

The Army and Society Forum

THE ISRAEL DEFENSE FORCES AND THE NATIONAL ECONOMY OF
ISRAEL



The Israel Defense Forces



The Israel Democracy
Institute

The Israel Defense Forces and the National Economy of Israel

An Article Summarizing the Seventh Session
of the Army and Society Forum

5 September 2003

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Introduction*

The subject of the seventh session of the Army and Society Forum of the Israel Democracy Institute, held in Summer, 2003, was “The Israel Defense Forces and the National Economy of Israel.” This session was held in the eye of the storm – that is to say, during the government debate on the 2004 state budget, a debate which naturally included a discussion of the defense budget. The session was attended by senior officers of the Israel Defense Forces officers headed by the chief-of-staff, the staff of the Israel Democracy Institute, academic researchers and public figures from various sectors of Israeli society.

A variety of opinions and approaches, summarized in this article, were expressed during the session. The present article is based on the participants’ comments and on the preparatory material distributed to the participants prior to the session.

Appendix A includes the session program; Appendix B provides a list of invited guests, according to the different discussion groups; Appendix C lists the background material distributed to the participants.

* We wish to thank Lieut. Col. Hadas Ben Eliyahu and Major Yehudit Sher from the IDF Department of Behavioral Sciences for their assistance in preparing this article.

What is National Resilience?

The Inter-Relationship between the Components of National Resilience

From a broad perspective, the components of national resilience may be divided into several principal categories: military (or physical) security, economic might, social cohesion, political and social stability, psychological health and well-being, levels of education and technology; and quality of life.

Due to its centrality in Israeli life, national resilience is often identified with military security. However, the other components of resilience are of key importance in two main respects. First, these components are important in and of themselves. Economic, social or political instability may cause internal rifts within the nation, just as a military threat may cause damage from the outside. Second, each of these components has an indirect impact on the others. For example, the larger the country's gross domestic product, the more resources it can allocate to defense without affecting other objectives: in other words, the larger the economic pie, the greater the ability to increase defense spending during periods of heightened threat. A high standard of living fortifies the resilience of the population and offers a measure of compensation for security tensions. Reducing economic and educational gaps, the quality of health care, and other factors, all contribute to the enhancement of social stability. On the other hand, an outbreak of dissent caused by the explosion of social tensions could, for example, lead to a reduction in domestic and foreign investments and tourism. Social tensions also have direct ramifications for defense, since a sense by some members of society that they suffer from discrimination

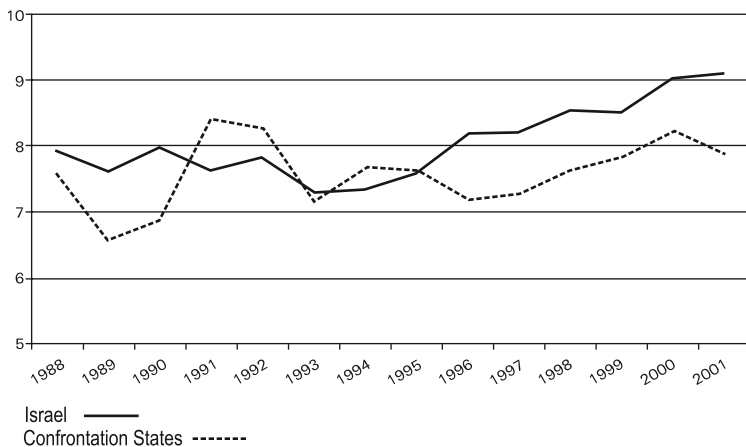
impairs feelings of identification and cohesion among a nation's citizens. A society's level of education and the quality of its health are also reflected in the general standard of health and education among those drafted to the army, and these factors, therefore, also influence military strength.

If national resilience is to be enhanced, society must also maintain a delicate and constant balance between the various components of such resilience. The country's national resilience is only as strong as the weakest link in the chain.¹

In examining the different aspects of national resilience, it may be useful to examine comparative data relating to each component over a given time frame. To illustrate this we shall offer a number of international

Diagram 1

Defense Spending in Israel and Neighboring Countries
(billions of US dollars at 1998 prices)



¹ Figures in this section are taken from the lecture by Prof. Ben-Bassat during the session.

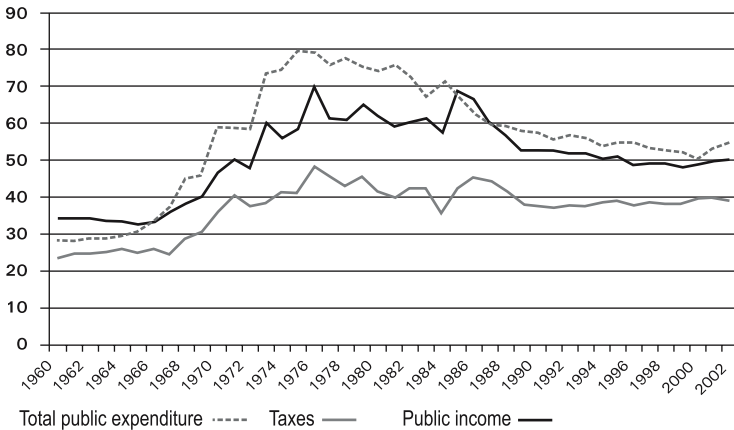
comparisons of data with reference to several components of national resilience.

One important comparative figure to be examined in the context of a discussion of military (physical) security is a comparison of Israel's defense budget with the defense budgets of its neighboring countries – Syria, Egypt, Jordan and Lebanon.

The diagram shows, for example, that from 1988 through 1995, Israel's defense expenditure was roughly equivalent to that of all its neighbors combined. In this context, it is important to recall that salary levels in the IDF are several times higher than in the armies of the confrontation states, which leads to an increase in Israeli defense expenditure.

Any discussion of the economic dimension of national resilience calls for a comparison between public expenditure on the one hand,

Diagram 2
Government Expenditure and Income, 1960-2002
 (As a percentage of GDP)

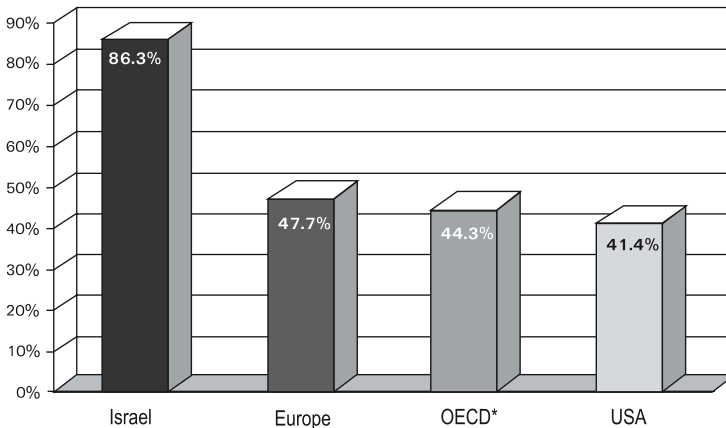


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and total public revenue and taxes on the other, each expressed as a percentage of the gross domestic product. This comparison is presented in Diagram 2. This diagram shows the government deficit (the shortfall between public expenditure and total public revenues), which is one (negative) index of national resilience. The greater the government deficit, the graver the damage inflicted on national resilience. As the diagram shows, between 1960-9, public revenues exceeded public expenditure (i.e., there was no deficit); the period between 1970-85 was characterized by the highest levels of deficit in Israel's public budget; and since 1988, Israel's budgetary deficit has gradually been reduced.

Diagram 3

Net Public Debt – International Comparison, 2002 (As a percentage of GDP)



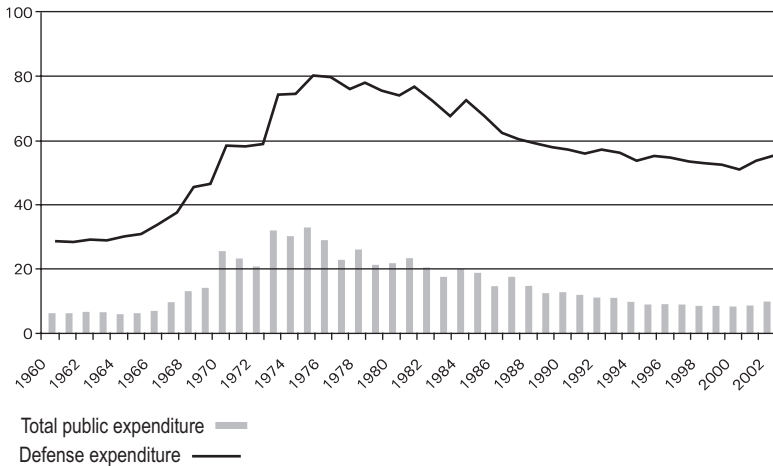
* The Organization for Economic Co-operation and Development (OECD) is an economic body linking countries committed to democratic government and the market economy. Some 30 countries are currently members; Israel is not a member, although it occasionally participates as an observer in meetings of the organization.

In making such comparisons, it is also important to consider the weight of the public debt as a percent of GDP. Public debt refers to the total money the state is obliged to borrow from external bodies and from the public in order to finance its activities. A high level of public debt is a threat to stability, while a smaller public debt reduces the risk of instability and financial crisis. Diagram 3 provides comparative data describing Israel's standing in this respect.

The above diagram shows that the public debt in Israel accounts for 86.3 percent of Israel's total gross product. This rate is higher than in the other areas included in the diagram.

It is also important to appreciate that a decline in the percent of product invested in one of the components of national resilience does not necessarily imply a reduction in the quantity of resources invested in that

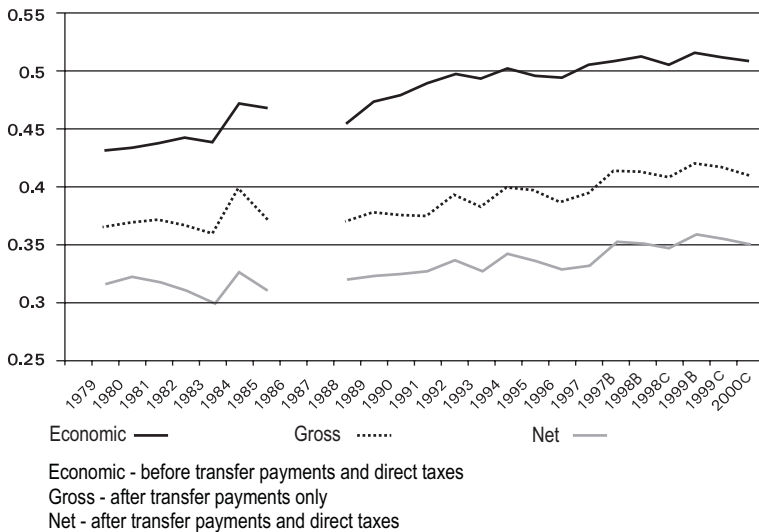
Diagram 4
Total Expenditure and Defense Expenditure
(billions of US dollars at 1998 prices)



component in absolute terms. An example of this appears in Diagram 4, which describes the defense component of national resilience.

Although in absolute terms, defense expenditure has increased slightly over the years, it has fallen as a percentage of the GDP, from over 20 percent in the mid-1970s to approximately eight percent of the GDP since the year 2000. During the same period, the total pie (i.e., the budget available for allocation to all the parameters comprising national resilience) has grown dramatically. Accordingly, in absolute terms, the utilization of a smaller proportion of total income has provided greater resources for defense.

Diagram 5
Gini* Index of Inequality in Income



* The Gini is an index for examining the inequality in the distribution of income among the entire population in society. The index values range from zero - total equality - to one - total inequality.

In social terms, it is important to examine gaps in income, education levels, etc. These gaps provide an indication of social tensions, which may, in turn, ultimately impair levels of investment. By way of example, we shall provide the Gini index for inequality in income (see previous page).

The diagram shows that in contrast to the sharp increase in the gap in terms of economic income (income from work, capital and pensions, and before transfer payments and direct taxes), the gaps in disposable income (after taxes) are more moderate. Over the years there has been a constant increase in the gap between economic income levels: in 1979, the Gini index of inequality in economic income in Israel was 0.43; by the year 2000, this index had reached 0.53. In other words, the past two decades have seen an increase in the economic income gap of approximately 23 percent. However, in terms of the gaps in disposable income, the Gini index of inequality was 0.32 in 1979, and rose some 12.5 percent through the year 2000. Thus, it appears that transfer payments and taxes have moderated the effect of the increasing disparity in economic income. Nevertheless, a constant increase, albeit a more moderate one, may also be seen in the index of inequality of income in Israel.

In response to the figures presented above, there are those who would argue that with regard to the issue of defense expenditure, the State of Israel is in a unique situation that prevents any comparison with the United States or Europe. Consequently, they would argue that it is a mistake to judge defense expenditure from the same standpoint as the other components of national resilience. The following, according to this argument, are the main reasons for distinguishing between defense

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and other expenditures. Israel's geopolitical situation is fundamentally different from that of other countries, and it faces a constant threat to its survival.

1. The investment in preventing terror is not symmetric to the investment by those who employ terror (a belt of explosives which costs \$150 to manufacture may kill 20 children on a bus in Jerusalem, whereas the cost of preventing terror acts by a dozen terrorists may run to millions of dollars).
2. The price of error is unique – in no other system in Israel is the price of an error an existential one.
3. The time frame for change in aspects of defense is much longer than in most other areas.
4. In the Western world, a balance of power in the ratio of one to five is normally considered to constitute a reasonable deterrence. This ratio does not apply in Israel as it implies that Israel would have a reasonable level of deterrence if, in the event that it were to sustain 100,000 casualties in an initial attack, it would have the capability of retaliating and causing 500,000 casualties among its enemies. Clearly Israel cannot accept such a ratio.

This article will focus on the military security factor, which is generally agreed to be the principal component of national resilience. We shall examine the reciprocal relations between defense and the other parameters comprising national resilience; we will discuss the principal problems posed by such relationships; and attempt to offer a number of possible avenues for solving these problems.

Military Security as a Component of National Resilience

Military security undoubtedly constitutes a principal component of national resilience. As discussed above, a reasonable level of physical security is an essential condition for the creation of economic activity. There can be no economic resilience without a certain level of security, and, conversely, it is impossible to maintain military resilience without economic resilience.

THE ARMY AS A CATALYST FOR ECONOMIC GROWTH: THE MILITARY INDUSTRIAL COMPLEX²

The IDF is a central force in the Israeli economy in terms of the quantity of personnel it employs and the professional training it provides, as well as in terms of its support for the security industries (as early as 1983, these industries' exports accounted for 16 percent of all Israeli exports). Israel is among the top ten countries in the world in most areas of defense-related exports.

Many entrepreneurs and employees in Israel's leading technological companies are graduates of IDF units in which they received their training. The IDF also promotes sales to the defense industries (Israel Aircraft Industries, Rafael, Military Industries and Elbit). Those who purchase from these industrial concerns are primarily interested in whether the IDF also purchases products from them. Thus, each shekel

² This section is mainly based on an article by Yoram Perry and Amnon Neubach, "The Military Industrial Complex in Israel," in *Democracy and National Security in Israel*, ed. Benjamin Heuberger and Ilan Ben Ammi, 1996.

invested by the IDF in acquiring weapons from the defense industries creates income of between two and a half to three shekels in terms of other sales. Accordingly, an economic scenario in which the IDF ceased to acquire Israeli-made products would involve direct damage to the general economy.

Israel's military industrial complex is one of the largest and most sophisticated in the world, relative to its population, and it is one of the key areas of economic activity in the country. A process of integration and convergence is evident between the interests of the military-industrial establishment and those of the political and bureaucratic establishment. This process of convergence has several ramifications that are potentially problematic. For example, it may lead to the development of an elite whose decisions and actions will exert real influence both on the national economy and on its foreign and defense policy, and even on its social systems and moral values. A profound de facto bond might develop between the military and economic structures in Israel, creating a relatively closed system whose actions and decisions will be much less subject to public scrutiny and criticism than other areas. Especially obvious, for example, is the lack of public debate regarding the issue of Israel's arms export policy – no one questions whether the economic benefits involved in arms exports could perhaps be obtained from commerce in various civilian areas. Nor is there any discussion of the question of whether arms exports damages Israel with respect to its foreign relations. There are other questions which remain unasked and unanswered.

While there is no argument that the IDF and the defense industry constitute a potent engine for economic growth, the development

of the Israeli economy in the direction of the defense industry seems to have been the result of a gradual and independent process, rather than of strategic decision-making. Moreover, and as we shall see below, serious problems arise when we attempt to estimate the true cost of military defense.

SECURITY VS. INSECURITY – DIFFICULTIES IN ESTIMATING COSTS

The “security burden” is defined as the total amount of budgetary resources allocated to the Defense Ministry. The “insecurity burden” relates to the total loss of profits and GDP lost due to Israel’s existence in an environment of conflict. Too low a level of security leads to falling investments, lost work-days, rising expenditure for the rehabilitation of people with disabilities, and a general impairment of the GDP. In other words, the security burden does not generally bring economic benefit to the nation, but it enables it to survive intact the experience of insecurity, and to minimize the economic damages necessarily created by a state of insecurity.

Insecurity has a very high negative economic price, since a security catastrophe also implies an economic catastrophe. On the other hand, as long as security seems to be under control, its output is not measured. This problem is characteristic of many economic actions – it is simple to measure inputs, but difficult or impossible to measure outputs. The problem is particularly pronounced in the area of defense – economists generally use market prices to measure output, but no market price can be established for the military’s output. What is the “market price” of a suicide attack at the Mahane Yehuda market? What

is the size of the economic gain secured by successfully thwarting such an attack?

From the moment conflict breaks out (such as the intifada or a war), it is possible, to some extent, to measure insecurity by measuring the damage to the economy. But if enormous investments are made in developing defense to prevent a distant and theoretical event (such as war with Syria or a nuclear attack by Iran) and such an event is indeed prevented, it would be difficult, if not impossible, to measure the investment's economic output.

Proposal for an Analytical Model for the Cost-Benefit of National Defense³

This model attempts to strike the proper balance between the cost of national defense and the level of growth.

The model's starting assumptions:

- A. The existence of a central cost for risk and insecurity. The central cost of insecurity is its influence on the economic behavior of individuals. A state of insecurity increases uncertainty in the lives of individuals, that is to say, in terms of the level of risks they face and the level of uncertainty regarding the political and economic existence of the state as a whole, and with regard to the personal existence of the individual.
- B. The economic behavior of individuals in a society changes with increased danger and insecurity.
- C. Defense expenditure is intended to reduce the level of danger and uncertainty faced by the state and individuals.

³ Based on a model developed and presented at the session by Prof. Danny Sidon.

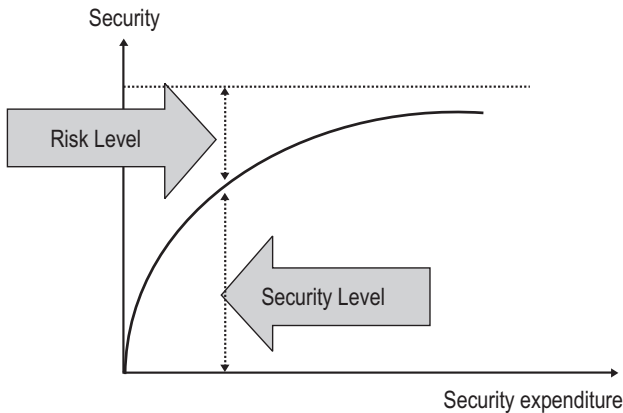
- D. The level of the security threat facing Israel is fixed and permanent, and is not likely to decline with the passage of time.
- E. The amount of funds allocated for defense purposes in Israel will not decrease significantly in the coming years.

In order to understand the model, two functions must be taken into account: first, the function of the production of defense, and second, the function of the compensation received in exchange for defense expenditure.

The security production function

Security is produced through the investment of its various inputs – generally speaking, the greater the expenditure on defense, the greater the security that is received. However, the marginal cost of defense depreciates, so that, at a high level of security, the addition of one unit

Diagram 6
Production Curves of Security



of expenditure adds less security than that same unit would contribute at a lower level of security (see Diagram 6).

Accordingly, the level of defense expenditure and the level of risk and insecurity have a negative correlation: the greater the expenditure on defense, the lower the level of risk and insecurity (see Diagram 7).

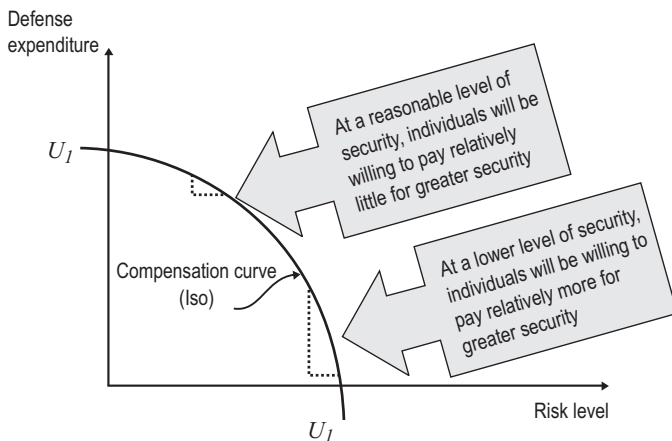
The greater the prevailing level of security, the lower the risk level and the resultant insecurity. Two processes take place as the security level rises:

1. Individuals become richer, since risks are smaller.
2. Individuals are more willing to invest.

There is thus a reciprocal relationship between security and growth. A greater level of physical security leads directly to a higher level of growth. Security provides existential and individual satisfaction, which

Diagram 7

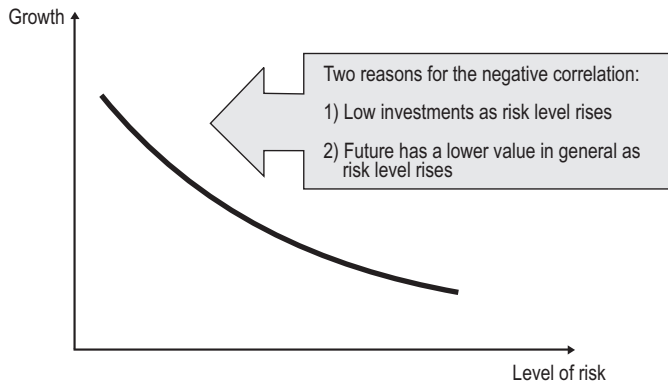
The Curve of Security Compensation (Iso)



in turn creates positive feelings and increases the level of investment by individuals. This is the economic benefit of security (see Diagram 8).

Diagram 8

The Connection between Growth and Level of Risk



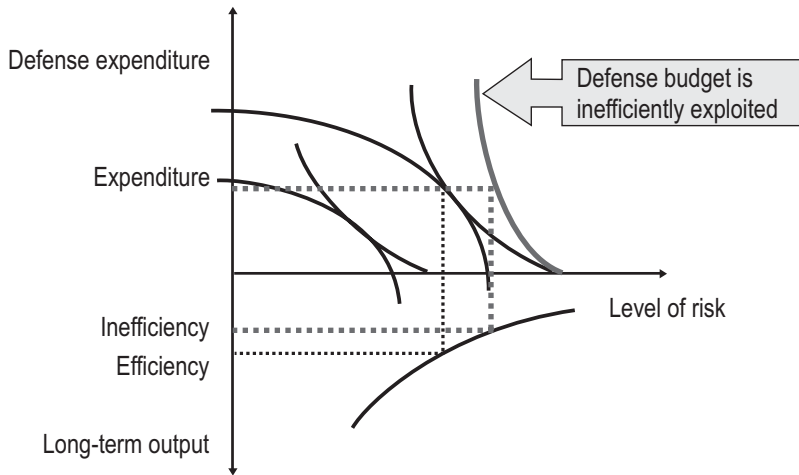
The combination of both functions enables us to observe the connection between defense expenditure and levels of growth, and to find the point of equilibrium: the optimum point in terms of cost-benefit analysis (see Diagram 9 on the following page).

It must be emphasized that if the defense expenditure budget is not effective, that is, if such expenditure does not provide the desirable level of security, the point of equilibrium does not lie within the optimum field, and the level of growth is impaired.

Until the outbreak of the current intifada, defense spending in the State of Israel accounted for six to eight percent of the GDP. This was evidently the point of equilibrium for the Israeli economy as far as defense was concerned. Israel differs from Europe in this respect: in

Europe, the point of equilibrium for defense expenditure may be two to three percent. In contrast, at the end of 2000, developments in Israel required a significant increase of investment in defense. Nevertheless, such a high level of investment in defense – at a level of ten to 12 percent of GDP – may, if it continues over a period of years, produce destructive economic results (see Diagram 9).

Diagram 9
Cost-Benefit Analysis



The Connection between Security Perceptions and Defense Expenditure

LONG-TERM PLANNING IN THE IDF

The required level of defense expenditure is defined on the basis of long-term planning by the Israel Defense Forces. Long-term planning takes into account several dimensions, and raises difficult dilemmas. In the following section, we shall attempt to discuss the complex considerations involved in the development of this type of planning.

Elements to be considered in the context of long-term planning

1. Circles of threat: Threats from terror and guerrilla warfare are to be found in the closest circle of threat; that from the neighboring states in the second and from such nations as Iraq, Iran and Libya in the third. Today, although the threat from Israel's neighbors (the second circle) has grown weaker relatively speaking, the threat from the first and third circles has increased greatly. (In the case of the third circle, while it is true that the threat from Libya and Iraq has declined, the threat from Iran has become more meaningful). Moreover, the struggle against terror and guerrilla warfare requires capabilities in such fields as targeted killings, highly sophisticated intelligence, electronic surveillance and the use of specially-trained units – all of which are expensive to maintain.

2. Priorities between branches of the armed forces: The differential investment in each of the three branches of the armed forces – air force, navy and land forces – reflects the operational perception that applies at a given point of time, one which varies with

changes in the nature of the threats being faced, the introduction of more advanced technologies, or upon the realization that an improved final outcome may be achieved through the investment of resources in one branch that are currently invested in another. Thus, for example, the threat from Iran requires investment in long-distance air capacity and in international intelligence.

3. Short-term and long-term responses: When there is considerable uncertainty regarding the future course of a conflict, the tendency is to concentrate on short-term responses. While this tendency is natural, it can cause problems if a threat emerges in the long term for which proper resources were not allocated at an earlier stage. On the other hand, the development of long-term responses may be perceived as a form of provocation if the enemy becomes aware of such developments.

Strategic planning must maintain a proper balance between several components

(A) The current defense expenditure; (B) the preparedness of the armed forces, as expressed primarily in available matériel and in the level of training of military personnel; (C) the size and composition of the armed forces; and (D) increased strength – achieved in the longer term, through research and development, acquisitions, etc.

The time required to adapt to changing realities varies for each of these components:

Component A consists of current expenditure (mainly used for preparedness, routine defense, etc.). If the short-term security situation changes and is rapidly identified, a response is possible with only a few days' warning – forces can be mobilized or reduced, larger or smaller forces can be deployed, etc.

In contrast, the implementation of a change in component B (the level of inventory of matériel and training) takes months or years. The identification of a window of opportunity in which the probability of war within a period of two or three years has declined, allows the military to take the risk of reducing stock for a given period, followed by adjustment as required. However, this involves a certain risk and may incur a price.

A change in component C – the size and composition of the armed forces (e.g., reduction in the number of airplanes, tanks, etc.) – will be spread out over a time-frame of five to ten years. After the 1973 Yom Kippur War, for example, most active components of the armed forces were increased, and it took some five years from the time the decision to implement the changes was made until the new matériel became operational.

Component D – research and development and the decision to invest in increased strength – is the most problematic in terms of the implementation of change. Weapons systems such as the Arrow only become operational some 15 to 20 years after the decision to develop them was made. Discontinuation of such projects at an advanced stage may delay the increase of military power for many years.

Additional dilemmas relating to long-term planning

1. Scenario-based versus generic capability planning – the natural tendency is to develop military strength in relation to a specific threat or scenario, and to perceive this scenario as reality in the following years. However, history has shown that even when the

predicted scenarios clearly fall into a particular type, it is important to maintain a generic capability suitable for meeting different scenarios. For example, the chances that Egypt will become involved in a war with Israel seem low at present – there is currently no concrete scenario in which Egypt would declare war against Israel. At the same time, the assumption that just because of the peace agreement with Egypt, Israel can completely forego air and sea capability on the Egyptian front is one that would involve a high level of risk.

2. Investment of resources in protection against a particular threat as opposed to multi-purpose investment - an additional consideration to be taken into account is the level of resources that should be invested in weaponry that has a single function (such as the Arrow, which provides a response solely against ground-to-ground missiles), as compared to the level of resources to be invested in components which, with limited modification, may address an entire range of threats: troops, tanks, and helicopters, or components which can provide a response to attacks by armed forces, terrorism, or other types of threats.
3. Risk management – an additional question to be resolved is whether it is desirable to maintain an outmoded operational capability within the system, and remove it only when a complete new capacity is acquired (for example, removing an outdated tank from service only when a new model is introduced), so that a measure of response is maintained at all times; or whether it is preferable in some cases, to save considerable amounts of money, even if it involves leaving the armed forces without a specific form of response at a given point in time.

4. The defense perception is not based exclusively on immediate threats. It is also a value-based perception, reflecting the manner in which the armed forces seek to position themselves. Should Israel confine itself to ensuring defense capacity on various fronts, or should it seek to maintain an image as a regional power? Each answer to this question will require a different type of military force and defense planning. As with other aspects, such positions reflect the political perceptions of the government. The government is supposed to set political objectives for the IDF, which are used to define military strategy.

In this context, it is important to stress that there is a correlation between Israel's self-image and the risk of war. Given the geopolitical reality in the Middle East, it is critical to avoid reaching a threshold of weakness that might encourage hostile elements to attempt to seize an opportunity for which they have been waiting.

The assumption that building Israel's military power helps channel the enemy's efforts into areas convenient for Israel, is not always axiomatic. The Syrian army, for example, has refrained from investing in fields in which it is obvious that it cannot achieve strategic parity with the IDF. At the same time, however, Syria's military has identified weak points in the Israeli system, and by developing an extremely inexpensive and asymmetric force, it has attempted to achieve partial parity of deterrence by threatening the Israeli home front.

Typical weak points in the process

As a general rule, several characteristic weak points may be identified in the long-term planning process:

1. The army strives for the ability to cover all options: the result is that there is sometimes a new response to a given threat, but there is also a tendency not to forego an older response.
2. The development of a new threat leads to an immediate investment in projects that are expected to provide a rapid response to the new needs. Practical priorities may change with time as the newness of the requirement fades, or as the need disappears. However, after any significant amount of time has passed, the discontinuation of such immediate response projects becomes difficult, especially if the investment in them has been considerable.

CHARACTERISTICS OF THE DEFENSE BUDGET

- **Sources:** Israel's defense budget derives from two sources: The State of Israel - (approximately 70 percent); and grants from the United States of America - (approximately 30 percent). The portion deriving from Israeli sources is spent almost entirely within Israel. In contrast, one of the conditions for receiving American aid, is that the IDF is required to spend over 75 percent of a US grant in the US, thus creating an obligation to purchase a larger proportion of weapons in the United States.

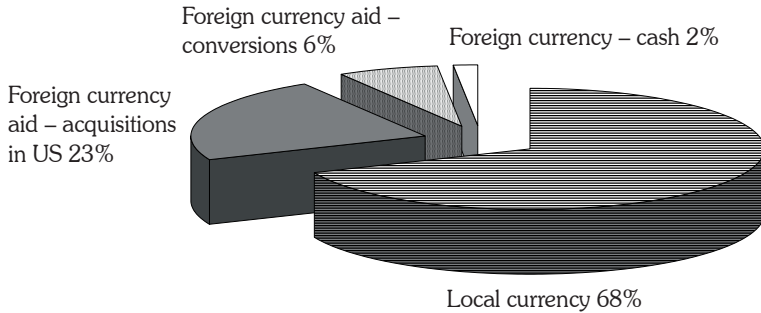
Diagram 10 illustrates the breakdown of the 2003 defense budget according to currencies.

- **Inputs** – Approximately 40 percent of the budget is expended on personnel, seven percent is devoted to payments and rehabilitation, and almost 40 percent is invested in military strength (acquisition of new weapons and replacement of obsolete items). The remainder of the budget is expended on basic and current expenses, maintenance, etc.

Diagram 10

Breakdown of the Defense Budget Framework for 2003

by currency

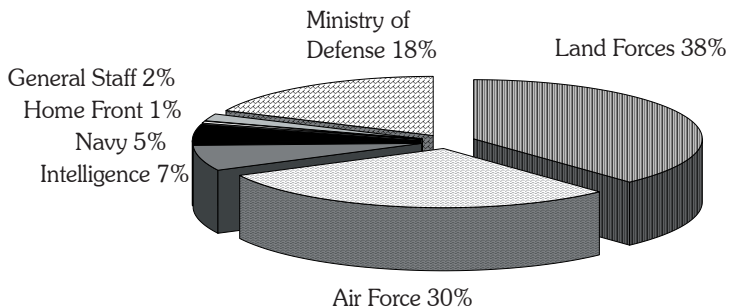


- **Branches** of the military forces – 38 percent of the defense budget is devoted to the land forces; almost 30 percent is spent on the air force; seven percent is for intelligence, approximately five percent goes to the navy, 0.5 percent is allocated to the home front (which also receives civilian budgets that do not form part of the defense budget), two percent is designated for the general staff, and 18 percent goes to the Defense Ministry (almost half the ministry’s budget is expended through the Rehabilitation Division in fixed payments allocated to individuals in accordance with statutory provisions – see Diagram 11).

- **Rigidity** – the possibility of modifying the budget from one year to the next is limited to a few percentage points. For example, it is impossible to reduce the scope of personnel from one year to the next by more than two or three percent without resorting to drastic steps and creating a crisis for those involved.

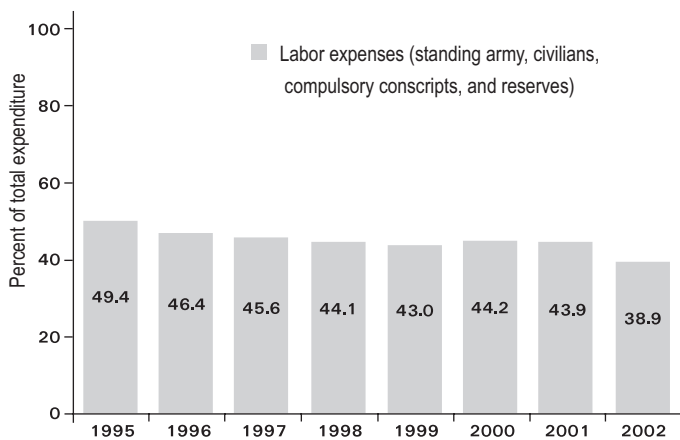
- **Personnel** – Expenditure on personnel accounts for some 40 percent of the IDF’s budget (including expenses for regular army personnel, civilian employees, regular troops, reserve troops during duty, and allocations for pensions). If the IDF were to pay an economic

Diagram 11
Expenditure by Service



wage to all conscripts on compulsory service, personnel expenses would expand and account for 55 percent of the budget (see Diagram 12).

Diagram 12
Expenditure on Personnel as a Proportion of Total Expenditure (%)



Source: CBS; Budget Division of the Ministry of Defense and the Financial Advisor to the Chief-of-Staff

Only a quarter of one percent (0.25%) of the regular army personnel serving in the IDF standing forces receive a salary, the monthly cost of which is estimated at more than NIS 35,000. Contrary to the public image, this figure is significantly lower than the proportion of those earning similar salaries in most public systems in Israel. The average gross salary of regular army personnel is lower than the average salary in the public sector.

Since the mid-1990s, the proportion of the personnel budget within the overall defense budget has been gradually reduced. This decrease is the result of such actions as outsourcing, a substantial cut in the number of more senior regular army personnel, and a reduction in personnel expenditure. According to the long-term plan, the IDF will cut 11 percent of the total number of employees in the coming years, including both regular army personnel and civilian employees.

- **Efficiency indices** – international comparison – It is interesting to compare Israel's level of defense expenditure and its total deployed forces with those of three European powers (the United Kingdom, France and Germany). With a budget of \$8 billion, compared to budgets of between \$23 billion and \$35 billion in each of the European powers, Israel maintains a similar level of deployment in terms of tanks and fighter planes (see Diagram 13).⁴

At the same time, the fact that Israel ranks first in the world in per capita dollar expenditure in the military field (based on disclosed sources) is

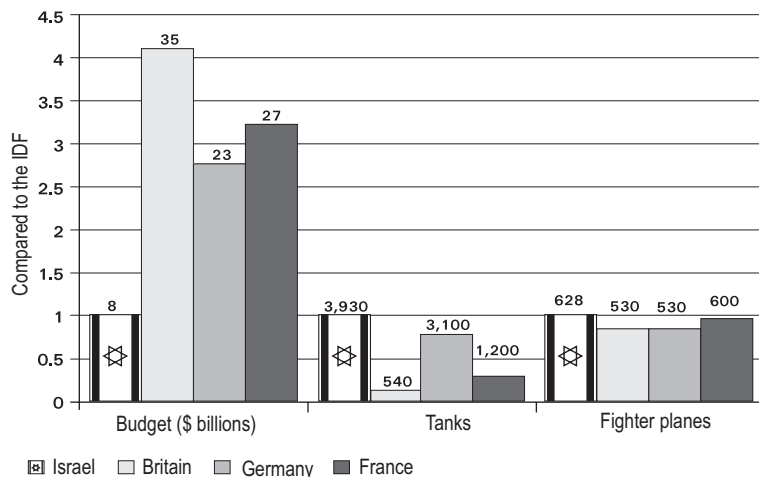
⁴ Even if we take into account the economic cost of compulsory service in Israel on the one hand and, on the other, Europe's expenses in maintaining and operating ocean-going fleets – which, of course, has no parallel in Israel – Israel still maintains its land and air forces at a much lower level of costs.

a finding worthy of special note. Israel also ranks third in the world in terms of the number of military personnel per thousand residents. The ratio of military personnel to total residents in Israel is approximately five times higher than in other Western countries (see Appendix D: An International Perspective on Defense Spending and Military Strength).

- **Cuts** – The proposed cut in the defense budget for 2003 and 2004 is one of the largest in the history of the State of Israel. A cut of this magnitude has been implemented only a few times: in the early 1950s, in the mid-1980s (in the context of the financial crisis of that period), and in the early 1990s (following the first Gulf War and the collapse of the Soviet Union).

Diagram 13

Comparison between the Armed Forces of Europe and the IDF



Source of data: SIPRI 2000, Jaffe Center; Budget Division in the Ministry of Defense and the Financial Advisor to the Chief-of-Staff

The Decision-Making Process in Preparing the Defense Budget

HISTORICAL REVIEW

In order to examine the manner in which the complex considerations and dilemmas discussed above are reflected in the work of the IDF, we shall begin with a historical review of the interface between the army, the economy and Israeli society during four key periods of Israel's history. This review is intended to provide a basis for identifying historical patterns and an understanding of the background to the current decision-making processes involved in the development of the defense budget.

First period – 1948 to 1967, from the establishment of the State of Israel through the Six-Day War.

This was a formative period, characterized by a mobilized society and a broad national consensus, particularly with regard to defense issues. In economic terms, this period saw rapid growth in excess of an average of ten percent per year. Defense expenditure constituted 7.5 percent of the GDP (including military imports but excluding US aid). Two prominent formative events took place during this period:

1. The chief-of-staff, Lieut.Gen. Yigael Yadin, resigned from his position following cuts in the defense budget. This was the only time in Israeli history that a chief-of-staff has taken such a step. In 1952, Levi Eshkol had taken over as minister of finance. The Israeli economy faced profound problems: the population of the country had doubled, and there were significant demands for employment, infrastructure and housing for new immigrants. One of the first steps Eshkol took in

dealing with the challenges he faced was to develop an institutional infrastructure, including the creation of the Budget Division in the Ministry of Defense. This division was charged with preparing an orderly annual budget. In contrast to Prime Minister David Ben Gurion, Eshkol decided to devote most of the nation's resources to civilian issues – infrastructure, immigrant absorption, industrial development, the creation of the development towns and so on, and to allocate to defense a lower level of priority. This decision meant that expenses on the defense system did not exceed seven percent of the GDP.

2. On the civilian front, the 1960s were characterized by an economic recession and social unrest. The presidents of Egypt and Syria felt that the young state was vulnerable and fragile in terms of national resilience, and the military threat that these countries posed was realized with the outbreak of the Six-Day War in 1967.

Second period – 1967-73, from the Six-Day War to the Yom Kippur War.

This period was dominated by the euphoria that followed the dramatic victory in the Six-Day War of 1967, and by a broad-based national consensus regarding the fruits of that victory. In economic terms, the first part of this period saw a doubling in national defense expenditure, from seven percent to 14 percent, together with rapid growth in the GDP of approximately ten percent.

One characteristic of this period was the tension between institutionalized social needs (the effort to create a welfare state) and growing defense needs. Unlike her predecessors, Prime Minister Golda Meir did not reach a clear decision in this respect. As a result, the lack of coherence between defense spending on the one hand, and civilian

expenditure required to maintain the welfare state on the other, now came into sharp relief for the first time.

Third period – 1974-85.

This period is referred to by economists as “the lost decade.” Annual per capita growth fell from 5.0-5.5 percent per year to just 0.5-1 percent. At the same time, defense expenditure during the same period was very high (almost 25 percent of GDP). The early years of this period, following the Yom Kippur War, were devoted to rebuilding Israel’s military force and replenishing military matériel – a process that greatly increased the defense burden on the economy. The Lebanon War (“Operation Peace for the Galilee”) erupted toward the end of the decade, ushering in a period marked by an absence of national consensus. Before the war, the then Minister of Defense Ariel Sharon and Finance Minister Yoram Aridor had agreed upon a five-year framework for the defense budget. The agreement did not survive even one year, and together with financing for the costs of the war, the budget was cut several times to reach a total amount of several billion shekels.

Fourth period – 1985-2001.

This period was marked by a transition from a mobilized society to a civilian and individualistic society. During this period, the economic recovery plan of 1985 constituted a turning point in the budgetary and financial fields, including the composition of the defense budget. Israeli society in general became more critical of the IDF, the government became less stable, and public debate on the defense budget became more vociferous. Criticism of the defense establishment during these years was not confined to budgetary aspects, but also reflected a

growing perception of inequality regarding compulsory service, reserve duty and other aspects. The debate between the defense establishment and the Ministry of Finance related to the ministry's focus on the need to rebuild Israel's economy after the damage caused by the "lost decade" and to strive to achieve economic normalization, as opposed to the needs created by the geopolitical reality as perceived by the defense establishment.

Key events during this period include:

1. The willing relinquishment by then Minister of Defense Yitzhak Rabin of one billion shekels from the 1985 defense budget – the defense establishment's contribution to the plan to stabilize Israel's economy.
2. Reserve duty reform in 1986 – the defense establishment accepted a change in the budgetary and pricing perception of reserve duty days, which were now included in its budget.
3. Cancellation of the Lavie project in 1987 – the government cancelled this major aeronautical project after the investment of hundreds of millions of dollars. This decision was the result not only of a debate between the defense establishment and the Ministry of Finance, but also a reflection of internal disagreements within the military establishment.
4. Decisions relating to the defense budget during the 1990s and through 2000 were made against the background of a perceived window of opportunity in the political and security situation against the background of the development of the Israeli-Palestinian peace process.

By way of illustration, Diagrams 14 and 15 describe the changes in Israel's defense consumption during the periods discussed above.

The above survey also reviews the decision-making processes relating to the development of the defense budget during each of the periods.

In this context, several key points may be noted:

- A. In preparing the budget, the authorities must constantly balance two genuine needs. On the one hand, Israel continues to face a unique reality in which it has incurred significant defense expenses throughout its 57 years of existence. On the other hand, civilian society in Israel demands and expects to enjoy a high standard of living and normalization. The point at which the responses to these two needs are correctly balanced may vary from time to time as circumstances change.
- B. Growth is a critical factor in maintaining this equilibrium. Substantial growth enables higher levels of expenditure while leaving adequate resources for other areas. (For example, a defense budget of eight percent of a larger GDP is preferable to a budget constituting ten percent of a smaller GDP).
- C. There is a reciprocal relationship between the level of defense expenditure and the level of economic growth. Defense expenditure at a level of 20 – 25 percent of GDP (as it was during the 1970s) does not permit growth, and is intolerable in economic terms.
- D. Israeli society is becoming increasingly civilian and individualistic in character. Israelis aspire to a high standard of living and the best possible level of security, and they expect the political and professional echelons to provide both. The democratic system in Israel obligates political leaders to take heed of these desires.

E. At certain points in time, a clear political decision is required regarding priorities. Such decisions were made by prime ministers David Ben Gurion in 1952 and Yitzhak Rabin in 1987.

Diagram 14

Defense Consumption as a Percent of GDP, 1950–2002

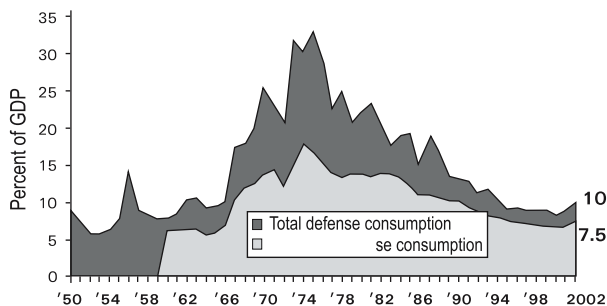
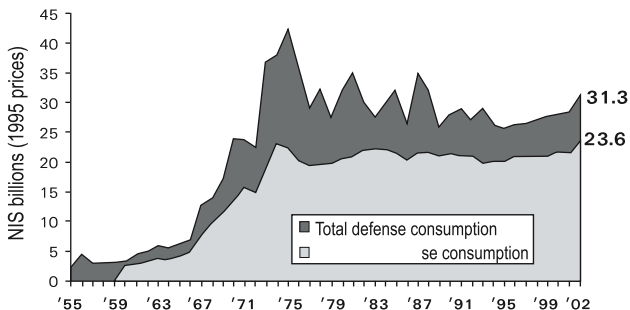


Diagram 15

Defense Consumption, 1955–2002



* No separate data are available for domestic defense consumption prior to 1960

** Source: Bank of Israel and CBS report; Budget Division, Ministry of Defense, and Financial Advisor to the Chief-of-Staff

ISRAEL'S DEFENSE VERSUS ISRAEL'S ECONOMY – THE PROBLEMATIC STATUS QUO

This historical review shows that over the years, tremendous tensions have developed in the relationship between two key elites in the State of Israel – the establishment entrusted with the country's defense, and the leaders entrusted with developing its economy. Reports occasionally appear of conflicts between the IDF and the Ministry of Finance in general, or of sharp disagreements between the Ministry of Defense and the Budget Division of the Ministry of Finance.

What is the reason for these clashes? There are several possibilities, which are particularly in evidence during the process of determining the defense budget:

Preliminary discussions prior to decision-making

- A. As noted above, national resilience is a product of numerous components. Despite this, discussions on the budget of each particular government ministry are attended only by the ministry in question and by the Ministry of Finance. Discussions focus on the specific problems of each ministry, while only the Ministry of Finance takes heed of the overall perspective.
- B. The discussion relating to each of the components of national resilience is not always in-depth. Attention is not always given to possible alternatives, and horizontal ramifications of budgetary decisions are not always taken into account. In most cases, for example, the process of preparing the budget does not include background discussions that might create an enhanced appreciation of the importance of a given issue (such as

understanding the significance of canceling one satellite within the IDF satellite project, or of waiving the acquisition of an advanced airplane). The discussions focus on inputs (numbers) rather than on outputs. Accordingly, for example, it is impossible to appreciate the price that will be paid for cutting NIS six billion from the defense budget in terms of the level of security it will be possible to provide after the cut is made.

- C. During budget discussions, the defense establishment and the Ministry of Finance present alternatives. However, each one of these entities is motivated by its own legitimate interests, and views the issues under discussion solely from its own perspective.

The Decision-Making Stage

- A. The political echelon is supposed to make the final decisions regarding the size of the annual national budget, and its allocation among government ministries. These decisions are expected to be based on national priorities. In practice, at this stage, professional civil servants with their own institutional biases continue to play a significant role.
- B. It is difficult to induce the political echelon to provide the necessary strategic guidelines (“the national narrative”).

Failure to Accept Responsibility for Decisions and the Lack of Continuity

Proper public management requires that the administration accept long-term responsibility. However, given the system of government in Israel, it is often possible to shirk this responsibility. The political echelon’s planning horizon, its depth of vision and the quality of its decision-making are not always adequate, due to the short terms of

office of any particular government and of its ministers. The result is that, in practice, the political echelon in Israel is not required to take responsibility for its decisions, including its budgetary decisions.

Criticism of the IDF

The IDF has been subject to considerable public criticism on budgetary matters, primarily in the following areas:

1. In general terms, the IDF does not have an ethos of thrift. The military system is designed mainly to spend money rather than earn it, and it does not focus on educating toward saving. The considerable level of waste in the military system is due mainly to the conservative character of the relevant economic structures (particularly the compensation structures for regular army personnel, and for pensions). These systems tend not to change and do not respond quickly enough to market changes.
Some argue that the IDF is unaware of the full cost of its operations. Misunderstandings regarding costs inevitably lead to waste. One example of this may be found in the budgeting for reserve duty days. This aspect of budgeting was transferred from the National Insurance Institution budget to that of the IDF, and the number of reserve duty days consequently fell by half. This reduction did not reflect a particular drop in the needs as much as it did the IDF's new understanding of the cost of reserve days and the price to be paid if the higher number of duty days was adopted.
2. Regular army personnel benefit from excessively high salaries. This criticism is leveled particularly at the pension payments, which begin at a relatively early age compared to the customary retirement age in the civilian marketplace. The level of these payments and the fact that they are made over a protracted period of time have significant economic ramifications.

Over the years, various conventions have been accepted by the IDF, which has refused to cut certain items in the budget (such as personnel costs). These conventions have been overturned in times of crisis, which suggest that it may have well have been possible to secure substantial savings in these areas at an earlier stage.

3. The IDF undertakes tasks that go beyond defense matters: absorbing new immigrants, working towards narrowing social gaps, integrating different populations, creating a technological infrastructure, etc. These functions are not usually profitable in financial terms, yet they consume valuable resources from within the defense budget.

Antagonism between the Ministry of Finance and the IDF

A. Mistrust: Over the years, an atmosphere of mistrust and competition has developed between the Ministry of Finance and the representatives of the IDF. Both sides openly acknowledge this reality. The root of the antagonism seems to lie in the approach used by the IDF in the past. The defense budget was managed as a “black box,” and the military generally contended that specific data from within the box could not be revealed. The failure to disclose data aroused suspicion in the Ministry of Finance, which lost confidence in the IDF’s reports. As time passed, this antagonism became endemic. Annual budget discussions now begin at a starting point of basic mistrust, and both sides have come to assume that it is impossible to change the situation. This mistrust also creates cyclical behavior patterns: since the defense establishment anticipates that its budget will eventually be cut, it frequently chooses to present an inflated picture of the threats being posed and of its consequent needs, in the hope that it will

ultimately obtain a budgetary response which will be at least acceptable from its standpoint.

A further result of this mistrust is that in order to protect the scope and size of the budgetary framework, the military establishment imposes restrictions on itself regarding large sections of the budget (for example, by signing long-term contracts), thus removing the possibility of cutting parts of its budget at a later stage.

B. The use of separate calculating systems: The IDF and the Ministry of Finance maintain two parallel and dissimilar calculating systems. The IDF examines budgetary costs on the basis of its own pricing system, while the Ministry of Finance prepares calculations of the cost to the national economy. These are completely different calculations, and the results obtained are equally dissimilar. For example, the IDF calculates that the cost of one soldier is NIS 2,000 per month, whereas in terms of cost to the national economy, the figure is NIS 6,000 (since the latter calculation also takes into account the loss to the economy of non-employment outside the IDF). Thus the viability of employing each additional soldier is seen in a different light.

C. Exploiting opportunities: Both sides work in opposition to each other and exploit their own opportunities as well as each other's weak points. If the level of security tensions rises perceptibly, the IDF manages to secure an increased budget. On the other hand, if there is an economic crisis and the national economy deteriorates, the Ministry of Finance is able to compel the IDF to tighten its belt.

Short-Term Perspective

Although the IDF prepares long-term plans, with all the inherent

complexities discussed above, the defense budget does not currently have a long-term structure. Indeed, in 2003 the defense budget was managed on only a quarterly basis, obliging the IDF to cope with additional cuts in each successive quarter.

This short-term approach has numerous costs. First, the IDF is reluctant to make long-term decisions, and this impairs long-term planning: the IDF postpones decisions, delays signing contracts and misses unique operational or technological opportunities. Hindsight often shows that these delays have led to increased costs. Furthermore, preparations made in accordance with such budgets are inefficient, since each element within the system has a different perception as to the substance of the next stage.

Second, the need to implement immediate cuts and the lack of time for proper processes to facilitate the reduction of routine expenses means that it is only the most available and flexible items that are cut. (In other words, the IDF cuts what it can, not what it should). The immediate price paid for this type of budget cut are matters such as reductions in flying hours for pilots and in the training time for reserve personnel, etc., as well as cutbacks regarding systems that usually require many years for development (new weapons systems require not just development, but also time for absorption, training, creation of operational capabilities, etc.)

Avenues of Action

THE POLITICAL AVENUE

1. Developing priorities between and among the components of national resilience

When making national security budgeting decisions in the face of scarce resources, two levels of budget distribution seem appropriate: distribution among the components of national resilience, and the distribution of resources within each one of these components, including the actual defense component itself.

The proper starting point for a discussion of such a distribution should be the policy regarding national resilience, and the national priorities of the State of Israel concerning its components (security needs, economic needs, education, health, etc.) The examination should also relate to other needs and elements. Discussion of priorities must take place prior to budgeting, since the budget is, essentially, a numerical manifestation of these priorities. In order for priorities to be properly determined, there is a need for a political leadership that manages risks and which, taking into consideration the political, security and other needs, establishes not only what budget level is required for each parameter, but also for which issues an immediate solution will be provided.

2. The decision-making body

Taking into consideration the discussion in Section 1, the strategic decisions regarding priorities need to be made at the national and civil level by the prime minister and the government. It is this political

echelon that should ultimately choose between the various components of national resilience. In terms of security, for example, the political echelon should decide what level of security the state will provide for its citizens, what risks may be taken, and hence, the range of resources in which to invest. Decisions such as whether to enter a particular area of threat and what equipment profile to adopt are decisions that also rest with the political echelon, and it would seem to be undesirable that the military echelon make such decisions on its own.

An amendment to the Government Law provided that the prime minister was to establish and operate a task-force responsible for providing ongoing professional advice on matters of national security. This statutory provision indicates a recognition of the need for a professional team to work together with the prime minister – a team that would provide the prime minister and the government with a complete overall picture of the situation and present alternatives in the area of national resilience within a timeframe that would enable in-depth analysis of all areas and of all relevant ramifications prior to reaching decisions (see Appendix E – Government Law, 5761).

3. The National Security Council (NSC) – to improve the government’s decision-making capability

The team described in Section 2 above should be an external advisory body providing professional support as a result of its broad and diverse approach and perspective; it should not, however, have any decision-making powers. The appropriate body for this purpose is the National Security Council, which is located, in organizational terms, within the Prime Minister’s Office.

As a third and independent element in the budget-making process, the NSC should be well-placed to receive all the necessary information. It should be able to summon all relevant bodies to appear before it, so that it can integrate information, prepare a master plan, carry out other preparatory work, and present alternatives for the distribution of the budget.

In order to ensure that the National Security Council has the necessary authority and support to function as a professional authority in contacts with the Ministries of Defense and Finance, its strength should be enhanced.

4. Enhanced Control

There are those who argue that the Ministry of Defense currently exerts inadequate control over the IDF. The interface between the two bodies is very close, and they often adopt identical positions. Accordingly, it would seem that the process of determining the budget should be more gradual and controlled.

The Knesset is empowered with an auditing role; one of its functions is to audit the executive branch. This function is not confined to the realm of defense – it applies to all the components of national resilience. The Joint Knesset Committee of the Finance and the Foreign Affairs and Defense Committees could be responsible for this multi-component supervision. The Basic Law - The National Economy already established that the proposed Defense Budget Law should not be submitted to the Finance Committee, as are the budget proposals of other ministries, but rather to the Joint Committee. This Basic Law further established that the government is to prepare a long-

term budget in advance of each financial year, including the budget for the coming year and a plan for the following two years. This provision reflects the principle that the budget planning process must be ongoing and continuous rather than short-term and disjointed. This is the only way to ensure that rational budget decisions are made based on in-depth work at the top level.

THE MILITARY AVENUE

1. Evaluating risks and expected damage

On a certain level, the IDF is expected to engage in a budget-planning process similar to that of the political echelon. The IDF must prepare a “vector of threats” and evaluate the probability that each particular threat might materialize, as well as evaluating the damage to be anticipated should that happen, in order to estimate the total expected damage. The results of this weighting process should then be presented to the civilian system.

2. Improving processes and striving for efficiency

During times of economic difficulty, it seems appropriate that the military consider possible ways to improve efficiency:

A. The need to consider the full cost of maintaining the armed forces: It is often argued that if the IDF were aware of the full cost of its existence and could take this into account in determining its budget, it could improve its own efficiency. As already noted, the transfer of the reserve duty budget from the National Insurance Institution to the Ministry of Defense resulted in a dramatic decrease in the number of reserve days. A similar process may also be required in terms of the pensions of regular army personnel and in

the economic cost of conscripts on compulsory military service. If the IDF could come to an appreciation of the full cost of these and other elements, it would be able to maximize the utilization of the allocated resources, and to decide by itself where to achieve savings and how to utilize the budgetary resources thus saved.

B. Outsourcing: In some cases, the outsourcing of functions to expert bodies may cut costs. Since it is generally difficult for elements within an organization to recognize the need to take appropriate steps to improve efficiency, it is necessary to consider what body should properly be charged with examining and identifying opportunities for using outsourcing to enhance efficiency within the military. The chosen body should have the required access to the military system and its data.

As an example of the use of this process, the Air Force recently decided that a particular component would be operated by an external company rather than by the Air Force's own School of Aviation. It may be appropriate to examine the possibility of taking similar steps with regard to additional services and entities that serve the IDF, such as logistical and manufacturing centers, medical institutions, etc.

C. Acquisition of capabilities versus development: A further issue that relates to economic efficiency is the question of which capabilities the IDF should develop by itself; which should be acquired externally; and in which cases would it be acceptable to rely on other countries. For example, it is worth examining whether the State of Israel can rely on intelligence from US satellites or whether it should develop an independent satellite project, given

the high overall costs that such a project entails. An examination and awareness of such questions is also required in order to improve efficiency within the IDF.

3. Defense only

As already noted, the IDF currently performs various functions that go beyond the sphere of defense. Some of these functions, such as absorbing new immigrants and nurturing youngsters from development towns, are directly related to the definition of the IDF as the “army of the people.” Other functions are essentially civilian, and are imposed on the IDF due to its status as the largest operational system in Israel. (One example of this is maintaining prison facilities.) There is considerable tension between the values of the IDF relating to its status as the “army of the people” and the national interest in developing and maintaining economic efficiency. One approach would be to have all functions that are currently performed by the IDF and which are beyond the purely military realm, transferred to external bodies having the appropriate expertise. Such a move would be consonant with the economic principle that bodies that concentrate on their particular areas of expertise are usually the most successful and efficient. An additional possibility is to decide that if the IDF should accept such tasks, it should receive appropriate special budgets for them, distinct from the defense budget.

4. Socio-Economic changes

The IDF must adapt to changes in economic and geopolitical circumstances in the context of its internal allocation of budget resources. In this respect, two global phenomena should be noted:

- A. Increasing life expectancy - every four to six years on average,

life expectancy increases by one year. This has far-reaching economic ramifications in terms of retirement age and pensions. The ages between 40 and 45 are certainly not perceived today in the same way as in the 1950s, when it was determined that the retirement age for regular army personnel would be within that range. The IDF should examine the relevant criteria and amend the retirement age appropriately.

- B. We have already noted the transition within Israeli society from a communal, collective and national orientation to a more individualist orientation. Some argue that this development will, sooner or later, affect the motivation of those serving in the IDF, since the motivation during compulsory service or reserve duty is traditionally derived - at least in part - from the willingness of individuals to make sacrifices for the collective, a willingness that is now perceived to be on the decline. According to this view, the IDF would be well served by the adoption of weapons that are based more on technology rather than on direct physical contact with the enemy. Such a transition would also exploit Israel's relative advantage vis-à-vis her neighbors in terms of the human quality of IDF soldiers.

5. Changes in the nature of threats

Another step that should be taken, in order to ensure the proper allocation of resources, budgets and costs, as well as to develop security strength, is to adapt the IDF to changing threats. Future conflicts will be different from those of the past in several respects:

- A. The dividing line between routine and emergency conditions has been considerably blurred.** The world in which war required total mobilization for a limited period of time is

gone forever. Today, many components of emergency situations are present during routine periods as well.

B. The modern world is characterized by conflicts within the reality of peace. The concept of “conflict resolution” is less obvious than in the past. What exactly does it mean for a conflict to have been “resolved?” Is it perhaps more appropriate to speak of alternatives to the actual resolution of a conflict? In the past, military activities were intended to thwart threats to security; today, the main objective seems to be to shape reality. In the past, the IDF was an actor on a stage; today, it functions not only as an actor, but also as a director, and the object of the exercise is “Producing Reality.” The purpose of the production is to stage victory, and to this end, Israel needs to know, for example, where it would like Palestinian society to be when Israel begins to engage it in dialogue. The same questions must also be asked regarding where Israel wants Israeli society, the Europeans, the Americans and others to be positioned at such a time.

C. Conflicts will be of a different type. It can reasonably be assumed that future conflicts will be based on technological developments (superior intelligence-gathering abilities combined with strong attacking and homing-in capacities). Conflicts will have a different character as well – they will be waged not between nations, but between organizations; they will have no clear start or finish; and they will be characterized by other departures from traditional warfare. The opponent’s activities will occasionally bear the characteristics of guerrilla and terror operations.

6. A capital-intensive instead of a labor-intensive army

One forecast suggests that in another 20-40 years, battles will take

place on empty fields. Sensors will be connected to highly-sophisticated control and monitoring systems, capable of transferring information on a real-time basis to extremely effective assault systems, with sophisticated attack and homing-in capacities. This futuristic scenario is also relevant in the context of low-intensity combat.

Coping with such a future reality will require substantial one-time financial investments in the acquisition and development of the sophisticated systems necessary. However, during routine periods, that is to say, periods with no active military conflicts – it can be expected that maintenance will involve relatively low costs.

THE POLITICAL/MILITARY INTERFACE

Openness and Transparency

It may be that the IDF's secretive attitude in all matters relating to its budget - to the point that its budget management process has, as we have noted, come to be seen as a "black box" - must now be modified. The IDF should open itself completely to the economic establishment; it should prepare reports, data and evaluations and adopt a more transparent attitude. The IDF should adopt an open-door policy not only toward government bodies and coordinating mechanisms such as the National Security Council, but even, to a certain extent, towards the general public. For example, the army should regularly indicate to the public the uses for which particular resources are required. Indeed, the IDF would seem to have an interest in ensuring that the government, the Knesset and the Ministry of Finance all have a better understanding of the various components of the defense budget and their ramifications. This will enable enhanced monitoring by the civilian authorities on the one hand, but at the same time, it will prevent the

Ministry of Finance and the political echelon from proposing the type of changes that the IDF tends to see as being divorced from reality.

A Multi-Year Work Plan Based on a Multi-Year Budget

We have already discussed the numerous problems caused by the absence of long-term planning. One sine-qua-non for this type of planning is the development of a multi-year work plan based on a multi-year budget. This is important from several perspectives.

First, if the defense budget was established for a multi-year framework, ten years for example, it might be possible to make meaningful decisions to cut NIS one billion each year, so that at the end of a decade the overall budget could have been reduced from NIS 40 billion to NIS 30 billion. The budget and work strategy for such a multi-year plan could be prepared so that the desired objective would actually be reached – a budget of NIS 30 billion. By contrast, it is impossible, in the context of a short-range, one year budget framework, to implement a decision to cut NIS five to six billion from the defense budget during a one year period.

Second, some long-term objectives have contrary effects if pursued only in the short term. For example, raising the age of retirement will not lead to any immediate savings in the budget. On the contrary, the result will be that people who would otherwise have retired will remain in the system and continue to acquire seniority, while others who were scheduled to replace them at a lower cost, will remain outside the system. Accordingly, in the short-term, costs will increase rather than decrease. However, from a national budget perspective over the long-term, a modification of the retirement age would be a correct step.

Developing Long-Term Plans and Budgets Entails Difficulties

One problem in long-term budgetary planning is that economic stability is required in order to achieve budgetary stability. Substantial budget cuts are required in light of the present economic reality, which has seen a decline both in per capita GNP and in income from taxes. These phenomena require substantial adjustments to budgets. The starting point for any proper discussion of this issue is the fact that the Israeli economy faces a burden of public debt which, it has been alleged, prevents adequate flexibility. If the level of Israel's public debt were on a par with that of other Western nations, and if the country's economic leaders were of the opinion that the current problem was temporary or cyclical in nature, it might be possible to get by for a limited period with a larger deficit, without the need for drastic budget cuts. There is a very close correlation between budgetary and economic stability: economic stability appears to be a vital condition for long-term planning.

A further problem relates to the need to balance the rigid nature of long-term planning with the need to maintain flexibility and the ability to adapt to changing circumstances. To this end, it has been suggested that a two-year budgetary framework is ideal. Others, however, argue that modern strategic planning is based on approximate evaluations: adjustments are always possible and even appropriate, as any economic plan would include elements which could not be foreseen. For example, it may be that economic growth is such an important element that it should form part of the long-term plan, despite the fact that its exact rate is inherently unforeseeable.

Another solution is the preparation of five-year budgets that distinguish between a particular current situation (e.g., a worsening of the intifada) and the long-term build-up of military strength. Budget optimization and adjustment must take place on an annual basis, rather than on a quarterly or four-monthly basis. Furthermore, these processes must form part of the discussion of all the priorities within society, rather than being decided in isolation from other issues.

Model for Preparing the Defense Budget

This model is based on the seventh session of the Army and Society Forum. It was proposed by an interdisciplinary team, comprised of Mr. Daniel Efrati, Prof. Arye Melnick, Prof. Baruch Nevo, Prof. Dan Peled and Dr. Zalman Shiffer.

The original document was forwarded to Major-Generals Giora Eiland, Aharon Ze'evi and Dan Halutz, as well as to Mr. Eli Horowitz, Dr. Yoram Turbovitch and Attorney Dan Meridor. The following chapter was prepared on the basis of their remarks.

THE DECISION-MAKING PROCESS RELATING TO THE DEFENSE BUDGET OF THE STATE OF ISRAEL

1. The Goal

Determining the scope and composition of the defense budget is one of the most important decisions made by the public sector, due to the significant ramifications for the physical security and economic well-being of the citizens of Israel.

In practice, several systems currently participate in preparing the defense budget, but there is no integration that allows for the making of balanced decisions regarding the different positions and proposals put forth.

The goal of this document is to propose an enhanced process for determining the defense budget, based on the following principles:

- The political echelon must accept responsibility for national objectives and priorities;
- The process must be orderly, cooperative, integrative and transparent;
- The civilian echelons (professional and political) must be genuinely involved;
- There must be integration between the defense establishment and the civilian establishment in general, and with the economic and budgetary system in particular;
- The political echelon should be presented with a more meaningful picture than is currently the case when deciding between different positions and proposals;
- The decision-making model is to combine two parallel processes – top down and bottom up.

2. Method

We shall discuss below (in Section 3) the basic elements required for decision-making regarding the allocation of resources for defense. We shall then present a practical proposal for developing a decision-making process based on the integration of these two parallel efforts:

- A. An orderly process of preparing the annual defense budget in a manner that more faithfully reflects civilian and military considerations (Section 4).
- B. An improvement of the basic infrastructure required for allocating resources for the defense budget; to this end, working parties will discuss the various issues involved in such allocation of resources (Section 5).

3. Essential Elements for the Determination of the Defense Budget

In principle, the defense budget should be determined on the basis of national strategic objectives as defined by the political echelon, taking into account the overall situation of the different ministries, and on the basis of an examination of security threats resultant from the geopolitical situation as defined by government policy:

- A. Identifying and mapping strategic opportunities within the sphere of responsibility of the defense budget.
- B. Examining the components of military strength (forces and weapons) that are sufficient for meeting relevant threats.
- C. Pricing the components comprising military strength.
- D. Evaluating the ramifications of providing various levels of resources for the defense establishment, with respect to the maximum level of security that the system will be able to provide and with the aim of securing the State's strategic objectives.
- E. Evaluating the ramifications of providing the defense establishment with various levels of resources in terms of foregoing other social and economic goals.

4. Process of Preparing the Annual Defense Budget

- A. A fixed format will be determined for discussions regarding the defense budget.
- B. The series of discussions will be spread over a relatively long period of time, and will be divided into several clearly-defined phases.
- C. The National Security Council will play an active role in coordinating the preparation of the defense budget and in the relevant discussions. Each phase will be implemented in

cooperation and consultation with the Ministry of Defense, the Ministry of Finance and the IDF. Cooperation and consultation should commence from the earliest phases of the process.

- D. Prior to each discussion, it will be decided which participants are to attend, what their responsibility will be for the elements that are to be presented and for the outputs expected at the conclusion of the discussion. The final phase will include a clear and explicit presentation of data and positions, for a final determination by the political echelon.
- E. During the course of the work, an effort will be made to concentrate the discussion on a number of options. However, none of the bodies involved will be empowered to reach final decisions, and it will be possible to continue presenting differing views at any stage, up through the final phase of determination by the political echelon.
- F. Discussions will take place on the basis of mutual transparency, together with a focus on the strategic ramifications of differing budget levels.
- G. The ultimate aim of the process will be to enable a decision regarding the scope of resources that the government is willing to allocate for security purposes at that particular juncture. This decision will be derived from the evaluations made by the above-mentioned bodies, and from the relative importance attached by the government to the reduction of security risks, compared to the importance assigned to the achievement of its civilian objectives.

5. Establishing Working Groups to Address Infrastructure

Together with the establishment of a framework for determining the annual defense budget, it is also necessary to discuss in-depth, various

fundamental questions relating to security and to the allocation of resources for security. It is proposed that working groups be established for the purpose of examining these issues. Each working group will focus on a particular task, and will include respected public and academic figures, IDF staff and experts from the relevant government ministries.

After approval by the government, the conclusions and recommendations included in the reports of the working groups will be combined, and will function as building blocks in the development of an approach to managing security and economic matters, so as to integrate them into the multi-year work plans and annual budgets.

The working groups will address three key areas

- A. The creation of a transparent and agreed database for the pricing of various activities and the valuation of the components of military strength. The data will reflect both budgetary and overall economic costs, and they will create a clear, shared and user-friendly language for use by both military personnel and the civilian echelons.
- B. Questions of security perceptions – threats and responses will be analyzed, as well as the processes involved in building-up military strength, management of personnel and allocation of tasks among the various bodies both within and outside the defense establishment.
- C. Questions relating to budgeting and work plans – for example, the possibility will be examined of preparing long-term budgets and dividing the budget into segments of varying rigidity.

Comments

- A. For the process to be successful, the defense establishment must internalize an integrative approach to the national economy. At the same time, the Ministry of Finance and civilian decision-makers must gain a deeper understanding of substantive and long-term security related issues
- B. In the light of the inherent differences in approach between the Ministry of Finance and the defense establishment, serious work is required at the top levels, under the direct authority of the decision-making echelon. Within the government system, the National Security Council should perform this function, although it will be recalled that this body is not completely independent. Accordingly, the NSC should be provided with appropriate means, and pro-active government support for its operations.
- C. This paper has adopted a minimalist approach, concentrating on the defense budget without involving representatives of other ministries. Further attention should be given to the question of whether this approach should be broadened at a later stage. For example, it may be worthwhile to examine whether additional bodies, such as the Ministry of Internal Security, the General Security Service and the Mossad, should be included both in the discussions and in the budgeting process.
- D. Successful operation of the process on an ongoing basis will also require an appropriate control system.
- E. It will also be appropriate to encourage more parliamentary involvement.

PROPOSAL FOR A STRUCTURED PROCESS FOR PREPARING THE DEFENSE BUDGET

Stage	Details	
1	Substance:	Instructions given by the prime minister and the defense minister.
	Date:	January.
	Participants:	Prime minister, defense minister, finance minister, security cabinet, head of the NSC.
	Output:	Defining political, defense and strategic objectives for the coming year.
2	Substance:	Start-up meeting.
	Date:	February.
	Participants:	Ministry of Defense, IDF, Ministry of Finance, NSC, additional bodies/individuals as decided.
	Background material:	<p>IDF: Draft of presentation of relative threats (preferably including possible alternatives); draft evaluation of the situation; underlying data; perceptions of different responses (preferably including possible alternatives); multi-year planning scenario.</p> <p>Ministry of Defense: Database; preliminary budget requirements + draft outline of work plan.</p> <p>Ministry of Finance: Database; (estimate for current year + forecast); draft outline of economic policy; preliminary framework for defense budget.</p>
Discussion output:	<p>(1) Preliminary identification of differences and disagreements.</p> <p>(2) Identification of gaps between proposals and areas requiring additional examination.</p>	

3	Substance: Date:	Integration session. March-April.
	Participants:	Ministry of Defense, IDF, Ministry of Finance, NSC, additional bodies/individuals as decided.
	Background material:	IDF: Advanced draft of presentation of relative threats and of additional documents underlying the Ministry of Defense proposal. Ministry of Defense: Proposed program for the defense budget. Ministry of Finance: Proposed defense budget.
	Discussion output:	Points for the political echelon detailing agreements, disagreements and the sources thereof, as well as budgetary differentials.
4	Substance: Date:	Interim presentation to the decision-makers. May or later, as instructed by the prime minister.
	Participants:	Prime minister, defense minister, finance minister, additional ministers as decided by the prime minister, Ministry of Defense, IDF, Ministry of Finance, NSC, additional bodies/individuals as decided.
	Background material:	Ministry of Defense and IDF: Position + background papers as above. Ministry of Finance: Position + background papers as above. National Security Council: Integrative document detailing agreements, disagreements and the sources thereof, as well as gaps and recommendations.
	Discussion output:	As agreed with the prime minister.
5	Substance	Joint version of the defense budget for presentation to the government (as part of overall budget).

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	Date:	July-August.
	Participants:	Ministry of Defense, IDF, Ministry of Finance, NSC, additional bodies/individuals as decided.
	Background material:	As above, with changes based on the prime minister's decision. Ministry of Finance: budget proposal.
	Discussion outputs:	(1) Defense budget proposal as prepared for the government by the Ministry of Finance. (2) Document presenting gaps between proposed budgets, should any still exist.
<hr/>		
6	Substance:	Presentation to the government (as part of the overall budget).
	Date:	August or later, as instructed by the prime minister.
	Participants:	Government ministers, Ministry of Defense, IDF, Ministry of Finance, NSC, additional bodies/individuals as decided.
	Background material:	As above, with changes based on the prime minister's decision and the outcome of phase 4. Ministry of Finance: budget proposal.
	Discussion output:	Government approval of the budget proposal for presentation to the Knesset.

Notes:

- * Each phase will be preceded by work at the top level of each of the bodies involved in order to prepare the necessary documents for that phase and develop positions relating to the required summary.
- * The phases described in the table are formal meeting points. Before each phase, it is highly desirable that a series of preparatory contacts and meetings take place between the bodies involved.
- * Each phase is described in the table as if it were a single discussion, but particular phases may in fact be extended over several discussion sessions (not more than three) in order to improve preparation of the outputs for that phase.

Appendices

APPENDIX A – SESSION PROGRAM

The Israel Defense Forces and the National Economy of Israel

Program of the Seventh Session

Thursday-Friday, 4-5 September 2003

Session Chair: Lieut. Gen. Moshe Ya'alon, Chief-of-Staff

Plenum Moderator: Prof. Arik Carmon, President, Israel Democracy Institute

Opening Remarks

Prof. Arik Carmon, President, Israel Democracy Institute

Lieut. Gen. Moshe Ya'alon, Chief-of-Staff

Plenum Study Sessions

- The Defense Budget and National Resilience
Prof. Avi Ben-Bassat, Senior Fellow, Israel Democracy Institute;
Department of Economics, Hebrew University of Jerusalem
- The Multi-Year Planning Process in the IDF
Maj. Gen. Giora Eiland, Head of the Planning Division, IDF
- Structure and Method of Building the Current Defense Budget
Brig. Gen. Muli Ben Zvi, Economic Advisor, IDF

Group Discussions

Discussions took place in three separate groups, each of which discussed one of the subjects detailed below.

Plenum

Decision-Making Processes in Preparing the Defense Budget – the Interface between the Army, Society and Government

David Brodet, Chairperson, YES; former Director-General, Ministry of Finance

Reports from the discussion groups

Closing Remarks

The Chief-of-Staff and the President of the Israel Democracy Institute

APPENDIX B-INVITED GUESTS TO THE SESSION BY DISCUSSION GROUP

Group A: National Defense and the Israeli Economy

- Issues of national defense from a broad perspective: reciprocal relations between national resilience (economic growth, education, social stability, welfare) and military defense.
- The affinity between investments in civilian infrastructure and development and the investment in defense.
- Investment in defense – the impact on the economy; ramifications of investment in infrastructures supporting economic growth on sources that may be allocated to defense in the future.
- Can the army serve as a catalyst for economic growth? (Employment, vocational training for personnel, technological entrepreneurship, support for defense industries, etc.)
- The economic significance of defense spending for the national economy – routine versus emergency situations.

Moderators

Eli Horowitz, Chair, Executive Board of the Israel Democracy

Institute; Chair of Teva Pharmaceutical Industries

Maj. Gen. Aharon Ze'evi (Farkash), Head of Intelligence Corps, IDF

Civilian Guests

David Arzi, Chairperson, Executive Board of HTMS –High

Technology School of Management

Prof. Avi Ben-Bassat, Senior Fellow, Israel Democracy Institute;

Department of Economics, Hebrew University of Jerusalem

Dr. Karnit Flug, Director of Research Department, Bank of Israel

Sever Plocker, Economic Editor, Yediot Aharonot

Prof. Danny Zidon, Chair, Center for Implementation of the Kibbutz

Arrangements

Yossi Kutchik, Chair, Manpower Israel

Prof. Yedidia Z. Stern, Senior Fellow, Israel Democracy Institute;

Faculty of Law, Bar-Ilan University

Dr. Ya'akov Sheinin, Executive Director, Economic Models

Dr. Liora Meridor, Chair, Bezeq International

IDF Guests

Lieut. Gen. Moshe Ya'alon, Chief-of-Staff, IDF

Maj. Gen. Amos Yadlin, Commander of IDF Colleges

Brig. Gen. Eval Giladi, Head of Strategic Planning Division, IDF

Brig. Gen. Muli Ben Zvi, Economic Advisor, IDF

Brig. Gen. Ruth Yaron, IDF Spokesperson

Maj. Gen. (ret.) Amos Yaron, Director-General, Ministry of Defense

Shmuel Keren, Development of Weapons System Infrastructure

Group B: The Connection between Security Perceptions and Defense Expenditure

- The process of developing Israel's security perceptions in the context of changes in the domestic and international arenas; identifying sources of threats and determining the level of security – when, how and by whom is the required level of security to be defined?
- The weight of economic considerations in determining the level of defense – should Israel's security be adjusted to meet budgetary sources, or vice versa?
- How flexible is the IDF in changing its preparations in the light of accumulating evidence of changes in the type of threat? Inertia versus flexibility in the defense budget from a long-term perspective.
- Outputs and inputs of security – how can we achieve “a great deal of security for not much money?” The economic efficiency of “producing security” in Israel.

Moderators

Attorney Dan Meridor, Senior Fellow, Israel Democracy Institute

Maj. Gen. Dan Halutz, Commander-in-Chief, Israel Air Force

Civilian Guests

David Brodet, Chairperson, YES; former Director-General, Ministry of Finance

Ya'akov Gadish, economist; formerly responsible for the defense budget in the Ministry of Finance

Nir Gilad, former Comptroller-General, Ministry of Finance

Ariel Halperin, Tanram Investments

Ya'akov Lifschitz

Prof. Baruch Nevo, Director of the Army and Society Project, Israel
Democracy Institute; Faculty of Psychology, Haifa University

Prof. Dan Peled, Faculty of Economics, Haifa University; Director,
Defense Economics Research Forum, Technion, Haifa

Dr. Zalman Schiffer, National Security Council

Uri Dromi, Israel Democracy Institute

IDF Guests

Maj. Gen. Gabi Ashkenazi, Deputy Chief-of-Staff

Maj. Gen. Benny Gantz, OC, Northern Command

Maj. Gen. Israel Ziv, Head of Operations Directorate

Maj. Gen. Yedidia Ya'ari, Commander-in-Chief, Israel Navy

Maj. Gen. Yiftah Rontal, GOC Army Headquarters

Maj. Gen. Yosef Kuperwasser, Head of Research Division, Intelligence
Corps

Maj. Gen. (ret.) Amos Malka

Group C: The Decision-Making Process in Preparing the Defense Budget

- The IDF, Ministry of Defense, Ministry of Finance, Knesset and government – the basic assumptions underlying their operations, and their place in the decision-making process. What are the institutional mechanisms and phases in the context of which the process takes place?
- The budgeting process versus the definition of national priorities, contrasted with economic needs versus defense requirements.
- Scope and components of the defense budget – what preparations do the relevant bodies require in order to discuss these issues?

- Multi-year planning versus annual planning: Can priorities in training, equipment, etc., be altered in the light of changing threats? What is the role of elected officials in the planning process as opposed to that of civil servants?
- Extent of depth, detail and transparency required for civilian control of the defense budget – scope, manner of management and method of implementation.

Moderators

Dr. Yoram Turbovitch, businessman in the private sector

Maj. Gen. Giora Eiland, Head of Planning Division, IDF

Civilian Guests

Yoram Gabbai, Chair, Pe'ilim

Attorney Moshe Gavish, Chair, the Finance Committee and Board Member, Israel Democracy Institute

Kobi Haber, Deputy Head, Budget Division, Ministry of Finance

Imri Tov, Director of Mata Holdings, Tel Aviv University, Strategic Studies Research Institute

Eli Yunes, former Director-General, Bank Hapoalim

Prof. Arik Carmon, President, Israel Democracy Institute

IDF Guests

Maj. Gen. Udi Adam, Head of Technology and Logistics

Maj. Gen. Gil Regev, Head of Manpower

Maj. Gen. Dan Harel, OC Southern Command

Brig.-Gen. Ofir Shoham, Deputy Head, Planning Division

Col. Moshe Lippel, Head, Land Budgets Department

Maj. Gen. (ret.) Gideon Sheffer

Col. Ofra Ben-Yishai, Head, Department of Behavioral Science

APPENDIX C – SOURCES FROM THE INFORMATION FOLDER*

A. General

- Defense expenditure – comparative table
- Center for Defense Information. <http://www.cdi.org>
- Adva Center – Weight of Defense in Government Expenditure – 1997
- Weight of Defense Expenditure in the GDP – 1998
- Human Development Report 2000, table 16, pp. 214-217
- World Bank, World Development Indicators 2001, table 5.7, pp. 294-296
- Central Bureau of Statistics, Defense Expenditure, 1950 – 2001

B. National Security and the Israeli Economy

- Shmuel Ben Zvi, “The Cost to the Israeli Economy of Security, and the Decision Regarding the Size of Defense Expenditure,” Based on a lecture given by the author at the Tenth Economic Conference (July 2002) of the Israel Economics Association
- Ezra Sadan, “The Economy and National Security,” Introduction to National Security, 2002
- Yoram Perry and Amnon Neubach, “The Military-Industrial Complex in Israel,” in *Democracy and National Security in Israel*, 1996, Benjamin Neuberg and Ilan Ben Ammi (eds.)
- Amnon Barzilai, “The Double Life of the IDF,” *Ha’aretz*, March 2003, p. B 5

* The Information Folder was sent to the participants several weeks before the session, and also served as a source of information in preparing the present article.

Military Strength – According to International Data

	Tanks	Armored Personnel carriers	Airplanes	Helicopters	Warships	Soldiers in the regular army (000s)	Soldiers in the reserves (000s)
Israel	3,900	5,900	945	295	2	172	425
Taiwan	739	2,080	733	297	37	1,658	370
Syria	4,850	4,785	640	221	2	396	316
Saudi Arabia	1,055	4,710	574	206	8	127	75
Britain	616	3,278	1,146	435	50	212	303
France	834	6,041	1,160	642	46	294	419
USA	8,303	24,075	9,030	6,779	200	1,212	1,385
China	7,060	5,500	3,362	497	125	2,470	600

Source: *Military Almanac 2001–2002*, Center for Defense Information

APPENDIX E – PARAGRAPHS FROM THE GOVERNMENT LAW, 5761-2001

6. Ministerial Committee for National Security

Within the government, a Ministerial Committee for Matters of National Security shall operate, comprised of: the prime minister – chair, deputy prime minister if appointed, defense minister, minister of justice, foreign minister, minister of internal security and the minister of finance. The government is entitled, if proposed by the prime minister, to add other members to the committee, provided that the number of members of the committee shall not be greater than half the number of the members of the government.

7. National Security Advisory Staff

The government shall have a staff, appointed and operated by the prime minister, for providing ongoing professional advice on issues of national security; the prime minister shall be entitled to charge the staff with additional consultative responsibilities.

The following publications have appeared under the auspices of
The Army and Society Project

Women in the IDF

Human Dignity in the IDF

“The Army of the People?” – Reserve Duty in Israel

The Contract between the IDF and Israeli Society: Compulsory
Service

The IDF and the Media in Times of Combat

Morality, Ethics and Law in Conflict

The IDF and the National Economy of Israel

Publications may be purchased from
The Israel Democracy Institute