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### ISRAEL'S DEFENSE BURDEN GROWS, DESPITE THE PEACE WITH EGYPT

David Kochav

#### The Political and Strategic Background

The completion of the Israeli withdrawal from Sinai is unquestionably the most important politico-strategic event of the year. It marks the beginning of a new chapter in the development of relations between Israel and Egypt, and impresses its stamp upon the Middle East as a whole.

One may assume that Egypt, after receiving control over the whole of Sinai, will come under heightened pressure to return to the ranks of the Arab states hostile to Israel. The rulers of the other Arab states, including Saudi Arabia, have expressed publicly their hope and belief that Egypt would, under one pretext or another, join the united Arab front, which would then strive for renewed confrontation with Israel. Of course, Israel expects this hope to be revealed as a mere will-o'-the-wisp. President Mubarak has declared publicly, and reiterated privately, that if Egypt should again draw near to the Arab countries, and even to re-establish diplomatic relations with some of them, it will not be done at Israel's expense. He has emphasized that to Egypt, peace with Israel is an irreversible process. Israel's defense policy is founded on the assumption that Egypt will in fact live up to the obligations it undertook to honor when it signed the Camp David Accords, and that the heavy price which Israel has paid for peace shall not have been in vain.

It is likely in any case that, in the next few years, the states of the "Rejectionist Front," including Syria, Iraq, and apparently Jordan also, will continue to maintain their policy of active hostility to Israel. The center of gravity of Arab-Israeli violence will undoubtedly shift to the "Eastern Front." Israel's defense policy will have to take into account the danger of an outbreak from that quarter. The rejectionist states' politico-strategic planning very likely expects that, should there in fact occur a deterioration of relations leading to military confrontation on the eastern front, it could drag Egypt into joining a united Arab front.

In short, Israel will not be able to base its defense policy on the expectation of a period of quiet and tranquility along its borders.

One may further assume that the PLO will continue to be a cause of ferment in the territories. The PLO, with the encouragement of Syria, Iraq, and apparently the Soviet Union as well, will continue to be a focal point for the sharpening of the enmity against Israel. This will be manifested in attempts to infiltrate into Israel by way of the northern and eastern borders and by hostile activities in the territories. Even if there should be real progress toward the gradual realization of the autonomy

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plan for the residents of the territories, a prospect which the PLO activity places in great doubt, one may yet assume that some Palestinians in Lebanon and the territories will continue these activities.

Another event which has affected Israel's defense policy is the appointment of Ariel Sharon as Defense Minister in 1981. Whether Sharon will be faithful to the moderate declarations of his first few weeks in office is still a mystery. In any case, there are already clear signs that Sharon has begun to strengthen political control over the Israel Defense Forces (IDF). This is in contrast to the period in which Prime Minister Begin retained the Defense portfolio and could devote only a small part of his time to the job. During that period the power of the Chief of Staff increased, not only as Supreme Commander of the Army, but as an influential decision-maker.

#### The Level of Defense Expenditures

Israel's defense burden is among the heaviest, if not the heaviest, in the world, relative to the size of the state and the extent of its resources. The most common index of the defense burden is the ratio between defense expenditures and the GNP. During the 1974-79 period, defense expenditures averaged 28.6% of the GNP, in comparison with less than 5% in the U.S. and 3-4% in the western European countries. In Israel's case, GNP alone does not reflect the total resources at the state's disposal, therefore we should measure the defense burden as a percentage of total resources, or GNP plus the import surplus (the excess of imports over exports, which is financed by capital flows). Even so, we find that the defense burden averaged 21.7% in those years.

Table I (page 6) presents the development of Israel's defense burden since the middle of the 1950s. The table indicates a clear trend of steady growth in spending, which peaked after the Yom Kippur War. This growth derived principally from a continuous rise in the real level of defense expenditures. Another reason for the increase was the substantial decline in economic growth following that war. The rate of growth of the GNP declined to an annual average of 2.5% during the period from 1974 to 1980, in contrast to the more than 9% average from 1954 to 1972.

Though the rate of defense spending has declined somewhat since 1980, it nevertheless remains at the very high level of over 25% of the GNP, and over 21% of total resources. Expenditures in 1981 increased beyond the level of the previous year largely due to stepped up defense imports. There were, in the course of the years, substantial fluctuations in the rate of supply of major weapons systems, such as warplanes and tanks, particularly from the United States, which do not necessarily reflect meaningful fluctuations in the level of defense expenditures from one year to the next.

Even if allowances are made for the massive one-time expenditures which the redeployment of the IDF has necessitated, one can still conclude that the signing of the peace treaty with Egypt has not significantly mitigated Israel's defense burden.

#### High Maintenance Costs

One of the basic reasons for the high level of local defense expenditures in the period following the Yom Kippur War was the high cost of maintaining the IDF's sophisticated weapons systems. Despite the fact that these include the most advanced and most expensive warplanes and tanks, this does not allow savings in current defense spending. On the contrary, such sophisticated systems require very intensive

maintenance by a highly trained corps of technicians, all in the framework of an expensive local infrastructure.

One may explain this phenomenon in economic terms: though modern weapons systems are capital- and technology-intensive, they do not economize on labor, because they demand a high level of maintenance, which is labor-intensive. Indeed, though these advanced weapons substantially increase the IDF's firepower, they also require increased local expenditures.

#### Freeze on Defense Expenditures

After Ariel Sharon's appointment as Minister of Defense, the appropriate level of military spending was reevaluated. It should be pointed out that before his appointment Sharon had declared that Israel would have to accept economic constraints and that it would have to freeze or even cut the defense budget. He pointed out that this would not necessarily reduce Israel's level of military readiness, if the IDF were tailored to conform to budgetary limitations. Indeed, after becoming Defense Minister Sharon induced the government to freeze the level of defense expenditures for five years.

This freeze refers, in the main, to local defense expenditures, whereas defense imports will undoubtedly be influenced by the changes which are anticipated in future American military aid. This decision will be of great importance should it indeed be implemented in spirit and letter.

The defense budget for the fiscal year 1982-83 reflects this policy. According to the Budget Proposal, defense expenditures in calendar year 1982 will amount to I.S. 57.6 billion in 1981 prices, as compared to I.S. 65.2 billion in 1981 (see Table II, page 6). The decline is the result of a drop in defense imports, which for reasons mentioned above were unusually high in 1981. Local defense expenditures, which are more stable and more useful for the purpose of comparison over time, will be in 1982 at a level similar to that of 1981 -- more than I.S. 35 billion in 1981 prices (see Table II).

#### The Influence of Defense Expenditures on the Composition of Production and Prices

Israel's high defense expenditures, particularly their local component, have had an enormous effect on the economy. There is no doubt that if Israel's defense spending conformed to the level maintained in the developed countries, it would influence the composition of the national product and the rate of inflation. Such a change would most likely produce a significant increase in investment, which has been quite low since the Yom Kippur War. This low rate of investment has probably been one of the causes of the slow growth of the GNP. A higher level of investment would have contributed to the acceleration of that growth.

The high level of local defense spending is another highly inflationary influence. Because the government could not finance its expenditures out of tax revenues and because it was hard put to cut its civilian budget, it was left with no choice but to maintain a large excess demand. This was manifested in the gap between the monies absorbed from the public by taxation and by the sale of bonds of low negotiability (i.e., savings plans, provident funds, etc.), and its local expenditures. That is, the government was forced to "print money." Although the link between the level of defense expenditures and the government's excess demand is indirect, there is no doubt that a strong link

between the two exists. One can assume that, with a lower level of defense spending, the government would be able to reduce its excess demand and thereby induce a significant slowdown in the rate of inflation.

#### American Military Aid

Israel undoubtedly could not have maintained its level of defense expenditure over the years without the aid it receives from the United States. Table III summarizes the scope of American military aid for the period 1980-82. Regular aid for defense purposes amounted to nearly \$1.3 billion in 1980 and over \$1.45 billion in 1981. In addition, Israel received "special" aid to help finance the IDF's redeployment following the withdrawal from Sinai totalling \$716 million in 1980 and \$905 million in 1981. These sums were received within a special framework for redeployment aid, amounting to \$3.2 billion, which was agreed upon following the Camp David Agreement.

It ought to be emphasized that less than half of U.S. military aid is given in the form of grants. Most of the military aid is in the form of loans at interest rates only somewhat lower than the rates commercially available in the U.S. In addition, 75% of "special aid" is in the form of loans.

Israel has not received full financial compensation, either in terms of the sums involved or in the conditions attached, for the expenditures connected with the evacuation from Sinai. In these respects it seems that Israel conducted its negotiations with the U.S. Government, at Camp David and afterwards, in such a way as to impair its own economic interests. Furthermore, Israel renounced assets (roads, water and sewerage systems, communications, etc.) which cost billions of dollars to build, and transferred them to Egypt without any compensation.

The scope of the "regular" American aid for 1982 is estimated to amount to \$1.5 billion, half in loans and half in grants. "Special aid" is expected to amount to \$525 million.

Total American military aid to Israel (including special aid) has been roughly the same as the cost of all Israel's direct military imports. There is no full correlation between these sums, as Israel imports military equipment not only from the United States but from Europe as well. In addition, Israel spends great sums on indirect military imports, such as raw materials and components for local military production. Despite this, there exists a rather high correlation between the level of American aid for defense purposes and the level of direct military imports. There is no doubt that the American aid has served to increase U.S. exports to Israel.

Israel has tried to convert a portion of its American aid dollars into local currency in order to finance local weapons production. The United States has responded to this request by allowing the conversion of limited sums.

#### Local Military Production and Exports

Local defense expenditures had considerable effect on economic activity in Israel, particularly in several industrial subsectors. Total local purchases by the Israeli Ministry of Defense in 1981 are estimated to have exceeded I.S. 23 billion, concentrated for the most part in industry and construction.

In Israel, as in the developed industrial countries, the military plays a key role in the metals and electronics industries and in other sophisticated industries. This is manifested in a number of ways: in direct aid to R&D in these industries, which is financed partly by the military establishment and partly by other government ministries; in the setting of high standards for the products which the IDF orders; in large scale military orders; and sometimes in measures to encourage exports. The rapid development of industries producing for the military has also

contributed significantly to the expansion of industrial exports. The extent of Israel's military exports has been estimated at \$810 million for 1981, which constituted about 22% of all industrial exports other than diamonds.

Israel's Military Industries is the country's largest exporter of military products. Israel Aircraft Industries and Tadiran Electronics deal in hundreds of millions of dollars of exports per year. The rapid growth of military exports has been facilitated by the excellent reputation of Israeli military products, the multiplicity of potential conflicts in various regions, and by the aggressive marketing system which the Israeli enterprises have developed. In the past the American approach has been to restrain the export of military products manufactured in Israel containing American-made components (as in the case of the Kfir warplane), but now it appears that the Reagan Administration will lift the restrictions imposed under Carter on such sales.

#### The Lavie Aircraft

One decision of great importance for the future of the military industries was Defense Minister Sharon's determination to continue to develop the Lavie aircraft. This plane is intended to meet the needs of the Air Force in the 1990s, particularly by replacing the Skyhawk, which by then will be obsolete. The plane's development is estimated to cost about \$1.2 billion. The development of the Lavie's systems will not be conducted by Israel Aircraft Industries alone, but by many other enterprises throughout the public and private sectors. The Lavie project is estimated to provide, directly or indirectly, employment for about 18,000 workers. The Lavie's development will also provide a strong stimulus for the technological advancement of sophisticated industries in Israel. Nonetheless, it is not yet clear how Israel will finance that development. Even if the Lavie's price tag should be lower than that of its competitors, there are political realities which may inhibit potential buyers from purchasing warplanes of Israeli manufacture, as the case history of the Kfir demonstrates.

#### Unforeseen Factors

The developments we have discussed concerning Israel's defense burden are based on a number of strategic assumptions mentioned at the outset of this survey. It goes without saying that the degree of Israel's defense burden is especially sensitive to any unexpected political developments. The measure of uncertainty in this area is, of course, very great.

Any dramatic escalation of tensions on the eastern front, including Lebanon\*, or an increase in terrorist activity in the territories, would be likely to adversely affect the level of defense expenditures. In sum, such events might increase the defense burden. At this stage no new factors present themselves which might lighten the load Israel must bear, despite our basic assumption concerning the faithful implementation of the Camp David agreements.

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\* *Editor's note: Mr. Kochav's manuscript was completed before the outbreak of hostilities between Israel and PLO forces in Lebanon. It is expected that this military action will significantly change any projected 1982 figures in this paper.*

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David Kochav is currently a senior economist with one of Israel's largest commercial banks. In the past he has served as Economic Advisor to the Israel Ministry of Defense, head of the Economic Planning Authority in the Ministry of Finance, and for several years as an economic advisor in the World Bank, Washington. This Jerusalem Letter was prepared by him as part of the current project studying Israel's political economy, conducted in association with the American Enterprise Institute for Public Policy Research.

TABLE I: INDICATORS OF ISRAEL'S DEFENSE BURDEN (percent)

<u>Defense Expenditures</u>	<u>1955-61*</u>	<u>1962-66</u>	<u>1968-72</u>	<u>1974-79</u>	<u>1980</u>	<u>1981 estimate</u>	<u>1982 forecast</u>
As % of GNP	8.3	10.3	21.6	28.6	25.3	27.8	23.5
As % of total re- sources (GNP + import surplus)	6.9	8.4	17.6	21.5	21.2	22.9	20.0

\* Not including 1956, the year of the Suez Campaign

Source : The Israel Central Bureau of Statistics

TABLE II: DEFENSE EXPENDITURES, 1980-82 (in I.S. millions)

<u>Defense Expenditures</u>	<u>1980</u>	<u>1981(est.)</u>	<u>1982 in 1981</u>	<u>Quantitive change from</u>	
				<u>current prices</u>	<u>prices (est.)</u>
Total:	25.1	65.2	57.6	11.5	-11.7
Of which: local	14.8	35.3	35.8	-1.5	1.4
imports	10.3	29.9	21.9	29.8	-27.0

Source: Ministry of Finance

TABLE III: UNITED STATES GOVERNMENT ASSISTANCE (in US\$ millions)

	<u>1980</u>	<u>1981</u>	<u>1982</u>
	<u>(actual)</u>	<u>(estimate)</u>	<u>(forecast)</u>
Total United States Assistance	<u>2832</u>	<u>3147</u>	<u>2800</u>
Military	71%	75%	72%
Economic	29%	25%	28%
Grants	<u>51%</u>	<u>59%</u>	<u>55%</u>
Loans	49%	41%	45%
Total Military Assistance	<u>2009</u>	<u>2362</u>	<u>2015</u>
Grants: Regular	(646)	(729)	(745)
Special	(352)	(350)	(-)
Total	<u>998</u>	<u>1079</u>	<u>745</u>
Loans: Regular	(647)	(728)	(745)
Special	(364)	(555)	(525)
Total	1011	1283	1270
Total Economic Assistance	<u>823</u>	<u>785</u>	<u>785</u>
Grants	455	785	785
Loans	368	-	-