DOCUMENT RESUME

06858 - [B2347417]

U.S. Economic Assistance for Israel. ID-78-31; B-125029. August 18, 1978. 13 pp. + 7 appendices (13 pp.).

Report to the Congress; by Elmer B. Staats, Comptroller General.

Issue Area: International Economic and Military Programs (600); International Economic and Military Programs: Impact of U.S. Security Supporting Assistance Abroad (611);International Economic and Military Programs: U.S. Development Assistance Overseas (603).
Contact: International 'v.
Budget Function: International Affairs: Foreign Economic and Financial Assistance (151).
Organization Concerned: Agency for International Development; Department of State.
Congressional Relevance: House Committee on International Relations; Senate Committee on Foreign Relations; Congress.
Authority: International Security Assistance Act of 1977 (P.L. 95-92; 91 Stat. 614). Cargo Preference Act of 1954 (P.L. 83-664). Foreign Assistance Act of 1961. Foreign Assistance and Related Appropriation Act of 1976. Foreign Assistance Appropriations Act of [of] 1972. H.R. 12222 (95th Cong.). S. 3075 (95th Cong.).

U.S. support for Israel's political and economic stability has been expressed through a variety of economic and military aid programs. The Security Supporting Assistance Program, involving a Commodity Import Program (CIP) and cash grants, is the primary economic aid program for Israel. This aid is usually justified for political rather than solely economic reasons. Under the CIP, the United States reimburses Israel for commercial and government purchases from U.S. suppliers, excluding purchases for military use or for sale in occupied territories. This has eased Israel's balance-of-payments deficits. The cash grant is called "untied" aid because the funds do not have to be spent on purchases in the United States. Funds are to be spend on nonmilitary commodities in nonoccupied areas. Findings/Conclusions: The CIP carried $258 million in undisbursed funds into 1978 because reimbursements have not kept pace with increases in annual funding levels. A key CIP question is whether it is essential for aid levels to be linked to specific U.S. purchases or whether it is acceptable to establish that Israel make certain general levels of U.S. nonmilitary imports. Present procedural requirements have been burdensome to both the Agency for International Development (AID) and to Israel. Alternatives to present methods were considered in response to GAO suggestions. The State Department and AID felt that program objectives could best be served by replacing the CIP with a cash transfer program. Although the impact of this proposal cannot yet be fully evaluated, GAO believed that it would alleviate the problem of documenting specific U.S. exports

and would expedite the transfer of funds. Its effect on U.S. exports to Israel is not clear, but arrangements could be made for continuing U.S.-flag vessel shipments. Fiscal year 1979 foreign aid bills authorize a cash transfer program for Israel linked to maintenance of some level of U.S. exports. To implement the proposed program, AID and State Department officials said that formal understandings with the Israeli Government would be reached on levels of U.S. nonmilitary exports and on the U.S. competitive position. (HTW)

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BY THE COMPTROLLER GENERAL

Report To The Congress

OF THE UNITED STATES

U.S. Economic Assistance For Israel

U.S. support for Israel's political and economic stability has long been expressed through a variety of economic and military aid programs. This report discusses economic aid to Israel such as cash grant assistance, the Commodity Import Program, the problem of undisbursed fund balances, and other matters.

ID-78-31
AUGUST 18, 1978

COMPTROLLER GENERAL OF THE UNITED STATES
WASHINGTON, D.C. 20548

B-125029

To the President of the Senate and the
Speaker of the House of Representatives

This report on the Security Supporting Assistance Program for Israel describes the Program's composition, how it works, what has been accomplished, and how the Program is being changed. An overview of other U.S. economic aid to Israel is also included.

The survival and security of Israel is a key U.S. foreign policy concern, and the economic aid described in this report is part of an overall U.S. interest in bringing about a just and lasting peace in the Middle East. U.S. efforts are intended to involve the Middle East countries in economic rather than military concerns.

Our review was made pursuant to the Budget and Accounting Act, 1921 (31 U.S.C. 53), and the Accounting and Auditing Act of 1950 (31 U.S.C. 67).

We are sending copies of the report to the Director, Office of Management and Budget; the Secretaries of State and Commerce; the Administrator, Agency for International Development; heads of other interested Government agencies; and cognizant congressional committees.

Elmer B. Staats

Comptroller General
of the United States

COMPTROLLER GENERAL'S
REPORT TO THE CONGRESS

U.S. ECONOMIC ASSISTANCE
FOR ISRAEL

D I G E S T

The largest U.S. economic aid program for Israel is Security Supporting Assistance, which has amounted to $2.8 billion from 1972 through 1978. This aid is furnished when economic and political stability is threatened and usually is justified for political rather than solely for economic reasons.

Higher levels of U.S. economic aid since 1975 have been aimed at helping the Israeli economy recover from the effects of the 1973 Yom Kippur War and at improving prospects for Middle East peace, including support of the Egyptian-Israeli Sinai II Agreement. (See p. 5.)

The Security Supporting Assistance Program has consisted of a Commodity Import Program and a cash grant. The latter is called "untied" aid because the funds do not have to be spent on purchases in the United States. However, they are to be spent on nonmilitary commodities used within the area controlled by Israel prior to the June 1967 war.

The Agency for International Development writes quarterly cash grant checks to the Israeli Government which become part of Israel's foreign exchange and can be spent freely without identity as U.S. aid. From $150 million in 1976, the cash grant increased to $300 million annually in fiscal years 1977 and 1978. (See p. 7.)

The Commodity Import Program also eases Israel's burdensome balance-of-payments deficits. The United States reimburses Israel for thousands of commercial and government purchases from U.S. suppliers.

Purchases for military use or for sale in the occupied territories are not eligible for reimbursement. Almost half of Israel's 1976 U.S. commercial purchases have been financed under the Program, which has made about $2 billion available in foreign exchange through fiscal year 1978. (See p. 9.)

UNDISBURSED FUND BALANCES

The Commodity Import Program carried $258 million in undisbursed funds into 1978 because reimbursements have not kept pace with increases in annual funding levels. This balance would have been higher if $150 million had not been transferred in 1977 from the Commodity Import Program to an untied cash grant. U.S. and Israeli Government statistics show that Israel makes more than enough eligible nonmilitary U.S. purchases to meet authorized Commodity Import Program dollar levels. But the large unspent balances have built up because the Israeli Government has not been able to collect import documentation to support required amounts of purchases in the private sector. The outlook for disbursements in 1978 is that Israel's relaxation of foreign exchange controls will add another $100 million to the undisbursed pipeline.

A key Commodity Import Program question is whether it is essential for these aid levels to be linked to specific U.S. purchases or whether it is acceptable to establish that Israel make certain general levels of U.S. nonmilitary imports. The present system of requiring specific evidence of each transaction to be reimbursed ties the aid to U.S. procurement and allows the Agency for International Development to monitor compliance with certain commodity financing rules. These cumbersome procedural requirements have been a burden to both the Agency and the Government of Israel and have hampered the timely transfer of funds. The latter was detracting from the program's objective of easing Israel's balance-of-payment deficits.

GAO suggested that State and the Agency consider the advantages and disadvantages of alternatives to the present Commodity Import Program method and present them to the congressional foreign aid committees. (See p. 15.)

AGENCY ACTION

In a joint response by the State Department and the Agency for International Development, officials advised that program objectives could best be served by replacing the Commodity Import Program with a cash transfer program. The substitution would be subject to satisfactory assurances from the Israeli Government that civil imports from the United States would be at least equal to the level of U.S. aid and that the competitive position of U.S. exporters would not be adversely affected. The Agency requested that the Congress authorize these changes in a revised fiscal year 1979 aid request proposal for Israel. (See p. 16.)

The Department of Commerce acknowledged the administrative burden of the current Commodity Import Program operation, particularly since the Israeli Government had relaxed its internal economic controls. Commerce suggested that the current cumbersome procedure be replaced by a simplified system requiring Israeli Government verification of U.S. exports through customs statistics. Commerce expressed interest in seeing that U.S. exports to Israel did not decline and that the U.S. market share be maintained. It also expressed concern that an expansion of the cash transfer program would adversely affect enforcement of the Cargo Preference Act, which involves ensuring that 50 percent of the U.S.-financed ocean cargo moves on U.S. flag vessels. (See p. 16.)

GAO EVALUATION OF AGENCY ACTION

At the conclusion of GAO's review only the broad outline of how a proposed cash transfer would be implemented was available from agency officials. Therefore, the impact of the proposal cannot yet be fully evaluated. GAO believes that the cash transfer proposal would alleviate the problem of gathering documentation evidencing specific U.S. exports from the Israeli private trade sector. It would also expedite and systematize the transfer of funds to meet Israel's balance-of-payments deficit. But what is not yet clear is what effect it will have on U.S. exports to Israel and on U.S.-flag ocean shippers--the latter participate in the Commodity Import Program through cargo preference requirements.

GAO believes that arrangements could be made for continuing U.S. flag shipments by:

--Retaining the Commodity Import Program for agricultural purchases made by the Israel Supply Mission; cargo preference would thus continue for these transactions.

--Specifying in aid agreements that certain tonnage levels will be shipped on U.S.-flag vessels. (See p. 17.)

FISCAL YEAR 1979 FOREIGN AID LEGISLATION

Both the House and Senate foreign aid bills for fiscal year 1979 authorize a cash transfer program for Israel linked to maintenance of some level of U.S. exports. The proposed legislation does not, however, comment on the relationship between cargo preference and the cash transfer program. At the conclusion of GAO's review the House and Senate had passed their respective bills. The final congressional authorization will emerge from a House-Senate foreign aid conference.

PROPOSED IMPLEMENTATION

To implement the proposed cash transfer program, Agency for International Development and State Department officials said that formal understandings with the Israeli Government would be reached on levels of

U.S. nonmilitary exports and on the competitive position of U.S. commercial exporters in the Israeli market. These government-to-government initiatives will be preceded by U.S. Government interagency discussions to formulate a U.S. position on such questions as:

--To what level of U.S. exports to Israel should the proposed cash transfer be linked, and how will this be monitored?

--What will happen if agreed-upon export levels are not met?

--Will some commodities be required to be shipped on U.S.-flag vessels?

Agency for International Development and State Department officials advised GAO that the fiscal year 1979 foreign aid authorization will establish the basic guidelines for how the Israel Program will be switched over to a cash transfer. After interagency discussions, the Agency for International Development will be the lead agency in negotiating an aid agreement with the Israeli Government.

The views of these agencies should be fully explored. However, cargo preference and other U.S. trade concerns should be addressed in the context of achieving the stated balance-of-payments and foreign policy objectives of the Security Supporting Assistance Program for Israel. (See p. 18.)

Contents

ABBREVIATIONS

AID	Agency for International Development
CIP	Commodity Import Program
GAO	General Accounting Office

CHAPTER 1

INTRODUCTION

The survival and security of Israel is a key U.S. foreign policy concern, and U.S. support for Israel's political and economic stability has long been expressed through a variety of economic and military aid programs. The U.S. Security Supporting Assistance Program, involving a Commodity Import Program (CIP) and cash grants, is the primary economic aid program for Israel. (For an Agency for International Development (AID) summary of total U.S. aid to Israel, see app. I.)

Security Supporting Assistance is provided to foreign countries when economic and political stability is threatened and U.S. security interests are involved. This assistance, although economic in form, is usually granted primarily for political or security reasons rather than solely for economic development. 1/ This distinction between Security Supporting Assistance and development assistance has been recognized both in Program authorization and implementation in that:

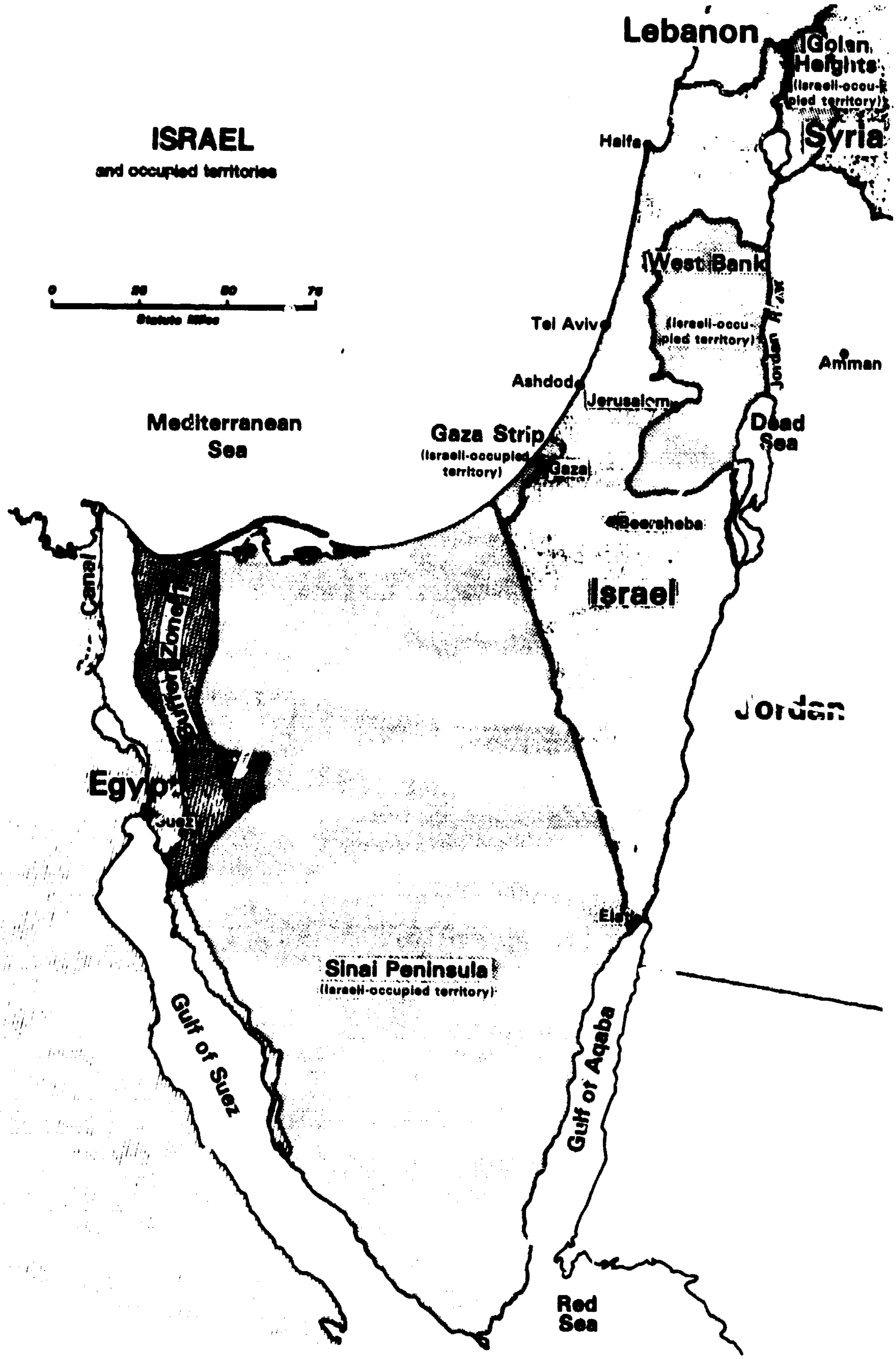
--Security Supporting Assistance is legislatively linked with military assistance in a separate authorization, "The International Security Assistance Act of 1977" (Public Law 95-92, 91 Stat. 614).

--The decision to grant this form of assistance and the appropriate funding level goes through the same political review channels within the State Department as does military assistance.

U.S. assistance for Israel is part of an overall U.S. interest in bringing about a just and lasting peace in the Middle East. The President has set a high priority on U.S. diplomatic efforts to get the Middle East countries involved in economic rather than military concerns.

About 90 percent of the $1.89 billion fiscal year 1978 Security Supporting Assistance Program is earmarked as shown on page 3.

1/For more information and our views on Security Supporting Assistance, see "Issues and Observations On the Purposes of Special Security Supporting Assistance Programs," ID-76-11, Sept. 12, 1975.


ISRAEL
and occupied territories
0 25 50 75
Statute Miles
Lebanon
Golan Heights
(Israeli-occupied territory)
Syria
Haifa
West Bank
(Israeli-occupied territory)
Jordan R.
Tel Aviv
Amman
Ashdod
Jerusalem
Dead Sea
Mediterranean Sea
Gaza Strip
(Israeli-occupied territory)
Gaza
Beersheba
Israel
Canal
Buffer Zone
Jordan
Egypt
Suez
Elat
Sinai Peninsula
(Israeli-occupied territory)
Gulf of Suez
Gulf of Aqaba
Red Sea

	(millions)
Israel	$ 785
Egypt	750
Jordan	93
Syria	90
	$1,718

CONGRESSIONAL SUPPORT FOR MIDDLE EAST PEACE EFFORTS

In recent years, the Congress has appropriated a high level of security assistance to support Middle East peace initiatives. Israel is the largest recipient of security aid. The Senate Committee on Foreign Relations, in recommending approval of the fiscal year 1978 Security Supporting Assistance request, noted that the United States was currently engaged in delicate negotiations to bring parties to the Geneva negotiating table and that circumstances have probably never been more favorable for a peaceful solution to Middle East problems.

The House Committee on International Relations authorized the administration's fiscal year 1978 request for Security Supporting Assistance funds in anticipation that the programs would promote a Middle East settlement.

OUR STUDIES OF SECURITY SUPPORTING ASSISTANCE

We have given priority attention to the Security Supporting Assistance Program, both because of the Program's size and because of congressional concern about its impact. In mid-1976 the Chairman, Special Subcommittee on Investigations, House Committee on International Relations, asked us to do a study on the Program in Egypt. We issued our report on this subject in September 1977. 1/

We followed up this congressional interest by reviewing the large and important Security Supporting Assistance Program for Israel, to give the Congress an independent view of the Program's composition, how it works, what has been accomplished, and how the Program can be improved. These matters, as well as an overview of other economic aid to Israel, are the subject of this report.

1/"Egypt's Capacity to Absorb and Use Economic Assistance Effectively," ID-77-33, Sept. 15, 1977.

During our review, we also obtained information on the status of U.S. assistance programs conducted by AID and U.S. voluntary agencies in the Israeli-occupied territories of the West Bank and Gaza. Our observations on these programs are discussed in a separate report. 1/

SCOPE OF REVIEW

Information for the report was obtained principally from U.S. Government records and discussions with officials of AID and the Departments of State, Treasury, Commerce, and Agriculture.

In September and October 1977, we visited the U.S. Embassy in Tel Aviv and the U.S. consulate general in Jerusalem, and also talked with Israeli Government officials and Israeli importers and bankers.

In New York City, we made a limited review of the records of the office of the Israel Supply Mission.

1/"U.S. Economic Aid For The West Bank and Gaza--A Positive Contribution," July 5, 1978, ID-78-35.

CHAPTER 2

SECURITY SUPPORTING ASSISTANCE FOR ISRAEL

The U.S. Congress initiated Security Supporting Assistance for Israel by earmarking $50 million in the fiscal year 1972 Foreign Assistance Appropriations Act. A report of the House Committee on Foreign Affairs noted that the Israeli Government had requested aid for foreign exchange and other needs related to Middle East hostilities.

JUSTIFICATION FOR FUNDING

Through 1978, Security Supporting Assistance levels were set as follows:

Fiscal year	(millions)
1972	$ 50.0
1973	50.0
1974	50.0
1975	324.5
1976 (including transition quarter)	775.0
1977	735.0
1978	785.0
	$2,769.5

Until 1975, the assistance was on a grant basis; in 1976, a mix of one-third concessional loans and two-thirds grants was introduced to recognize Israel's ability to pay for some U.S. foreign aid.

The 1973 and 1974 funds served primarily to bolster Israel's balance-of-payments position. The higher aid levels since 1975 were aimed at helping the Israeli economy recover from the adverse effects of the 1973 Yom Kippur War and maintaining a positive climate for Middle East peace, including support of the Egyptian-Israeli Sinai II Agreement.

Economic crisis and responses

Israel was achieving rapid economic growth until the 1973 Yom Kippur War, which with other economic events brought growth to a halt. Inflation reached 56 percent in 1974, and Israel's balance-of-payments deficit on goods and services rose from $1 billion in 1972 to $4 billion in 1975. (See app. III.) By 1976, defense expenditures were consuming some 40 percent of the gross national product, and external debt reached $9.2 billion. (See app. II.) These adverse conditions required austerity measures as well as infusions of large amounts of U.S. economic and military aid to stabilize the economy.

To confront its economic problems, the Israeli Government adopted a series of austerity and reform measures, and by 1977 these efforts had begun to bring positive results. To reinforce this trend, Israel in October 1977 launched a series of broad-ranging measures, commonly referred to as the new economic policies, which (1) allow the Israeli pound to float, (2) abolish almost all foreign exchange controls, (3) raise the value-added tax from 8 to 12 percent, and (4) increase the prices of subsidized goods and services. According to Israeli officials, these measures would significantly increase exports, lower imports, attract foreign investment capital, and increase employment and productivity.

Despite improvements, however, the Israeli economy is relatively austere, reflecting government-imposed belt-tightening measures. Taxation rates are among the highest in the world, while inflation and high government budget expenditures are persistent problems. Even so, per capita real consumption levels are relatively high in terms of other U.S. aid recipients, and they have been maintained in recent years.

Sinai II Agreement

In support of the peace initiatives contained in the September 1975 Sinai II Agreement, 1/ the United States has provided high levels of aid to both Egypt and Israel. Aid for Israel stems in part from a separate United States-Israeli agreement, which states that the U.S. Government will make every effort to be fully responsive, within the limits of its resources and congressional authorization and appropriations, on an ongoing and long-term basis, to Israel's military equipment and other defense requirements, to its energy requirements, and to its economic needs. The full text of

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1/Our report, "U.S. Early Warning System in the Sinai," June 6, 1977 (ID-77-11), notes that, largely as a result of U.S. initiatives after the October 1973 Mideast War, Egypt and Israel signed this disengagement agreement.

the agreement is recorded in the October 1975 Senate Committee on Foreign Relations hearings on the Early Warning System in the Sinai. Annual assistance requests have taken this agreement into account.

HOW SECURITY SUPPORTING ASSISTANCE LEVELS ARE SET

Israel Security Supporting Assistance Program levels are discussed with Israeli officials by the Agency for International Development, which also reviews Israeli projections of balance-of-payments, foreign-exchange requirements, and other supporting data. After that, an economic assessment of Israel's foreign exchange assistance requirements is made by the balance-of-payments group from the Departments of State and the Treasury, the Office of Management and Budget, and the Central Intelligence Agency. Then various political considerations are factored in during the Arms Export Control Board review process. 1/ An integrated assessment of all factors bearing on the Foreign Military Sales and Security Supporting Assistance Programs--economic, military, and political--is then forwarded through the Office of Management and Budget for a final review by the President.

SECURITY SUPPORTING ASSISTANCE PROGRAMS

Security Supporting Assistance to Israel has consisted of a Commodity Import Program and a cash grant. Funding for the last three fiscal years is shown below.

Program	1976	Transition quarter	1977	1978
	(millions)			
Commodity Import Program	$550	$60	$435	$485
Cash grant	150	15	300	300
Total	$700	$75	$735	$785

1/The Board is chaired by the State Department and includes representatives from the Departments of the Treasury and Defense, Joint Chiefs of Staff, Arms Control and Disarmament Agency, Central Intelligence Agency, National Security Council, and Office of Management and Budget.

Under the Commodity Import Program the United States reimburses the Government of Israel for the foreign exchange used to purchase nonmilitary U.S. commodities. Commercial documents are submitted to AID as evidence that these transactions have taken place.

The cash grant introduced in fiscal year 1976 is essentially unrestricted aid, although by formal agreement it is to be spent for nonmilitary commodities used within the pre-1967 boundaries of Israel. AID writes quarterly checks payable to the Israeli Government, and there is no requirement to account for how the funds are spent.

The cash grant was initially justified as assisting the Government of Israel to meet the indirect foreign exchange costs associated with implementation of the Egyptian-Israeli interim disengagement agreement of September 4, 1975. These foreign exchange costs associated with the Sinai II withdrawal included (1) extraordinary costs necessitated by the Israeli redeployment from the Suez Canal area, (2) increased imports of oil as a result of Israel's return of Sinai oil fields, and (3) increased oil storage capacity in Israel.

In September 1977, the Congress was advised that the justification for the cash grant had shifted. The State Department noted that the original Sinai-related goals had been largely accomplished and that the Israeli Government was now having difficulties in making timely use of the CIP funds. The Department noted further that (1) within a short period, CIP levels had increased from $50 million to more than $500 million and (2) the administrative requirement of collecting documentation to evidence this level of transactions resulted in the Israeli Government being unable to fully use the CIP funds. Thus, a portion of the CIP funds ($150 million in fiscal year 1977) were transferred to a cash grant, and in 1978 the Congress earmarked not less than $300 million of authorized Security Supporting Assistance funds as a cash grant for Israel.

In May 1978, AID proposed to the Congress that the CIP and the cash grant program be replaced by a cash transfer program in fiscal year 1979. Both the House and Senate fiscal year 1979 foreign aid bills authorize a cash transfer program for Israel.

CHAPTER 3

THE COMMODITY IMPORT PROGRAM

The Commodity Import Program has made about $2 billion in foreign exchange available to Israel from fiscal year 1972 through 1978. This Program financed almost half of Israel's 1976 nonmilitary purchases in the United States.

HOW THE CIP WORKS

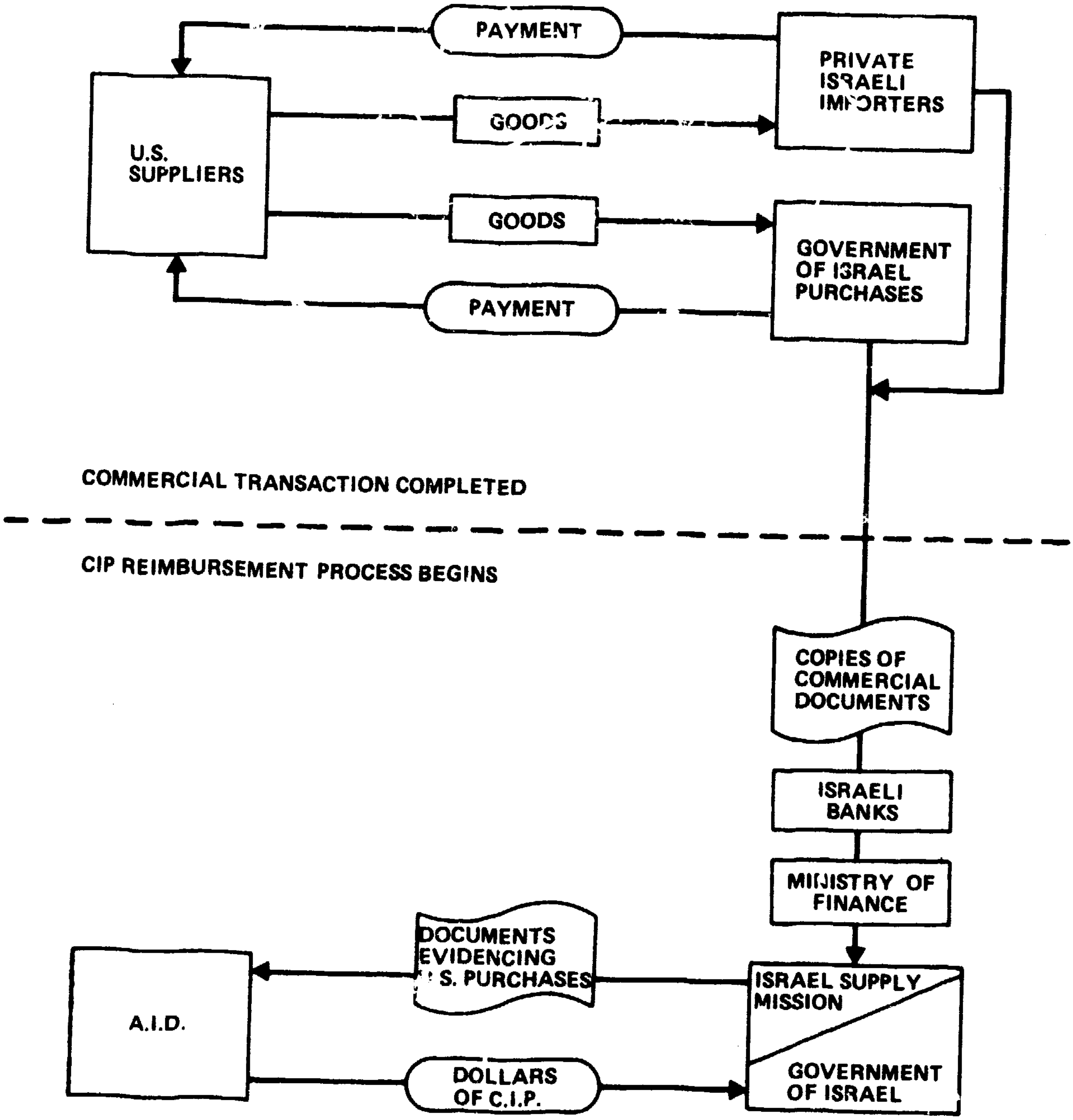
For the Israel CIP, Agency for International Development financing takes place on a reimbursement basis after the commercial transactions have been completed; this differs from the principal form of AID commodity financing, in which AID approves transactions before payment is made to suppliers. Private importers or the government purchase U.S. goods with Israel's foreign exchange, then send copies of the commercial documents evidencing purchases to AID, as well as AID-required suppliers certificates. AID reviews the documentation and reimburses the Israeli Government in CIP dollar funds. Purchases for milit. , use or for sale in the occupied territories are not eligible for reimbursement. This process is illustrated on the following page.

The Congress authorizes and appropriates funds for the CIP each year. AID then signs grant and loan agreements with Israel. (See app. IV for list of CIP grants and loans.)

The Government of Israel Supply Mission in New York has day-to-day responsibility for assembling the documentation and submitting it to AID. Grain purchases made by the Mission account for about half of the dollars reimbursed; however, most of the documentation comes from the private sector. It is collected in Israel by the Ministry of Finance and sent to the Mission in New York, which then submits it to AID.

AID's Office of Commodity Management has primary responsibility for implementing and monitoring the CIP agreements after they are prepared by the Bureau for Near East. The Office of Commodity Management reviews the transactions submitted by the Israel Supply Mission to determine eligibility for AID financing and forwards the approved transactions to the Office of Financial Management, which makes reimbursement.

CIP FLOW OF PAPERWORK AND FUNDS



AID has no staff in Israel, and the limited CIP monitoring there is done by the U.S. Embassy staff. The AID Auditor General makes periodic audits of the CIP.

(The diagram on the following page shows how the organizational elements of AID were involved in the Israel CIP during the time of our review.)

AID MONITORING

AID reviews transaction documentation to determine that all required documents are complete and that the commodity is eligible and appropriate for AID financing. AID also screens transactions to ensure compliance with cargo preference requirements, since the grant and loan agreements specify that at least 50 percent of the gross tonnage and revenues of commodities (computed separately for dry bulk carriers, dry cargo liners, and tankers) financed by AID will be shipped on U.S.-flag vessels to the extent that such vessels are available at fair and reasonable rates for U.S.-flag vessels.

AID spends considerably less time in administering the large Israel CIP than it spends on other CIPs. The Office of Commodity Management estimates that about 5 to 6 staff-years are spent in administering the Israel Program, a minimum effort that is possible because the commercial nature of the Program is kept intact and the Israelis are experienced in U.S. markets.

AID PROCESSING OF CIP DOCUMENTATION

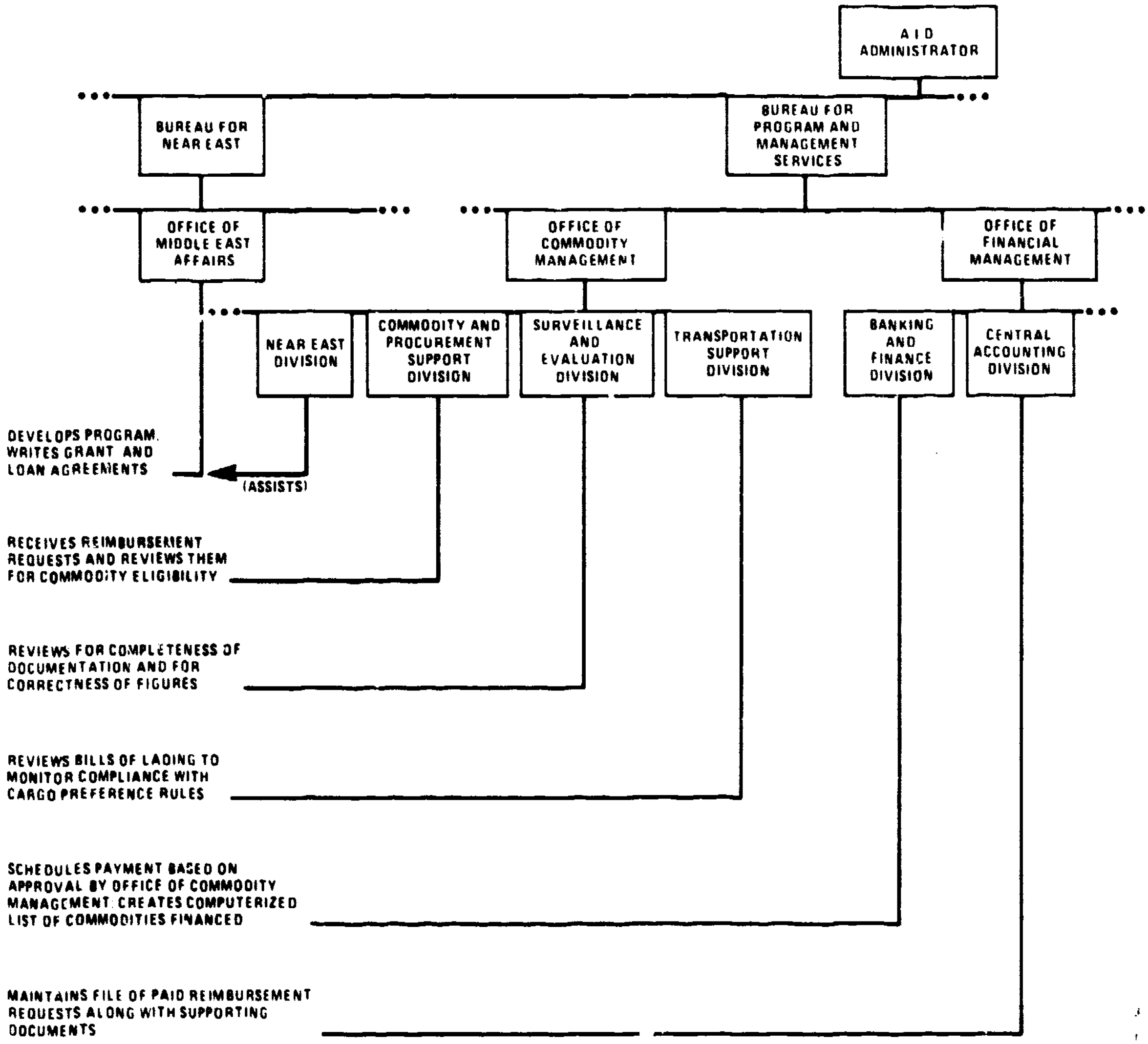
By requiring evidence of U.S. purchases, AID specifically carries out congressional intent to tie the CIP funds to U.S. procurement and ensures that AID and statutory commodity financing requirements are met.

AID has adopted "minimum commodity financing procedures" in processing the documentation for completeness and commodity eligibility in order to minimize its administrative involvement and to expedite reimbursements to Israel.

PROBLEMS IN TIMELY USE OF THE CIP

CIP reimbursements have not kept up with increases in funding levels, and $258 million in undisbursed funds was carried into fiscal year 1978. This amount would have been higher had $150 million not been transferred in fiscal year

A.I.D. ORGANIZATIONAL INVOLVEMENT
IN ISRAEL C.I.P. DURING PERIOD
COVERED BY OUR CASE STUDY



1977 from CIP to an "untied" cash grant (the funds do not have to be spent on purchases in the United States) because Israel could not collect enough documents evidencing U.S. purchases. A control system was established in Israel to improve the document-gathering process. However, the Israeli Government recently adopted economic reforms which are expected to add to the undisbursed pipeline.

In analyzing the CIP reimbursement backlog, one question that should be addressed is whether Israel is buying enough eligible nonmilitary products to reach the authorized CIP levels. Both U.S. and Israeli trade statistics indicate that purchases do exceed CIP levels. For example, 1976 statistics indicate that Israel imported about $900 million worth of U.S. nonmilitary commodities. Israel Supply Mission and AID officials reduce this figure by some $250 million to $300 million to recognize items not eligible for CIP financing, including luxury items, personal belongings, and items financed under some other U.S. programs, such as Public Law 480 agricultural sales and U.S. Export-Import Bank loans. This leaves some $600 to $650 million which was considered eligible for CIP financing. However, the Israeli Government has not been able to present the documentation for AID reimbursement of the $600 to $650 million.

How the problem developed

When the CIP was initiated in 1972 at a level of $50 million, Israel could readily present documents evidencing this amount of eligible U.S. imports. When Program levels were sharply increased in 1975 and 1976, Israel had to compile documentation showing a much larger amount of U.S. imports, and commodity eligibility criteria had to be broadened considerably.

To permit drawdown of a fiscal year 1975 level of $324.5 million, AID and the U.S. Department of Agriculture decided to make soybeans (a large agricultural purchase item) retroactively eligible for CIP financing. When the CIP level increased to $550 million in 1976, AID broadened the eligibility list further, to include other major agricultural items such as wheat, corn, and sorghums. Grain purchases made by the Israeli Supply Mission account for a significant portion of CIP reimbursements. For example, in August 1977 the Mission showed us records indicating that CIP-eligible documents amounted to about $338 million over a 7-month period, about $185 million (or 55 percent) of it for grain. Thus, government grain purchases draw down large amounts of CIP funds with a small amount of paperwork and, in effect, they comprise a distinct and relatively trouble-free element of the CIP. The remaining CIP level must be drawn down through documentation evidencing thousands of small dollar value private sector purchases of U.S. goods. This latter aspect of the Program is the source of most of the paperwork, problems, time, and effort.

Efforts to compile documentation in Israel

Under present procedures, documentation on private sector imports is collected in Israel by the Ministry of Finance, which screens the transactions for ineligible items before forwarding the documents to the Israel Supply Mission in New York. The Ministry of Finance collects the documents through the banks, which are under its control. The banks get copies of invoices and bills of lading under each commodity import commercial transaction. The required AID Form 282 or other certificate is not part of the commercial transaction, so special steps must be taken to try to obtain a certificate for each import.

At the outset, Israeli customs collected the forms as goods passed through their control. This arrangement proved unsatisfactory, so responsibility for document collection was assigned to the Israeli banks that handled the importers' foreign exchange payments. This approach also turned out to be unsatisfactory, because many transactions were not reported by the banks and only a small part of the total eligible CIP transactions were being identified.

To improve document collection, the Ministry of Finance initiated a system for accounting for all transactions potentially eligible for CIP financing. Under this system, Banking Form 34, which controlled foreign exchange payments, was required for every import transaction except for those made by the Ministry of Defense. The Form contained the name of the bank or bank branch, exporting country, pertinent dates and amounts, and sufficient information to identify each transaction.

All Forms 34 were submitted by the banks to the Ministry of Finance, which put the information into a computer and performed data-matching procedures to work with the banks in identifying CIP transactions. This procedure, which began in March 1977, was considered an improvement. Officials stated that, as of September 1977, documentation representing about $18 million a month, or 75 percent of the eligible commercial transactions, was being received. Later in 1977, however, Israel modified its controls over foreign exchange transactions. AID officials told us that this change included reorganizing the Ministry of Finance unit that handled the Form 34 control system.

Outlook for CIP drawdown

During fiscal year 1977, CIP disbursements were made at about the current level of $485 million. This drawdown rate, even if continued, would not relieve the existing $258 million in undisbursed funds, so this problem would have to be dealt with separately. Furthermore, Israel's relaxation of foreign exchange controls may add another $100 million to the undisbursed pipeline in 1978.

A key CIP question is whether it is essential for these assistance levels to be linked to specific U.S. purchases or whether it is acceptable to establish that Israel made certain general levels of U.S. nonmilitary imports. The present system of requiring specific evidence for each transaction to be reimbursed ties the assistance to U.S. procurement and allows AID to monitor compliance with certain commodity-financing rules, particularly cargo preference. 1/ It also permits AID to compile statistics on what was financed and where in the United States it came from. However, these cumbersome procedural requirements have been a burden to both AID and the Government of Israel and have hampered the timely transfer of funds. The pipeline problem should be addressed because the backup of unspent funds is detracting from the Program's objective of easing Israel's balance-of-payment deficits. Two courses of action would be to (1) eliminate the backup of unspent funds by providing the backed-up funds as cash grants or loans or (2) apply the unspent funds to Israel's general level of nonmilitary U.S. purchases if simplified documentation procedures were adopted. If no action is taken, undisbursed balances would continue to be carried over until aid levels were eventually reduced.

We suggested that State and AID consider the advantages and disadvantages of alternatives to the present CIP processing method. For example, we outlined for consideration the pros and cons of linking the CIP disbursements to a level

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1/CIP agreements contain provisions to comply with U.S. statutory requirements concerning U.S. cargo preference, procurement pricing standards, marine insurance, ineligible vessels, foreign assets control, and Cuban assets control.

of U.S. exports as compiled and reported by the Department of Commerce. We also proposed that State and AID: (1) assess the economic and political factors that would be affected by efforts to resolve the undisbursed funds problem, (2) decide on a course of action or alternative actions, and (3) present proposals to the foreign aid committees of the Congress.

AGENCY COMMENTS

In a joint State-AID response of May 11, 1978 (see app. V), agency officials advised us that they were in accord with our overall findings and suggestions. AID concluded that Program objectives could best be served by replacing the CIP with a cash transfer program. The substitution would be subject to satisfactory assurances from the Israeli Government that civil imports from the United States would be at least equal to the level of U.S. assistance and that the competitive position of U.S. exporters would not be adversely affected. AID requested that the Congress authorize these changes in a May 1978 revision to the proposed fiscal year 1979 assistance request for Israel.

The Department of Commerce acknowledged the administrative burden of the current CIP operation, particularly since the Israeli Government had relaxed its internal economic controls. (See app. VI.) It suggests that the current cumbersome procedure be replaced by a simplified system requiring Israeli Government verification through customs statistics. Commerce expressed interest in seeing that U.S. exports to Israel did not decline and that the U.S. market share was maintained. It also expressed concern that expanding the cash transfer program would adversely affect enforcement of the Cargo Preference Act (Public Law 664), noting that it would be difficult to identify specific U.S.-financed commodities to ensure that 50 percent of the ocean cargo moves on U.S.-flag vessels.

The Department of Treasury was in general agreement with our description of the Israel aid program. The Department of Agriculture stated that it had no comment on the program.

The Israel Supply Mission advised us that our comments on procedures adopted by the Government of Israel to implement the CIP, as well as on problems encountered, were correct.

OUR EVALUATION OF AGENCY COMMENTS

At the conclusion of our review only the broad outline of how a proposed cash transfer would be implemented was available from agency officials. Therefore, the impact of the proposal cannot yet be fully evaluated. Specific implementation would follow from FY 1979 congressional direction; interagency discussions; and U.S.-Israeli Government understandings. The proposal generally involves making periodic--probably quarterly--disbursements of funds, based on some form of Israeli certification that a specified level of U.S. nonmilitary products were imported by Israel. This certification could be based on Israeli Government trade statistics and verified by U.S. Department of Commerce data.

The cash transfer proposal would alleviate the problem of gathering documentation evidencing specific U.S. exports from the Israeli private trade sector. It would also expedite and systematize the transfer of funds to meet Israel's balance-of-payments deficit. But what is not yet clear is what effect it will have on U.S. exports to Israel and on U.S.-flag ocean shippers--the latter participate in the CIP program through cargo preference requirements. We believe that arrangements could be made for continuing U.S. flag shipments by:

1. Retaining the CIP for agricultural purchases made by the Israel Supply Mission; cargo preference would thus contine for these transactions. As noted on page 13, the Mission's paperwork can be handled without undue difficulty.

2. Specifying in aid agreements that certain tonnage levels will be shipped on U.S.-flag vessels.

CONGRESSIONAL ACTION

Both House and Senate foreign aid bills for fiscal year 1979 authorize a cash transfer program for Israel linked to maintenance of some level of U.S. exports. Under Senate bill 3075, all of the $785 million earmarked for Israel may be used as a cash transfer. House bill 12222 earmarked at least $560 million of the $785 million for foreign exchange support only.

Both bills address the question of the program's effect on U.S. exports. The Senate bill states that the President shall ensure that the level of cash transfers does not cause an adverse impact on the total amount of U.S. nonmilitary exports to Israel. The House bill states that the

President may waive the requirement if he determines that the foreign exchange support would adversely affect the level of U.S. exports. The proposed bills do not comment on the relationship between cargo preference and the cash tranfer program.

At the conclusion of our review the House and Senate had passed their respective bills. The final congressional authorization will emerge from a House-Senate foreign aid conference.

PROPOSED IMPLEMENTATION

To implement the proposed cash transfer program, AID and State Department officials told us that formal understandings with the Israeli Government would be reached on levels of U.S. nonmilitary exports and the competitive position of U.S. commercial exporters in the Israeli market. These government-to-government initiatives will be preceded by U.S. Government interagency discussions to formulate a U.S. positio - such questions as:

--To what level of U.S. exports to Israel should the proposed cash transfer be linked, and how will this be monitored?

--What will happen if agreed-upon export levels are not met?

--Will some commodities be required to be shipped on U.S.-flag vessels?

U.S. exports

Nonmilitary U.S. exports to Israel totaled $888 million in 1976 and $956 million in 1977, and represented 21.5 percent of 1976 total Israeli imports and 19.9 percent of 1977 imports.

State and AID officials maintain that the switch to the proposed cash transfer program will not adversely affect U.S. exports to Israel since the CIP operates on a reimbursable basis covering commercially purchased goods. Private sector purchases are based on commercial considerations without regard to the source of foreign exchange for financing the purchases.

The Department of Commerce, however, wants to maintain the level of U.S. exports to Israel and is concerned about the effect of a switch to the proposed cash transfer on U.S.

exports. Commerce cited the difficulties in maintaining U.S. exports because of Israel's preferential trade arrangements with the European Economic Community. To address these concerns, agreements must be made on what levels of U.S. exports or U.S. market share are expected to be maintained and how this will be monitored. Commerce stated that verification of U.S. exports through Israeli customs statistics would be a satisfactory procedure.

In addition to decisions on U.S. export levels, there are also questions of how and by whom the export agreements will be monitored and what procedures would be followed if export levels or market share falls below agreed upon levels.

Cargo preference

In the Israel Security Support Assistance Program, AID has applied cargo preference requirements to the CIP but not to the cash grant. For the CIP, AID Transportation Division officials estimated that over the January 1976 to April 1978 period, U.S.-flag shippers earned annual revenues of about $30 million in carrying CIP cargo to Israel. This consisted of about $17 million shipped in "tramp" dry-bulk cargo ships and about $13 million in liner cargo ships. AID officials noted that not all of this shipping is AID-financed. For example, AID estimated that in 1977 they reimbursed Israel for about $17 million worth of tramp U.S.-flag shipments and about $6.5 million of liner U.S.-flag shipments.

U.S.-flag ship revenues are expected to decline when the proposed cash transfer program is introduced, but there are no firm estimates on by how much. AID transportation officials stated that since tramp shipping is booked at rates much higher than world shipping rates, there was no reason to believe it would be continued. The effect on liner traffic, however, was more difficult to estimate. AID officials acknowledged there would be a decline, but pointed out that U.S.-flag liners would still carry U.S. military and Public Law 480 cargoes to Israel. Maritime Administration officials thought that without specific requirements, U.S.-flag liners would carry much less of the AID cargo to Israel.

The question of whether cargo preference applies to the cash grant program has been in dispute between AID and the Maritime Administration. This issue was discussed in our recent report 1/ on cargo preference programs. The Maritime Administration position is that cargo preference laws apply to all cargoes that move because of the Federal Government's involvement. Under this definition, AID cash grants would be subject to U.S.-flag vessel requirements, but the Maritime Administration has not yet addressed these programs because of other priorities and limited staff.

AID, on the other hand, does not include a U.S.-flag shipping requirement in its cash grant agreements because AID's General Counsel ruled that there is no evidence that AID is financing commodity shipments and the grant agreements do not identify the cash grant funds with commodity purchases. The proposed cash transfer differs from the cash grant since the cash transfer is linked to commodity purchases in the United States. As noted in the agency comments section of this report, the U.S. shipping controversy carries over into the proposed cash transfer program for Israel and the applicability of cargo preference remains an unanswered question. We recommend in our cargo preference report that the Congress clarify (1) the types of programs covered under preference legislation and (2) the extent of the Maritime Administration's authority to determine the applicability of cargo preference legislation to specific programs.

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In summary, the fiscal year 1979 foreign aid authorization is expected to provide the basic guidelines for switching the Israel program to a cash transfer. After interagency discussions, AID will be the lead agency in negotiating an aid agreement with the Israeli Government. We believe that the views of the involved agencies should be fully explored. However, cargo preference and other U.S. trade concerns should be addressed in the context of achieving the stated balance-of-payments and foreign policy objectives of the Security Supporting Assistance Program for Israel. High levels of aid are being provided to show U.S. support and create a positive environment for Middle East peace negotiations. Thus, appropriate emphasis should be given to this U.S. foreign policy interest.

1/"Cargo Preference Programs for Government Financed Ocean Shipments Could be Improved," CED 78-116, June 8, 1978.

CHAPTER 4

OTHER U.S. ECONOMIC PROGRAMS FOR ISRAEL

The United States has provided Israel with a variety of other economic assistance programs, as summarized below.

JOINT WATER-DESALINIZATION PROJECT

For this $55 million project to establish a prototype water-desalinization plant, $20 million will be provided by the United States and $35 million by Israel. The 10 million gallon per day capacity plant is to be built in Ashdod, an industrial city south of Tel Aviv. The project is currently in the design phase, and project engineers expect to begin operations of a prototype plant late in 1983.

As of September 1977, only about $170,000 of the project funds had been expended. However, $3 million has been committed for a letter of credit to purchase eligible goods and services in the United States.

We were told the United States Government will have free use of any technology developed as a result of the project and that U.S. firms will be able to acquire the technology by purchasing licenses.

PUBLIC LAW 480 FOOD SALES

Israel purchases U.S. agricultural products under the Title I sales program, which is financed by long-term concessional loans. The commodities are sold in Israel for local currency, and the Israeli Government uses the proceeds for economic development.

Israel received Title I sales of about $11 million in fiscal year 1977 and $7 million in 1978. In recent years, Title I program dollar levels for Israel have decreased because most of Israel's purchases of U.S. agricultural products are being financed through the CIP. Also, Public Law 480 legislation earmarks most of the available sales funds for countries with low per capita incomes. This minimizes the amounts that can be programed for more-developed countries like Israel. However, a U.S. Embassy official told us that the Israeli Government would like to have a small Title I program in order to "keep their hand in" in case the CIP is withdrawn.

HOUSING INVESTMENT GUARANTEES

AID provided $125 million in loan guarantees from 1974 to 1978 for private U.S. financing of mortgages for low-cost housing in Israel. Our November 4, 1977, report to the Congress 1/ was an overview of housing assistance, and we are currently reviewing the housing investment guarantee program, including the Israel program.

BANK AND INVESTMENT COVERAGE

The Export-Import Bank of the United States and the Overseas Private Investment Corporation have programs in Israel. Eximbank provides direct loans and guarantees as well as re-lending credit programs and cooperative financing facility programs. The Overseas Private Investment Corporation insures selected projects against inconvertibility, expropriation, and war-risk losses.

REFUGEE ASSISTANCE

Our June 20, 1977, report to the Congress 2/ noted that through 1976 the United States had provided about $120 million in grants to the United Israel Appeal to help resettle Soviet refugees in Israel and about $10.3 million in grants to the Intergovernmental Committee for European Migration to transport the refugees to Israel and other countries.

The resettlement grants were used in an ongoing resettlement and absorption program operated for many years by the Jewish Agency for Israel. The grant funds for each program area generally represented only part of total program funding.

BINATIONAL FOUNDATIONS

In March 1976, Israel and the United States signed an agreement establishing an industrial research foundation. The agreement calls for contributions of $30 million from each country, and the U.S. share came from the prepayment of Public Law 480 sales loans payable by Israel. The foundation is expected to support specific joint industrial projects.

1/"The Challenge of Meeting Shelter Needs in Less Developed Countries," ID-77-39.

2/"U.S. Assistance Provided for Resettling Soviet Refugees," ID-76-85.

The industrial venture was the second of three Israel-United States cooperative foundations. In September 1972, a mutually financed $60 million Binational Science Foundation was established, and just recently a mutually financed $80 million fund for agricultural research was signed subject to congressional approval.

AMERICAN SCHOOLS AND HOSPITALS ABROAD

Section 214 of the Foreign Assistance Act of 1961 authorizes assistance to American-founded or sponsored institutions overseas which reflect quality U.S. education or medicine and U.S. ideas and practices. Since 1970, the United States has provided more than $40 million in grants to various entities in Israel for developing schools and hospitals and related functions; and 18 grants totaling about $10.5 million were active as of September 30, 1977.

DEBT RELIEF

The Congress canceled repayments of about $29 million due from eight Israeli institutions under certain Public Law 480 dollar-repayable loans. This debt cancellation was authorized by section III of the 1976 Foreign Assistance and Related Appropriations Act.

EXCESS PROPERTY GRANTS

The United Israel Appeal was authorized to obtain U.S. excess property having an original acquisition cost of $4.2 million for relief, rehabilitation, and development. It was charged transportation and rehabilitation costs for the excess property and also incurred costs for refurbishment, repair parts, and transportation associated with obtaining 125 mobile homes considered excess. Other property acquired included cargo trucks and trailers, generators, steel pipe, and folding beds.

DUTY-FREE IMPORT PRIVILEGES

The Generalized System of Preferences program permits certain categories of exports from developing countries to the United States to be more competitive through special duty-free entry privileges. Israel is authorized by this program to export 2,700 products to the United States duty-free if they are of Israeli origin. In May 1977, the U.S. Embassy reported that Israel's preferential exports in 1976 showed a much larger increase than overall exports to the United States.

APPENDIX I

AID SUMMARY OF U.S GOVERNMENT AID TO ISRAEL

AID programs	1970	1971	1972	1973	1974	1975	1976	transition quarter	1977	1978	1979 proposed
	Fiscal year								Fiscal year		
	(millions)										
Security Supporting Assistance:	$ -	$ -	$(50.0)	$(50.0)	$ (50.0)	$(324.5)	$ (700.0)	$(75.0)	$ (735.0)	$ (785.0)	$(785.0)
Cash grant	-	-	-	-	-	-	150.0	15.0	300.0	300.0	-
CIP	-	-	50.0	50.0	50.0	324.5	550.0	60.0	435.0	485.0	-
(CIP loan)	-	-	-	-	-	-	225.0	25.0	245.0	260.0	-
(CIP grant)	-	-	50.0	50.0	50.0	324.5	325.0	35.0	190.0	225.0	-
Housing Investment Guaranties	-	-	50.0	-	25.0	25.0	25.0	-	25.0	25.0	-
American schools and hospitals	12.5	2.5	5.6	4.5	3.3	2.5	3.6	1.3	4.6	(b)	(b)
Other	-	-	-	-	-	a/20.0	-	-	-	-	-
Public Law 480:	(41.1)	(55.8)	(54.2)	(48.0)	(29.2)	(8.7)	(15.5)	-	(11.2)	(7.2)	(5.4)
Title I	40.7	55.5	53.8	47.6	29.1	8.7	15.5	-	11.2	7.2	5.4
Title II	0.4	0.3	0.4	0.4	0.1	-	-	-	-	-	-
Foreign Military Sales	30.0	545.0	300.0	300.0	2,482.7	300.0	1,500.0	200.0	1,000.0	1,000.0	1000.0
Immigrant assistance	-	-	2.0	49.0	36.5	40.0	15.0	-	15.0	20.0	(b)
Export-Import Bank Loans	10.0	31.0	21.1	21.1	47.3	62.4	109.0	13.0	2.3	(b)	(b)
Other	-	-	-	-	-	-	-	-	(c)	-	d/40.0
Total	$ 93.6	$634.3	$482.9	$472.6	$2,674.0	$ 783.1	$2,368.1	$289.3	$1,793.1	$1,837.2	$1,830.4

a/Water desalinization project.

b/Not available.

c/Excludes funding for Binational Industrial Foundation. U.S. contribution was $30 million payable by advance payment of Public Law 480 loans due after 1987.

d/U.S. half of an endowment for a Binational Agricultural Research Fund.

ISRAEL'S FOREIGN DEBT AND

DEBT-SERVICE PAYMENTS

CALENDAR YEARS 1971-77

Israel experienced a large increase in foreign debt and debt-service payments, as shown by the government's financial data.

Calendar year	Foreign debt at end of year	Debt service payments: Principal	Interest	Total
	(millions)			
1971	$ 3,430	$330	$175	$ 505
1972	4,081	432	219	651
1973	5,093	420	327	747
1974	6,250	469	517	986
1975	7,617	528	646	1,174
1976	9,231	630	645	1,275
1977	a/10,425	(b)	(b)	(b)

a/This represents a per capita debt of $2,900 in 1977, up from $1,100 in 1972 and $515 in 1967.

b/Not available.

Although the absolute level of debt is high, the burden of debt is not as large as it might appear because of the long-term structure and "soft" nature of much of the debt. More than 80 percent of the total debt is long-term, about 23 percent of it owed to Israel bond holders and 32 percent to the U.S. Government.

It should also be noted that some of the Israel bond borrowing is not a foreign exchange liability because some bonds are redeemed in Israeli pounds or in new issues of bonds. Moreover, much of the debt to the United States represents borrowing on concessional terms. Israel's official debt to the United States at June 30, 1977, as compiled by the Treasury Department, is shown on the following page.

Loan source	Principal outstanding on utilized credit
Foreign Assistance Act and related acts	$a/349,141,233
Public Law 480 agricultural sales	281,239,818
Foreign Military Sales	2,394,257,210
Export-Import Bank loans	146,031,452
Total	$3,170,669,713

a/Security Supporting Assistance accounts for $245 million of this amount.

Israel's annual repayments to the U.S. Government will amount to about $375 million in 1977 and $394 million in 1978, according to the Treasury Department.

ISRAEL'S BALANCE OF PAYMENTS

Trade accounts	1975	1976	1977 (estimated)
	(millions)		
A. Exports:			
Goods	$2,181	$2,670	$3,391
Service	1,585	1,760	2,169
Total	$3,766	$4,430	$5,560
B. Imports			
Defense	-1,846	-1,496	-942
Civil goods	-3,806	-3,826	-4,485
Services	-2,175	-2,424	-2,693
Total	-7,827	-7,746	-8,120
C. Balance-of-payments deficit on goods and services (A & B)	-4,061	-3,316	-2,560
Capital accounts			
D. Unrequited transfers (grants, etc.)	1,759	2,281	2,084
E. Foreign investment, net	89	52	87
F. Long and medium-term loans			
Receipts	2,166	2,011	1,650
Repayments	-528	-655	-755
Net	1,638	1,356	895
G. Net capital imports (D, E, and F)	3,486	3,689	3,066
H. Overall balance (C and G) (note a)	$ -575	$ 373	$ 506

a/Totals may not add due to rounding.

Source: Israeli Government Publications.

APPENDIX IV

ISRAEL COMMODITY IMPORT PROGRAM

FISCAL YEARS 1972-78

Fiscal year	Agreement number	Amount of agreement Grant	Loan	Total	Undisbursed as of Sept. 30, 1977
1972	271-K-601	$ 50,000,000	-	$ 50,000,000	-
1973	271-K-602	50,000,000	-	50,000,000	-
1974	271-K-603	50,000,000	-	50,000,000	-
1975	271-K-604	324,500,000	-	324,500,000	-
1976	271-K-605	325,000,000	-		-
	271-K-141	-	$225,000,000		-
				550,000,000	
Transition quarter	271-K-608	35,000,000	-		-
	271-K-142	-	25,000,000		-
				60,000,000	
1977	271-K-610	a/190,000,000	-		$ 21,122,168
	271-K-143	-	245,000,000		236,777,246
				a/435,000,000	
1978	271-K-612	225,000,000	-		-
	271-K-144	-	182,000,000		-
	271-K-145	-	78,000,000		485,000,000
				485,000,000	
Total program for 1972-78				$2,004,500,000	

a/Grant 271-K-610 originally amounted to $340 million; during 1977, $150 million was transferred to a cash grant, which reduced the CIP carry-in for 1978.

DEPARTMENT OF STATE
AGENCY FOR INTERNATIONAL DEVELOPMENT
WASHINGTON, D.C. 20523

AUDITOR GENERAL

MAY 1 1 1978

Mr. J. K. Fasick, Director
International Division
U. S. General Accounting Office
441 G Street, N. W.
Washington, D. C. 20548

Dear Mr. Fasick:

Thank you for providing the draft report, "U. S. Economic Assistance For Israel," for comment. Officials of the Department of State and Agency for International Development have reviewed it with interest and are in general agreement with the findings and the thrust of the recommendations.

Attached are joint comments of the Department of State and Agency for International Development which provide more specific information regarding our views. In addition detailed comments regarding specific findings and wording of the report were provided in a meeting with GAO officials and in writing.

If we can be of any further assistance in this matter, please call upon us.

Sincerely yours,

Herbert L. Beckington

Enclosure

JOINT COMMENTS OF THE AGENCY FOR INTERNATIONAL DEVELOPMENT
AND DEPARTMENT OF STATE ON THE GAO DRAFT REPORT TITLED
"U.S. ECONOMIC ASSISTANCE FOR ISRAEL"

We have reviewed in draft the GAO's report on U.S. assistance to Israel. In general, we find the report accurate, comprehensive, and a useful review of our economic assistance program to Israel.

We have discussed the draft report informally with the GAO and have suggested a number of relatively minor revisions in the text. These include:

-- Making more explicit the role of political factors in the determination of overall Security Supporting Assistance levels for Israel. The report's discussion of this topic (page 8) places excessive stress on the role of the AID-chaired Inter-Agency Balance-of-Payments Working Group. While this group provides very useful and necessary input into the decision-making process, its findings are not, in themselves, necessarily determinate. We suggested the addition to this section of a sentence or two making it clear that the Arms Export Control Board chaired by the State Department considers all factors military, economic, and political in reviewing both the proposed SSA and FMS programs as separate elements of an integrated assistance package.

-- Rephrasing part of the draft's treatment of our commitments under Sinai II. With respect to the initial justification for the cash grant portion of our assistance, the report states: "These commitments involve assistance to finance (1) the redeployment of Israeli military forces from the Sinai ..." It would be more correct to state this in terms of the need to offset the foreign exchange costs to Israel associated with the Sinai redeployment.

-- Attenuating the draft's statement on the degree of austerity currently being imposed on the Israeli economy. We suggest language to the effect that appropriate belt-tightening measures are being pursued by the government and a reasonable degree of austerity has been imposed. It might also be useful for the report to note that per capita real consumption levels in Israel are high by LDC standards and have been maintained in recent years.

-- A clarification of points raised in the draft's review of the commodity import program. (Written comments of AID's Commodity Procurement Office and the AID General Counsel's Office on these points were made available to the GAO team during our discussion of the draft report.)

We are in accord with the report's overall findings and the thrust of its recommendations. As the report notes: the CIP program has a substantial backup of unspent funds because of documentation problems; this pipeline is likely to grow as a result of recent Israeli economic reform measures which further restrict the government's ability to collect import documentation from the private sector; and that the backup of funds detracts from program objectives. The report recommends that AID and State assess, in both the economic and political dimensions, the CIP problem and the range of possible corrective measures. AID should then present proposals to the appropriate Congressional committees. The report further states (on pages 23 and 24) that AID is pursuing this course of action.

Subsequent to the drafting of the GAO report, AID has concluded that program objectives could best be served by the elimination of the CIP program and substituting for it an all cash transfer program subject to satisfactory assurances from the Government of Israel that civil imports from the United States will be at least equal to the level of our economic assistance and that the competitive position of U.S. exporters will not be adversely affected. At the time of our meeting with the GAO team on April 27, 1978, a revised FY 1979 Congressional Presentation formally proposing this change was in process, and has now been transmitted. A copy of this document was previously provided to the GAO and is attached here. We thus consider the GAO's recommendations presented in the draft report to have been fully implemented.

UNITED STATES DEPARTMENT OF COMMERCE
The Assistant Secretary for Administration
Washington, D.C. 20230

15 MAY 1978

Mr. Henry Eschwege
Director, Community and Economic
Development Division
U. S. General Accounting Office
Washington, D. C. 20548

Dear Mr. Eschwege:

This is in reply to your letter of April 6, 1978, requesting comments on the draft report entitled "U. S. Economic Assistance for Israel."

We have reviewed the enclosed comments of the Assistant Secretary for Industry and Trade and believe they are responsive to the matters discussed in the report.

Sincerely,

Elsa A. Porter
Assistant Secretary
for Administration

Enclosure

UNITED STATES DEPARTMENT OF COMMERCE
The Assistant Secretary for Industry and Trade
Washington, D.C. 20230

MAY 5 1978

Mr. Henry Eschwege
Director, Community and Economic
Development Division
United States General Accounting Office
Washington, D.C. 20548

Dear Mr. Eschwege:

This responds to your request for the comments of this Department on the draft report entitled "U.S. Economic Assistance For Israel".

This report has provided an excellent review of the aid program to Israel and the problems in implementing it. While this Department is sympathetic to these problems, and is interested in any solutions which might alleviate them, we are also concerned that U.S. interests, namely the maintenance of the U.S. share of the Israeli market and our compliance under Public Law 664 (the Cargo Preference Act), might not be fully satisfied. Comments on these aspects are included as an enclosure to this letter.

Sincerely,

Frank A. Weil
Assistant Secretary
for Industry and Trade

Enclosure

The Department of Commerce recognizes the administrative burden faced by A.I.D. and the GOI in accounting for private sector procurement under the CIP, particularly since the GOI has relaxed its internal economic controls. Therefore, while the Department still opposes any additional conversion of CIP funds to cash grant, we have nevertheless suggested that the current cumbersome procedure be replaced by a simplified system requiring verification by the GOI, using Israeli customs statistics.

The Department is interested that the level of U.S. exports to Israel does not fall and that our market share is maintained. While the CIP program does not provide absolute assurance that these goals will continue to be met, U.S. chances of maintaining a leading market position are enhanced as long as a significant part of civilian sales to Israel is financed under tied aid.

(See GAO note below.)

The Department is further concerned that a change in the method of reimbursing the GOI for purchases with funds provided by A.I.D. may result in the non-compliance with the provision of Public Law 664 (the Cargo Preference Act) which applies to cargoes purchased by Israel and financed with U.S. Government funds. It is our understanding that the ISM cannot request reimbursement for commodities carried on Israeli-flag vessels if the quantity of cargo exceeds the quantity carried by U.S.-flag vessels or if the documentation is incomplete.

GAO note: The deleted comment refers to matters omitted from or revised in the final report.

APPENDIX VI

Since it is the position of the Department of Commerce Maritime Administration (Marad) that cargo preference requirements apply to the shipment of commodities purchased with grant funds, we envisage that if the CIP funds are converted to grant funds, additional burdens will be placed on A.I.D. as well as on the GOI. Inasmuch as the grant funds would be commingled with the GOI's own foreign exchange, it would be difficult for all parties concerned to identify the specific commodities financed with the grant funds to assure that 50 percent of the cargo moves on U.S.-flag vessels. Accordingly, an expansion of the grant program would adversely affect the Department's ability to enforce the provisions of the cargo preference laws as enacted by Congress.

PRINCIPAL OFFICIALS RESPONSIBLE FOR ACTIVITIES DISCUSSED IN THIS REPORT

	Tenure of Office From	To
DEPARTMENT OF STATE		
SECRETARY OF STATE:		
Cyrus R. Vance	Jan. 1977	Present
Henry A. Kissinger	Sept. 1973	Jan. 1977
AGENCY FOR INTERNATIONAL DEVELOPMENT		
ADMINISTRATOR:		
John J. Gilligan	Mar. 1977	Present
John E. Murphy (acting)	Jan. 1977	Mar. 1977
Daniel S. Parker	Oct. 1973	Jan. 1977
U.S. OFFICIALS IN ISRAEL		
U.S. AMBASSADOR:		
Samuel W. Lewis	May 1977	Present
Malcolm Toon	June 1975	Dec. 1976
U.S. CONSUL GENERAL;		
Michael H. Newlin	July 1975	Present
Arthur R. Day	May 1972	July 1975

(47140)