

**The Effects of the World Defense Industry and US Military Aid to Israel on the
Israeli Defense Industry: A Differentiated Products Model**

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Abstract

This paper models the interactions between the defense industry market structure and the defense needs of Israel, the USA and Western Europe, which produce several heterogeneous defense goods. The model specifies that the defense industries of the US and Europe are "large" while that of Israel is "small". The US military aid to Israel is also an integral part of the model. The results show that net defense costs of Israel are minimal when the number of its defense firms is one. The model predicts that an increase in the US military aid reduces Israel's government expenditure, its defense industry's profits and its net defense costs.

JEL classification: H56, H57, L11, L13

Key words: Defense industry, security levels, US military aid, net defense cost, industry profits