UNCLASSIFIED

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

PROGRAM ASSISTANCE PAPER
FY 1979

ISRAEL: FY 1979 CASH TRANSFER

UNCLASSIFIED

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(iii) CLASSIFICATION: UNCLASSIFIED

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PAAD

DEPARTMENT OF STATE
AGENCY FOR
INTERNATIONAL DEVELOPMENT

PROGRAM ASSISTANCE APPROVAL DOCUMENT

1. PAAD NO.: NE 79-2
2. COUNTRY: Israel
3. CATEGORY: Cash Transfer
4. DATE:

5. TO: John J. Gilligan, Administrator
6. OYB CHANGE NO.:

7. FROM: Joseph C. Wheeler, Assistant Administrator, Bureau for Near East
8. OYB INCREASE:

TO BE TAKEN FROM:

9. APPROVAL REQUESTED FOR COMMITMENT OF: $ 785,000,000
10. APPROPRIATION - ALLOTMENT: Loan 937-62-298005891; Grant937-62-298005091 Economic Support Fund

11. TYPE FUNDING	12. LOCAL CURRENCY ARRANGEMENT	13. ESTIMATED DELIVERY PERIOD	14. TRANSACTION ELIGIBILITY DATE
[X] LOAN [X] GRANT	[ ] INFORMAL [ ] FORMAL [X] NONE	n/a	n/a

15. COMMODITIES FINANCED

n/a

16. PERMITTED SOURCE	17. ESTIMATED SOURCE
U.S. only:	U.S.:
Limited F.W.:	Industrialized Countries:
Free World:	Local:
Cash: 785,000,000	Other: 785,000,000

18. SUMMARY DESCRIPTION

This assistance is part of a continuing U.S. assistance program to Israel and is intended to give Israel greater economic flexibility for easing some of the pressure on its economy.

It is recommended that you approve a cash Grant in an amount not to exceed Five Hundred Twenty-five Million United States Dollars ($525,000,000) and a cash Loan in an amount not to exceed Two Hundred Sixty Million United States Dollars ($260,000,000) on the following terms and conditions:

Interest and Terms of Repayment

Israel shall repay to AID in United States Dollars $260 million within forty (40) years from the date of first disbursement of the Loan. Israel shall pay to AID in United States dollars interest from the date of the first disbursement of the Loan at the rate of a) two percent (2%) per annum during the first ten (10) years, and b) three percent (3%) per annum thereafter, on the outstanding disbursed balance of the Loan and on any due and unpaid interest accrued thereon.

19. CLEARANCES	DATE
NE/PD:SATaubenblatt SAT	11/20/78
NE/DP:BLangmaid BL	11/17/78
GC/NE:JMullen	11/17/78
NE/EI:GKamens (draft) GK	11/9/78
NEA/IAI:JMcBride (draft)	11/14/78
PPC/DPRE:EHogan	11/21/78
AA/PPC:AShakow AS	11/21/78
DAA/NE:ADWhite AW	11-20-78

20. ACTION

[X] APPROVED [ ] DISAPPROVED

AUTHORIZED SIGNATURE: [signature] DATE: 11/?/78

TITLE: Deputy Administrator

ISRAEL

FY 79 PROGRAM ASSISTANCE PAPER

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Preface

The Foreign Assistance Act for FY 1979 provides for an Economic Support Fund cash transfer in the amount of $785 million for Israel. Within this Fund, $260 million and $525 million will be provided on a loan and grant basis respectively.

The following program assistance paper provides the justification for the $785 million package. We propose that the full amount of the cash transfer be approved. Obligation of the grant and loan will be made in the full amount but releases of funds will be made on a quarterly basis. The first tranche will be released immediately upon approval of the package and satisfaction of Conditions Precedent. Subsequent tranches will be released on or about January 1, April 1, and July 1, 1979. A draft loan and grant agreement is included as Annex A.

Program Assistance Committee

Chairperson	:	Robert Fedel, NE/PD
Desk Officer	:	Russell Misheloff, NE/EI/I
Counsel	:	Jan Miller, GC/NE
Project Officer:		James Watson, NE/PD
Program Officer:		Dale Pfeiffer, NE/DP

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I. POLITICAL AND ECONOMIC CONSIDERATIONS

Israel's political and economic stability have been deemed an essential requisite to achieving peace in the Middle East. U.S. assistance programs, including both FMS and ESF*, tangibly reflect U.S. support and help give Israel the confidence it needs to take the risks necessary to reach a peace settlement. The U.S. Economic Support Fund directly supports Israel's civilian economy, and is contributing significantly to the reestablishment of balance of payments equilibrium which Israel has confronted since the 1973 war.

Since its inception, Israel has had to struggle with the problem of limited resources. This challenge became particularly acute after 1973 as a result of its burgeoning defense expenditures; worldwide price inflation, particularly in 1974 and 1975; and economic recession in countries with which Israel trades. As a consequence, Israel became dependent upon large capital and aid inflows to meet the financial deficit. U.S. assistance rose to $2.5 billion in FY 1976 and the transition quarter. Israel's short-term debt spiraled nearly fourfold from its pre-1973 level of $200 million. Medium and long term debt grew 127% in the period between January 1973 and the end of 1976.

As a result of: (1) Government-imposed austerity measures designed in part to curb import demand, (2)rapid growth in export receipts, (3) U.S. assistance and (4) private resource transfers, Israel's balance of payments picture has shown improvement in the past few years. Thus, for example, the trade (goods and services) deficit declined from $4.1 billion in 1975 to $2.6 billion in 1977. In the latter year, Israel's civilian balance of payments was in surplus by over $400 million despite the fact that borrowing on commercial terms was much reduced from the level of the previous year. It must be added, however, that these improvements were achieved at the price of continued economic stagnation. The Gross National Product rose by only 1.6% in 1976 and 1.0% in 1977, i.e. by less than the rate of population growth.

Economic prospects for 1978 are encouraging. Continued growth in exports and revival of investment are contributing to an acceleration in the real growth rate of the civilian economy. To judge by preliminary Israeli Government data for the first six months of 1978, this in turn is contributing to a somewhat faster rate of growth in non-defense merchandise imports. This is expected, and does not portent a return to the serious problems of civilian balance-of-payments disequilibrium which Israel faced a few years ago.

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*Economic Support Fund. In the narrative, the term Economic Support Fund or ESF is used when the discussion is about FY 1979 and beyond, or about past, present and projected future economic assistance. When the discussion is about FY 1978 and/or prior years only, we refer to Security Supporting Assistance (SSA).

The U.S. Government continues to sponsor a broad program of assistance in response to Israeli economic requirements. In addition to the Supporting Assistance program, economic aid to Israel in FY 1978 included relatively small amounts of PL 480 Title I, housing investment guarantees, immigrant assistance, and American Schools and Hospitals Abroad (ASHA) contributions.

II. U.S. ECONOMIC ASSISTANCE PROGRAM

A. Recent Economic Programs

Since fiscal year 1972, AID has been providing Security Supporting Assistance (grants and loans), primarily for commodity import financing. Initially, obligations were fairly modest ($50 million in FY 1972, FY 1973 and FY 1974). By FY 1976, they had increased to $700 million in response to Israel's growing economic problems -- a $550 million CIP loan and grant program and a $150 million cash grant. The following year the program reached $735 million, of which $300 million was in the form of a cash grant, and in FY 1978 it was increased to $785 million -- $485 million in commodity import financing and a $300 million cash grant. Since FY 1976, approximately two-thirds of the SSA program has been provided on a grant basis and the remainder has been on concessional loan terms.

In addition to SSA, the U.S. has been providing PL 480 Title I food for several years to help Israel meet its requirements, and housing guarantees to assist Israel with its shelter needs. Under other legislation, assistance has been provided to help Israel settle new immigrants from the Soviet Union and other countries. During FY 1975, a $20 million grant for a Joint U.S.-Israel Desalination Project was obligated; the engineering design for the project is well underway, and site preparation and procurement are to begin in the near future.

The following amounts of military assistance have been provided: FY 1976, $1.5 billion; TQ, $200 million; FY 1977 and FY 1978, $1 billion in each year.

B. FY 1979 Economic Program

For FY 1979, Congress has appropriated $785 million for the Economic Support Fund. The two-thirds grant/one-third loan ratio of the past few years will be maintained.

Unlike previous years, the entirety of the program will be in the form of a cash transfer. The form of the program is being changed in FY 1979 to alleviate difficulties which the Government of Israel has encountered in utilizing available CIP funds. Despite the high volume of non-military imports from the U.S. -- $900 million to $1 billion a year for the past few years -- Israel has had increasing difficulty in collecting the necessary documentation on a sufficient volume of transactions to ensure timely disbursement of all available CIP funds. The problem arises because of Israel's traditional lack of government control over private sector transactions. Controls were further reduced under the New Economic Policy introduced in October 1977. The result is that as of September 30, 1978, undisbursed CIP funds totaled approximately $300 million.

In discussing the shift to a completely cash transfer ESF program with the Government of Israel, AID noted its concerns that the shift not impact adversely on the aggregate level of Israel imports from the U.S., or disadvantage U.S. firms in terms of their access to Israeli markets. The Government of Israel has indicated that it understands our concerns, and has provided written assurances covering both points (Annex C).

In addition to the ESF program, Israel is expected to receive approximately $5 million in PL 480 Title I assistance in FY 1979.

III. LOAN AND GRANT JUSTIFICATION

Security Supporting Assistance has been a key factor in enabling Israel to maintain economic stability. In order to maintain economic stability, Israel must run a civilian trade deficit of well over $1 billion. Its civilian sector financing shortfall was about $2.2 billion in 1976 and 1977. Over the past few years, approximately one-half of this amount was covered by private transfers from abroad. The remainder was financed by revenues realized from bond issues, commercial borrowing and U.S. economic assistance.*

The acceleration in the growth rate of the Israeli economy which began this year, while obviously welcome, adds to the need for imports and thus may create additional financing difficulties. Of course, strengthening the economy also makes it possible for Israel to cover more of her financing requirements by borrowing on nonconcessional terms.

The loan and grant cash transfer program proposed herein will assist Israel by providing foreign exchange needed to help meet the country's civilian foreign exchange financing requirements.

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*Foreign investment in Israel has not been significant in the post-1973 period; it may become more important if and when peaceful conditions are established in the Middle East.

A. Balance of Payments

Following the 1973 war, world recession, dramatic increases in import prices (particularly for petroleum products) and the need to rearm combined to strike an economically devastating blow to a society that had been accustomed to steady growth, stability and general improvement in the quality of life.

Beyond the psychological and emotional impairment experienced by many Israelis following the 1973 Israel-Arab war, the financial costs of replacing and upgrading a modern, high technology military inventory posed serious problems of resource allocation and ability to pay. The military drain on the civilian economy was staggering in terms of both human and financial resources. In recent years defense expenditures have claimed 30% to 45% of the national budget and 15% to 20% of the total resources available to the economy.

Coupled with this substantial diversion of resources to defense, the prosperity of the civilian economy was further undermined by the general slowdown of the world economy in 1974 and 1975 and a surge in oil prices. These factors led to a massive trade deficit in 1975 of $4 billion, while economic growth came to a virtual standstill.

The worsening balance of payments became the principal focus of decisionmakers and prompted the GOI to introduce policies ultimately designed to slacken demand for imports and stimulate production for export. Devaluation and economic slowdown were selected as the principal modalities to arrest the payments deficit. The complementary effect of these actions was intended to stem the flow of imports and shift resources to an export sector made more profitable by subsidies, special investment incentives, liberal credit and devaluations. In November 1974, Israel announced a 43% devaluation. Subsequently, monthly mini-devaluations were utilized to keep Israeli exports competitive in international markets (despite high rates of inflation) and to curb non-essential imports. Other specific austerity measures taken included raising prices of subsidized goods (including such essentials as bread, milk, and eggs), increasing taxes to very high levels, and reducing real public consumption.

In 1976 and again in 1977, significant progress was made toward the goal of reestablishing balance of payments equilibrium. The goods and services deficit which had reached $4 billion in 1975 was reduced to $2.6 billion in 1977. More importantly in terms of assessing the need for concessional financing, the civilian financing requirement* dropped by over

*Civilian trade gap (goods and services) plus external debt maturities.

$500 million to a 1977 level of $2.2 billion. These changes were the result of a substantial increase in total exports (48% over the two year period) and much slower growth (20%) in non-defense imports.

In 1976, the bulk of the improvement is attributable to real (i.e. volume) increases in exports. In 1977 the picture is more complex. The real increase in exports was only 6% as compared with 15% the preceding year. Price increases accounted for most of the growth in export receipts ($800 million of a total increase of $1.1 billion). Import prices also rose rapidly in 1977 (9%), although the rate of increase was only half that of exports. Of the total increase in civilian imports (15% over 1976) almost two-thirds is attributable to price increases. The real volume of civilian imports increased very modestly, continuing the pattern of recent years.

Perhaps the most encouraging development in 1976 and 1977 was the diversification of Israeli exports. Non-citrus agricultural exports almost doubled during this period, as growers continued to diversify to take advantage of lower air transport costs to Europe. In 1977, receipts from exports of these products exceeded those of citrus exports for the first time. Non-diamond industrial exports also rose dramatically (by 56%) and in 1977 accounted for almost 30% of Israel's total export receipts. Within this category chemicals, electrical and electronic equipment, and specialized metal products were most prominent. On the services side, foreign exchange receipts from tourism increased by 27% in 1976 and a further 55% in 1977. In the latter year, the number of tourists visiting Israel reached one million. Significant increases were also registered in passenger fares and shipping.

In 1976, the combined effect of a decrease in the current account deficit and an increase in unilateral transfers lessened the need for commercial borrowing to finance the deficit. In particular, short term, high interest loans showed a net reduction from December 31, 1975 to December 31, 1976 of about $123 million. At the same time, foreign exchange reserves grew by $190 million.

In 1977, the civilian financing requirement did not change much from the 1976 level of $2.2 billion. Nevertheless there were substantial changes in the sources which the Israeli economy tapped to finance the gap. Foreign exchange realized from the sale of bonds and disbursement of U.S. economic assistance rose by nearly $250 million. This was offset by a sharp reduction in medium and long term commercial borrowing. Foreign exchange reserves increased by some $275 million.

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On the basis of preliminary data for the first half of 1978, it appears that imports are rising at a somewhat faster rate than that of 1977. To some extent this is due to short term factors, particularly price increases and speculation in diamonds. It also reflects the accelerated pace of economic activity. The data are still too fragmentary to determine the most important influences.

Merchandise exports continued to increase at a healthy rate in the first part of 1978. For the first six months of the year, they were almost 30% higher than they were during the corresponding period in 1977. Growth in exports of diamonds, non-citrus agricultural products, metals, machinery and electronics was strongest. Nevertheless, as with imports,, pronounced price changes and erratic shifts in export receipts in recent months make it difficult to make projections on the basis of the 1978 data presently available.

The Government of Israel expects an overall increase of 15% in civilian imports for 1978. This represents 8% real growth and a 6% adjustment for anticipated inflation. Given that growth in the economy has accelerated and is expected to reach 4% to 5% this year, this appears to be a reasonable projection.

The Israelis project very conservative growth rates for exports. Projections made in 1977 underestimated exports for that year by approximately $370 million. Similarly, earlier projections for 1978 have already been revised upward by $500 million. On the basis of this experience, and taking into account the impact of prior investments in export oriented sectors and anticipated growth rates in countries which are major importers of Israeli goods, the U.S. Government is inclined toward a more optimistic view of Israel's export performance.

In summary, the economic measures taken by Israel over the past few years designed to curb import demand and stimulate export growth appear to have been remarkably successful. Favorable changes in Israel's terms of trade have also been helpful. Renewed emphasis on economic growth will, of course, lead to a somewhat more rapid growth of imports in the next several years. However, the prospects that export growth will exceed that of imports remains good. Additionally, economic growth will also make it easier for Israel to obtain the financing it will continue to require to cover future current account deficits.

The following table sets forth estimates of Israel's 1977 civilian balance of payments accounts.

ISRAEL: CIVILIAN BALANCE OF PAYMENTS

		CY 1977 (Millions of US $)
A.	Financing Requirements	
	Imports (civil only)	-7,023
	Exports	5,560
	Subtotal	-1,463
B.	Sources of Finance	
	Unilateral Transfers	1,084
	Net Foreign Investment	87
	Bond Borrowing	355
	Long & Medium Term Loans	350
	Total Sources	1,876
C.	Financing Gap	- 342
D.	U.S. Economic Assistance	822
E.	Surplus/Deficit on Civilian Account	480
	Military procurement financed from own resources	- 210
	Net Surplus/Deficit	270

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B. Debt Service

Israel's foreign debt increased by 17% in 1977 to a level of $10.875 billion. This represents a decline in the rate of increase from the past few years. The GOI currently estimates that outstanding foreign debt will reach $11.765 billion by the end of 1978. This would be increase of only 8%, less than two-fifths of the average annual rate of increase in the period 1974-1977 (21%).

While the overall amount owed continues to rise, the Government of Israel is succeeding in improving the term structure of its debt. This change in the term structure of Israel's borrowing arrested a disturbing trend which saw short-term debt rise from 3.7% of total foreign debt in 1973 to 12.2% in 1975. At $927 million at the end of 1975, short-term debt was equal to about 84% of Israel's foreign exchange reserves. By the end of 1977 it had declined to 8% of the total, equal to 55% of reserves.

A large portion of Israel's foreign debt consists of long-term obligations of the Israeli Government. Much of it is owed to Israeli bond holders and the U.S. Government, and is on terms not available from commercial lenders. The U.S. Government is now Israel's biggest creditor, with outstanding loans of approximately $4 billion. Israel bond obligations outstanding are at $2.381 billion, 21.9% of total debt.

Israel's future economic prospects appear to be favorable and, thus, the prospects for repayment of the $260 million loan appear reasonable.

As a result of the recent improvements in the term structure of Israel's foreign debt, and the relatively soft terms offered by the U.S. Government and purchasers of Israeli Government bonds, the ratio of debt service (principal plus interest) to total exports has declined from 28.3% in 1975 to 23% in 1977. A further decline to 20% or less is anticipated in 1978. These ratios are still fairly high compared to those of most developing countries.

C. Loan Terms

The terms recommended are 40 year maturity including a 10 year grace period with a 2 percent interest rate during the grace period with a 2 percent interest.

Unlike FY 1978, the FY 1979 Appropriations Act does not contain ceilings or limitations on Economic Support Fund (ESF) loan terms: The Senate bill recommended and contained a provision that of the $260 million proposed for loans to Israel that $60 million be at twenty-year terms and the remaining $200 million be at 40-year terms. S.REP. No. 95-1194, 95th Cong., 2nd Sess. 24 (1978). However, this provision was deleted in conference with no explanatory comment. H.R.REP. No. 95-1754, 95th Cong., 2nd Sess. 10 (1978).

Unlike Development Assistance accounts where the Executive Branch has linked loan terms to countries' per capita GNP, the Executive Branch has maintained that the Middle East countries (Egypt, Israel, Jordan, and Syria) for political reasons be accorded equal terms. In FY 1978, for example, the Appropriations Act contained a ceiling of $865,400,000 for loans in excess of 30 but not to exceed 40 years. The Executive Branch in allocating SSA (now ESF) loan funds provided that the harder terms would be apportioned to the Middle East countries in the same percentage as the percentage of a specific country's assistance level to the total level of all four countries.

Accordingly, it is proposed that the Middle East countries be given equal loan terms, regardless of per capita GNP. Since the Executive Branch has traditionally given 40 year terms to the Middle East countries, except where the legislation required stricter loan terms, it is proposed that the loan portion of Israel cash transfer program be 40 year terms including a 10 year grace period, with an interest rate of two percent during the grace period and three percent thereafter.

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IV. LOAN AND GRANT ADMINISTRATION

A. Procedures

Prior to FY 79, AID provided both commodity import financing and cash grant for Israel. The CIP was on a reimbursable basis. To obtain reimbursement, the Government of Israel submitted to AID certain documentation evidencing the foreign exchange costs of the eligible imported commodities. Such documentation became an administrative burden to AID and the GOI in accounting for private sector procurement under the CIP, particularly after the GOI further relaxed its internal economic controls. Consequently, the CIP objectives were not being achieved in a timely manner. To alleviate this problem, a decision was taken to provide all economic assistance (P.L. 480 and ASHA excepted) on a cash transfer basis linked only at the aggregate level to U.S. non-defense exports to Israel.

The Government of Israel agrees with this approach and has given its assurance that it will take all necessary steps to ensure, during U.S. FY 79, that the dollar level of Israel's non-defense imports from the United States will be at least equal to the level of U.S. economic assistance obligations (estimated at approximately $790 million) and that U.S. suppliers will not be disadvantaged by the termination of the CIP. (see Annex C)

Regarding Israeli Government procurement of large capital equipment items which U.S. suppliers may furnish, special measures will be taken by the GOI to assure that U.S. suppliers can compete on terms at least as favorable as those offered by prospective third country suppliers. Additionally, the GOI has agreed to continue importing from the U.S. corn, wheat, soybeans and other agricultural products purchased on government account at levels approximating those of the past few years, with due allowance for Israel's requirements for such goods and capacity to store them.

Concerning the carriage of goods imported from the U.S., the GOI will continue to follow present procedures for bulk shipments of grain on dry bulk carriers. These procedures were reviewed by AID and the the Maritime Administration to assure a fair share of the market for American carriers.

In the summer of 1979, the Israeli Government will undertake a analysis of experience with U.S. imports under the cash transfer procedures. A report of its findings will be presented to AID by September 1, 1979.

There is no AID Mission in Israel and implementation and monitoring of this program will be the responsibility of AID's Near East Bureau. The Department of Commerce has also agreed to monitor the level of U.S. non-defense exports to Israel and the impact of termination of the CIP on U.S. exports.

B. Utilization of Previous CIP and Present ESF Assistance

From FY 1975 to FY 1978, AID has made available to the Government of Israel $2.6 billion in Security Supporting Assistance. Of that amount $1.1 billion was to finance commodity imports on a grant basis, and $755 was to finance imports on a loan basis. $765 million has been provided as program cash grants. As of September 30, 1978, AID has disbursed $2.3 billion of the $2.6 billion obligated.

Israel continues to experience difficulties in meeting the 50/50 shipping requirement. This has slowed its draw down of CIP funds. AID/SER/COM will continue to work closely with the GOI on this problem in an effort to accelerate drawdown of remaining CIP availabilities.

C. FY 1979 Program Cash Transfer Obligation and Disbursement

AID will release the proceeds of the FY 1979 ESF loan and grant on a quarterly basis. The full amounts of the above loan and grant will be obligated in the loan and grant agreement. Releases will be made starting in about mid-November 1978 and thereafter on a quarterly basis on January 1, April 1, and July 1, 1979.

V. RECOMMENDATIONS

It is recommended that the following financing for the State of Israel be authorized -- program cash loan, $260 million and a program cash grant, $525 million -- on the following terms:

A. Loan Interest and Terms of Repayment

The Borrower shall repay $260 million of the loan to AID in United States Dollars within forty (40) years from the date of the first disbursement under the loan, including a grace period of not to exceed ten (10) years. Borrower shall pay AID in United States Dollars interest on the total loan at the rate of two percent (2%) per annum during the grace period and three percent (3%) per annum thereafter on the outstanding disbursed balance of the loan and unpaid interest.

B. Other Terms and Conditions

(1) AID shall release the proceeds of the ESF cash transfer loan grant on a quarterly basis.

(2) The loan and grant shall be subject to other terms and conditions as AID may deem advisable.

C. Disbursement

The assistance will be disbursed in approximately four equal installments. Each installment to consist of approximately one-third loan and two-thirds grant. The first installment upon satisfaction of conditions precedent and thereafter on January 1, April 1, and July 1, 1979.

ANNEX A

Agreement Number:
Loan 271-K-146
Grant 271-K-613

AGREEMENT

BETWEEN

THE GOVERNMENT OF ISRAEL

and

THE GOVERNMENT OF THE UNITED STATES OF AMERICA

acting through

THE AGENCY FOR INTERNATIONAL DEVELOPMENT

Date: December 1, 1978

AGREEMENT, dated the 1ST day of DECEMBER, 1978 between the Government of Israel ("Israel") and the Government of the United States of America, acting through the Agency for International Development ("A.I.D."), together referred to as the "Parties".

ARTICLE I

The Assistance

To support the economic and political stability of Israel, A.I.D., pursuant to the Foreign Assistance Act of 1961, as amended, agrees to grant to Israel under the terms of this Agreement not to exceed Five Hundred Twenty-five Million United States Dollars ($525,000,000) (the "Grant") and to lend to Israel under the terms of this Agreement not to exceed Two Hundred Sixty Million United States Dollars ($260,000,000) (the "Loan").

The aggregrate amount of disbursements under the Loan is referred to as "Principal". The Loan and Grant together are referred to as the "Assistance".

ARTICLE II

Loan Terms

SECTION 2.1. Interest

Israel will pay to A.I.D. interest which will accrue at the rate of two percent (2%) per annum for ten years following the date of the first disbursement of the Loan and at the rate of three percent (3%) per annum thereafter on the outstanding balance of the Principal and on any due and unpaid interest. Interest on the outstanding balance will accrue from the date (as defined in Section 4.2) of each respective disbursement, and will be computed on the basis of a 365-day year. Interest will be payable in semiannual installments beginning no later than six (6) months after the first disbursement of the Loan hereunder, on a date to be specified by A.I.D.

SECTION 2.2. Repayment

Israel will repay to A.I.D. the Principal of the Loan within forty (40) years from the date of the first disbursement of the Loan in sixty-one (61) semiannual installments of Principal and interest. The first installment of Principal under the Loan will be payable nine and one-half (9½) years after the date on which the first interest payment of the Loan is due in accordance with Section 2.1. A.I.D. will provide Israel with amortization schedules in accordance with this Section after final disbursement under the Loan.

SECTION 2.3. Application, Currency, and Place of Payment

All payments of interest and Principal hereunder will be made in U.S. dollars and will be applied first to the payment of interest due and then to the repayment of Principal. Except as A.I.D. may otherwise specify in writing, payments will be made to the Controller, Office of Financial Management, Agency for International Development, Washington, D.C. 20523, U.S.A., and will be deemed made when received by the Office of Financial Management.

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SECTION 2.4. Prepayment

Upon payment of all interest and any refunds then due, Israel may prepay, without penalty, all or any part of the Principal. Unless A.I.D. otherwise agrees in writing, any such prepayment will be applied to the installments of Principal in the inverse order of their maturity.

SECTION 2.5. Renegotiation of Terms

(a) Israel and A.I.D. agree to negotiate, at such time or times as either may request, an acceleration of the repayment of the Loan in the event that there is any significant and continuing improvement in the internal and external economic and financial position and prospects of Israel which enable Israel to repay the Loan on a shorter schedule.

(b) Any request by Israel or A.I.D. to so negotiate will be made pursuant to Section 6.1, and will give the name and address of the person or persons who will represent the requesting Party in such negotiations.

(c) Within thirty (30) days after delivery of a request to negotiate, the requested Party will communicate to the other, pursuant to Section 6.1, the name and address of the person or persons who will represent the requested Party in such negotiations.

(d) The representatives of the Parties will meet to carry on negotiations no later than thirty (30) days after delivery of the requested Party's communication under subsection (c). The negotiations will take place at the office of the Ministry of Finance in Israel.

SECTION 2.6. Termination on Full Payment

Upon payment in full of the Principal and any accrued interest, this Agreement and all obligations of Israel and A.I.D. relating to the Loan provision of this Agreement will cease. However, with respect to any obligation arising out of the disbursement of Grant funds, this Agreement will remain in full force and effect.

ARTICLE III

Conditions Precedent to Disbursement

SECTION 3.1. First Disbursement

Prior to the first disbursement of the Assistance, or to the issuance by A.I.D. of documentation pursuant to which disbursement will be made, Israel will, except as the Parties may otherwise agree in writing, furnish to A.I.D. in form and substance satisfactory to A.I.D.:

(a) An opinion of counsel acceptable to A.I.D. that this Agreement has been duly authorized and/or ratified by, and executed on behalf of, Israel, and that it constitutes a valid and legally binding obligation of Israel in accordance with all of its terms;

(b) A statement of the name of the person holding or acting in the office specified in Section 6.2, and of any additional representatives, together with a specimen signature of each person specified in such statement.

SECTION 3.2. Notification

When A.I.D. has determined that the conditions precedent specified in Section 3.1 have been met, it will promptly notify Israel.

SECTION 3.3. Terminal Dates for Conditions Precedent

If all of the conditions specified in Section 3.1 have not been met within ninety (90) days from the date of this Agreement, or such later date as A.I.D. may agree to in writing, A.I.D., at its option, may terminate this Agreement by written notice to Israel.

ARTICLE IV

Disbursements

SECTION 4.1. Disbursement of the Assistance

(a) Within thirty (30) days after satisfaction of conditions precedent, A.I.D. will deposit in a bank designated by Israel the sum of Two Hundred Million United States Dollars ($200,000,000) of which (1) One Hundred Thirty-five Million United States Dollars ($135,000,000) will be Grant funds; and (2) Sixty-five Million United States Dollars ($65,000,000) will be Loan funds.

(b) Thereafter, on January 1, 1979, April 1, 1979 and July 1, 1979, A.I.D. will deposit in the bank designated pursuant to Section 4.1(a) the sum of One Hundred Ninety-five Million United States Dollars ($195,000,000) of which (1) One Hundred Thirty Million United States Dollars ($130,000,000) will be Grant funds; and (2) Sixty-five Million United States Dollars ($65,000,000) will be Loan funds.

SECTION 4.2. Date of Disbursement

Disbursement by A.I.D. will be deemed to occur on the dates A.I.D. makes deposits to the bank designated by Israel in accordance with Section 4.1(a).

ARTICLE V

Special Covenants

SECTION 5.1. No Use for Military Purposes

It is the understanding of the Parties that the Assistance will not be used for financing military requirements of any kind, including the procurement of commodities or services for military purposes.

SECTION 5.2. Use Only Within Pre-1967 Boundaries

Program uses of the Assistance shall be restricted to the geographic areas which were subject to the Government of Israel administration prior to June 5, 1967.

ARTICLE VI

Miscellaneous

SECTION 6.1. Communications

Any notice, request, document, or other communication submitted by either Party to the other under this Agreement will be in writing or by telegram or cable, and will be deemed duly given or sent when delivered to such Party at the following address:

To Israel: Economic Minister
Embassy of Israel
Empire State Building (19th Fl.)
350 5th Avenue
New York, New York 10001

To A.I.D.: Director, Office of Project Development
Bureau for Near East
Agency for International Development
Washington, D. C. 20523

All such communications will be in English, unless the Parties otherwise agree in writing. Other addresses may be substituted for the above upon the giving of written notice.

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SECTION 6.2. Representatives

For all purposes relevant to this Agreement, Israel will be represented by the individual holding or acting in the Office of Economic Minister, Embassy of Israel and A.I.D. will be represented by the individual holding or acting in the office of Director, Office of Project Development, Bureau for Near East, each of whom, by written notice, may designate additional representatives for all purposes.

The names of the representatives of the Israel, with specimen signatures, will be provided to A.I.D., which may accept as duly authorized any instrument signed by such representatives in implementation of this Agreement, until receipt of written notice of revocation of their authority.

IN WITNESS WHEREOF, Israel and the United States of America, each acting through its duly authorized representative, have caused this Agreement to be signed in their names and delivered as of the day and year first above written.

GOVERNMENT OF ISRAEL

By: [illegible signature]

Title: Ambassador of Israel

UNITED STATES OF AMERICA

By: Alfred D White

Title: Acting Assistant Administrator
Bureau for Near East

FY 1979 - ISRAEL

CASH TRANSFER

COUNTRY CHECKLIST

Listed below are, first, statutory criteria applicable generally to FAA funds, and then criteria applicable to individual fund sources: Development Assistance and Security Supporting Assistance funds.

A. GENERAL CRITERIA FOR COUNTRY

1. FAA Sec. 116. Can it be demonstrated that contemplated assistance will directly benefit the needy? If not, has the Department of State determined that this government has engaged in consistent pattern of gross violations of internationally recognized human rights?	It cannot be so demonstrated. The Department of State has not so determined.
2. FAA Sec. 481. Has it been determined that the government of recipient country has failed to take adequate steps to prevent narcotics drugs and other controlled substances (as defined by the Comprehensive Drug Abuse Prevention and Control Act of 1970) produced or processed, in whole or in part, in such country, or transported through such country, from being sold illegally within the jurisdiction of such country to U.S. Government personnel or their dependents, or from entering the U.S. unlawfully?	It has not been so determined.
3. FAA Sec. 620(b). If assistance is to a government, has the Secretary of State determined that it is not controlled by the international Communist movement?	The Secretary of State has so determined.
4. FAA Sec. 620(c). If assistance is to government, is the government liable as debtor or unconditional guarantor on any debt to a U.S. citizen for goods or services furnished or ordered where (a) such citizen has exhausted available legal remedies and (b) debt is not denied or contested by such government?	Israel is not known to be in violation of this section.
5. FAA Sec. 620(e) (1). If assistance is to a government, has it (including government agencies or subdivisions) taken any action which has the effect of nationalizing, expropriating, or otherwise seizing ownership or control of property of U.S. citizens or entities beneficially owned by them without taking steps to discharge its obligations toward such citizens or entities?	Israel is not known to be in violation of this section.

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6. FAA Sec. 620(a), 620(f); App. Sec. 107, 114. Is recipient country a Communist country? Will assistance be provided to the Socialist Republic of Vietnam, Cambodia, Laos, Cuba, Uganda, Mozambique, or Angola?	Israel is not a Communist country. Assistance will not be so provided.
7. FAA Sec. 620(i). Is recipient country in any way involved in (a) subversion of, or military aggression against, the United States or any country receiving U.S. assistance, or (b) the planning of such subversion or aggression?	The President has not determined that Israel is engaged in such conduct.
8. FAA Sec. 620(j). Has the country permitted, or failed to take adequate measures to prevent, the damage or destruction, by mob action, of U.S. property?	No.
9. FAA Sec. 620(l). If the country has failed to institute the investment guaranty program for the specific risks of expropriation, inconvertibility or confiscation, has the AID Administrator within the past year considered denying assistance to such government for this reason?	There is an investment guaranty program between the U.S. and Israel.
10. FAA Sec. 620(o); Fishermen's Protective Act, Sec. 5. If country has seized, or imposed any penalty or sanction against, any U.S. fishing activities in international waters, a. has any deduction required by Fishermen's Protective Act been made? b. has complete denial of assistance been considered by AID Administrator?	Israel has not taken any such actions.
11. FAA Sec. 620(q); App. Sec. 503. (a) Is the government of the recipient country in default on interest or principal of any AID loan to the country? (b) Is country in default exceeding one year on interest or principal on U.S. loan under program for which App. Act appropriates funds, unless debt was earlier disputed, or appropriate steps taken to cure default?	(a) No. (b) No.
12. FAA Sec. 620(s). "If contemplated assistance is development loan (including Alliance loan) or security supporting assistance, has the Administrator taken into account the percentage of the country's budget which is for military expenditures, the amount of foreign exchange spent on military equipment and the amount spent for the purchase of sophisticated weapons systems?" (An affirmative answer may refer to the record of the taking into account, e.g.: "Yes as reported in annual report on implementation of Sec. 620(s)." This report is prepared at the time of approval by the Administrator of the Operational Year Budget.	Yes, as reported in annual report on implementation of Section 620(s).

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Upward changes in the Sec. 620(s) factors occuring in the course of the year, of sufficient significance to indicate that an affirmative answer might need review, should still be reported, but the statutory checklist will not normally be the preferred vehicle to do so.)

13. FAA Sec. 620(t). Has the country severed diplomatic relations with the United States? If so, have they been resumed and have new bilateral assistance agreements been negotiated and entered into since such resumption?

No.

14. FAA Sec. 620(u). What is the payment status of the country's U.N. obligations? If the country is in arrears, were such arrearages taken into account by the AID Administrator in determining the current AID Operational Year Budget?

To the best of our knowledge, Israel is not in arrears in its UN obligations.

15. FAA Sec. 620A. Has the country granted sanctuary from prosecution to any individual or group which has committed an act of international terrorism?

No.

16. FAA Sec. 666. Does the country object, on basis of race, religion, national origin or sex, to the presence of any officer or employee of the U.S. there to carry out economic development program under FAA?

No.

17. FAA Sec. 669, 670. *Has the country, after August 3, 1977, delivered or received nuclear enrichment or reprocessing equipment, materials, or technology, without specified arrangements or safeguards? Has it detonated a nuclear device after August 3, 1977 although not a "nuclear-weapon State" under the nonproliferation treaty?*

No.

18. FAA Sec. 901. Has the country denied its citizens the right or opportunity to emigrate?

No.

B. FUNDING CRITERIA FOR COUNTRY

1. Development Assistance Country Criteria

Not applicable since this is Economic Support Fund Assistance.

a. FAA Sec. 102(c), (d). Have criteria been established, and taken into account, to assess commitment and progress of country in effectively involving the poor in development, on such indexes as: (1) small-farm labor intensive agriculture, (2) reduced infant mortality, (3) population growth, (4) equality of income distribution, and (5) unemployment.

b. FAA Sec. 104(d)(1). If appropriate, is this development (including Sahel) activity designed to build motivation for smaller families in programs such as education in and out of school, nutrition, disease control, maternal and child health services, agricultural production, rural development, and assistance to urban poor?

c. FAA Sec. 201(b)(5), (7) & (8); Sec. 208; 211(a)(4), (7). Describe extent to which country is:

(1) Making appropriate efforts to increase food production and improve means for food storage and distribution.

(2) Creating a favorable climate for foreign and domestic private enterprise and investment.

(3) Increasing the public's role in the developmental process.

(4) (a) Allocating available budgetary resources to development.

(b) Diverting such resources for unnecessary military expenditure and intervention in affairs of other free and independent nations.

(5) Making economic, social, and political reforms such as tax collection improvements and changes in land tenure arrangements, and making progress toward respect for the rule of law, freedom of expression and of the press, and recognizing the importance of individual freedom, initiative, and private enterprise.

(6) Otherwise responding to the vital economic, political, and social concerns of its people, and demonstrating a clear determination to take effective self-help measures.

d. FAA Sec. 201(b), 211(a). Is the country among the 20 countries in which development assistance loans may be made in this fiscal year, or among the 40 in which development assistance grants (other than for self-help projects) may be made?

e. FAA Sec. 115. Will country be furnished, in same fiscal year, either security supporting assistance, or Middle East peace funds? If so, has Congress specifically authorized such use of funds, or is assistance for population programs, humanitarian aid through international organizations, or regional programs?

2. Security Supporting Assistance Country Criteria

a. FAA Sec. 502B. Has the country engaged in a consistent pattern of gross violations of internationally recognized human rights? Is program in accordance with policy of this Section?	No. Program is in accordance with policy of 502B.
b. FAA Sec. 531. Is the Assistance to be furnished to a friendly country, organization, or body eligible to receive assistance?	Israel is a friendly country.
c. FAA Sec. 533(c)(2). *Will assistance under the Southern African Special Requirements fund be provided to Mozambique, Angola, Tanzania, or Zambia? If so, has President determined (and reported to the Congress) that such assistance will further U.S. foreign policy interests?*	Not applicable.
d. FAA Sec. 609. If commodities are to be granted so that sale proceeds will accrue to the recipient country, have Special Account (counterpart) arrangements been made?	Not applicable.
e. App. Sec. 113. *Will security assistance be provided for the purpose of aiding directly the efforts of the government of such country to repress the legitimate rights of the population of such country contrary to the Universal Declaration of Human Rights?*	No.
f. FAA Sec. 620B. *Will security supporting assistance be furnished to Argentina after September 30, 1978?*	No.

Annex C

EMBASSY OF ISRAEL
WASHINGTON, D.C.

שגרירות ישראל
וושינגטון

August 29, 1978

Mr. Joseph C. Wheeler
Assistant Administrator for Near East
AID
Department of State
Washington D.C. 20520

Dear Mr. Wheeler,

Pursuant to our conversations on the shift of a portion of your Government's economic assistance to Israel from a commodity import program (CIP) to one of cash transfer, and the concerns you raised about the possible impact of such a change on the level of U.S. exports to Israel and access to Israeli markets by U.S. firms, my Government wishes to assure you that it will take all necessary steps to ensure that, during U.S. fiscal year 1979, the dollar level of Israel's non-defense imports from the United States will be at least equal to the level of U.S. economic assistance obligations during that year, and that U.S. suppliers will not be disadvantaged by the termination of the CIP.

We have considered what steps will be necessary to fulfill these commitments and have reached certain decisions. For example, with respect to Israeli Government procurement of large capital equipment items which U.S. suppliers might furnish, special measures will be taken as necessary to assure that they can compete on terms at least as favorable as those offered by prospective third country suppliers. Additionally, the Government of Israel has decided to continue importing from theUnited States, corn, wheat, soybeans, and other agricultural products purchased on government account at levels approximating those of the past few years, with due allowance for Israel's requirements for

EMBASSY OF ISRAEL
WASHINGTON, D.C.

שגרירות ישראל
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such goods and capacity to store them. Regarding the carriage of goods imported from the United States, my government will continue to follow present procedures for bulk shipments of grain on dry bulk carriers. As you know, these procedures were worked out with A.I.D and the Maritime Administration with a view toward assuring a fair share of the market for American carriers.

In the summer of 1979, the Israeli Government will undertake a review of experience under the cash transfer procedures. A report of our findings will be provided to the United States by September 1, 1979.

My government anticipates an increase in the level of non-defense imports from the United States, and is prepared to discuss with appropriate U.S. Government officials what reasonable steps it could take to make American sources of supply more attractive to Israeli importers.

Sincerely yours,

Dr. Zvi Dinstein
Economic Minister