *Davar*. June 23, 1936,

commitment acts as a deterrent to Israel's enemies. If the United States was at some point to make a unilateral decision to stop its assistance, whether due to diplomatic tensions with Israel or to an economic crisis, this would be seen as back-pedaling from its commitment to Israel's wellbeing, thus encouraging Israel's enemies and weakening Israel even more. However, if the same move was the outcome of an agreement between the two countries, at Israel's initiative, Israel's situation would not be impaired. The aid reduction in the 1990's, for instance, which took this form, did nothing to dent the unwritten alliance between the United States and Israel.

### **Curbing Israel's Sovereignty and its Leaders' Accountability**

The very act of accepting American assistance impairs Israeli democracy and sovereignty. When a country receives a sizable portion of its revenues from sources other than taxpayer money (whether from its natural resources or from foreign aid), policy makers have no incentives to act in accordance with citizens' interests or to advance the economy. This is known as the "curse of resources," a situation in which the higher the state's income from natural resources, the less the country is free. The political survival of leaders in countries like Venezuela, Iran, Saudi Arabia and Russia, for example, depends more on the price of oil than on the achievements of its educational system or the freedom of its citizens.

When it comes to foreign aid, the result is a compounded distortion. Countries receiving humanitarian aid are continuously required to demonstrate their weakness and inability to care for their citizens in order to qualify for ongoing aid. Thus, instead of Israel's leaders seeing their job as building Israel's capacity to defend itself, the defense system and military industry are guided by interests to preserve Israel's vulnerability as the prerequisite for more American aid.

### **Cultivating a Culture of Dependence**

The Government of Israel's reliance on the American taxpayer sets a negative example which acts to encourage a culture of dependence. The Government invests many resources in encouraging citizens to join the workforce and in extolling initiative and

entrepreneurship. Yet when a country like Israel, with its highly developed cutting-edge market, can live off someone else's tab, these state-backed initiatives lack moral standing. In cultivating a culture of dependence, the Government of Israel causes incalculable damage to Israeli society.

### **Short and Long-Term Projections**

Projections for the coming decades predict that the economic and strategic damage to Israel as an outcome of American aid will only increase.

The global economic crisis, added to the policies of the Bush and Obama administrations, have placed America heavily in debt, with forecasts of slow growth and continued high unemployment. Most economic indicators show Israel's position as better than America's, with unemployment in America at 9.8%, versus 6.6% in Israel. US debt-to-GDP ratio stands at 94% compared to 79% in Israel and the US Government deficit exceeds productivity by 10%, more than double the Israeli rate.

All this will oblige the American taxpayer to change its spendthrift ways and tighten its belt. Indeed, the main issue of the November 2010 Congressional elections was government waste of taxpayer dollars. The main, perhaps sole, plank of the "Tea Party" platform, which gained much power in those elections, was a call to reduce government spending. At a certain point, US taxpayers may ask themselves why they should be subsidizing a developed country like Israel.

Moreover, many commentators believe that America's standing and its ability to influence policies of other countries is in decline. This process stems from the economic crisis, America's military involvement in Iraq and Afghanistan along with the rapid growth of rising powers such as China, India and Brazil. America will continue to hold immense power on the international stage for decades to come, certainly, yet Israel's need to develop alliances with other countries will take on increased importance.

### **Summary**

The extensive economic and strategic damage wrought by America's financial assistance to Israel cannot be assessed with full accuracy until Israel disconnects itself from it entirely. Based on economic and geopolitical projections, this aid is bound to undergo changes, while its damaging effects will only worsen. Israel would be well served if the Government acts to pre-empt the inevitable and initiate a disengagement.