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National-Strategic Spheres of Activity

Preparedness of the Ministry of Defense and the IDF to Implement the Memorandum of Understandings with the United States for the years 2019 – 2028 on the Matter of Defense Aid

Abstract



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Background

In September 2016, representatives of the delegations of Israel and the United States governments signed a memorandum of understandings¹ regarding defense aid to Israel in dollars and joint missile defense plans for the years 2019 – 2028. A portion of the aid funds was converted into NIS and is being used for procurements from the defense industries in Israel. According to the MOU, the currency-exchange funds will be gradually reduced, mainly as of 2025, until they are cancelled in 2028.

1 Memorandum of Understandings – MOU.



Key figures

**USD 3.8 billion
(ILS 13.8 billion²)**

per annum – the total of the defense aid and the American support of the joint missile defense plans for 2019 – 2028

ILS 12 billion

the Ministry of Defense's total annual procurements from the defense industries in "recent years"³

Several billions of NIS

are annually required to implement the Ministry of Defense's procurement policy in NIS

ILS 5.6 billion⁴

will be deducted per annum from the Defense Establishment's⁵ annual NIS sources of funding as of 2028 as a result of the implementation of the MOU.



**USD 815 million
(ILS 3.2 billion⁶)**

per annum were converted into NIS from the aid funds in 2013 – 2018 for procurements from the defense industries in Israel

38%





the ratio of total sales of the three largest defense industries⁷ to the Ministry of Defense to the currency-exchange funds in 2013 - 2018

Audit actions

-  From July 2018 to September 2019, alternately, the Office of the State Comptroller examined the Preparedness of by the Ministry of Defense and of by the IDF for implementing the MOU. The audit was conducted in the Ministry of Defense and in the IDF.
-  The subcommittee of the Knesset State Control Committee decided not to submit to the Knesset and not to publish parts of this report for national security reasons, pursuant to section 17 of the State Comptroller Law, 1958 [Consolidated Version]. The classification of these parts does not prevent the understanding of the fundamental issues raised in this audit.

2 In NIS according to the exchange rate of ILS 3.63/USD 1, which was defined in the State Budget Proposal for 2019.
 3 As written in Ministry of Defense documents of December 2017.
 4 In NIS according to the exchange rate of ILS 3.63/USD 1, which was defined in the State Budget Proposal for 2019.
 5 In this report, the Defense Establishment is the Ministry of Defense and the IDF.
 6 In NIS according to the average annual exchange rates of the Bank of Israel.
 7 Israel Aerospace Industries Ltd., Elbit Systems Ltd. and Rafael Advanced Defense Systems Ltd.

Key findings

-  **Lack of examination of the implications of implementing the MOU relating to security aspects have not been examined:** the Ministry of Defense has not yet examined the possible implications of the reduction in the Ministry of Defense's procurements from the large, medium-size and small defense industries in Israel resulting from the implementation of the MOU, including on the IDF's strengthening and on the Defense Establishment's preparedness for emergencies, and it did not examine the possible adverse impact on national security resulting from these implications. Furthermore, the Ministry of Defense, in collaboration with the IDF, did not conclude the alternatives to reduce the mentioned procurements.
-  **The Ministry of Defense has not yet defined the specific areas of research and development and manufacturing that should be maintained in the defense industries in Israel:** the Ministry of Defense, in collaboration with the IDF, has not yet determined the specific areas of R&D and manufacturing in the defense industries whose manufacturing independence and functional continuity should be maintained during war and subsequently in order to support the IDF's activities. The IDF has not mapped and has not prioritized the war materials whose manufacturing should be maintained in Israel⁸ and it has not issued its position in this regard to the Ministry of Defense.
-  **Lack of complete information in the Ministry of Defense regarding the expected implications of implementing the MOU on the reduction of the NIS sources of funding that will be available to it:** the Ministry of Defense does not have complete information about the possible implications of implementing the MOU on a possible reduction in the NIS sources of funding that will be available to the Defense Establishment until 2028 for the purpose of procurements from the defense industries in Israel. This is due to a failure to examine alternatives for making NIS sources of funding available and a failure to determine the costs for retaining Israeli production lines and the costs in respect of duplicate production lines⁹ and a "logistics trail."¹⁰ This makes it difficult to discuss solutions for this issue at a national level with all relevant government ministries.
-  **Implementation of the Ministry of Defense policy regarding the procurements from the aid funds:** it appears that, as of 2028, the sum that will be required to implement the policy approved by the Director-General of the Ministry of Defense in February 2019 for retaining the Ministry of Defense procurements in NIS from the defense industries may be higher than the estimated annual sum to be

8 Among the Prime Minister's comments of August 2007 to the State Comptroller's reports it was mentioned that the IDF had reported that in June 2007 it had determined several production lines that should be maintained.

9 The construction and operation of production lines outside of Israel concurrent with the production lines in Israel, in order to retain particular development and manufacturing capabilities in Israel.






10 The possible increase in the NIS procurement costs for the purpose of maintaining war materials.

allocated for such procurements. As for the essential production lines, the Ministry of Defense has not yet determined the NIS sums that will be required to retain them.




The formation of teams in the Ministry of Defense and in the Ministry of Economy and Industry to examine the implications of implementing the MOU: the Office of the State Comptroller commends the formation of a Ministry of Defense team led by the Chief Economist of the Defense Establishment in January 2017 in view of the implications of implementing the MOU. The Office of the State Comptroller also commends the strategic work being performed by a team led by the Director-General of the Ministry of Economy and Industry that was formed in July 2018 to examine the impacts of implementing the MOU on the Israeli economy and industry as a whole, which has not yet been completed.

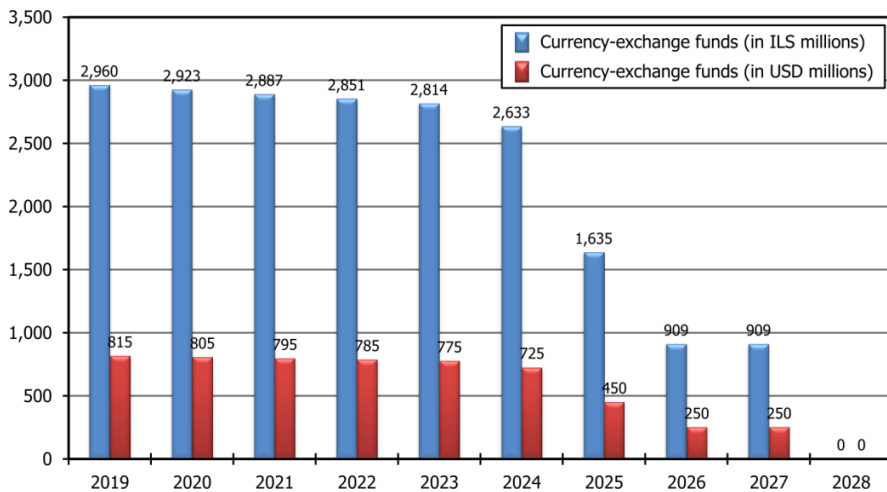
Key recommendations

-  The Ministry of Defense, in collaboration with the IDF, should examine all of the implications of the reduction in procurements, if such reduction occurs, from the defense industries in Israel, according to possible alternatives relating to aspects of the IDF's preparedness and readiness and relating to national security.
-  The Ministry of Defense, in collaboration with the IDF, should examine its ability to contend alone with the possible implications of implementing the MOU and the need to receive support at a national level, and should present a plan, if necessary, to the decision-makers in the Ministry of Defense and in other relevant government ministries for contending with the possible reduction in the NIS sources of funding and its implications, inter alia, on the IDF's future long-range needs, including those included in the multiyear plan currently being formulated in the Defense Establishment.
-  The team led by the Ministry of Economy and Industry and comprised of members from the Ministry of Defense and the Ministry of Finance should jointly determine the implications of implementing the MOU on industries in general and on defense industries in particular, so that it will be possible to take action to minimize the possible adverse impact on Israeli industry as a whole.
-  The Ministry of Defense, in collaboration with the IDF and the government defense industries, should determine the specific areas of essential research and development and manufacturing in the defense industries that should be maintained in Israel, and should determine the budget needed to retain them.
-  The Ministry of Defense, in collaboration with the IDF, should assess the implications of adopting the policy set by the Director-General of the Ministry of Defense to retain NIS procurements and should present to the relevant authorities in the government ministries involved in the matter all of the possible implications

of implementing the MOU, including the budgetary and defense implications that can be expected in the event of a reduction in the Defense Establishment's procurements in the spheres of activity that the Director-General of the Ministry of Defense determined will continue to be carried out in Israel.

 The Director-General of the Ministry of Defense, in collaboration with the director of the Government Companies Authority, should examine with the three largest defense industries their preparedness in light of the MOU.

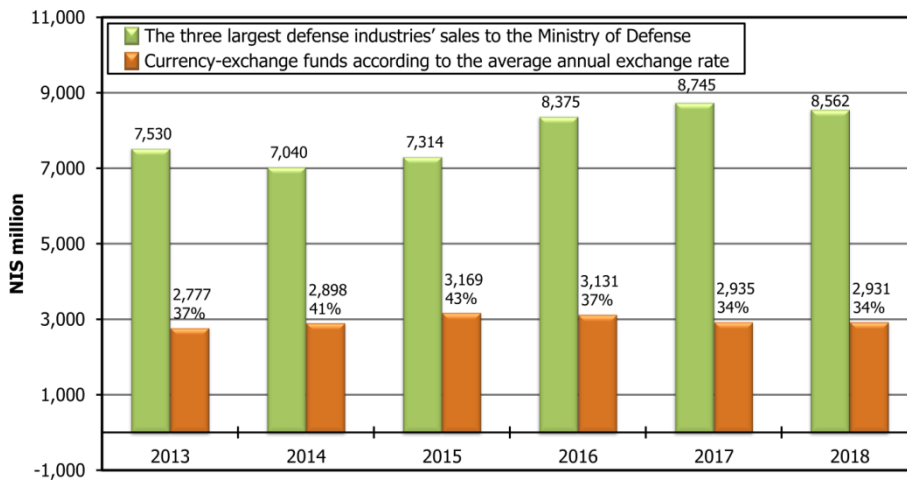
Total annual currency-exchange funds in 2019 – 2028*



* In USD millions, in nominal sums and in NIS according to the exchange rate of ILS 3.63/USD 1, which was defined in the State Budget Proposal for 2019. The sums in NIS serve to clarify the monetary volume of the currency-exchange funds in dollars.

Source: The Memorandum of Understandings for 2019 – 2028; processed by the Office of the State Comptroller.

The three largest defense industries' sales to the Ministry of Defense and the sums of the currency-exchange funds 2013 – 2018 (in ILS millions)



Source: Annual financial statements of Israel Aerospace Industry Ltd., Elbit Systems Ltd. and Rafael Advanced Defense Systems Ltd. for 2013 – 2018; State Budget Proposals for 2013 – 2018; some of the data were converted into ILS according to average annual exchange rates of the Bank of Israel; processed by the Office of the State Comptroller.

Summary

The MOU contributes significantly to the Defense Establishment's certainty with regard to the resources that are available to it, improves its multiyear planning and has a strategic impact on the relations between Israel and the United States. Pursuant to the MOU, a significant decrease is expected in the available NIS sources of funding that will be made available to the Defense Establishment, mainly as of 2025. According to the Ministry of Defense, this can be expected to reduce its procurements from the defense industries in Israel. The Ministry of Defense has not analyzed the possible implications of this reduction on the manufacturing independence in Israel and on the IDF's strengthening, or the magnitude of the possible adverse impact on national security. The Ministry of Defense, the Ministry of Finance and the Ministry of Economy and Industry should formulate a plan, if required, for the preparedness as a result of implementing the MOU.