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Ending Cash Flow Financing to Egypt: Issues for Congress

name redacted

Specialist in Middle Eastern Affairs

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Summary

On March 31, 2015, after a phone call between President Obama and Egyptian President Abdelfattah al Sisi, the White House announced that beginning in FY2018, the United States would stop providing cash flow financing (CFF) to Egypt. Cash flow financing is the financial mechanism that enables foreign governments to pay for U.S. defense equipment in partial installments over time rather than all at once; successive Administrations have authorized CFF for Egypt since 1979.

In recent years, as public scrutiny of U.S. military aid to Egypt has increased, some observers have criticized the provision of CFF to Egypt. Critics argue that the financing of expensive conventional weapons systems is based on an assumption of future appropriations from Congress. Others argue that as the Egyptian military combats terrorism in the Sinai Peninsula and elsewhere, now may not be the optimal time to alter U.S. military aid to Egypt.

The Administration's proposed policy change comes after its lengthy review of U.S. foreign assistance policy toward Egypt, a process that began immediately following the Egyptian military's ouster of former president Mohammed Morsi, a leading figure in the Muslim Brotherhood.

The House draft FY2016 Foreign Operations Appropriations bill specifies that the Secretary of State shall consult with the Committees on Appropriations on any plans to restructure military assistance for Egypt.

This report analyzes this proposed change in U.S. foreign assistance to Egypt; it provides background on the history of CFF and reviews various issues for Congress. For more on U.S. policy toward Egypt, please see CRS Report RL33003, *Egypt: Background and U.S. Relations*, by (name redacted).

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Overview

Cash flow financing (CFF) is a statutory provision in the Arms Export Control Act that enables presidentially authorized recipients of U.S. foreign military aid to pay for U.S. defense equipment in partial installments over time rather than all at once.¹ Countries which are not authorized by the President to benefit from CFF must adhere to “full commitment financing” and reserve the total amount of a purchase upon reaching a contractual agreement with a U.S. supplier.² Traditionally, the President has authorized CFF to select countries in order to demonstrate strong U.S. support for their continued security. CFF began as a benefit exclusively available to Israel in the mid-1970s,³ and the arrangement has since been expanded to other nations.⁴ Egypt has been authorized to benefit from CFF arrangements since 1979. Other countries, such as Turkey,⁵ Greece,⁶ and Portugal, have used CFF to finance purchases of the F-16 fighter jet. South Korea and Spain also have been authorized to benefit from CFF. However, as of May 2015, only Israel and Egypt are currently authorized to use cash flow financing for their purchases of U.S. weaponry.

The Defense Security Cooperation Agency (DSCA) and the Defense Finance and Accounting Service (DFAS) administer foreign military sales using CFF. If a foreign government has

¹ Section 23 of the Arms Export Control Act (22 U.S.C. §2763) authorizes the President to finance the “procurement of defense articles, defense services, and design and construction services by friendly foreign countries and international organizations, on such terms and conditions as he may determine consistent with the requirements of this section.” Section 23(g)(1) of the Arms Export Control Act requires congressional notification of Letters of Offer and Acceptance (LOAs), Amendments, and commercial contracts for \$100 million or greater that are partially or totally funded with cash flow financing.

² See, General Accounting Office (GAO), B256183, February 8, 1994.

³ To help Israel rebuild its military capabilities after the 1973 war with Egypt, Congress appropriated \$2.2 billion for Israel in P.L. 93-199, the Emergency Security Assistance Act of 1973. Section 3 of that act stated that “Foreign military sales credits [loans or grants] extended to Israel out of such funds shall be provided on such terms and conditions as the President may determine and without regard to the provisions of the Foreign Military Sales Act as amended.” At the time, the Foreign Military Sales Act of 1968 (amended in 1971 and the precursor to the Arms Export Control Act of 1976), capped the annual amount of foreign military sales credit that could be extended to a recipient at no more than \$250 million per year. Under the authorities contained in P.L. 93-199, President Nixon, in two separate determinations (April & July 1974), allocated the \$2.2 billion to Israel as \$1.5 billion in grant military aid, the largest U.S. grant aid package ever for Israel at the time. The remaining \$700 million was designated as a military loan.

A year and a half later, the Ford Administration reached a new arms sales agreement with Israel providing that, according to the *New York Times*, “the cost of the new military equipment would be met through the large amount of aid approved by the just-completed session of Congress as well as the aid that will be approved by future Congresses.” See, “U.S. Decides to Sell Some Arms to Israel that it had Blocked in the Past,” *New York Times*, October 12, 1976.

⁴ In a 1978 Senate Subcommittee on Foreign Operations Appropriations hearing, one U.S. military official outlined the FY1978 CFF arrangements for proposed arms sales as follows: “The total request is for \$707.75 million. This would finance a total program of \$2,217.5 million. Of this total program, \$1,735 million, or about 78 percent, is proposed as follows: \$1 billion for Israel, repayment for half which would be forgiven; South Korea, \$275 million; Turkey, \$200 million; Greece, \$140 million; Spain, \$120 million.” See, Senate Appropriations Committee, Subcommittee on Foreign Operations Appropriations, Hearings on Foreign Assistance and Related Programs Appropriations, FY1978, Feb. 10, 21, 24, Mar. 2, 8, 10, 16, 22, 24, 30, Apr. 6, 1977.

⁵ Until 1996, Turkey used cash flow-financed FMF to purchase F-16s. See, Subcommittee on Europe and the Middle East, House Committee on Foreign Affairs, Hearing entitled, *Rewrite of the Foreign Assistance Act of 1961 and FY95 Foreign Assistance Request* (Part 2), March 24, 1994.

⁶ In 1992, the Greek government purchased 40 F-16s. It paid for these planes using a combination of cash flow-financed FMF and national funds. op.cit., Subcommittee on Europe and the Middle East hearing, 1994.

insufficient U.S. military aid (which is nearly always Foreign Military Financing or FMF) to meet its CFF commitments for a given fiscal year (perhaps due to appropriations decisions by Congress), then the cash flow amount must be paid from the purchaser's national funds. If a foreign government cancels an existing CFF defense contract, funds may be provided to U.S. defense contractors from what is known as a "Termination Liability Reserve." Foreign governments must set aside a portion of their annual CFF funds to contribute to the reserve.

Critiques of Cash Flow Financing

Advocates of CFF have touted it for facilitating the sale of technologically advanced but high-cost U.S. weapons systems, particularly U.S. fighter aircraft, to friendly foreign nations. For example, presidential authorization of CFF for Israel has enabled Israel to purchase U.S. combat aircraft such as the F-15 and F-16, and more recently the F-35 Joint Strike Fighter, while still continuing purchases of other critical U.S.-supplied weapons. However, at times some lawmakers and observers have criticized the use of CFF, arguing that as a policy tool, it effectively commits Congress to future appropriations in order to pay for previously purchased, high-priced defense systems. Over 20 years ago, former Representative and House Appropriations Chairman David Obey remarked that, "It is, in fact, going to be virtually impossible for this committee to consider reductions in aid to that region [Middle East] over the next decade if those military contracts continue to be signed because of the principle of so-called cash flow financing."⁷ In the early 1980s, the then-General Accounting Office (now U.S. Government Accountability Office or GAO) published a report on U.S. foreign assistance to Israel in which it stated, "Cash flow financing implies a strong commitment by the United States to provide large amounts of credit in future years, limiting, in our view, the prerogatives of the Congress in authorizing the U.S. security assistance program."⁸

The Origins of Cash Flow Financing for Egypt

The 1979 Peace Treaty between Israel and Egypt led to a dramatic expansion in what had previously been limited amounts of U.S. foreign assistance to Egypt. In 1979, President Carter authorized CFF for Egypt, and the Reagan Administration⁹ and successive Administrations have continued the practice, though recent announcements by the Obama Administration (see below) indicate the practice will be discontinued in FY2018. According to the 1982 congressional hearing testimony of Frank Conahan, former Director of the International Division at the GAO:

The decision to provide cash flow authorization to Egypt was made in 1979 at the time U.S. and Egypt were considering the types and amounts of military equipment Egypt would buy

⁷ "Clinton Challenged on Share of U.S. Aid Going to Israel and Egypt," *New York Times*, March 9, 1993.

⁸ See, General Accounting Office, *U.S. Assistance to the State of Israel*, June 24, 1983. Available online at <http://www.gao.gov/assets/150/140281.pdf>

⁹ In a hearing before the Senate Appropriations Committee, one Administration witness testified that: The FY1981 Congressional Presentation Document on security assistance programs, while not using the word "cash flow," referred to the cash flow concept in stating that FMS funds would be used to make "start-up payments" for new programs. This [Reagan] Administration likewise concluded that cash flow financing is a key element of our Egyptian military assistance program and has so informed the Congress..." See, Senate Committee on Appropriations, Subcommittee on Foreign Operations Appropriations, Hearings entitled, Foreign Assistance and Related Programs Appropriations, FY1983, Part 1, Feb. 25, Mar. 10-11, 17, Apr. 22, 27, 29, May 4, 11, 13, 20, 27, Jun. 10, 15, Jul. 15, 1982.

with the \$1.5 billion credit authorization from the peace treaty. While the peace treaty credits were originally seen as a one-time payment, U.S. officials quickly realized that Egypt's needs would require much more financing over a longer period of time. Cash flow financing was seen as a way to allow Egypt to order larger quantities of equipment in the early years of its relationship with the United States. Without cash flow, Egypt could only order equipment with a total price of \$1.5 billion. Under cash flow authorization, Egypt placed orders totaling \$3.5 billion over the same time period.¹⁰

Although at the time there appeared to be significant congressional support for the 1979 Israel-Egypt peace treaty and expanded U.S. foreign assistance to both Israel and Egypt, some lawmakers did question whether the extension of CFF to Egypt ostensibly bound Congress to future appropriations in order to meet payment obligations for U.S. defense equipment. In one exchange between the late Senator Daniel Inouye and a State Department official at a congressional hearing, Senator Inouye asked if this method of financing “places considerable pressure on the Congress to continue providing substantial levels of credit” to Egypt. In response, the officials stated that the Reagan Administration had repeatedly told the Egyptian government that future appropriations are subject to the approval of Congress and “to the extent that pressure exists, it stems not from the cash flow system but from the importance of the relationship which the United States enjoys with Egypt ... any action on our part to curtail that support could only be interpreted by Egypt as reflecting a reassessment on our part of the basic relationship.”¹¹

Current Changes Proposed by the Obama Administration

As U.S. military assistance to Egypt has continued fairly steadily for over three decades,¹² successive administrations have continued the practice of authorizing CFF for Egypt—until earlier this year. On March 31, 2015, after a phone call between President Obama and Egyptian President Abdelfattah al Sisi, the White House announced that, though the Administration was releasing the deliveries of select weapons system to Egypt that had been on hold since October 2013 (and pledged to continue seeking \$1.3 billion in aid from Congress), “Beginning in fiscal year 2018, the President noted that we will channel U.S. security assistance for Egypt to four categories—counterterrorism, border security, Sinai security, and maritime security—and for sustainment of weapons systems already in Egypt’s arsenal.”¹³ In a separate National Security Council (NSC) press release, NSC Spokesperson Bernadette Meehan noted that

At the same time, the President has decided to modernize the U.S.-Egypt military assistance relationship. First, beginning in fiscal year 2018, we will discontinue Egypt’s use of cash flow financing (CFF)—the financial mechanism that enables Egypt to purchase equipment on credit. By ending CFF, we will have more flexibility to, in coordination with Egypt, tailor our military assistance as conditions and needs on the ground change.

¹⁰ op.cit.

¹¹ op.cit.

¹² See, CRS Report RL33003, *Egypt: Background and U.S. Relations*, by (name redacted).

¹³ The White House. Office of the Press Secretary, Readout of the President’s Call with President al-Sisi of Egypt, March 31, 2015.

This announcement had come after the Administration's lengthy review of U.S. foreign assistance policy toward Egypt, a process¹⁴ that began immediately following the Egyptian military's ouster of former president Mohammed Morsi, a leading figure in the Muslim Brotherhood. These events triggered questions about the legality of continued assistance to Egypt's government given U.S. law prohibiting assistance to any government whose duly elected leader is deposed by military coup or decree, as well as questions about the advisability of such assistance given a number of considerations.

During this review between 2013 and 2015, several lawmakers, outside experts, and media outlets called on the President to end the practice of authorizing Egypt for CFF. These include

- Senator Patrick Leahy in 2013, at the time the Chairman of the Senate Appropriations Subcommittee on the Department of State, Foreign Operations, and Related Programs: "It [CFF] has gotten us into a situation where we are mortgaged years into the future for expensive equipment.... It is not a sensible way to carry out U.S. policy toward a country of such importance, where circumstances have changed, our interests and needs change, our budget is under stress, and yet we've been stuck on autopilot for more than 25 years."¹⁵
- A 2014 letter to President Obama signed by "The Working Group on Egypt," a bipartisan group of various foreign policy and Egypt experts: "Cash flow financing—the special arrangement for military aid that allows Egypt to make demands on U.S. public resources before they have been approved by our Congress—must come to an end so that U.S. policy is no longer handcuffed by contractual arrangements that narrow policy options."¹⁶
- A 2014 op-ed in the *New York Times*: "First, Washington must stop allowing Egypt to place military hardware orders under a preferential system called cash flow finance. Available only to Israel and Egypt, the mechanism works much like a credit card, permitting the countries to place orders under the assumption that Congress will eventually appropriate enough funds to cover them. It will take years to wean Egypt off cash flow finance, since orders can take years to process, but doing so now will help untangle contractual and legislative knots in the future."¹⁷

Analysis

The President's decision to phase out CFF to Egypt is perhaps part of a broader policy approach that may seek to balance national security interests and the promotion of democratic principles in dealing with the post-Morsi, military-backed Egyptian government.¹⁸ The March 31 White House announcement contemplates maintaining a modicum of security cooperation (e.g., ending weapons suspension and continuing \$1.3 billion in aid) while moving the relationship away from

¹⁴ The White House, Office of the Press Secretary, Statement by President Barack Obama on Egypt, July 03, 2013.

¹⁵ "In Debate over Military Aid to Egypt, Contractual Issues loom large for U.S." *Washington Post*, July 25, 2013.

¹⁶ Available online at <https://freedomhouse.org/article/us-should-overhaul-its-policy-toward-egypt#.VUuPxv1VhHw>

¹⁷ "Reining In Egypt's Military Aid," *New York Times*, October 4, 2014.

¹⁸ See, for example, the President's 2013 speech before the United Nations General Assembly. The White House Office of the Press Secretary, Remarks by President Obama in Address to the United Nations General Assembly, September 24, 2013.

its traditional military-to-military foundations (e.g., ending CFF and limiting future arms sales to specific defense categories).

In practice, U.S. military aid to Egypt has not been used to finance purchases of new acquisitions of major defense equipment in recent years. The Defense Security Cooperation Agency (DSCA), which issues notifications of proposed sales of major defense equipment to Congress, has notified Congress of just one such new proposed sale to Egypt between 2011 and April 2015.¹⁹ Instead, cash-flow-financed FMF has been channeled toward paying for previous purchases. This is due to a number of factors, such as

- a large amount of Foreign Military Sales (FMS) cases that were agreed to between 2009 and 2011;²⁰
- the uncertain political environment that surrounded Egypt from 2011 to 2013; and
- congressionally mandated restrictions on FMF to Egypt in both the FY2014 and FY2015 Appropriations Acts (P.L. 113-76 and P.L. 113-235) that partially limited the use of FMF obligations to existing sales only.

Thus, the President's plan to eliminate CFF by 2018 seems to be in line with recent trends and congressional action.

Moreover, since CFF has been used primarily to fund air power acquisitions for foreign militaries, it is entirely unclear whether the United States needs to extend credit to the Egyptian Air Force when Egypt, unlike Israel and Turkey, is not a partner in the new generation of technologically advanced platforms such as the F-35. Since Egypt is already the fourth-largest operator of F-16s in the world, U.S. defense officials may encourage Egypt to allocate a greater proportion of annual FMF grants to sustainment and upgrades of existing U.S.-origin systems rather than for procurement of new items.

Issues for Congress

In order to phase out CFF, Congress could include in future legislation language from previous acts specifying that FMF to Egypt "shall only be made available at the minimum rate necessary to continue existing programs."²¹ However, unless Congress specifically prohibits Egypt from being eligible for CFF in law, the next President could conceivably reverse President Obama's pledge to end CFF. Conversely, Congress could legislate a continuation of CFF for Egypt, whether in deference to presidential determinations on the matter, under specified conditions in an annual appropriations bill, or by amending standing law such as the Arms Export Control Act.

¹⁹ This was for a \$69 million contract to DynCorp for personnel support services in support of 140 U.S. government and contractor representatives in Egypt. The threshold for the notification of a major defense equipment to Congress is \$14 million, per the terms of the Arms Export Control Act.

²⁰ Some notable major FMS sales to Egypt include a 2011 \$1.3 billion sale of M1A1 Tanks to Egypt and a 2009 \$3.2 billion sale of F-16 aircraft to Egypt.

²¹ Under the FY2015 law, the President would have to issue a national security waiver in order for the equipment being paid for via obligations under this authority to be delivered to the Egyptian government.

To date, there has been relatively muted public discussion of the President's proposed policy changes. According to Tamara Coffman Wittes of the Brookings Institution, "In Washington, Egypt's cash-flow financing had lost support from both parties and is not likely to be reinstated no matter who moves into the White House in 2017."²² Others have blamed President Obama for ending CFF and therefore hurting overall U.S. Egyptian-relations. According to Eric Trager of the Washington Institute for Near East Policy, "Ironically, President Obama may have thought his phone call to Cairo announcing the release of weapons would turn a new page in a rocky relationship. But by coupling that decision with the cancellation of a financing scheme that was a signal of Egypt's special relationship with Washington, Obama might have closed the book on any chance for closer U.S.-Egypt ties until a new president takes another look at this old alliance."²³

Public response to the President's policy from the Egyptian government has also been limited. Overall, Egypt seems to be searching for new international partners in order to both diversify its military-to-military relationships and signal its displeasure with recent U.S. policy that has maintained a certain distance from the Sisi regime. The military has signed new arms agreements with Russia (S-300) and France (Rafale Fighters), while Saudi Arabia, Kuwait, and the United Arab Emirates continue to provide significant financial assistance to Egypt. Nevertheless, it is unclear whether Egypt's reliance on U.S. platforms for its key military capabilities is likely to change in the near term. Some longtime supporters of the U.S.-Egyptian relationship may lament the possibility of diminished U.S. influence in Egypt, while others may see a U.S.-Egyptian rebalancing, and particularly the proposed elimination of CFF, as necessary and ultimately healthier for both governments.

Author Contact Information

(name redacted)
Specialist in Middle Eastern Affairs
[redacted]@crs.loc.gov, 7-....

²² "The Politics of Restoring Egypt's Military Aid," *Washington Post*, April 2, 2015.

²³ "Obama Wrecked U.S.-Egypt Ties," *National Interest*, April 7, 2015.

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