

# **THE PRIVATIZATION OF ISRAEL**

The Withdrawal  
of State  
Responsibility

EDITED BY

Amir Paz-Fuchs,  
Ronen Mandelkern,  
Itzhak Galnoor



# The Privatization of Israel

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Editors

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The Withdrawal of State Responsibility

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## PREFACE

Is there a completely private good in the sense that there is no governmental involvement whatsoever in owning, financing, delivering and regulating it? I suppose we can construe several examples such as jewelery, assuming that even the materials used are not subject to some regulation. Is there a completely public good in the sense that it is entirely in the hands of a public authority? In this case, we may refer to the traditional roles of public bureaucracies that were engaged in technical services such as land registration or water allocation; or in administrating justice, collecting taxes, supervising weights and measures; and above all—managing war-related affairs. Yet even in performing such tasks, official authorities needed the involvement of non-public entities.

Against this background, when we launched in 2007 the project “Privatization Policy in Israel” at the Chazan Center at the Van Leer Institute, we assumed that the definition of “state responsibility”, and the boundaries between the public and the private are a matter of ideology and social preferences, rather than a result of rigorous economic theory. Ten years later, we can say with a reasonable degree of confidence that, first, the main fallacy regarding privatization in Israel (and perhaps elsewhere) has been the sweeping assumption that the economic market is always superior to the state (more efficient, better in quality, less corrupt, etc.) in producing and delivering goods and services. Secondly, the assumption that state intervention is required only in cases of “market failures” proved to be incorrect, empirically (see Galnoor, this volume).

The adoption of the privatization policy in Israel has been part of the neo-liberal ideology which has taken root in many western countries. In Israel, privatization has been the most significant, comprehensive and consistent reform since the mid-1980s regardless of which party or leader (right, center or left) was in power. As this book shows, the Israeli case would be interesting for other countries because it is an extreme version of socio-economic change: moving swiftly from a centralized economy, a very strong trade union, and a sense of solidarity—to a rather polarized and unequal market-oriented society. Another comparative question emerging from our Israeli study concerns the implications of transferring services to non-governmental entities that are not democratically accountable. In this context, scholars studying privatization policies in welfare oriented countries, could benefit from following the ongoing struggle within Israel to preserve state responsibility in health, education, housing and welfare.

The purposes of the project as a whole, as defined by its inter-disciplinary steering committee were:

- Examine the advantages and disadvantages of privatization policy in Israel in various fields and assess the responsibilities of the state and the impact on an equitable and just society.
- Monitor developments in privatization and nationalization and function as the focal point for research, analysis and publications on these issues.
- Develop and advance legislation on privatization and out-sourcing and propose recommendations for a suitable regulatory system that will create effective decision-making mechanisms.
- Empower decision makers and the Israeli public through access to real-time studies and information that will encourage debate and appropriate regulation of privatization and of out-sourcing.

In addition to the book on privatization, published in Hebrew in 2015, the following summarizes the main output of our project to date.

- **Annual Report on Privatization**—published since 2010, and presented to the Speaker of the Knesset. The Report listed and analyzed the cases of that year and a follow up on the previous one, and serves as a public monitoring source. It has now been

reconstituted as an interactive website (<http://hafrata.vanleer.org.il/>, in Hebrew).

- **Policy Papers**—aimed at stimulating public discussion on topical issues. Examples: privatization of ports; privatization of public water corporations; contracting-out teaching; privatizing governmental policy-making; compulsory arbitration; regulation of private schools; privatization of the checkpoints in the West Bank; out-sourcing national parks.
- **Regulation Research**—as a follow-up a new project was launched in 2012 to examine regulation in Israel through test cases. It will be published as a book in 2018, with concrete recommendations for regulatory models appropriate for Israel.
- **Academic Courses on Privatization**—taught at several universities and colleges by academics involved in the project.
- **Conferences on Privatization**—numerous public conferences on general and specific topics of privatization and regulation.
- **Manual on Privatization and Out-Sourcing for Government Ministries**—published in 2014 as a guidebook for decision-making for ministries considering privatization of social services.
- **Legislative Initiative**—in collaboration with the Association for Civil Rights, a committee of experts drafted a bill aimed at creating a general policy of privatization and out-sourcing. The possibility of legislation was discussed with the Ministry of Justice and submitted as a private bill in 2017 by Members of Knesset from different—coalition and opposition—parties.
- **Collaborative Governance**—The most recent extension is a workshop, which started in 2015, to examine collaboration between the state and non-state agencies as an alternative, in certain areas, to privatization. It will present public policy-making processes in Israel that are formal, collective, deliberative, consensus-oriented and based on trust and exchange of knowledge between the participants. The results will be published in a book (Palgrave, 2019).

Our work, summarized in this book, indicates that government ministries and local authorities in Israel virtually ceased functioning in certain areas, while private and voluntary organizations operate in their stead. The claim that the state is still responsible for policy-making and regulation, while only performance has been privatized, needs to be carefully examined. The shift from a policy orientation that places heavy

obligations on the state, to an extreme consumer orientation that essentially perceives citizens solely as clients, has had drastic repercussions for the meaning and strength of democracy in Israel.

Jerusalem, Israel

Itzhak Galnoor



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## ABBREVIATIONS

CBS	Central Bureau of Statistics
CNP	Comparative Nonprofit Sector Project
FSU	Former Soviet Union
ILA	Israel Land Administration
ILC	Israel Land Council
IQC	Institute of Quality and Control
ISRAC	Israel Laboratory Accreditation Authority
JNF	Jewish National Fund
KHC	Kupat Holim Clalit (General Sick Fund)
MoE	Ministry of Education
MoF	Ministry of Finance
MoH	Ministry of Health
MoIA	Ministry of Immigration and Absorption
NET	National Employment Tribunal
NGOs	Nongovernmental organizations
NHI	National Health Insurance
NIF	New Israel Fund
NII	National Insurance Institute
NOP	National Outline Plan
NPM	New Public Management
OECD	Organization for Economic Co-operation and Development
SNA	System of National Accounts
UN	United Nations

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# Privatizing Israel: An Introduction

*Ronen Mandelkern and Amir Paz-Fuchs*

## INTRODUCTION

“Revolutionary”, “Transformational”, “Unprecedented” (e.g., Gutwein 2003). These are only some of the expressions used to describe the change that the Israeli political economy underwent in a mere 20 years. The common analysis suggests that Israeli economic and social institutions were established during the pre-state period and consolidated in the early 1950s on a collectivist foundation but, since the mid-1980s (some would say the late-1970s, when the Labor Party lost the general elections for the first time), after those foundations began to crumble, industries and services were privatized, labor unions were downsized to a role that is a faint relic of their omnipotent past and, as a consequence, inequality and poverty grew substantially.

The case of the Israeli political-economic transformation seems to be, at least in terms of its vast scope, unprecedented. Political economies

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tend to have institutionalized configurations and, despite changes in government, which sometimes lead to changes in policy, they tend to preserve their basic structures (Campbell 2004; Hall and Soskice 2001). Like welfare states, which have been analogized to “elephants on the move”, prevailing political-economic structures are normally subject only to minor and gradual change of direction (Hacker 2004; Pierson 1996; Streeck and Thelen 2005). A transformative upheaval of the kind and depth seen in relation to the Israeli political economy is exceptional, and deserves special attention.

How did this come to pass? Accepted wisdom suggests that the (neo) liberal streak, which was latent and disparaged in Israel’s first 30 years, gained credence, ideologically and professionally, following the economic meltdown that occurred in the early 1980s. Professional economists who were schooled under neoliberal guidance warned against reckless government policy in advance, and successfully saved the economy from the brink. In the aftermath, they were rewarded with significant public legitimacy, which was converted into institutionalized political influence (Mandelkern 2015, 2017). The most prominent manifestation of that dynamic was the legal empowerment of the two state bodies that were led from the 1950s onwards by Israeli economists: the Ministry of Finance and the Bank of Israel (Maman and Rosenhek 2011). These two bodies played a crucial role in “liberating” Israeli financial and labor markets from the stronghold of the government and the labor unions and, most relevant for present purposes, led an unabashed policy of privatization of government industries, corporations, and services (Shalev 1999).

In this respect, Israel exemplifies well, perhaps even paradigmatically, the ubiquitous shift toward privatization of economic enterprises, public utilities, and public and social services. Against this background, this book aims to explore how these far-reaching transformations took place, what they included and what were their effects. In this sense, this book will provide important insights not only for students of Israel but also for those interested in how privatization, and neoliberalism more generally, affects employment and social and political relations across society.

At the same time, the Israeli case also demonstrates how the interaction between the forces of privatization and other forces shaping public policy produces complex results in practice. The national forces upon which the formation of the Israeli state was formed continue to influence Israel’s public policies (Mandelkern and Shalev, forthcoming).

In some cases, national and privatization trends counter each other; while in others they interact in more subtle and unexpected ways. In other words, and given the strong political power of national identity in the Israeli context, this case also reveals how the political power of nationalism interacts with that of neoliberalism. In this context, we should note that we see the Israeli experience as comparable in many significant ways to that of other countries (cf. Levi-Faur 1998). Accordingly, this book shows that privatization in Israel, as well as its limits, has been shaped by normative, ideological, economic, and political influences that are present in other countries.

This introductory chapter includes three sections. The first provides a conceptual background for the rest of the book, focusing on defining privatization and its various possible manifestations. The second provides a political-economic background that places Israeli privatization policies in their concrete—and to a certain degree unique—historical context. The third section provides an overview of the book and its organizing logic.

### PRIVATIZATION: A CONCEPTUAL INTRODUCTION

The remit of this book is vast, covering areas as diverse as public utilities and education, security and welfare services, and much in between. As scholars of these fields often arrive from a wide range of disciplines—including (but not exclusively) law, political science, sociology, education, geography, and public policy—they may well disagree not only on theory and application but also on the foundational understandings of the concepts themselves. Bearing in mind the task ahead, we have made a conscious decision *not* to offer an independent contribution to the conceptual analysis of privatization and related concepts (outsourcing, liberalization, etc.). However, we find that it is useful to state, at the outset, how we understand the term “privatization” as it used throughout this book.

The debate over the meaning of privatization has been a vibrant one for over 30 years. In a narrow, traditional sense, privatization refers to the transfer of ownership from the state, a local authority or one of their subsidiaries to a business entity or to a third-sector organization (commonly referred to as an NGO (OECD 2002)). For the purposes of this book, however, we adopt a wider understanding of the term. Generally speaking, privatization will refer to a process which shifts the boundaries

between the state (also known as “the public”) and the business or third sector (“the private”). Therefore, it will include not only the transfer of ownership, but also the following: (i) employment of user charges (“fiscal privatization”) for public services (on this see Paz-Fuchs 2017); (ii) contracting-out, or outsourcing, in which services are still paid for by the public authority, but are operated by non-state actors; and (iii) privatization by omission, which refers to the authorities’ decision (or nondecision) not to fund new social initiatives or to cut funding for existing social initiatives, thus creating a quantitative and/or qualitative gap between public demand and actual supply of services, which is filled by non-state actors.

It will be apparent that conceptual issues have surfaced within this brief outline of privatization. Thus, outsourcing includes a wide range of practices. For example, one may want to distinguish between the government’s use of a private construction company for a social housing project or to build a bridge, on the one hand, and its use of a company to run a prison or a shelter for victims of domestic violence. The first involves a fixed term contract, offered to a company that has gained expertise in an area where the government is lacking, based on parameters that are easily reducible to exact parameters. The latter is an open-ended contract for the provision of “soft services”, which are not easily quantifiable, in an area that has traditionally been the preserve of the state. A further instance of outsourcing has attracted attention in Israel in recent years: the engagement of individual consultants, or small firms, to plan, negotiate, draft contracts (including procurement contracts), supervise, and regulate on behalf of the government. The fact that the government continues to pay for these services and goods, in all their permutations, has led some to argue that they should not be seen as privatization. Others are more willing to acknowledge this undoubtedly important aspect of financial burden by referring to these cases as “partial privatization”. While the relevant chapters will address the unique attributes of each form, we view them as part of the general policy of privatization as, again, they lead to a change in the boundaries between the public and the private.

A further complexity arises from the concept of privatization by omission, also referred to as privatization by attrition. These terms refer to an all too familiar policy of austerity, budgetary contraction or refusal to answer increased demand in public services, which is followed by allowing the private sector to fill the gap (Barak-Erez 2010; Doron and

Karger 1993). Interestingly, arguments in favor of broadening privatization to include these scenarios are accepted in Israeli scholarship more than they are elsewhere. In certain clear cases, the argument seems quite persuasive. Thus, imagine a local authority that decides to cut its education budget by 40%, leading schools across the district to cut the number of classes by a proportionate amount. As students are left without places in schools within a reasonable distance, business entrepreneurs enter the fray, opening private, fee-paying schools. It is apparent that the crucial element that distinguishes this scenario from traditional “privatization” is that none of the schools in the hypothetical district were transferred from public to private hands. And yet, the actions of the local authority have led private actors to assume part of the roles that were previously taken by public actors.

While the latter example may make the case for “privatization by omission” in a straightforward fashion, not all cases are as simple. Thus, if your car is stolen, you will go to the police and file a report, mainly for insurance purposes. As the best-case scenario, if police officers come across your stolen car, it will be returned to you. However, realistically, you are probably unlikely to see it again. Now, if you have a personal attachment to the car, you may wish to retain the services of a firm that provides a service of searching for your car. This would be done through a GPS device installed in your car that permanently transmits its location to the company servers. It cannot be expected, one assumes, that the police would provide these services for every car on the road. But would that mean that it has privatized its responsibility to the said firm? Probably not.

What distinguishes the two examples—of the schools and the car—is nothing less than our vision of the normative role of the state. We find that we can identify privatization by omission when, and only when, we *assume* that the market has taken the role that the state *should have taken*. These assumptions, of course, take the discussion into the realms of political philosophy; as such, intuitions and scholarly positions differ. *Should* the state play a role in financing and/or administering shelters for the homeless or for victims of domestic abuse? *Should* it run methadone clinics through its health services? Again, the crucial question for present purposes is as follows: if it does not do so, in general or in a particular sector, thus allowing or requiring charities or businesses to fill the gap, should that be considered privatization of the service? Our general position is that the answer to these questions is case contingent, and in



particular that the claim that a particular case of privatization by omission is indeed “privatization” should be buttressed by a normative argument explaining why government agencies should be involved in the provision of the said service.

And yet, while the reader may detect a broad approach to the concept at the heart of this book, it has its boundaries. Thus, we will not be including transfers of power, authority or budgetary responsibility that take place *among* public authorities as privatization. Devolution, which includes such transfers from central to local authorities, has strong links to privatization. The same may be said about transfer from government ministries to statutory agencies. Such reforms sometimes derive from proponents of the same agenda, sometimes referred to as New Public Management. They may create inequalities between poorer and richer authorities. They may even be a stepping stone toward privatization, under the assumption that opposition at a local level is weaker than opposition at a central level. Yet the fact that the service is still controlled by a body that is responsible to the public either through the ballot box or through the rules of civil service is sufficient to exclude it from our remit.

### PRIVATIZATION IN ISRAEL: POLITICAL-ECONOMIC AND HISTORICAL CONTEXT

Since the mid-1980s, Israel has undergone substantial changes. The Israeli political system has experienced fragmentation, personalization, and the substantial weakening of the formerly two major parties (Labor and Likud) (Kenig and Tuttnauer 2017; Rahat and Sheaffer 2007). These changes reflected, at least to a degree, the reshuffling of power and hegemonic norms within the Israeli society and a growing influence of cultural globalization and Americanization (Azaryahu 2000; Ram 2013). But most crucial in the current context was the transformation of the political-economic sphere.

Though certainly crucial and of central importance, privatization in Israel reflects only part of a wider political-economic transformation from an “illiberal” to a globalized and liberalized market economy (Ben-Bassat 2002; Ben-Porat 2008; Maman and Rosenhek 2012; Shalev 1999). In this sense, privatization in Israel represents not only changes in the ownership and management of economic enterprises and public services but

also part of a wider transformation of the structure of the Israeli economy and the Israeli public sector and the logic of labor relations.

Before privatization processes in Israel began, vast segments of the Israeli economy were owned by either the government or by *Hevrat HaOvdim*, the labor federation's holding company which was established during the pre-state period. This was especially true for public infrastructure and public utilities companies (including construction, public transportation, telecommunications, water, and electricity) but also for major civilian and military industries and for the largest local bank (the second largest bank was owned by the Zionist Federation). At the same time, market competition, especially between "big businesses" (public or private) was highly limited. Major companies enjoyed government subsidies, such as tariff protection, as well as access to cheap financial credit, which the government was able to ensure by controlling the major parts of the financial and capital markets (Ben-Bassat 2002; Shalev 1992).

Public and welfare services were also generally controlled and delivered by either the government or the labor federation (Doron and Kramer 1991). The "division of labor" between the two derived, to a certain extent, from pre-state policy legacies. The labor unions, which began to operate pension and sick funds before the state was established, continued to provide welfare services and benefits well into the 1990s. Other public services were formed and/or expanded by the government, and generally speaking were financed and directly delivered by government units and government employees.

Within this context, and certainly in the larger companies and in the public sector, workers were commonly unionized and generally enjoyed both employment protection and adequate compensation. Within the system of industrial relations that prevailed before political-economic liberalization took place, these protected workers generally had the upper hand and were able to bring employers to cooperate with them (Grinberg 1991). As Kristal shows in this volume, historically workers were able to secure a relatively large slice of the wider economic pie in the years that preceded liberalization. Among other things, this was related to the fact that governments made an effort to maintain full employment throughout most of these years (Ben-Porath 1986a). At the same time, workers in the "secondary" labor market—including Palestinians (both citizens and occupied territories residents) and newly arrived immigrants—were subject to weaker job protection and lower wages.

Like many other countries, political-economic conditions in Israel began to change during the 1970s. The Yom Kippur War (1973), the first oil crisis, and the world economic stagnation that followed brought an end to the rapid growth of the Israeli economy (Ben-Porath 1986b). At the same time, oil prices and other factors increased inflationary pressures, taking inflation to 20–30% annually rates. Interestingly, stagflation in Israel was not accompanied by unemployment, as the public sector was substantially enlarged during the 1970s (reflecting, perhaps, the Israeli bias against unemployment). Crisis conditions only intensified throughout the 1970s and early 1980s, however. Attempts made by the right-wing Likud party, which led the government since 1977, to liberalize the foreign currency market escalated inflation and brought its annual rate to more than 400% in 1984. At the same time, a chronic balance of payments deficit kept worsening.

The turning point was the July 1985 stabilization plan which, beyond its immediate aim to curtail spiraling inflation, set the stage for the liberalization of Israel's political economy. The basic logic of the stabilization plan was the application of strict monetary and fiscal restraint: a substantial increase of nominal and real interest rates, freeze of all prices and the exchange rate, and unprecedented budgetary cuts. The immediate consequence was a quick economic improvement in terms of both price stability and the balance of accounts.

Following the stabilization plan, Israeli governments began to adopt a wide variety of long-term liberalization reforms, which were aimed at integrating Israel in the globalizing international economy. The two state bodies leading the way were the Ministry of Finance and the Bank of Israel, both of which enjoyed enhanced political power and autonomy due to legislative changes that accompanied the implementation of the stabilization plan (for an elaboration on their role in enabling and promoting privatization, see Mandelkern, this volume). The role of these two bodies in the promotion of economic liberalization in Israel reflects the fact that the adoption of neoliberal capitalism in Israel was first and foremost a state project (Maron and Shalev 2017).

It is difficult to determine where political-economic transformation was most significant (see Maman and Rosenhek 2012 for a comprehensive account). In the capital market, the state gave up its almost exclusive role in credit mobilization and allocation by reducing the minimum required investment of long-term savings schemes in government bonds and annihilating its subsidized credit schemes. In the financial markets,

restrictions on international financial trade were removed and the state kept pursuing—not always successfully—enhanced competition, which aimed to curtail the economic power of the major banks. In the labor market, the labor federation lost its pivotal political-economic position and gave up its ownership of central segments of the economy and the provision of welfare services, beginning to function exclusively as a workers' union (see also Lurie, this volume). At the same time, unionization rates were slashed by half or more, from 80 to 90% in the early 1980s to 30–40% in the 2010s, and various forms of precarious employment emerged (see also Paz-Fuchs, this volume).

At first, the welfare state seemed resilient to liberalization-triggered changes, and certain services and benefits became universal and/or expanded. Prominent examples include the abolishment of discriminatory practices in the allocation of child benefits and the legislation of a universal healthcare law during the 1990s (Asiskovitch 2017; Rosenhek 1999; Filc, this volume).<sup>1</sup> The need to integrate an enormous number of Jewish immigrants from the former soviet union during the 1990s probably also contributed to the fact that social expenditures were not reduced at first (see also Shpaizman, this volume). This changed when the government had to cope with a fiscal crisis in 2002/03 and the market advocate, then Finance Minister Benjamin Netanyahu, joined forces with the technocratic elite. Consequently, welfare benefits in various programs were substantially reduced and, at the same time, by changing their indexation mechanisms, their long-term value was gradually diminished (Doron 2007).

Privatization policy—in its various dimensions—was a central component within this wider political-economic transformation. In terms of transfer of ownership, the government sold off a vast number of its corporations, including its national airline, telephony company, oil distilleries, and chemical industries (see also Hasson 2006 and Tevet, this volume). Since the process of selling government corporations stretched over several decades, it is difficult to calculate in a meaningful way the aggregate economic value involved. Nevertheless, a plausible approximation is the share of workers in government corporations within the total Israeli labor force, which dropped from 5.1% in 1976 to 1.6% in 2014.<sup>2</sup> This number is expected to decrease further, as the government has already begun the process of privatizing some of its remaining major corporations, most notably military industry corporations and the postal company. In parallel, the quasi-governmental labor federation,

with a holding company and affiliated bodies that used to employ some 25% of Israeli employees, also sold all of its business corporations. In other words, the business sector in contemporary Israel is virtually fully privatized.

Contracting-out of public services has been no less vast and comprehensive, and ranges from technical and administrative functions like cleaning, security, and IT services for government ministries to consulting, tender writing, and supervision over outsourced services. Contracting-out has been particularly prominent in the social services: In 2008, 56% of the budget of the Ministry of Social Welfare was directed for the purchase of services from nongovernmental contractors (see also Benish, this volume). Since aggregate data on the size of governmental outsourcing is missing, we use the data of government purchases as a rough approximation of the trend: Between 1980 and 2007, the share of the purchases of the total government civil expenditures has more than tripled, from 12% to 39%. At the same time, the share of wage payments in the government sector reduced from 75% in the early 1980s to 57% in the early 2000s (Bank of Israel 2009).

Lastly, privatization by omission has been most prominent in the education and health services. As discussed in this volume by Harel Ben Shahar and Filc (respectively), these social services have also been characterized by vast outsourcing. But as these services are also consumed by the middle and upper classes, the unsatisfactory quality of these public services triggered the expansion of a private layer that “complements” the basic public layer.

The continuous process of economic liberalization and privatization policy was seemingly dealt a blow in 2011 when unprecedented social protests took place. Protestors explicitly criticized economic liberalization and privatization policies, and the committee appointed by the government in response to the protests suggested in its report to reexamine the privatization of government services (Trajtenberg Committee 2011). This was followed by additional governmental committees recommending policies for reducing privatization in the health services and improving governmental supervision over contracted-out services (German Committee 2014; Praver Committee 2016, respectively). Nevertheless, at the moment there are very few signs of any significant change taking place (see also Mandelkern, this volume).

## THE STRUCTURE OF THIS VOLUME

This introduction is followed by a comprehensive overview by Itzhak Galnoor (Chapter 2), which discusses the general debate with regard to privatization policy in Israel and beyond. According to Galnoor, although privatization is the most significant, comprehensive and consistent policy in Israel since the mid-1980s, there has been no assessment of whether this policy has been a “success” or a “failure”, even in economic terms. Galnoor presents common attitudes, or “myths”—supportive and negative—regarding privatization and explains why they could be regarded as aphorisms rather than sound reasoning. Next, he discusses the attempt to build a private for-profit prison in Israel as an example of confused policy and of the blurring of the boundaries between government, business and social organizations, which has changed drastically the institution of the civil service. The chapter concludes by asserting that, given that privatization policy is impacted by the desired relationship between the state and its citizens, the burden of proof falls on those who wish to shift the boundaries between the public and the private.

As the rest of the volume covers the privatization of Israel in a variety of areas and issues, it is divided into four major themes. The three first themes correspond to a basic distinction of the main domains in which privatization policy has been taking place: public assets, social services and the welfare state, and core state functions. The fourth and last part of the book pertains to the social and political aspects of privatization in Israel, which cross specific policy domains.

The first part of the volume includes two chapters that critically assess the privatization of two prominent types of public assets that also carry national significance: space and land, and public utilities. Reviewing the privatization and nationalization policies with regard to space, in Chapter 3 Erez Tzfadia and Haim Yacobi address the relationship between ethno-nationalism, capitalism, and privatization. Their critical analysis of the production of Israeli territory in relation to the ongoing transformation of land and planning policies—from a purely nationalistic approach toward one based on neoliberal logic—suggests that privatization is not necessarily encapsulated in ideas of liberty, fairness, or economic efficiency. Rather, they suggest that privatization can also reflect the ethno-national logic of control. Tzfadia and Yacobi’s main argument is that the growing dominance of neoliberal policies, expressed in the

privatization of space, planning, and territorial management, is entangled within Israel's ethno-national politics.

In Chapter 4, Eyal Tevet reviews the developments and changes in government companies in Israel, with a focus on incorporation and privatization in the infrastructure sectors. Institutional changes in infrastructure companies are of particular importance, as their impact on the economy as a whole is far greater than their financial output. Tevet also assesses the results of incorporation and privatization in the infrastructure sectors, arguing that they enhanced the concentration of ownership without promoting competition, that they contributed to the commodification of essential services, and that they weakened Israeli democracy.

The second part of the volume is dedicated to one of the central domains on which privatization policy in Israel has left a particularly strong imprint: the welfare state. This part includes five chapters, which cover pensions, health, education, welfare services, and absorption of Jewish immigrants. In Chapter 5, Lilach Lurie discusses the privatization of pensions in Israel, which followed an influential report from the World Bank that recommended countries adopt a privatized pillar in their pension systems, and thereby enables an evaluation of pension privatization implemented according to these recommendations. According to Lurie, the case study of Israel shows that privatization leads to inequality: inequality of benefits, inequality of services, and inequality of pension coverage. She also suggests that proper regulation and an inclusive process of pension reform, in which unions, employers, and NGOs are consulted, may alleviate the system's problems.

In Chapter 6 Dani Filc reviews the privatization and commodification in the Israeli healthcare system. Filc analyzes three main forms of privatization of healthcare services in Israel: the privatization of financing, the privatization of service provision, and the privatization of regulation. He argues that a dominant form of contemporary health privatization is the blurring of the boundaries between the public and the private sectors, which generates inefficiency due to duplicate insurance, duplicate use of services, and weakening of regulation in the introduction of new technologies. Privatization in health services also deepens inequalities in access between the better off and the poor, and between the country's center and its periphery.

The topics discussed by Filc are closely connected to those covered in Chapter 7, in which Tammy Harel Ben Shahr surveys the privatization

processes in the Israeli education system. In this chapter, Harel Ben Shahar distinguishes between three main categories of privatization in education: funding, which involves the growing share of private resources infiltrating state schools through parental payments and donations; provision, including the establishment of private schools and the transfer of pedagogical and management roles in state schools to private entities; and commercialization, namely the introduction of market-oriented practices and norms, such as competition and choice, into public education. This chapter also suggests that the distinction between public and private education in Israel is diluted as state regulation on non-state schools increases.

In Chapter 8, Avishai Benish analyzes the privatization of social and welfare services in Israel. Benish firstly provides an overview of the privatization of social services in Israel and then discusses the broad lessons and dilemmas that arise from the Israeli case in terms of competition, performance-based management, consumer choice, quality and price, workers' rights, professionalism, accountability, and state regulation in social and welfare services. The chapter concludes by revisiting the consequences of the privatization of social services and looks forward to the future of privatization in this field through the vision of a "regulatory welfare state", according to which welfare state values are maintained in the new structure by regulatory means.

Chapter 9 concerns the privatization in the absorption policy of Jewish immigrants. In this chapter, Ilana Shpaizman follows the non-linear development of state responsibility for the integration of Jewish immigrants from 1989 to 2017. According to Shpaizman, during the 1990s the state decreased funding and provision of services for most immigrants, but simultaneously increased funding and provision of services for less affluent immigrants. From the mid-2000s, as integration services for most immigrants continued to erode, the state increased the funding and guidance provided to the wealthy and skilled immigrants. Shpaizman explains this nonlinear dynamic as a consequence of the interaction of a Zionist idea of the gathering of exiles and a neoliberal idea of seeing immigration as a mean for economic growth.

The third part of the book considers privatization processes as they affect core state functions and duties: regulation and policy formulation. Hitherto, privatization in these areas was hardly explored, since the expansion of privatization in these areas is, relatively, a recent phenomenon. In Chapter 10, Yael Kariv-Teitelbaum views the collaboration with



private bodies in the act of regulation as the privatization of regulation. Kariv-Teitelbaum maps the different methods of privatizing the state's power to supervise, monitor, and control, focusing on mechanisms of certification, accreditation, and auditing. She suggests that privatizing regulatory powers should be understood as a new "generation" of privatization, which stands in contrast to the original rationales of privatization, and calls for a focus on how state regulators can maintain their expertise in the face of new regulatory challenges.

In Chapter 11, Reut Marciano uses a systematic review of public tenders for procurement of consulting services to explore the outsourcing of strategic and national public policy formulation in various policy areas. Marciano demonstrates that the Israeli government allows external providers to define policy problems and to formulate the public policy that should be implemented to address them. Following that, she discusses two aspects of the implications of these findings: first, a possible democratic deficit that stems from the use of private firms for policy formulation and, second, implications for the professional capacity and status of the public service.

The four chapters in the final part of the book do not assess privatization policies in specific domains but rather analyse the wider implications of privatization in Israel, in terms of employment relations and labor law, inequality and labor's share in the national income, the nonprofit sector and civil society, and the politics of privatization policy.

In Chapter 12, Amir Paz-Fuchs focuses on the effect that outsourcing, as a subset of privatization, has had on employment relations in Israel. In particular, this chapter highlights the adverse, and perhaps counterintuitive, effects that the law has had on the plight of Israeli contract workers. According to Paz-Fuchs, Israeli governmental agencies and local councils have turned to outsourcing as a means to circumvent post limits and to increase "flexibility" in the civil service, a euphemism employed to indicate the weakening of trade union power. Intriguingly, paradoxically, and tragically, the law's effort to regulate this growing phenomenon has led employers to resort to tactics that have redefined agency workers (teachers, nurses, etc.) as workers subject to the "outsourcing of services" (teaching, nursing, etc.). This has moved such workers into a legal void, depriving them of rights and protection.

Tali Kristal complements Paz-Fuchs's law-oriented portrayal by focusing in Chapter 13 on how privatization policy and economic liberalization in general have impacted workers' political-economic standing. Kristal underlines a less acknowledged outcome of these policies in Israel and other countries: the decline of workers' share of national income. She develops a new political economy approach that stresses the importance of state policy for determining how national income is distributed between workers and capital, and applies this conceptualization to the dynamics of labor's share in Israel, once a socialist economy with little inequality, and today one of the world's most unequal societies.

In Chapter 14, Varda Shiffer discusses how privatization processes influence "civil society" and thereby not only the relations between government and citizens but, more importantly, the nature of democracy itself. Shiffer describes the dubious legacy of the nonprofit sector in Israel, which adversely affected the trust it was able to generate. She then demonstrates how the privatization process encouraged the formation of large nonprofit organizations that enhanced their managerial abilities to compete successfully with for-profit organizations for government tenders. At the same time, however, these nonprofit organization neglected their previously praised features of innovation and entrepreneurship. Thus, their ability to act effectively as social change organizations and contribute to a flourishing civil society was therefore curtailed.

Finally, Ronen Mandelkern discusses, in Chapter 15, the political processes that led to the institutional transformation that privatization in Israel constitutes. Mandelkern employs historical institutionalism and discursive institutionalism to reveal the political conditions and factors that facilitated Israeli privatization and the processes through which the various dimensions of privatization have been taking place. He focuses on how political and economic crises, neoliberal ideas, and gradual change processes like institutional layering and drift have together contributed to the consolidation of privatization, and briefly discusses the political possibilities for, and hurdles facing, a future retreat from privatization policy in Israel.

## NOTES

1. The latter was part of the effort to weaken the labor federation. See also File, this volume.

2. Authors' calculations based on data published by the Central Bureaus of Statistics and the Government Companies Authority. Note that the employment share indicator also has its limitations, since some present government corporations may have been units within governmental ministries in the past (the Postal Company is a prominent example).

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## Privatization Policy: The Burden of Proof

*Itzhak Galnoor*

Privatization is the most significant, comprehensive and consistent policy in Israel since the mid-1980s. This policy has continued for several decades, almost independently of the party or leader in power. Nonetheless, we do not know whether it has been a “success” or a “failure,” not even in economic terms. There has been no assessment of this policy, neither on the macro level—the cumulative influence on Israel’s economy and society, nor on the micro level—the advantages of privatizations in specific areas, e.g., water resources, pension system, health, and education. It was assumed self-evident.

The chapters in this book present the motivations for privatization decisions, the different concepts regarding the meaning of state responsibility and the kind of state authority that can or cannot be privatized, delegated, and outsourced. It is evident from these chapters that there has been little awareness to the significance of shifting the boundaries between the spheres: the public (the state), the private business (for-profit enterprises), and the social (nonprofit organizations).

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This chapter presents common concepts and attitudes—either supportive or negative—regarding privatization and explains why they could be regarded as proverbs rather than sound reasoning. Next, the attempt to build a private for-profit prison in Israel will be discussed as an example of confused policy. This example will serve the basis for presenting the need to recognize the blurring of the boundaries between the traditional “sectors”—i.e., government, business, and society. What has been the impact of these developments on the institution of the civil service is the subject of the subsequent section. The concluding part is concerned with the need for a privatization and outsourcing policy in Israel that serves the public at large, rather than the cultivation of misconceptions about the role of the state, or the adhering to slogans about economic efficiency.<sup>1</sup>

### THE PROVERBS OF PRIVATIZATION

If it is a matter of rationalizing behavior that has already taken place or justifying action that has already been decided upon, proverbs are ideal. Since one is never at a loss to find one that will prove his point – or the precisely contradictory point, for that matter – they are a great help in persuasion, political debate, and all forms of rhetoric. (Simon 1946, 53–67)

The controversy about privatization stems from ideological differences and, in particular, from disagreements about the role of the state in the era of globalization. Proponents of the “lean state” support privatization, the transfer of tasks to private organizations, and increasing the share of citizens private outlay in financing social services. Conversely, supporters of the “welfare state” are against privatization, and favor extensive state involvement, direct responsibility for realizing social rights by providing the necessary public funds. Beyond these positions on both sides of the fence, we find several myths and legends and no criteria, let alone data, to support them. I refer to them as “proverbs”—Herbert Simon’s concept quoted above—because for each of them one can find another that is equally plausible, and yet contradictory. They represent, at best, conventional wisdom that became self-evident. I do not set out to “prove” that these proverbs are wrong, only to point out the fallacy and add examples. The purpose of this exercise is to advocate a more balanced view regarding privatization and outsourcing (and nationalization), and to move away from myths and legends—some of which are

already questioned in many countries. In the case of Israel, such a balance is urgently required, both in terms of an overall privatization policy, and in specific areas, especially in the social services.

### *Myths and Legends Among Privatization Proponents*

The source of many fallacies among privatization proponents is the ideology that “efficiency” is a value in and of itself. Accordingly, the exclusive test is efficiency, narrowly defined in terms of economic savings/gains—minimize input (cost) for a given output, or maximize output for a given input. However, if we add to this crude formulation other criteria, what some economist refer to as “social efficiency,” i.e., the essence of the service provided, the assessment of privatization may change entirely. The same could be said about benefits that exceed the exclusive sovereignty of the customers into the realm of collective gains, where again the equation must change, as per merit public goods.

Let us examine now some of these proverbs in a simple form to which I will add my reservations.

**i. Governments do not know how to manage (to perform, to implement, etc.). Hence privatization and outsourcing are by definition always positive, unless one can prove that it will be inefficient.**

Government is given the task of managing some of the most important and critical areas of our life: security, justice, crime prevention, preventative medicine, welfare services, coping with natural disasters, and many more. As we pointed out in Chapter 1, the list does not include only public goods, or tasks “ejected” from the demand and supply system of transactions and branded as “market failures.” So if we cannot trust government performance, why do we entrust it with managing these important critical areas?

There is no evidence whatsoever to support the claim, and still, the sweeping generalization that governments do not know how to manage is strongly held and provides justification for the privatization policy. A case in point is government corporations in Israel—some were well managed and prospered, so much so that they were eagerly purchased by private investors; some were a partial or total failure. The same could be observed regarding government corporations that were privatized—the successful ones were mainly those that were previously badly managed—mainly as a result of inept political appointments. Others failed despite their transfer to the business market.



Furthermore, even if we assume that governments do not know how to manage, can we trust them to carry out an efficient privatization process that will safeguard the public interest? Or in sensitive areas—that they will be able to regulate the privatized business enterprise (e.g., electricity) or the social service (e.g., health care)? Research in other countries revealed many a flaw in privatization processes, outcomes and particularly in regulating privatized services. As I discuss later, another victim of privatization is the quality of the civil service. In many cases governments do not know how to manage, that is cannot perform, because the civil service has been depleted. This weakness is then used as a reason why privatization is necessary.

**ii. The private market is always the best or a better solution. Hence, goods and services should be initially provided or transferred to the market to increase the efficient use of the overall national resources.**

This assertion differs from the previous one because it asserts *a priori* the advantage of the market over other institutions. Indeed, the economic market excels in resource allocation of certain goods and services, especially when it approximates the requirements of behaving “perfectly”—no information barriers, etc. However, in many areas the allocation cannot even aim at approximating perfection, not because of “market failure” but because economic efficiency is not relevant when we are dealing with merit public goods. Generally, the more intangible the good, the more the private market tends to raise the cost and contribute to inequality. For instance, in education, the service provided is so intangible, that it shies away from simple definitions of quality let alone precise measurement, such as external tests. In teaching services, the “client” must participate in the production process. That is, students determine the essence of the service provided to them, and it cannot be “efficient” without their collaboration. Measurements opt for surrogates such as teaching hours, formal tests, or degrees that do not capture the quality of the learning process, intellectual development, erudition, skills, and more. We need proof that where such intangible goods and services are concerned, the market is indeed superior in terms of benefits to both direct recipients and indirectly—to society as a whole.

The new cyber technologies seem to contradict the above—they are intangible enough, and yet they have been developed and their services

are provided by private companies. However, can we ascertain that the market has been the best solution for these networks? Suffice it to say here that a public infrastructure (e.g., free internet for all) could be a better solution for equal access. Moreover, the obvious need for a wide scope of public regulation could eventually make it less private (on the role of governments in developing these technologies see Mazzucato 2013).

**iii. State intervention is required—directly in providing goods and services, or through regulation—only when there is a market failure justification.**

The list of market failures is well known<sup>2</sup>: conditions of natural monopoly; lack of competition stemming from economies of scale; externalities—costs or benefits that occur to external individuals or communities; the inability to prevent “free riders” who have unpaid access; inability to establish property or ownership rights; information asymmetry which causes disparity among players and distorts market allocation (Arrow 1971).

Yet, a market failure can be discovered only when a certain good or service withstood a market test, failed, and calls out for government intervention. This market test is a priori annulled when the public signifies a preference for public consumption, namely, indicates that it should be a public good governed by nonmarket (administrative/political) procedures. The preference could be based on considerations of justice (the tax collection system), equality (income guarantee), or lack of market transaction qualities (emergency services).

The preference does not apply to typical public goods only, but also to private goods that a given society is determined to keep out of the market. Court services, for example, are run by state or local public entities not because they failed market tests, but because they are not suitable to the market logic of pursuing efficiency. The court system is inefficient, by definition, in its attempt to apply the law and pursue justice. The presumption of innocence is a good example of cherished inefficiency. The same applies to other sensitive areas that could be referred to as “inherently governmental” (USA Federal Government 1998) such as recruitment to the military, detention and imprisonment, or determining daylight saving time. Antiquities, for instance, are an obvious private good enjoying great demand in the private market. Nevertheless, in

almost all countries, the discovery of national antiques and relics does not entail ownership and the right to sell. Thus, the dictum “market failure” cannot be applied to a good or service when the analogy to the market does not exist. A certain good or service is “public” because the public (in a democracy) wants it to be so.

**iv. The private sector is efficient and innovative while the public sector is not.**

This assertion, often stating that the public sector **cannot** be efficient, is the basis for the demand to cut it back. In Israel, then Finance Minister Netanyahu stated in 2003 that the “lean” private sector can no longer carry the “fat” public one on its shoulders (Rolnick 2003). The dichotomy itself is misleading because the definitions of what is “public” and “private” are skewed, given the fact that the boundaries are blurred (see examples in Harel Ben-Shachar, Filc, this volume). For instance, where should we include institutions of higher education? Or not-for-profit organizations that provide outsourced services? The irony of this proverb came to light during the global economic crisis of 2008 when “fat” governments were desperately summoned to rescue business enterprises, thus enlarging the public sector even further. The presumably efficient market mechanisms could not prevent the crisis. Indeed—some of them caused it.

The efficiency presumption about business does not explain why many government services or nonprofits are efficiently managed and doing well. The same goes for the innovation claim. Suffice it to say that many technological and cybernetic inventions—military and nonmilitary—were based on governmental research and development, or on close collaboration between the sectors—usually state financed—such as in the development of nuclear energy, aviation and space, the Internet, biotechnology, green technology, and many more.<sup>3</sup>

The crisis in 2008 was not confined to isolated domains within the financial market, and it raised fundamental questions pertaining to the claim of efficiency of the market as an institution. It requires new thinking about the optimal size and components of the economic market, state responsibility, and modes of regulation (Bogdanor 2005; Donahue and Zeckhauser 2012).

**v. Privatization enhances competition, which necessarily increases efficiency, reduces cost and improve the quality of services.**

This commonly held belief seems plausible and in many cases is actually valid. However, it is not self-evident, especially because privatization does not necessarily enhance competition (Fercshtman 2007). When privatization creates competition, as in the case of telecommunication in some countries, it can reduce cost and improve the service.<sup>4</sup> In other cases, ownership was transferred to private hands, but no real change took place, thus creating a private monopoly (sometimes a duopoly, or a cartel) instead of the previous public one.

When competition does occur, it does not necessarily improve the quality of the service. For instance, in higher education, competition may lead to “product” conversion when the paid-for academic degree is the only goal, rather than learning and enhancing the quality of education. Competition may encourage the institution to “sell” the degree to students by reducing academic requirements, shortening the learning period and reducing cost by hiring lower-paid temporary staff. When the state retreats from financing, savings are considerable, but at the expense of the quality of higher education.

In outsourcing, there is usually a contest through public tenders, but after that, there is no competition during the franchise period and the franchisee has a monopoly (e.g., toll roads) which the public authority has difficulties to regulate, despite the detailed contract (see Shiffer, this volume). Moreover, when the contract is up for renewal other contenders are often at a disadvantage in the competition. After decades of privatization, many countries discovered that despite the shortcomings of state monopoly, they are at least democratically accountable and preferable to uncontrolled, profit-oriented, private monopolies.

**vi. Privatization helps fight corruption.**

This myth is on its way out simply because it has been refuted repeatedly. Bribed persons need bribers and the latter in most cases are business interests who bribed public officials. Moreover, the private sector is also tainted with corruption and we find similar corrupt and unethical behavior in all sectors: bribes, conflict of interests, nepotism and non-merit appointments, irresponsible and indolent board of directors, sky-high unjustified salaries of managers, etc. Some share-holding company on the brink of collapse stopped paying their workers, but continue to

remunerate their managers. Privatized enterprises have not become a model of behavior, and no one expected them to, and this should eradicate the corruption proverb once and for all.

**vii. Privatization increases “managerial flexibility” in public resource utilization, particularly regarding human resources.**

As a management proposition, the first part of the above sentence is a substitute to reforming the public sector, and the second part is a self-fulfilling prophecy. Of course, in many countries, the civil service is bureaucratic, cumbersome, and inefficient. In Israel, the tenure system is based on collective agreements with the trade union, which makes dismissal of incompetent workers almost impossible. Granted that, one would expect the government to introduce reforms to modernize the civil service and increase internal management flexibility. Instead of adjusting the civil service to the new requirements by investment and reform, which in the long run is more economical, the stagnation of the public bureaucracy is used as an excuse for justifying privatization. This self-propelled vicious circle is particularly evident in social services as follows:

Budget cuts » Service deterioration » Blame inefficient bureaucrats = Privatize!

In Israel, such a chain of developments occurred regarding the incarceration of prisoners, discussed in the next section.

The main component of “managerial flexibility” is in fact “employment flexibility” which defines the human resources of the organization as raw material that can be changed and exchanged. This slogan reverberates the working conditions in the nineteenth century when management had total control over their employees. And before that—in slavery, employment flexibility was traded for very low cost. The phenomenal increase of the percentage of contract employees, in public and private organizations alike, is a reflection of such an attitude. The formula was transplanted into the public sector from private companies and is rather simple: cut the cost of permanent employees; outsource their tasks to outsiders that pay much less to their exchangeable employees in money and benefits; pocket the difference in higher net earnings for owners and managers, even if the quality of the product has not improved (see Paz-Fuchs, this volume). And of course, globalization forces everyone to join, otherwise they will be out.<sup>5</sup>

The declared enemy of “employment flexibility” is organized labor. Privatization, particularly of government corporations, is often aimed at breaking the power of trade unions and of collective bargaining (see

Mandelkern, this volume). As in other examples of conventional wisdom, privatization in the public sector has decreased the number of employees, but not the cost of providing the same services. The line-item in the state budget has moved from “salaries” to “purchase of services.” And even if the cost was reduced, there is no proof that the introduction of precarious modes of employment has increased the quality of products and services.

**viii. Effective regulation solves most of the problems of privatization and outsourcing.**

One popular formula is: competition + effective regulation = positive privatization. The assumption is that when a certain good or service is transferred to private hands, state responsibility does not disappear entirely, only its role changes: instead of being the manager/producer/provider, it supervises cost, access, quality, etc. Enter the realm of regulation. In this case, there is enough evidence to show that if the expertise of a government agency is gone, because it ceases to manage or provide a service, gone over time is also its ability to supervise and regulate.

In Israel, privatization caused some ministries to outsource not only the provision, but also the supervision (Marciano, this volume), thus causing regulation to be an empty procedure that facilitates the weakening and sometimes the disappearance of state responsibility. Hence, the common assumption that outsourcing is not privatization, or just partial privatization, because it leaves responsibility in the hands of the state, is not always substantiated.

A different problem stems from narrowing the goal of privatization only to saving public funds. When this is carried to the extreme, state outlay reaches zero, regulation is unimportant and as long as the savings continue, no one guarantees the quality of services to the citizens. As we noted (in discussing higher education), lack of effective regulation could take place even when there is competition among private suppliers. In Israel—as many examples in this book indicate, particularly regarding conditions of employment and job security—efforts have been made to leap from one pole to the other, from overcentralization and overregulation to complete privatization and deregulation.

*Myths and Legends Among Privatization Opponents*

The source of many fallacies among privatization opponents is the inability to draw conclusions from—and sometimes even comprehend—the

social and economic changes over recent decades, especially globalization. The need to draw conclusions is unrelated to the downfall of communist systems, because this is irrelevant to my point here. Directly relevant, however, is the growth of the public sector after World War II and the emergence of “Big Government” in democratic countries. Thus, the failure of nationalization, especially in some infrastructure services in countries like Britain and France, signified the limits of state capabilities. Moreover, even before neoliberalism took over, the socioeconomic structure was changing while the boundaries between the public and private sectors, between public and private goods, were becoming blurred. Governments needed the private sector to try and meet the rising expectations of citizens for better and new kinds of services, e.g., in communications. And so, enters the “mixed economy” (later incorporated in the “third way” platform in the UK), even in countries with socialist parties in power.

Opponents refuse to acknowledge the advantages of the market economy, stripped from the greedy, aggressive, and socially destructive components perpetrated by its neoliberal version. Such advantages enable positive cases of privatization. One interesting example is the 1994 National Health Insurance Law in Israel. On the one hand, it nationalized health insurance and made it compulsory for the entire population through a universal health tax. On the other, it recognized the existing nongovernmental, nonprofit health funds as the agents for health service delivery. This can be regarded as a constructive case of outsourcing.<sup>6</sup> Let me examine some of these proverbs in a simple form to which I will add my reservations.

**i. Avoiding privatization (or the nationalization) of public assets safeguards the public interest.**

This opinion ignores the possibility that transferring ownership, authority, and responsibility from the state to private citizens could be positive, as in the case of transferring the ownership of public housing to the tenants.<sup>7</sup> Another example: parental involvement in their children’s public schooling, which entails transferring some responsibilities to them, can be very positive, if it enables all parents to participate equally. State ownership is not always beneficial to the public, and sometimes it is preferable to assign managerial functions to professional, private entities while leaving overall responsibility for the service in the hands of the state. For example, state partnership with a private company to build and maintain

roads could benefit the public on condition that profits (usually guaranteed by the state) do not take precedence over the public interest.<sup>8</sup>

Public policy is made and implemented not just by state authorities. Transferring responsibility for service provision from the state to a not-for-profit organization is also within the realm of privatization. Such privatization is often successful when the service provider is closer to the service recipients, as happens with organizations working with migrant communities, for example.<sup>9</sup> Moreover, civil society organizations force the state to be more transparent and involve the public in decision-making, thereby working to safeguard the public interest.

## **ii. Cooperation between the state and the business sector is improper.**

The main concern here is that such cooperation begets corruption, but this is not inevitable. Honest collaboration is possible and often desirable as far as the public is concerned. The fact that such cooperation has existed from time immemorial and usually for the benefit of the few, is immaterial as an example. The model is not feudalism where kings and lords used private functionaries to collect taxes and impose military recruitment. Nowadays the state can collaborate with other organizations in a variety of productive forms. A simple example: in Israel as in many other countries, private employers deduct income tax from employees “at the source”, and banks deduct capital gains taxes on behalf of the state. A more elaborate example, which requires intensive regulation, are the Public–Private Partnership (PPP), long-term agreements between governments and private business, usually in construction projects.

The shrinking power of the state, relative to the business and social sectors in western countries has also weakened the public sector. What’s more, increased individual participation in financing social services is characteristic not just of Israel (Grunau 2012), but of most western countries. The blurred boundaries between the sectors have led to new and creative combinations: Some were instrumental and necessary in light of the changed status of the state, the demands to improve services through greater efficiency and the delegation of authority, and concern for the rights of disadvantaged groups by strengthening third-sector organizations. Some partnerships of organizations across the three sectors—state, social, and business—have succeeded and led to quasi-governmental or quasi-private organizations whose long-term performance should be evaluated. Not-for-profit social enterprises run as businesses are an example of



the fact that opponents need to update their perceptions of privatization. Even more so regarding the need to cope with the existence of a few private global colossi such as Amazon, Apple, Facebook, and Google.

### **iii. Privatization always hurts the little guy.**

Not necessarily. In many cases, services that are not essentially public goods improved dramatically when removed from government ministries—by outsourcing the expertise needed, or creating conditions for real market competition. Examples of beneficial outsourcing in Israel has been a liberalization policy intended to increase competition in areas such as car licensing, the issue of state documents, and the contracting out of many technical services in government ministries. Beneficial competition occurred in cellular telecommunications and commercial aviation. When successful, the state takes on a new role of overall responsibility and supervision. In principle, regulation may work well.

### **iv. Privatization means the state is shirking its civic duties.**

It is hard to identify the tipping point when the state “shirks its responsibility”; indeed, sometimes the state acts irresponsibly in areas for which it has sole responsibility. Furthermore, privatization can sometimes add to the responsibility of the state because it broadens regulatory options and the range of sanctions that can be imposed on non-state providers of essential services. State responsibility in and of itself does not always guarantee concern for the citizens—ongoing harm to the environment provides clear evidence of this.

The state may continue to bear responsibility for a service, but farm out its provision to a nongovernmental entity or private company, while closely regulating it. This requires the setting up of a regulation structure simultaneous with privatization and outsourcing. In many countries, however, the attempt to ensure responsibility after privatizing a service has not succeeded, sometimes because of the precipitous manner in which the state shed its responsibility. Examples in Israel include the Ministry of Education closing its eyes to “grey education” for the wealthy (see Harel Ben-Shachar, this volume in this book); the Ministry of Health not properly regulating private medical services offered in public and private hospitals (see Filc, this volume); and the state failure to ensure free public access to the beaches. In all these cases, the state may have acted differently, forging new types of collaboration (see third section of this article) with non-state entities.

**v. Regulation does not solve the problems of privatization, which ipso facto is a front for giving preference to powerful interests and groups.**

Indeed, this is often the case while regulation, some claim, is designed to soften the opposition to privatization. Supporters of private prisons, for example, seek to assuage the fears of its opponents by asserting that the business-oriented prison operators would be closely monitored. Another argument is the documented phenomenon of “the captive regulator”: Over time, regulators tend to develop symbiotic relationships with their supervised “clients,” and in practice stop serving the public. Similarly, in many countries, regulators resign their government posts to take senior positions in the commercial companies that they had regulated while they were civil servants. And, vice versa, industry executives and lobbyists accept senior government positions—moving from “regulated” to “regulator.”

Although these claims are well founded, they do not invalidate the need for carefully thought out privatization, accompanied by proper, long-term regulation. Claims of “too much” or “too little” regulation miss the mark. We defined regulation as ongoing, targeted supervision of organizational and individual behavior based on binding rules, standards, and enforcement. Regulation is usually carried out through a public entity to safeguard social values. The most common way to establish regulatory mechanisms and formulate the rules and criteria of regulation in a specific field is legislation—such as the Israeli Accountants Act, the Patents Act, the Securities Act, and the Telecommunications (Satellite Television Broadcasts) Act. There are also ordinances, bylaws, administrative arrangements, etc. However, state regulation over privatized services is a relatively new field. Many countries are still groping with how to ensure proper regulation and the safeguarding of the public interest, particularly of disadvantaged groups.

There is consensus about the need for regulation in critical areas such as prevention of diseases, ensuring safety, preventing fraud, and generally protecting civil rights and the environment. The question that remains unanswered is whether regulation is preferable to state ownership of infrastructure such as energy and transportation. Once we have reliable studies that prove that regulation increased public benefits in privatized goods and services, there is no reason not to privatize them. Above all, it is important **to avoid privatizing the regulation itself**. When regulation is outsourced, the state loses control of the supervision, that is of the regulation which was initially presented as a justification for the argument that privatizing would not entail shirking state responsibility.

**vi. The responsibility for service provision should not be handed over to third-sector organizations.**

First, these organizations have their own interests; second, they allow the state to dodge its responsibility to the citizens; and third, third-sector organizations are not publicly accountable. Therefore, the argument goes, state entities are preferable as they are publicly responsible and accountable to the democratically elected institutions. Even commercial organizations, according to this view, have the advantage over the nonprofits, because they operate under a market regime of supply and demand, which forces them to satisfy customers.

This is a complex issue, particularly when it concerns not-for-profit, service-provision organizations that operate like a business (e.g., in which management salaries are based on profits), or that operate in a competitive environment (e.g., Health Funds in Israel competing for members). Accordingly, in farming out services to the third sector, one must distinguish between “minor privatization”—handing over services to a public not-for-profit; and “major privatization”—handing them over to a not-for-profit that functions in all respects as a business. The latter should be considered privatization for all intents and purposes; whereas in the case of the former, critics should reconsider their opposition to minor privatization. Most social organizations are in fact public entities that do not pursue profit, and they have a deep commitment to society, or to a specific group within it. Sweeping opposition to all privatization in which third-sector organizations provide services fails to give full weight to the critical role of civil society and its importance in a democracy.

**vii. The economic market is necessarily contrary to distributive justice.**

This approach ignores the benefits of the economic market. Under optimal conditions (a perfect market), it not only allows for efficient use of the means of production, but is a democratic institution that could allow broad access to buyers and sellers, enable freedom of choice, and create opportunities for social change. It can be argued, however, that even a perfect market creates inequality and needs regulation to ensure that the principle of equality is upheld. Indeed, Adam Smith’s “invisible hand” may not always aggregate private interests to benefit society at large, but it could accomplish this in many important areas.

Considerable experience and knowledge have accumulated about the structural malfunctions of the “free market” economy, from monopolies

to the concentration of wealth to the need for strict regulation (as with banks, for example), or to prevent the exploitation of natural resources (such as gas), or for the safe use of public infrastructure (such as flight paths). Free markets generally operate in countries that are democracies, and market mechanisms are not by definition contrary to distributive justice. In all democracies, they are used—in varying degrees of commitment and expenditures—to address social needs, disabilities, unemployment, and more. Progressive taxation, which exists in all capitalist countries, or negative income tax, are market mechanisms aimed at redressing market failures. Indeed, in evaluating “economic efficiency,” many economists include social preferences such as “distributive efficiency.”

### **viii. The welfare state should be restored.**

This aspiration may have merit. In many countries, and markedly in Israel, the transition to the so-called market-based economy was too abrupt, and carried out haphazardly. For instance, the decision to “liberalize” the financial market in the 1980s almost overnight was one of the main reasons for a soaring inflation of over 400%. Moreover, the welfare state can boast significant achievements, and there are successful examples of mixed economies in democratic countries that manage to combine the advantage of state welfare policy and a free market.

Beyond the ideological debate, however, one must recognize that conditions have changed, particularly in the age of globalization, and that the welfare state of yore no longer exists—because of the emphasis on individual rights, among other reasons. The “anti-politics” atmosphere in many democracies reflects a loss of confidence and trust in the political system, elected leaders and in the civil service. It has resulted in increased skepticism toward public servants and “experts”, including doctors, teachers, engineers, and so forth. At times, this is worrying, allowing for the emergence of “alternative” facts, but, at times, it also indicates a gradual maturity of democracies, empowering people to think for themselves. The combination of lack of trust in the state and individualization has been one of the main reasons for widespread public support of privatization policies. Accordingly, a more intricate approach and new modes of public policy-making are needed for the division of work among the three sectors—state, business, and social organizations—to which I will turn in the third part of this article. Before that, I will present the attempt establish a private for-profit prison in Israel as a case study of:

- An attempt to leap from one pole of complete state monopoly to the other—a private business enterprise.
- The lack of a coherent policy of privatization based on solid social and economic conceptualization.

## AN ATTEMPT AT PRIVATIZATION OF A PRISON IN ISRAEL

### *Background*

Israeli prisons operate within the framework of the civil service. The correctional officers, much like police officers, are agents of the state who operate under the jurisdiction of the Minister for Internal Security. In 2004, the Finance Ministry initiated an amendment to the law that would enable the establishment of an experimental private prison.

ALA Management and Operations, controlled by diamond magnate Lev Leviev, won the tender and was awarded the contract for construction and operation of the first private prison in Israel. The principal arguments cited by advocates of prison privatization were efficiency and the saving of public resources. It was also claimed that private prisons would offer some relief from the extreme overcrowding in Israel's prisons.<sup>10</sup> As to the fear of violations of prisoners' rights, the promoters argued before the High Court of Justice that the "supervisory environment" that they would provide for the private corrections officers would exceed the supervision in state prisons, preventing the violation of prisoner rights. They further claimed that Israel should follow the examples of democratic nations such as the USA, Britain, Australia, New Zealand, and Canada, all of which had privatized some of their prisons. In 2005, there were approximately 200 privatized prisons worldwide, nearly 80% of these in the United States (Ben David and Truan 2006).

The proponents distinguished between the authority to punish, which remains with the state courts, and the "management of punishment" carried out by prisons, which may be privatized. Accordingly, they presented most of the arguments listed above in the first section, particularly that the privatized prison management would be efficient, services would be improved, human resources better utilized, etc.

Opponents pointed out that very few countries had introduced full privatization of prisons, such as the one proposed in Israel, a model based primarily on the prison system in the state of Texas (ALA had consulted with Emerald, a firm that operated five incarceration facilities in Texas).

Moreover, most countries have refrained from total privatization, preferring partially privatized services, such as outsourced medical care, catering, maintenance, security, etc., with the state retaining all correctional authority having to do with direct contact, guard duty, or punishment of the inmates. They also argued that for-profit prisons—regardless of what happens in other countries—represent a conceptual misunderstanding by advocates of a market economy of the responsibilities of the state. They noted that several governments, including the United States, were reevaluating their prison privatization policies (Culp 2005). In New Zealand, for example, the Parliament decreed in 2004 that prison privatization had failed, and passed legislation preventing future attempts.

In 2005, the Human Rights Center at the College of Law and Business in Ramat Gan petitioned the Supreme Court (sitting as the High Court of Justice), challenging the law that established the private prison. The petition argued that in this case the distinction between state responsibility and state management of punishment is unacceptable. Implied also was an attempt to show that the government did not present a coherent policy, and although the bill passed and became a law, Knesset procedures surrounding this legislation were far from thorough and transparent.

### *The Supreme Court Ruling*

In 2009, after four years of long deliberations, the Israeli Supreme Court delivered a precedent-setting decision by striking down the amendment that allowed for the privatization of prisons in Israel.<sup>11</sup> The Court stated that the law is a disproportionate infringement of prisoners' rights. By ruling that a private prison is illegal, the Court declared that in Israel the imprisonment of citizens and the protection of their rights is the responsibility of the state (Galnoor 2006; Harel 2008). Much like the public good of collecting taxes and running a court system, it would simply not be possible to write out a contract that would completely detail how privatized prison workers must operate in each custodial situation that would arise. Privatization of this sort could potentially lead to an undesirable influence of financial interests over decisions of citizens' rights. The Supreme Court's decision clarified that a main concern regarding the potential implications of the privatization would result in ceding policy decisions on preserving prisoners' rights—a sensitive state function—to for-profit companies. The profit motive of these businesses would potentially conflict with the public's interest of taking responsibility for

prisoners who are inherently vulnerable and marginalized members of society.

The implicit message was that even staunch supporters of privatization ought to recognize its inapplicability to certain fields, and that responsibility for the prison system must be prevented from passing into the profit-making sector. The state must retain exclusive responsibility, even if delivering a public service in this manner is more expensive and less efficient.<sup>12</sup> The Court, however, did not rule out the possibility of outsourcing certain auxiliary services. This ruling seems to close the door to the possible privatization of prisons in Israel. Beyond that, the Israeli case has had a strong impact outside Israel, influencing the debate about private prisons and privatization in general (Volkh 2012; Resnik 2013).

### *Broader Issues*

The prison system, as well as other essential services, must remain beyond privatization, thereby preventing the violation of basic constitutional rights and society's collective goals. Reforms must clearly demarcate areas of governmental authority suitable for privatization and outsourcing, and those that should not be privatized, such as the state monopoly on the legitimate use of force. One of the most extreme sanctions the state has against the individual is imprisonment, and this should not be entrusted to profit-oriented private companies.

Incarceration of prisoners constitutes a unique public service, with deterrence as its primary objective; when deterrence fails, the system implements court-ordered penalties; and when offenders are imprisoned, the correctional institutions are responsible for rehabilitation. The objective of business-motivated, privately owned prisons, on the other hand, is the opposite—they have a vested and pecuniary interest in long-term, full-capacity incarceration. Moreover, privatization is based on the premise that the market is more effective than the government due to competition. The privatization of prisons does not create competition, however, unless competition is instituted between public and private prisons, or unless the “customers”—the prisoners themselves—are permitted to choose between various private prisons (and pay different incarceration fees?). Prisoners are not consumers, and the idea of competition between prisons is absurd. In incarceration of prisoners the needs of society at large, as well as human and civil rights, must be taken into account. As to prisoners' rights, these are almost impossible to guarantee in private

prisons, even if there is a detailed legal contract between the state and the operator, with ironclad regulation rules. With higher profits in mind, contracting companies might hire low-quality staff, cut back on food, or increase the number of prisoners per cell, requiring the state to maintain high-cost, full-time supervisory staff to prevent violations. In other words, adequate supervision denotes increased regulation—which ideological proponents of privatization are likely to oppose.

While instrumental arguments against privatizing prisons are important, they are secondary. More to the point is that the dark days of authoritarian-style prisons and custody by private contractors are long gone.<sup>13</sup> Incarceration, even in neoliberal states, is the responsibility of the state, and its transfer to the private sector poses a threat to the very tenets of democracy. Extending the logic of privatizing prisons, the state could revert to feudal practices and hire private tax collectors—and this has already happened in Israel in collecting local taxes in some municipalities—arguing that they would reduce tax evasion. Similarly, “private courts” could ease the backlog of court cases—shortening due process and expediting those convicted to privatized prisons. Again, this happens to some extent in mandatory arbitration in Israel—though not in criminal cases—arguing that it shortens queues and avoids publicity. Regulating profit interests in these cases would be virtually impossible because contracts stipulating how the judges, arbitrators, tax collectors, or correctional officers are expected to perform and use professional judgment are inconceivable. Furthermore, privatization of this sort opens the door to corruption, as the government creates private, for-profit entities with a financial interest in the penal system. Indeed, scholars have noted the emergence of a private prison lobby that promotes deregulation, reduced supervision, and longer prison terms (Timor 2006). The sole consolation is that a lobby like this would probably oppose capital punishment.

The possibility of the emergence of a “prison industry” became a dark reality in the so-called “kids for cash” scandal in the United States. In 2002, two public detention facilities for juvenile offenders in Luzerne County, Pennsylvania, were shut down because they were unsafe, and a contract was signed to send all juvenile offenders to two private facilities. Payment to the private prison operator was based on the number of juveniles incarcerated, and the authorities carefully monitored the financial accounts. Very soon, however, penalties for minor infractions became harsher, as offenders were sanctioned with incarceration



rather than community service or a suspended sentence. Some youths were told to plead guilty or waive legal counsel in exchange for avoiding prison time. Yet these agreements were not kept by the court, which in hasty trials, closed to the media supposedly to protect the identity of the minors, sent them to prison. The two private facilities filled up with youth offenders, and the spillover was sent to hired space in public prisons in nearby counties (Urbina and Hamill 2009). The horror of the system became known when two judges confessed to having received bribes amounting to \$2.6 million for their services from prison authorities—a per capita fee for each youth they had imprisoned. All of this took place while strict regulation by the state of Pennsylvania had been in place.

\* \* \*

The Supreme Court decision in Israel concerning private for-profit prisons suggests some broader implications. First, privatization policy requires a much wider vista of state responsibility than mere economic cost–benefit calculations. When scholars who opposed prison privatization warned against the emergence of a private “prison industry” (Timor 2006), the predictions of deregulation, reduced supervision, and longer prison terms seemed entirely imaginary. The “kids for cash” story described above, however bizarre, succinctly epitomizes the unethical and antisocial “noise” that market considerations may introduce when the public interest and the public goods designed to serve it are ill conceptualized.

Second, privatization does change the method of structuring the relevant information for policy alternatives and limits the scope of choices available to policy makers. The private prison case indicates that when the overriding assumption is that governments do not know how to manage and therefore the first (and sometimes only) choice is to privatize or contract out, there is no room for other options, from increased public spending to user fees to state collaborative ventures with nonprofits and for-profits organizations.

Third, the counter arguments that this case “may establish a strong presumption against privatization, [but not] a convincing case for the state monopoly theory it advances,” barges through an open door (Feely 2013, 1404).<sup>14</sup> In the next section, the blurred boundaries that exist in many areas are discussed. However, this is precisely the reason why, in certain other areas, what is inherently state responsibility should be carefully delineated and firmly guarded. Indeed, the call for “more appreciation for

the ways of the modern administrative state” (ibid., 1436), comes close to the notion, discussed below, of collaborative governance.

Fourth, the Israeli Supreme Court ruling opened a door for facilitating the discernment of overarching principles that determine whether an inherently governmental function is suitable for privatization. Moreover, even though the Supreme Court decision is institutionally limited, and cannot create a general policy for other areas, it established a precedent that state monopoly, also in social services, could be positive and socially efficient. Accordingly, a coherent policy of privatization is imperative, recognizing that the burden of proof for the economic and social worthiness of privatization and outsourcing rests on the shoulders of the state.

## THE BLURRED BOUNDARIES BETWEEN SECTORS—PUBLIC, BUSINESS, AND SOCIAL<sup>15</sup>

### *Taxonomy*

Distinctions between the sectors, including the traditional division between business—private and state-public, are not sharp. In some states, like France and Germany, the sectors were once rather distinct, while in others, such as England and the United States, the separation was imperfect because of the powerful role of the business sector. Nowhere, however, was the separation absolute, particularly in the wake of the expanded executive branch of government in the first half of the twentieth century (Wright 2000, 157–159). The blurring of the divide between the sectors took place when some public services were provided through private bodies. Some examples: state-subsidized bank loans; joint funding of projects; cooperation between state organizations and interest groups; senior employees moving back and forth between the public and private sectors; and government regulation of private business. In the new technological era, the borders have become even more permeable. The complex needs of modern society have seen links forged among governmental, social, and business organizations, leaving the distinction between profit-making and nonprofit organizations not always perfectly clear.

In Israel, too, a significant part of the nongovernmental sector (non-profits and for-profits), is financed by the state. To this we can add the various state grants and loans for promoting business enterprises and small business. On the other hand, entities that had been commercial

in the past, such as Bank Leumi, are now partially government owned. Other examples of public–private combinations are the Amal vocational high school that belonged to the Labor Union (Histadrut), and since 2007 is a state-subsidized nonprofit network; the privately owned shelters for the mentally disabled, which are under state regulation. Some of the publicly owned government corporations could also belong to this mix category, because despite some restrictions, they can operate freely, on par with their competitors in the business sector. And, of course, business and public-sector organizations all vie for tax concessions and subsidies, while private commercial firms turn to the public coffers to bail them out at times of crisis.

Hence, distinguishing between different types of public goods is complicated; even more so when the typology is not by product or service, but according to the organization providing them. This is further complicated by the rise of the third sector as part of the civil society, complementary to the governmental sector, and sometimes as a substitute or replacement for its services (Shiffer, this volume). Instead of the profit orientation typology, we propose a test of *accountability*, intended to underscore the difference between public and private organizations and to include third-sector organizations. Accordingly, we can distinguish between public accountability of state and local authorities to the citizens; private accountability of business entities to owners and shareholders; and group-societal accountability of the third-sector organizations to their members, their groups, and the public at large. These distinctions are not refined if, for example, we are interested in the legal status of various organizations, or trying to classify the accountability of some distinctive organizations such as foundations, universities, cooperatives, community-interest companies, social enterprises, and governmental welfare nonprofits. Indeed, a significant portion of the literature about civil society organizations is an effort at taxonomy—coming up with a clear and precise system of classification (Salomon and Anheier 1998). Unlike flora and fauna, however, whose taxonomies are based on structural similarities, common origins, etc., we posit that human organizations are artificial inventions designed for specific needs, and many of them defy clear-cut classification.

### *New Clusters*

Interdependence between the public and business sectors is also the result of the fact that the steering roles of the government necessitate alliances, a division of labor, and the exchange of resources among the

partners. Collaboration is required for pursuing common goals in any society. Thus, rather than perceiving citizens as passive “subjects” of the state, characteristic of étatist ideologies, or assuming that public policy is executed solely by official public authorities, in practice different stakeholders from many organizations in all three sectors work together in designing and implementing policy. This conglomerate operates in many areas, but has no clear legal standing. Bertram Gross (1964) suggested calling it the “central guidance cluster” to convey both the complexity of its components and the limitations of its power.<sup>16</sup>

The new pluralism therefore challenged the institution of the state as the supreme and exclusive organization in society, with globalization as the crucible in which this change is forming. What is the nature of the change that is taking place in the status of the state? Despite the differences, several changes are common to many countries. First, there is a change in values—a greater willingness to question the monopoly of the state in all areas. Much has changed due to neoliberal ideology, which advocated the strengthening of the market as an alternative to the state. It sought to nurture the business sector through economic incentives, but also tax concessions and other state benefits, undermining trade unions, allowing private interest groups to work within government ministries, shrinking the social safety net, etc.

Second, institutional changes: Quasi-Nongovernmental Organizations (QUANGOs) and independent organizations were established to perform the functions of the state. Israel also has public-interest companies, with ministries and local authorities even setting up their own not-for-profits. Third, government ministries contract out many services to business organizations and not-for-profits, such as the chronic health care that the state must provide by law (Galnoor Report 2003).

### *The Civil Service*

The process of “reshaping the state” was also expressed in structural changes of the civil service: fewer posts, reduced geographic coverage, and an effort to introduce “business practices” and “employment flexibility” in government ministries (Galnoor and Oser 2015). Accordingly, the functions of the civil service are in transition, with independent public and private entities and agencies performing what used to be civil service tasks. Other functions have been “privatized,” “marketed,” or “outsourced,” notably in infrastructure development, but also in licensing, computer services, or even recruitment to the civil service itself.

The blow to the authority and prestige of the civil service—an effort to “reduce bureaucracy” and save money—undermined its foundations: loyalty, honesty, integrity, impartiality, and objectivity. Moreover, there is no evidence that the privatization of public bodies has enhanced ethical conduct. Indeed, some would say the opposite—that corruption increased because hybrid institutions were created with ambiguous codes of ethics and accountability.

As boundaries between the governmental–public, business–private, and civil society–nonprofit sectors have shifted, there is greater need to clarify the responsibility for policy-making and implementation in contemporary democracies. Extensive privatization may be beneficial in the short term, but can also create problems for the long-term capacity of the civil service or local authorities to design policy. It could hinder the development of internal policy-making mechanisms, and is therefore likely to leave the public sector lacking in terms of the skills, experience, and the capacity to carry out this work on its own. Attention should be focused on cases where the state evades its responsibility for merit public goods under the pretense of being merely assisted by others or by experts, while retaining the final say for the outcomes. Furthermore, states that do not perform inherently governmental functions cannot regulate them well, simply because the public interest is gradually removed from the policy-making equation.

Another outcome has been the growth of a powerful third sector that has appropriated many areas traditionally considered the responsibility of the state, either willingly or out of necessity. In many countries, the result has been that government ministries and local authorities virtually ceased functioning in certain areas, while private and voluntary organizations operate in their stead. The broader context is society’s transitions from one based on a civil orientation that places heavy obligations on the state to one based on a consumer orientation that perceives its citizens as “clients”. This has resulted in increased regulation to ensure that privatization produces real competition and better, cheaper services. The ability of the state to regulate lagged behind the increased power and expertise of the bodies in charge of privatized and contracted out goods and services. This, in turn, has caused a counter-attempt to reduce regulation under the banner of de-bureaucratization.

If outsourcing involves the transfer of policy-making out of the civil service, one must consider the potential injury to the public and particularly to members of social and economically marginalized communities.

The process, which began at the end of the previous century, is deepening in some countries, though it slowed and even came to a halt in others following the 2008 global economic crisis and the 2011 social protest movement that took place in many countries.

One way or another, the public sector has experienced structural change and, as noted, has undermined its own foundations with no substitution to preserve administrative rules, conduct, and accountability. Since transparency declined in the services provided privately, the public continues, justifiably, to view the state or the local authority as responsible, while they have not been successful at overseeing the private entities. The blurring of boundaries therefore raises questions pertaining to the heart of democracy. In this new era, when the nature of the roles of government is changing, new technology is revolutionizing life and risk and complexity of problems is increasing—can the public continue to demand accountability from its elected officials? And can it depend on them to bear the required responsibility?

### *Collaborative Governance*<sup>17</sup>

Clearly, new modes of planning and implementing public policy are needed, and have been contemplated and promoted. One such the idea is “collaborative governance.” The term refers to an action or strategy in which different stakeholders work together to promote a consensus-driven policy process or decision-making on public issues (Ansell 2012; Ansell and Gash 2008; Emerson et al. 2012). Collaborative governance highlights the need to be more responsive to citizens and to re-enforce the trust in democratic processes, and the importance of the interdependence between policy design and implementation (Booher 2004; Keast and Mandell 2014; Vigoda-Gadot 2004; Williams 2012).

Obviously, collaborative governance raises new problems: Who will be responsible to the public for the outcomes of these new structures and processes? What will be the new definition of accountability? What would happen to the institution of the civil service? Is it possible to develop **democratic** collaborative governance?

\* \* \*

Privatization is a movement away from full state control toward other patterns of accountability and control, the opposite pole being one in which the individual product is entirely in the hands of the private

market. A shift from nationalization to total privatization is relatively rare; thus in Israel, the process is usually gradual—from the responsibility of a government ministry to a government corporation, or from a government corporation to an NGO with varying degrees of regulation. In Israel, as we indicated above, the attempt to leap from one pole of complete state monopoly to the other (establish private for-profit prisons) reflected a market ideology rather than an economic-social policy.

### PRIVATIZATION IN ISRAEL

The state sector in Israel, which—together with the Histadrut and the national institutions—had controlled some 70% of the GDP in the 1960s, gradually shrank to about 43% because of changes in the Israeli economy and society, as well as external ideological influences. The turning point came in 1985, with the implementation of a major economic reform after which a privatization policy was launched.

The social protest movement of 2011 demonstrated the desire for change in Israeli society and a different perception among the public, particularly young people, about the role of the state. Within a short time, citizens from diverse groups joined the mass demonstrations held throughout Israel, demanding relief from the high cost of living with its heavy burden on middle- and lower-income strata; investment in public housing, education, health, and welfare services; and reduced indirect, regressive taxes. There was also a general demand to return to the welfare state and introduce policies promoting social solidarity, and to put an end to privatization and outsourcing.<sup>18</sup>

In response to the mass demonstrations, the government appointed a committee for socioeconomic change (the Trajtenberg Committee). The committee formulated a series of recommendations, including expansion of the social services budget, reducing military allocations, enhancing progressive tax laws, expanding the supply of housing, and a review of the privatization policy (Trajtenberg Report 2011). Although the government approved this report in October 2011, only a minuscule number of recommendations were implemented, and even those were completely ignored by the governments formed after the 2013 and 2015 elections.<sup>19</sup>

The protest movement had few immediate achievements, but it transformed the Israeli public's perception of the state responsibility to its citizens and the limits of privatization. The protest reflected opposition not

just to the economic policies, but also to the imported and unbridled neoliberal agenda that had long dominated the Israeli scene. The public protest also expressed a desire for state involvement in society and the economy, revival of welfare services, and displeasure with assigning state functions to the business sector because it was supposedly more efficient and not corrupt. The privatization policy carried out by Israeli governments was a clear target, evoking sweeping opposition that crossed political and party lines. Some leaders of the protest were elected to the Knesset, strengthening the social agenda in Israel's parliament.

\* \* \*

Privatization is not just an economic issue, but also closely related to questions about the desired relationship between the state and its citizens—both on the level of overall policy as well as the specific benefits of privatization in particular fields. The starting point for deliberating this question should not be the absolute pros and cons of privatization, but establishing that the burden of proof falls on those who wish to shift the boundaries between the public and the private.

## NOTES

1. See glossary in Chapter 1 about the ideological component of privatization.
2. On the general subject, see Musgrave (1998, particularly Chapter 1); Buchanan (1965).
3. Mariana Mazzucato calls it the “public knowledge economy” (Mazzucato 2013).
4. Israel is an interesting case: Telecommunication was initially state-owned and centralized. The first stage was liberalization in the 1990s, which introduced competition. The second stage was the privatization of the state-owned corporation Bezeq in 2004 and it was not important as far as competition is concerned.
5. See an eye-opening comparison between Kodak and Apple (Irwin 2017).
6. On subsequent, less positive developments, regarding the Health Law, see Filk, this volume.
7. Privatization of public housing is positive on condition that sale of the apartments to the tenants does not put an end to the entire policy of public housing. Some would argue that the right to shelter does not necessarily entail the property right of home ownership, but in my opinion, this should be left to the decision of the tenants.



8. There are different ways to establish Public–Private Partnership (PPP). For instance, in Build–Operate–Transfer (BOT), a private company builds the road, operates it as a toll system, and returns the concession to the state after an agreed period.
9. It depends often on the ability of such civil society organizations to perform their tasks independently of the government (see Shiffer, this volume).
10. At that time, the average area per inmate in a public Israeli prison was 3.4 sq.m., while ALA’s private prison planned to provide 5.28 sq.m. per inmate.
11. HCJ 2605/05 *Academic Center for Law and Business v Minister of Finance* (2009), available in English: [https://www.privateci.org/private\\_pics/Israel\\_Ruling.pdf](https://www.privateci.org/private_pics/Israel_Ruling.pdf).
12. There is no proof that federal private prisons in the United States are more cost-effective in the long run, when precise calculations of the regulation costs are included, given that they tend to be also more violent (Pratt and Maahs 1999).
13. In England up to the twentieth century, the hangman of executed prisoners was a private contractor, compensated on a per-neck basis (Feely 2013, 1413). As the title of the article suggests, the author argues that the state monopoly theory against privatization (not only of prisons) is flawed.
14. His other arguments about the “success” of private prisons in Australia or the examples of other forms of delegated correctional responsibilities of the state are not very convincing (*ibid.*, 1429–1434).
15. My thanks to Amir Paz-Fuchs for his help with this section.
16. Musolf and Seidman (1980) observed rather early that the shrinking power of the state-led governments to transfer responsibility for the performance of certain functions to outside quasi-governmental or quasi-private organizations (Musolf and Seidman 1980, 124–130).
17. Based on the deliberations in the workshop of a research group headed by Dr. Neta Sher-Hadar and Dr. Lihi Lahat at the Van Leer Institute, Jerusalem, 2015–2017. The outcome of this research will be published in a book: *Collaborative Governance—Theory and Lessons from Israel*, The Van Leer Institute (Hebrew) in 2019.
18. One of the popular slogans in the demonstrations was: “The response to privatization is revolution.”
19. The protest movement had an “experts committee” of its own, which proposed comprehensive and far-reaching solutions for social and economic issues, including specific recommendations regarding privatization and the need to regulate it by legislation (Yonah and Spivak 2012).

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PART I

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# Privatization of Public Assets



## CHAPTER 3

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# Privatization and Nationalization of Space in Israel: Are They Complementary Processes?

*Erez Tzfadia and Haim Yacobi*

### PREFACE

Privatization, conventionally thought of as part of “liberalization,” is perceived as a process engendering economic efficiency, freedom and blindness to ethnic, gender, religious or national differences. We challenge this idea and argue that, at least in the context of privatization of space, privatization is both based on and reproduces an ethno-national logic. This is particularly true in colonial and postcolonial contexts in which nation-building policies aim at reinforcing territorial control. Spatial rights in these contexts are conferred subject to ethno-nationalist criteria. We will base our argument on several cases of privatization of Israeli space.

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Our discussion is built on fundamentals of social and political thought concerning the relationship between privatization, capitalism, liberalism, and nationalism. It is commonly thought that capitalism and liberalism go hand in hand. Liberalism supposedly lends capitalism moral justification for defending property rights. Capitalism, for its part, gives liberalism the key element needed for applying itself to the economic sphere: economic freedom that is blind to gender, ethnic, religious, or national differences. The capitalist free market boasts not only an invisible hand but also a blind eye—an indispensable means to realizing the liberal idea that all humans are born equal (see the canonical writings on the subject by Hayek 1944 and Friedman 1963; and criticism by Harvey 2005). When based on such blindness to differences, privatization, or “the transfer of tasks to private organizations and increasing the share of citizens’ private outlay in financing social services” (see Galnoor, this volume), promotes economic development and efficiency and reinforces freedom.

Blindness to differences, of course, goes against the very heart of nationalism, which privileges people based on their ethnic belonging (*jus sanguinis*) or birthplace (*jus soli*). Such privileges might, in some nationalist traditions (e.g., the republican), undermine capitalism’s color-blindness, introducing in its stead a national logic of capital flow, bestowing or withholding property rights based on ethnicity or on a level of engagement in the national project. This subversion of the blindness to differences is particularly prominent under conditions of nation-building in settler-colonial societies. Nationalism in such societies seeks to impose its own dominance and to dispossess other groups of their spaces and to deny them equal rights.

The relationship between colonialism, nationalism, capitalism, and privatization remains unexplored in political and social thought. This is the very relationship on which we would like to shed light as an underlying basis of the privatization of space in Israel. Toward this end, we examine various cases in which lands, development rights and other spatial goods under state ownership, management, and financial care were transferred to the hands of private or nongovernmental sectors. These cases will demonstrate that the privatization of space serves the ethno-national logic of territorial and demographic control. This logic allocates spatial rights to, or withholds them from, various groups according to whether their engagement with society is deemed compatible or incompatible with national interests. That is to say, privatization is not

necessarily encapsulated in ideas of liberty, fairness or economic efficiency but, rather, can also reflect the ethno-national logic of territorial control.

The cases discussed highlight the values, political considerations, and practical consequences underlying the privatization of space in Israel. We focus on nationalization and selective privatization of spatial rights in the first two decades of Israeli independence; on land and planning reforms during the first two decades of the twenty-first century; and conclude with several remarks regarding the privatization of space.

But first, a clarification of our definition for *privatization of space* is in order, as is a short background review of spatial policy in Israel.

### WHAT DOES *PRIVATIZATION OF SPACE* MEAN?

When discussing privatization and nationalization in general, we are asking who is entitled to the specified property, goods, and services and what does this entitlement include? In the legal systems of most countries, the ultimate true “owner” of all land is the sovereign—either directly or via local government entities. The sovereign may grant, through legislation, spatial rights to individuals, businesses, or third sector organizations. Such bestowment is called “privatization of space.”

There are two kinds of spatial rights: planning rights and property rights. Planning rights concern the regulation of land use (“zoning”) and development timing, as well as the allocation of betterment profits. Property rights denote the rights to convey, devise, gift, or mortgage spatial rights (including planning rights) by the owner (Alterman 1999). Ownership—be it private or public—is defined as the aggregate of all those rights. Such aggregates are called *fee simple* or *fee simple absolute*, representing the highest ownership interest possible that can be had in real property. A privatized space is one where aggregates of such rights, relating both to property and to planning, reside in the hands of private individuals, businesses, or NGOs. In contrast, in a nationalized space, the sovereign holds a broad aggregate of property and planning rights, allocating only a small part of them to its citizens, primarily by way of leasehold. Private individuals usually acquire aggregates that comprise a portion of those rights, with the sovereign retaining the rest. Managing the spatial rights partnership between the individual and the sovereign is a central component of spatial policy.

Privatizing or nationalizing space is not only a pragmatic move but also an ideological decision. After World War II, spatial policy (reflected,

*inter alia*, in privatization and nationalization) was considered an integral part of modern, rational, professional thought and, therefore, a “scientific” means of promoting development, spatial order, efficiency and social justice—ostensibly without any ideological or political “baggage” (Faludi 1973). In reality, however, privatization and nationalization are far removed from ideological neutrality. The significance of space for nations, economies, societies, and the environment charges it with a multiplicity of competing values.

So, for example, if a nation feels that its exclusive spatial rights are challenged by a minority group, it might stress nationalistic-territorial values and design its spatial policy accordingly by nationalizing property and planning rights and selectively allocating parts of those rights to the majority. At the same time, it might also restrict the spatial rights of a minority group by restraining its property rights, curb its potential territorial expansion, place environmental hazards in its vicinity, and avoid constructing any economic infrastructure in its towns. Then again, societies favoring multicultural values and acknowledging minority groups living in their midst may tend to partially privatize spatial rights and even bridge inequalities by way of affirmative action (McCann 2002; Young 2000). According to traditional analysis, a dominance of neoliberal values leads to broad privatization of space, for then space is treated simply as real estate whose monetization carries economic benefits, albeit sometimes at the cost of such societal values as justice and equality (Deininger 2003) or at the expense of the environment (e.g., Lerman et al. 2004).

### PRIVATIZATION AND NATIONALIZATION OF SPACE IN ISRAEL

Privatization and nationalization of space in Israel is based on the legislation and planning set during the Ottoman rule and British Mandate of Palestine. The Ottoman Land Law of 1858, which applied to the entire Empire, held that all land was owned by the sovereign, i.e., the sultan. Property and development rights were given to individuals, communities or as mortmain property based on location and land use intention. An urban plot, for example, might be deemed private, with its owner holding a relatively broad aggregate of property and development rights. Location also determined the type of the planning rights bestowed: Lands at the outskirts of towns were used for agriculture, including for planting trees. Limited rights in nonarable, rocky lands were given to private individuals to promote development (Kedar 2001).



The British did not make fundamental changes to the applicable land laws, since the Ottoman Land Law had given many spatial rights to the central government, and the British Mandate turned them into a means of controlling population and space. The Mandatory regime bolstered its control over space in Palestine in three additional ways: it conducted a cadastral survey of land ownership (a survey that ended in 1936, following a Palestinian revolt [Gavish 2005]); it nationalized development rights, detaching them from property rights: through the 1921 and the 1936 Town Planning Ordinances, the British denied urban land owners the right to build freely and subjected them to planning laws; it also denied private individuals and business corporations the prospect of acquiring limited rights in rocky lands by cultivating them—contrary to the previous Ottoman law.

In 1948, when Israel was established, the map of ownerships was as follows: The total area inside the 1949 armistice borders (Israel's official borders) was 21,800 km<sup>2</sup>. Of those, 1000 km<sup>2</sup> were owned by the Jewish National Fund (JNF), the Zionist organization in charge of purchasing land in Israel, with a further 500 km<sup>2</sup> under private Jewish ownership. Some 6500 km<sup>2</sup> were privately owned by Palestinians. Another 1000 km<sup>2</sup> belonged to Mandatory authorities, comprising mainly army bases and infrastructure. About 12,000 km<sup>2</sup> of nonarable rocky terrain were under state ownership, of which 2000 km<sup>2</sup> were used irregularly by Palestinians. The status of the remaining land—some 1000 km<sup>2</sup>—is unclear (Granot 1952; Kedar and Yiftachel 2006). This state of affairs forms the basis for our discussion of the cases presented below.

### *Case No. 1: Selective Nationalization and Privatization, 1948–1965*

The 1948 Arab–Israeli War sharply altered Israel's geography. First, 416 Palestinian towns and villages were abandoned and their former inhabitants—some 750,000 Palestinian refugees—were not allowed to return (Morris 1987). Abandoned Palestinian property was then nationalized, including some 6500 km<sup>2</sup> of land (Kedar 2001). Second, around 800,000 Jewish immigrants and refugees settled in Israel, of which 55% came from North African and Middle Eastern Arab countries (Lissak 2003). Third, the newly founded state became the owner of more than 90% of the land (Kedar 2001) and established a centralist government that wielded powerful systems for planning and managing land use,

rooted in a nationalist-Zionist ideology (Efrat 2004) that promoted the nationalization of property and planning rights.

Abandoned Palestinian property was used for compensating Jewish war refugees and immigrants. Initially, Jews were settled in the city houses of Palestinian refugees (Morris 1987) and, subsequently, in 368 villages built on abandoned lands previously cultivated by Palestinians (Golan 2005). This was done for a number of reasons: to create demographic realities on lands that were meant to form part of the independent Palestinian state under the UN's 1947 Partition Plan for Palestine; to increase the Jewish population in areas where there was still a Palestinian majority; to provide housing and employment opportunities for new Jewish immigrants; and to preclude the return of Palestinian refugees (Efrat 2004). These aims all allude to the social context of that spatial policy that made it possible to nationalize the rights of "enemy" populations and to bestow limited property and spatial rights on disadvantaged Jewish communities (provided that they aid, either wittingly or unwittingly, the realization of the nationalist-territorial vision of Jewish control over the land).

We view this policy as *selective privatization*, that is, allocation of limited spatial rights to specific populations. Selective privatization stratifies society according to each group's relative spatial rights. At the same time, space becomes a reflection of the *relative* positions of different groups in the social hierarchy. This structure is not based on a dichotomy between members of the dominant nation and its "enemies" but, rather, on a complex hierarchy *within* the dominant nation—a hierarchy determined by stigmas of ethnicity, political status, level of national commitment, etc. Within this complex structure, space can also serve to disadvantage populations, such as newly arrived, Jewish immigrants, provided that they take part in strengthening the state's and the nation's control over that space. It seems that over the years, selective privatization has served, and still serves, as a central element of spatial policy in Israel, influencing ethno-class stratification.

The expropriation of Palestinian lands and the settlement of Jews on abandoned Palestinian real estate encouraged Israeli authorities to legalize the transfer of Palestinian property to the hands of the State. This was done by passing the Absentees' Property Law 1950, which expropriated all land whose owners resided in enemy territory during the War or subsequently fled from their lands to other parts of Israel—that is, mainly

Palestinian refugees. Later, the Land Acquisition Law (Validation of Acts and Compensation) 1953 retroactively authorized the expropriation of 1200 km<sup>2</sup> from Palestinians, who had become Israeli citizens, for the purposes of Jewish settlement and national security (Kedar 2001; Cohen 2002; Forman 2002). Of those, some 1000 km<sup>2</sup> were sold to the JNF. These legislations were employed by a legal system that gave its own interpretation to the Ottoman Land Law 1858, transferring ownership of 12,000 km<sup>2</sup> of rocky terrain (some of which had been previously used by Negev Bedouins) to the state.

These expropriations, together with the “inheritance” of Mandatory lands, made the State of Israel the owner of some 14,500 km<sup>2</sup> of land. The JNF came to own about 2500 km<sup>2</sup>, and a further 2500 km<sup>2</sup> were held by the Development Authority—entrusted to manage the property of Palestinian refugees. All in all, these lands amounted to about 93% of Israel’s territory. The rest of the land, approximately 1500 km<sup>2</sup>, remained in equal parts in the hands of Palestinian and Jewish Israeli citizens. We emphasize that this is a case of selective privatization, not because of the transfer of power and resources to the JNF, but because of the ethnic and territorial logics of allocating property rights to some Jewish communities and not to others. The JNF was a vehicle toward this end, because it allocated lands only to Jews, without being committed to equity in law, as state institutions were.

In 1960, the Israel Land Administration (ILA) was founded, and was charged with managing lands owned by the state, by the JNF and by the Development Authority. Israel’s Basic Law: Israel Lands 1960 prohibited the sale of public lands and only allowed their lease. The ILA was subjected to the Israel Land Council (ILC), a public authority, half controlled by the JNF, that directs the policy of the ILA. This system subjected most of Israel’s land to the national interest, as determined by the Zionist institutions, precluding any popular intervention, through democratic processes, in Israel’s land policy. In effect, then, the management of Israel’s lands was removed entirely from the hands of the elected legislature and became a matter of national, rather than civic, interest. The ILC’s decisions created a system whereby the allocation of limited property rights is determined by weighing nationality, ethnicity, and various other nationalist considerations, such as the Judaization of space, increasing the Jewish population in the periphery, and foiling the development of 1948 Palestinian

space (Kedar and Yiftachel 2006; Tzfadia and Yacobi 2011). This kind of allocation according to national and territorial logic is what we term “selective privatization,” which was part and parcel of a wider national perspective that viewed the selective privatization of rights as empowering state control of space.

Israel’s planning policy was aligned with and laid the foundation for selective privatization of property rights. During and after the 1948 War, the Israel Defense Forces and the institutions of the Zionist movement established 368 rural, peripheral settlements (Tzfadia 2010). From the beginning of the 1950s onward, Outline Plans, the best known of which was the one devised by Arie Sharon (not to be confused with, and no relation to, former Prime Minister Ariel Sharon!), were initiated. The Sharon plan sought to continue settling Jews in the periphery by founding frontier towns, which were also expected to provide sufficient housing for massive Jewish immigration (Efrat 2004).

Realizing the plan required building some half a million housing units, three-quarters of which were not merely state-planned but actually almost entirely constructed by the government and its branches (Carmon 2001). Some housing units, especially in highly sought-after areas in central Israel, were marketed to *vatikim* (native-born Israelis or veteran immigrants) in tracks that led to private home ownership. Newer Jewish immigrants, particularly those from Islamic countries, were directed to public housing programs, especially in the newer towns in Israel’s periphery, where ownership of home and land remained in the hands of the state. That is, right from the start, different patterns of spatial right allocation were formed to house Jews—according to ethnicity. These allocations helped shape the future ethno-class hierarchy of Israel (Yiftachel 2006; Tzfadia and Yacobi 2011).

This case paints a complex picture of Israel’s spatial policy in the first two decades of its independence. On the one hand, spatial policy was based on large-scale nationalization of lands and planning rights. On the other hand, allocating spatial rights to different groups marked a course of selective privatization, that is, an unequal allocation of partial spatial rights based on each group’s affinity to the mainstream and its level of commitment to the national effort of gaining Jewish control over the land. In other words, while the transfer of partial rights could be described in terms of privatization, its main purpose was, in fact, to reinforce the exclusive control of Jews over the territory.

*Case No. 2: Land Reform (2009 and Onward)*

With neoliberalism taking root in Israel, the last three decades were marked by accelerated privatization (Ram 2013). But where property rights in land were concerned, privatization proceeded in a selective manner, in keeping with nationalist-territorial aims. Communal, suburban settlements built strictly for Jews sprang up in the Galilee and the Negev, regions of Israel where most of the 1948 Palestinian population lives. But, simultaneously, the nationalization of 1948 Palestinian-owned lands slowed down considerably, even stalling after the mass protests of the 1948 Palestinian population against land expropriation in 1976, known as Land Day. Yet the policy of not allocating public land for Palestinian use continued uninterrupted. The fervor of expropriating Palestinian land, allocating it for the use of Jewish and creating a settlement system was transferred to the territories that Israel has occupied since 1967 (Weizman 2007).

The 1990s saw deeper changes in the privatization of planning and development rights. Among them, Jewish farmers leasing land from the ILA received ILC permits to change their land's zoning from farming to commercial and residential, and thus to benefit from the rise in their value. The ILC and the farmers thought this would enable farmers to pay their debts to Israeli banks, incurred during the agricultural sector economic crisis of the 1980s. The ILC further believed that this would encourage accelerated building of homes, as a means to deal with the Jewish immigration wave from the former Soviet Union (FSU). This privatization was meant, then, to aid economic development.

But Ehud Olmert, then chairman of the ILC and later Prime Minister of Israel, gave a different reasoning for this privatization, linking it to ethno-national interests (quoted in Bashan 2003):

These people, without whom Israel would not be what it has become, deserve this... I remember well who they are... the best people... the spearhead of the Jewish People... They are among Israel's great strengths, and we are all morally indebted to them... So what can we give that generation of pioneers, of warriors, who broke the earth with their bare hands and set facts on the ground, drawing the circle that made Israel possible?... in my opinion [they] should receive certain benefits.

These special benefits stirred public outrage, manifested in various objections and demands: the Jewish farming sector called to increase

the benefits; the urban sector warned against the outflow of businesses from cities to rural settlements following the new zonings; organizations for social change urged the introduction of distributive justice in Israeli lands; the 1948 Palestinian population demanded an equitable reallocation of public land; the business sector called to free up land for housing development; environmental organizations championed stopping the expansion of building and the suburbanization of open areas; organizations for social change advocated shutting admission committees in new neighborhoods that were built on the ex-farm land; banks pressed for farmers to pay back their loans by increasing their rights on the land; and public housing tenants appealed to increase their own rights in their urban homes.

In response to this outcry, in 2004, the Israeli government set up a public committee tasked with making recommendations for an ILA reform (Gadish 2005). The Gadish Committee's main recommendation was to register urban lands leased for housing as private property, that is, to privatize all property rights in urban areas to their leaseholders. At the same time, the committee suggested to impose further regulation of planning rights. In other words, the committee sought to privatize property rights and to nationalize planning rights.

Another important recommendation focused on JNF lands and on JNF representation within the ILC. The committee was of the opinion that the ethno-national logic had become "injurious to the general public, holding back development and growth" (Gadish 2005, 36). It should be noted that most JNF lands are in high-demand areas, and that their usage in promoting the Judaization of space is marginal these days. Therefore, the fact that JNF refuses to lease its lands to non-Jews has been perceived as an unnecessary challenge: JNF does not Judaize frontier regions (because it does not have undeveloped land there) and does not contribute to Israel's egalitarian facade. This, we argue, is exactly what enabled the committee to criticize the over-representation of the JNF in the ILC, and to suggest reducing it to one-sixth of the total, matching JNF's relative share of ownership in Israeli lands. The committee also called for the transfer of ownership of undeveloped JNF lands to the state in return for full monetary reimbursement. This was the committee's way of stopping discrimination against the 1948 Palestinian population, a consequence of JNF's refusal to lease its lands to non-Jews. Note, however, that the committee did not suggest compensating

1948 Palestinians whose lands were expropriated and transferred to the JNF.

The Gadish Committee's recommendations were approved by the government in June 2005 and served as a partial basis for the land reform proposed in 2009. The reform did, in fact, include the transfer of ownership in urban residential property to the hands of leaseholders. And yet, contrary to the Gadish Committee's recommendations, the government also attempted to privatize undeveloped lands. But this attempt was blocked by the Israeli Parliament (the *Knesset*), partly due to pressures exerted by civic society organizations. The larger reform was legislated by way of the Israel Lands Administration Law (Amendment no. 7) 2009, which permitted the transfer of ownership in developed urban lands to leaseholders. Previously, apartments could have been privately owned, but the land on which they were built was leased from the ILA. The same principle was applied, to a more limited extent, to industrial lands. This was not a revolutionary change in terms of privatization. Apartment owners in Israeli cities had already enjoyed rights on the lands they leased: the right of possession, the right to transfer and sell, to mortgage, and to bestow enjoyment rights.

Due to JNF objections, the reform left out some of the Gadish Committee's recommendations. The status of JNF lands—unleasable to non-Jews and managed by the ILA—was not amended. A compromise proposal to exchange developed residential JNF lands with public lands in Israel's Negev region was rejected by the JNF. But the ratio of JNF representatives in the ILC was indeed reduced to two out of ten—whereas, in the past, ten of the 22 ILC members were JNF representatives.

The importance of the Gadish Committee and subsequent reform was more in the discourse they spurred than in any practical change they made. As a consequence of the public debate, the government and the Knesset started challenging, to some extent, the logic that had served so long as a basis for nationalizing Israeli land and started exploring the idea of subjecting land management to an economic logic. But the attempt to enact the Gadish Committee's recommendations on issues that challenged the logic of nationalization failed due to resistance from nationalist organizations, and as a result of the JNF's refusal to implement reform on its own lands. So national-territorial values remained dominant, albeit in a slightly weakened form.

The land reform was presented as having moral significance and as promoting free market development by way of privatization and simplification of bureaucracy. But a counter-argument, put forward by Palestinian activists, purported that the reform largely preserved the achievements of nationalization: ownership of public lands (most of which, it should be remembered, were expropriated from Palestinian absentees or simply designated for public use) and ILA lands (previously owned by Palestinian absentees) was transferred only in the case of urban leaseholders, most of whom were middle- and upper-class Jews. The reform thus created a new model of privatization of land rights, one that continued to uphold nationalist-territorial values (for more on this issue, see Tzfadia and Yacobi 2011).

Regardless of this criticism, the 1948 Palestinian public showed ambivalence toward the reform. On the one hand, they supported the claim that Jews were merely arguing among themselves on whether the lands they had once taken from Palestinians should now remain under public ownership and management that benefits Jews, or whether it should be given to Jewish landowners. On the other hand, they supported the reform and refused to join the socially motivated struggle against it, claiming that a privatized land market may still be less discriminatory than a system of nationalized land (Jabareen 2009). Both arguments were made within the context that most urban properties in 1948 Palestinian population centers were privately owned anyway, the remaining Palestinian lands that were not nationalized—for the ILA seldom allocated public lands to 1948 Palestinians and their towns.

A final note is that the realization of the reform encountered some organizational difficulty, as well as resistance by ILA's labor union (State Comptroller of Israel 2014), which was concerned that the privatization of urban land might lead to mass dismissals. We regard this resistance not only as a technical or organizational matter but as one that should also be viewed in the context of the resistance to challenges to the ethno-national logic.

### *Case No. 3: Planning Reform (1990s and Onward)*

Israel's planning system is built hierarchically—from the national through the district down to the local level, with each level making its own outline plans, subject to those devised higher up in the hierarchy. National outline plans (NOPs), made by the National Planning and



Construction Committee, are authorized directly by the government (Alfasi 2006). Under this framework, the national committee can make detailed outline plans, which do not leave much room for local initiative; or it can make more general plans and leave the specifics to local planning bodies, which consult with contractors and property owners. The first approach should be considered a nationalization of planning rights, in which case the national committee decides on the exact nature of development for every land unit; while an approach of the second variety would be considered privatization of planning rights, because it leaves most of the decision making regarding development to local negotiations between contractors, property owners, and local planners.

We link privatization and decentralization because both practices (a) are encapsulated in the similar agenda of “new public management“ and (b) are essential for entrepreneurial urban governance and public–private partnership (Harvey 1989), which obviously leads to privatization (Savas and Savas 2000). As we shall see, this idea was at the core of planning reform in Israel, in which selective decentralization resulted in more private–public cooperation and entrepreneurship on the local level, which stemmed from more involvement of private initiators in local planning. This movement of the border between the public and the private should be considered as privatization.

In this sense, Sharon’s outline plan (1951) represented a nationalization of space, for it specified local details even at the building planning level (Efrat 2004), and left no room for local authorities nor the private sector in the planning process. This approach, however, changed in the 1990s as a consequence of the national planning system having to deal with the great immigration wave from the FSU (Alterman 2002). NOPs 31 (1993) and 35 (2005) marked a fundamental shift with respect to the role of the state in the planning process. Both plans were based on similar conceptions of Israel: as a cluster of four metropolitan areas that boasts a developed economy that leans on the different specialties of each its metropolitans; as a country marching toward an era of peace, where the significance of security and ethno-national considerations diminishes in favor of economic and environmental considerations; and as a society that wishes to promote private and local initiatives in the development of space (Shachar 1998). Despite certain differences in their practical approach, NOPs 31 and 35 both gave a wider role—and, thus, more comprehensive planning rights—to entrepreneurs cooperating with local authorities.

The new approach ignited a planning reform that spans across two decades. In 1995, two years after NOP 31 was ratified, the Knesset passed Amendment 43 to the Planning and Building Law. In a petition against the amendment, Israel's High Court of Justice laid out the amendment's principal aim:

“[T]he emptying of powers from vessel to vessel, that is: the transfer of various powers from district [planning] committees to local ones... the purpose being: to shorten planning procedures and improve their efficiency... to give independent powers to local committees, to approve local outline plans and even detailed plans on certain issues without needing the (previously required) consent of district committees.” (HCJ 5145/00 *Local Planning and Building Commission for Hof HaSharon vs. The Ministry of Interior et al.*)

But this broadening of powers of local planning committees, which usually are subject to local authorities, was made possible primarily in “strong,” necessarily Jewish, municipalities—as they had both the required land reserves available for development and the resources needed to promote independent planning initiatives. Amendment 43 provided these particular local authorities with two important budgetary levers: First, the potential for increased municipal taxes, inherent in the power to make local zoning changes. Thus, many local authorities, in cooperation with the private sector, rezoned industrial areas as commercial ones, thereby increasing their municipal taxes. The amendment further allowed municipalities to increase population density, another potentially financially lucrative change. The second budgetary lever was revenue from betterment taxes—a consequence of rising land values due to changed outline plans. The betterment tax, which can amount to one half of the total increase in land value, again goes into the local authority's coffers. So, the broadening of planning powers at the local authority level, combined with the understandable desire to increase revenue, prompted local authorities, in cooperation with private initiators, to approve plans that could raise land value to increase their revenues.

Another issue concerning Amendment 43 was the involvement of local authorities in determining the characteristics of constructed residential units in their jurisdiction. Large apartments and single-family detached homes were—and still are—an important means of attracting populations of a higher socioeconomic status. By preventing the building of smaller and mostly cheaper apartments, many local authorities could

not only dissuade weaker populations from settling in their jurisdiction, but also displace such resident populations out—to less expensive localities (Blank 2002). Displacing poorer populations obviously strengthens the financial position of local authorities, for it makes municipal taxes easier to collect, saves the need to offer discounts or provide welfare services and, last but not least—creates a positive image that serves to attract more businesses and further raise the value of property.

Amendment 43 seemingly reflected the strengthening of economic values in determining spatial policy. Together with decentralization tendencies, they gave rise to an increase in the planning powers of local authorities and the private sector. In this sense, the passing of Amendment 43 represented a crucial development: if, previously, planning policies were grounded in the central government's desire to increase its own control, partly for promoting national-territorial values, the amendment gave extra weight to economic values.

But the strengthening of economic values only highlighted their social inadequacy. While Amendment 43 seemingly allowed every municipality to use its planning powers to strengthen its economic position, in effect it was only wealthier, stronger municipalities that benefitted. Smaller and poorer municipalities, which lacked the means to operate local planning committees and initiate independent plans, could not take advantage of these new levers in order to increase revenues, and could not compete against richer municipalities for stronger populations (Razin and Hazan 2013). In this sense, Amendment 43 initiated “selective decentralization.”

Notwithstanding these social inadequacies, the Knesset passed Amendment 76 of the Planning and Building Law in 2006, which further increased the powers that local planning committees had acquired with Amendment 43, again, enjoyed only by *qualified* local committees. It turned out that no more than seven local authorities (out of 255 in total) could meet the strict criteria put forward by Amendment 76. Those were, invariably, strong Jewish municipalities with adequate resources for reinforcing and professionalizing their planning committees.

With the approval of Amendment 76, the National Committee for Planning and Building started writing a proposal for another amendment (no. 90)—which was termed “a mini-reform” by the High Court of Justice (HCJ 1658/10 *Israel Union for Environmental Defense v Government of Israel*). The main purposes of Amendment 90 were to

enlarge yet again the scope of powers given to local planning committees, to deepen the professional relationship between local, district, and national committees, and to enact the amendment into law rather than leave it at the regulatory level.

The memorandum for Amendment 90 never turned into a legislative bill, and by 2009 government officials were already working on a proposal for a new Planning and Building Law, intended to replace the 1965 law altogether. Then Prime Minister Benjamin Netanyahu explained the motivation for replacing the old law: “The reform... seeks to remove bureaucratic obstacles, to simplify and shorten approval processes, and to increase transparency, in an effort to boost economic growth” (Wrobel 2010).

Eyal Gabbai, then Director-General of the Israeli Prime Minister’s Office, described the desired change as follows:

Local committees will get professional reinforcements and the powers of district committees will be shared, to some extent, with local committees. District committees will not be cancelled, but will focus from now on more general outline plans and on infrastructure. The national committee will be in charge of the larger vision... Dysfunctional [local planning] committees will be dispersed, and potentially replaced with interim ones. So local committees will be given powers and responsibilities, but these powers will be taken away in cases where they cannot handle them. (Avital 2010)

The new Planning and Building Law seems appropriate from the point of view of local authorities: localism holds numerous opportunities for communal empowerment and local democracy. Furthermore, planning closer to home may disregard national-territorial values and endorse environmental and economic ones. It may also encourage residents to consider local planning (an issue that has never received center stage) when voting in elections for local authorities. Under such circumstances, mayors wishing to further their political career would have to take planning considerations into account and provide for local social interests.

Unfortunately, a deeper consideration of the bill leads us to conclude that its supposed decentralization in effect only further empowers the government, specifically the Minister of Interior. Indeed, the bill would offer more planning powers to stronger municipalities—inevitably Jewish and located either in central Israel or where benefits are offered

to Judaize the land, as in the territories occupied since 1967. But the bill grants the Minister of Interior the power to disperse local planning committees that do not qualify for extended powers and to appoint interim committees that are subject to his authority, wielding vast powers of local planning over mayors or local councils. As noted in our discussion of Amendment 76, it is primarily wealthy local authorities that meet the designated criteria and, thus, qualify for receiving the extended planning powers. Furthermore, the bill puts the financial burden of operating the new, professionalized planning system on the local authorities themselves—entrenching further the preexisting inequality between stronger and weaker municipalities. At the end of 2017 only 23 local authorities out of 255 in total could meet these criteria. As we noted, this inequality is inherent in the ethno-national power relations in Israel.

The issue of regional committees is yet another aspect of the bill proposal that attests to the true intentions of its authors. According to the current law, regional committees are in charge of more than a single local authority, and similarly are subject to the Minister of Interior's powers of appointment and dispersal. The relative share of 1948 Palestinian local authorities in regional committees is especially large: 66 out of 73 local authorities are included in regional planning committees, while half of the Jewish local authorities (74 out of 148) operate independent local committees. The new bill gives extensive powers to the Minister of Interior in appointing members to regional committees and in determining the nature of their plans. It, therefore, seems that the government's surveillance over 1948 Palestinian municipalities will not change much in the near future.

The proposal for the new Planning and Building Law was abandoned following a massive protest, and had being reframed as a new amendment to the old planning law (Amendment 102). The opposition to the bill was driven by values shared by some Knesset members, as well as by environmental and non-governmental organizations cooperating for this purpose under the Forum for Responsible Planning. Other protestors were contractor organizations, heads of local authorities, and municipal coalitions. The struggle was waged in animated meetings of the joint committee of the Knesset, in courts, in the press, and in the halls of the government and Knesset. The dust has not settled yet, but this much is clear: The reform, Amendment 102 or a new bill will continue the trend of transferring regional powers—mainly development rights—to local authorities, based on economic logic. But this very logic highlights the

persistent inequality between local authorities, which has its roots in the ethno-national logic of territorial control.

## CONCLUSION

In this chapter, we reviewed the changes that have taken place over the years in the interplay between nationalization and privatization of space in Israel, placing the discussion in concrete historical and contemporary contexts. As we have shown, the dynamics of the privatization of space in Israel cannot be understood independently of a colonial political and geographical framework. This framework accounts for the state's control over the supposed "release" of market forces which, in effect, is just another instance of state direction.

However, our argument gives rise to an important question, which we propose as a prism for discussion and conclusion: Why is privatization of space needed at all for promoting the ethno-national interests of territorial control? Would it not be simpler to *nationalize* space for these purposes? We propose three complementary explanations, without exploring them any deeper:

1. Nationalization is commonly identified with the social responsibility of the state toward its citizens. But this is the very obligation that Israeli governments have been shunning for decades—and all the more so when fulfilling this obligation does nothing to advance a national territorial agenda (Tzfadia and Yacobi 2011).
2. Nationalization is incompatible with the global discourse of recent decades that equates privatization, decentralization, and deregulation with efficiency. Nationalization, as well as centralization, might, therefore, be construed as an element of an unfavorable business and investment climate, which would disadvantage a country trying to compete in the global economy (Panitch and Gindin 2012).
3. Even when directed by the logic of ethno-nationalism, privatization creates a semblance of democracy. Nationalization, however, when directed by the very same motives, is akin to admitting that the nationalizing society is nondemocratic. Privatization can serve, therefore, as an effective guise for promoting ethno-nationalist causes that are in conflict with the democratic values of citizenship and equality.

The above question and answers imply that the colonial political and geographical framework is not steady, and changes over time. However, the tendency to portray privatization as opposed to nationalization should be questioned. The three presented case studies are very telling and support our argument concerning the necessity to understand privatization and nationalization as two complementary vectors rather than two opposite apparatuses. Spatial policy in colonial societies is embedded in the logic of ethno-nationalism and territorial control, a logic that is encapsulated in most acts related to privatization of space.

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# Incorporation and Privatization in the Infrastructure Sectors in Israel: Processes and Consequences

*Eyal Tevet*

When you think of infrastructure, you probably think of roads, bridges, and highways—not social justice. But there’s a growing group of city officials, community leaders, activists and academics who are calling on us to transform the way we think about this important issue. Infrastructure is about something bigger than construction: It’s a fundamental issue of equity and opportunity.

—Maya Harris

From the beginning of the 1980s onwards, countries began pursuing structural reforms in such infrastructure sectors as transportation, communications, electricity, energy, water, and sewage. In Italy, for example, reforms were carried out in the communications and natural gas sectors; in France, in energy and communications; in Britain, in communications, electricity, ports, and natural gas; in Canada, in communications and electricity; and in Japan and Germany, in communications. These reforms included restructuring of the sector; changes in the rules governing its

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operations and the actors who participate in it; liberalization of the sector by increasing competition within it; corporatization of companies into a single entity; deregulation of the sector; and privatization.

This chapter contains a review of the developments and changes in government companies in Israel, with particular focus on companies that operate in infrastructure sectors, and whose importance and impact on the economy as a whole is far greater than their financial output. The chapter has three sections: In the first, I present the historical background for the creation of government companies in general, and in Israel in particular; in the second, I describe the characteristics of Israel's infrastructure sectors, and the processes of incorporation and privatization of government companies in these sectors; and in the third section, I describe the results of these processes: concentrated ownership and a lack of competition; commodification of essential services; and a weakening of democracy.

## BACKGROUND

### *Government Companies—Historical Background*

The primary motivation for governments to establish government companies was to ensure a regular, reliable, and cheap supply of essential services to the public, including the creation of infrastructures for economic development and for efficient use of natural resources. To this end, many government companies were set up in sectors in which there is a natural monopoly, based on the premise that a state-run monopoly is preferable to a monopoly controlled by a commercial corporation. Moreover, governments nationalized private companies—mainly following the end of colonial or mandatory rule—to prevent the collapse of essential structures, or for ideological reasons. The evolution of government companies over time can be presented as a six-stage process:

During the **first stage**, a government department would manage the limited and restricted commercial activity in a certain domain. Typical examples of this are the postal services and railways. This arrangement allowed for considerations such as equality, accessibility for the periphery, security, or low cost to the citizen of the service to play a role, as well as for continuous oversight, but it suffered from a lack of flexibility, having only a limited capacity to respond to changes and to meet new needs of the domain's clients (the public).

The **second stage** began with the First World War. The commodification of raw materials caused by the war, and the need to distribute foodstuffs to the population, demanded centralized direction of the economy. Many countries saw fit to set up special bodies for purchasing and distributing materials. It was assumed that these bodies would become unnecessary once the period of emergency passed.

The **third stage** followed the global economic crisis that began in 1929. Many countries became aware that their growing commercial activities were very different in nature from their governing activities, and that special frameworks were needed for the former; these frameworks would have to be able to perform an economic role on the government's behalf in key operational areas, while being free from the restrictive financial regulations that apply to government ministries. An example of this can be found in President Roosevelt's 1933 request to Congress (Roosevelt 1933): "I, therefore, suggest to the Congress legislation to create a Tennessee Valley Authority, a corporation clothed with the power of Government but possessed of the flexibility and initiative of a private enterprise."

The **fourth stage** began with the end of the Second World War, and involved the nationalization of industries (such as coal and steel), energy infrastructures, and the marine, land, and aeronautical transportation sectors. Many countries that gained independence from colonial or mandatory rule nationalized private or foreign companies engaged in mining or the production of raw materials, or even public services that were operated by foreign governments. Many also purchased factories that had developed financial or managerial difficulties but whose continued operation was deemed to be important.

The **fifth stage**, which began (on a large scale and in many countries) at the beginning of the 1980s and has continued to the present day (at varying levels of intensity), has involved the privatization of government companies, including infrastructure companies.

More recently, the **sixth stage** began with the turn of the twenty-first century. Following a period of extensive privatization and the use of traditional regulatory tools, current efforts focus on creating corporative government arrangements to improve company performance under government ownership (see, for example, Aivazian et al. 2005; OECD 2005, 2015).

### *Government Companies in Israel*

In Israel, responsibility for government companies is shared by the Ministry of Finance and the relevant government ministry. Thus, the Ministry of Energy and Water is responsible for the electric and water companies; the Ministry of Transport for the port companies; the Ministry of Communications for the postal company; and so on.

Government companies were established during the early years of the State of Israel, decades before the Government Companies Law was passed in 1975, and the process of founding and privatizing these companies has continued, albeit inconsistently, ever since. There is no clear single reason for the establishment of government companies, and it is difficult to distinguish between ideological motives (Savas 2000), political reasons (Sharkansky 1979), and pragmatic concerns (Friedmann and Garner 1970). For example: Were the reasons for the formation of the *Israel Program for Scientific Translations* (later, Keter Publishing House) pragmatic or ideological? And were there political motivations behind the founding of the *Meir Shefiya Youth Village*? In general, the case for viewing the main motivation for the establishment of government companies in Israel as based in pragmatism seems more persuasive, as they served as a vehicle to ensure the government's involvement in society and the economy (Tevet 2015).

The change in the number of government companies over the years has reflected changing social realities in Israel and the need to respond to different challenges at different times. In the first years following independence, the lack of sufficient nongovernmental sources of capital, the desire to rapidly develop certain economic sectors, settle development areas of the country, absorb immigration, and prevent unemployment, all led to significant growth in the number of government companies, from 39 in 1955 to an all-time high of 270 in 1970. Subsequently, conclusions were drawn from the economic crisis of the 1980s and the government began to withdraw its involvement in the economy, partly by selling off government companies. The number of these dropped sharply, from 208 in 1980 to 161 in 1990, 105 in 2000, 96 in 2010, and back slightly to 100 in 2015. This recent minor rebound does not indicate a new trend, but rather, heightened privatization processes. The reason being that most of the new companies formed were administrative units or statutory authorities that were transformed into government companies in advance of being sold. Examples include the *Israel Postal*

*Company Ltd.* and the *Postal Bank Company Ltd.* that were spawned from the *Israel Postal Authority*.

The list of government companies includes both for-profit companies and noncommercial companies.<sup>1</sup> There are substantial differences between different types of companies in terms of their market share, number of employees, and various economic parameters. This chapter focuses on for-profit companies in the infrastructure sectors.

## INCORPORATION AND PRIVATIZATION IN ISRAEL'S INFRASTRUCTURE SECTORS

Of all the government companies, 13 stands out as having the largest share of the total income (96%) and owning the vast majority of government company assets (97%).<sup>2</sup> Ten of these operate in infrastructure sectors, with the other three being military industry companies. The term “infrastructure sectors” usually comprises: **transportation infrastructure**, including roads, railways (not including engines and carriages), ports, and air transport; **communications infrastructure**, including telecommunications and postal services; **electricity infrastructure**, including generation, transmission, distribution, and supply; **energy infrastructure**, including refineries and prospecting for oil and natural gas; and **water and sewage infrastructure**, including production, provision, distribution, and sewage treatment.

The infrastructure companies provide the necessary conditions for economic growth, and are critical for the functioning of the economy as a whole. David Ashauer (1989) and Alicia Munnell (1990) identified a direct link between investment in infrastructure and economic growth. Economists at the Bank of Israel also emphasize that the infrastructure sectors exert external influence on the economy as a whole, and their importance far outweighs their financial output (Bank of Israel 2009, 86).

The regular supply of infrastructure services is seen as a public service that the government is obliged to provide itself or, at the very least, ensure its provision, for a number of reasons. In the monopolistic sections of the infrastructure sectors, oversight and regulation are required to ensure open access (for example, that multiple electricity producers have access to the electricity transmission network). Similarly, whether infrastructure sectors are under government ownership, shared

ownership, or private ownership, government oversight is necessary to ensure access to shared infrastructures, standards of service, investment in development and maintenance, and compliance with environmental standards.

The establishment of government companies in infrastructure sectors expressed a high level of government involvement in the economy as demanded by the nature of those sectors, their economic characteristics, and the direct link between the quality of infrastructures and economic growth. The privatization processes subsequently carried out brought other forms of government involvement to the economy, whether through selling companies to private bodies, or instituting oversight and regulation following privatization.

### *Models and Patterns of Privatization of Infrastructure Companies in Israel*

There is a range of possibilities for involving the private sector in developing national infrastructures, from outsourcing certain well-defined operational activities to transferring full ownership of certain bodies, or parts of them, with no limitations or oversight. In recent decades, we have seen different types of partnership between the public and private sectors, depending on the legal, political, economic, and technical parameters of the infrastructure sector and on the particular sector involved.

Table 4.1 shows different levels of government involvement in infrastructure sectors (not including regulatory involvement). The first row represents the provision of services by a government office (an authority or administrative unit), as used to be the case with the *Israel Postal Authority*, *the Public Works Department*, *Bezeq*, and *Israel Railways*.

**Table 4.1** Different levels of government involvement in infrastructure sectors

<i>Management structure</i>	<i>Example in Israel</i>
Government office	<i>Bezeq</i> (until 1984), <i>Public Works Department</i> (until 2004), <i>Israel Postal Authority</i> (until 2006)
Government company	<i>Israel Electric Corporation</i> , <i>Mekorot</i> , <i>Ashdod Port Company</i>
Outsourcing	Laying roads, laying railway lines, constructing ports
Concession	<i>Trans-Israel Highway</i> , <i>Eilat Port Company</i> , water desalination
Privatization by licensing	Oil and natural gas prospecting, electricity generation
Privatization	<i>Bezeq</i> , <i>National Oil Company</i> , <i>Pi Gllilot</i>

Subsequent rows represent decreasing levels of government involvement in a particular body or sector, culminating in full transfer to private ownership. For each ownership structure, prominent Israeli examples are provided.

*Incorporation and Privatization of Infrastructure Companies  
in Israel: Analysis by Sector*

Between 1948 and 2000, 16 government companies were founded in infrastructure sectors. Between 2000 and 2015, another 11 were added, mostly due to structural changes in Israel's ports, the electricity market, and the *Mekorot* water company. Full privatization of government infrastructure companies began in 1988, and 14 companies were privatized by 2015, as shown in Table 4.2.

In its early years, the state intervened in the infrastructure sector in two main ways: first, via direct operation of a government ministry, such as the Postal Ministry (later the Ministry of Communications), which was directly responsible for providing telecommunications and postal services; and second, by setting up government companies in certain fields, such as water (1949), electricity (1954), and energy (1959).

Although government involvement in the economy has not declined over the years, the method of involvement has changed, in response to conceptual changes regarding the role of the state in developing and supplying infrastructure services. This shift has meant a change in the organization of governmental activity from government ministry to corporations or government companies. The establishment of a government company or a corporation reflects a transition to a business-oriented form of activity.

**Table 4.2** Number of government companies in infrastructure sectors established and privatized 1949–2015 (*Source* Government Companies Authority annual reports)

<i>Years</i>	<i>Infrastructure companies established</i>	<i>Infrastructure companies privatized</i>
1949–1960	8	–
1961–1985	6	–
1986–2000	3	8
2001–2015	10	6



The main changes carried out in Israel's infrastructure sectors are as follows:

### *Transportation*

The greatest number of government companies is found in the transportation sector. These companies were set up with an "expiry date," that is, they were created with an aim to be sold, a reflection of the government moving away from direct operations and supply toward outsourcing.

In the **ports**, there has so far been one full privatization, that of Eilat Port, and preparatory steps have been taken (structural changes) toward the privatization of the *Ashdod Port Company* and the *Haifa Port Company*, although at the time of writing it is doubtful whether these privatizations will indeed be carried out, in particular following the decision to liberalize this sector by building new docks to be operated by private companies.

In terms of **development**, *Israel Railways* was separated from the Port and Rail Authority and began operating as a government company in 2003. A year later, the *Public Works Department* (roads infrastructure) was transformed from an administrative unit within the Ministry of Transport into a government company.<sup>3</sup> This change was not only one of name but also of function, a transition from a unit directly engaged in planning, implementation, and oversight to a company making large-scale use of outsourcing. In addition, the transportation sector has seen a proliferation of public-private partnerships (PPPs), which began in 1970 with the *Ayalon Highways Company*.

### *Communications*

Initially, communications services were provided by a department of the Ministry of Communications, which formed the basis for the formation of government companies. In **telecommunications**, the government company *Bezeq* was formed in 1980. The privatization of *Bezeq* began in 1989, from which time the government gradually divested its holdings until it was finally sold completely in May 2005. This sale was completed before the sector had been fully regulated, and the company continued to exploit its strength as a monopoly in order to prevent and obstruct competition. Attempts to break up *Bezeq* or to influence its behavior via legislation (most recently in 2015) have failed.

In 2013, the state entered an area which had until then been exclusively the domain of private companies—internet infrastructure. The Ministry of Communications awarded a license for laying a fiber optic network, for the purposes of internet infrastructure and connecting end users, to a company called *Unlimited*. The company is jointly owned by the *Israel Electric Corporation* (40%), itself a government company, and by private investors (60%). Today, the future of the company is unclear, with the pace of creating the network and the number of users both lower than expected.<sup>4</sup>

In **postal services**, governmental activity existed since the time of the British Mandate period. With the establishment of Israel, the powers held by the Postal Director, who reported to the High Commissioner and the Mandate Government, were transferred to the Ministry of Communications. In 1988, the postal department became the *Postal Authority*, an interim stage toward being transformed into a company. As part of a process aimed at opening up the postal market to competition, the *Postal Authority* became a government company in 2006, the *Israel Postal Company*. A year later, in 2007, the quantitative postal market (accounts, publications, and business mail) was opened to competition. The Government Companies Authority has been trying to move forward with plans to sell the *Israel Postal Company* since 2009, but without success—in the past, due to opposition from the Ministry of Communications, and currently, due to opposition from the Ministry of Finance to the privatization model proposed (but not to privatization per se).

The *Israel Postal Company* is now close to insolvency, as a direct result of the manner in which the postal market was opened up to competition. The private companies have focused on the “cream” portion of the market—delivering mail mainly in the large cities, and contracting with large corporations—while the *Israel Postal Company* continues to deliver mail nationally, a service with high costs and low income. Moreover, the Ministry of Communications, which is responsible for the postal company and for regulating the sector as a whole, has shied away from using its authority to force private companies to deliver mail in the periphery and/or help fund universal postal services. As owners, the government has refrained from providing guarantees for the loans taken out by the *Israel Postal Company*, thus increasing its financing costs due to a lack of securities against the loans.

### *Electricity*

The *Israel Electric Corporation* was founded in 1923 as a private company which operated in Mandatory Palestine based on a concession awarded by the High Commissioner. It continued to operate on this basis after Israel gained independence, but the growth in demand for electricity following the great waves of immigration and economic development required a level of investment that the company struggled to provide. Thus, the company was nationalized in 1954, and it has been a government-owned company ever since, charged with generating, transmitting, distributing, and supplying electricity throughout Israel. In 1996, the company's concession expired, and it has operated since under the terms of the Electricity Market Law 1996, according to which the concession was replaced by a vertical cluster of licenses, each for a period of ten years. Since then, four official plans have been prepared for privatizing the company, while a number of other plans were drafted but did not reach fruition. In the meantime, the company continues to operate in all niches of the sector, and the licenses under which it operates are repeatedly renewed.

In tandem with the efforts to restructure the electricity market, the **generation of electricity** was opened to competition.<sup>5</sup> The conditional licenses granted by the Electricity Authority for future private generating facilities indicate that the share of private generation companies is expected to rise to 42% of the total generating capacity within a decade. Changes have also been made to **electricity distribution**, and licenses issued to private distributors. As a first step, licenses were granted to distributors that have already been active in this field, but it is the regulator's intention to expand the number of licensees in the future.<sup>6</sup> Opening distribution to competition was part of the reform program that was formulated in 2014 for the electricity sector and the *Israel Electric Corporation*.<sup>7</sup>

### *Energy*

The energy sector includes **natural gas and oil exploration**, refineries, storage, and supply. Oil and natural gas exploration began in Israel at the beginning of the 1950s, after the Petroleum Law was passed in 1952. Drilling was conducted at different levels of intensity by a number of companies assisted by two government institutions—the Geophysical Institute, and the Geological Institute.<sup>8</sup> Between 1958 and 1963, the

state founded and nationalized five companies that engaged in oil and natural gas exploration. After disappointing results, the state decided to abandon direct involvement in the physical search for hydrocarbons, and between 1993 and 1997 the government companies in this field were privatized. As of 2015, there were more than 80 private companies working in Israel in oil and natural gas exploration. Following the discovery of natural gas fields in Israel, in 2003 the state formed a company to establish and operate a system for delivering natural gas.

In the area of **importing, storing, and selling petroleum products**, the state privatized the companies involved in import and retail in 1988 and 1992, and the petroleum storage company in 2007. As for **refining**, the state sold its refineries in 2006 and 2007.

### *Water*

The *Mekorot* company was founded in 1937, under joint ownership of the Jewish Agency for Israel, the Jewish National Fund, the Nir company which was under the ownership of the *Histadrut* (General Federation of Workers) and the Agricultural Center. In 1949, the company's shares were purchased by the state and it became a government company. Under the terms of the 1959 Water Law, the company (and its daughter companies) were charged with setting up water facilities, and with water pumping, transportation, and distribution.

In 2007, the government decided to disband *Mekorot* and in its stead to create three new government companies that would (1) manage the assets of the "national water carrier"; (2) set up a desalination plant at Ashdod and engage in commercial activities in Israel and abroad; and (3) develop and renew Israel's water facilities. This framework was intended to separate monopolistic activity from competitive activity that can be privatized and to open up the sector to new actors.

The company charged with developing and renewing water facilities was established in 2008, with the aim of privatizing it in 2014 (but it remains a government company at the time of writing). Also, the field of **water production via desalinization** of seawater was opened to competition. While *Mekorot* previously had sole responsibility for producing the vast majority of Israel's water for various uses, by 2016 there were five private desalination plants producing around 50% of the water for private, public, and industrial use.

As we turn to an assessment of the above reforms, we find that they were conducted in manner that reveals a series of systemic failures, including: lack of prior regulation; lack of decision-making regarding the structure of the sector; lack of prior agreement with the government company in question (and its employees) about the implementation of structural changes in the sector; and a lack of government determination together with changes of ministers in the relevant ministries (Tevet 2015), which have delayed privatization and had an adverse effect on the outcomes of the reform, as detailed in the next section.

### CONSEQUENCES OF THE INCORPORATION AND PRIVATIZATION OF ISRAEL'S GOVERNMENT INFRASTRUCTURE COMPANIES

There are methodological barriers to comparing the situation in which government companies were responsible for supplying infrastructure services with the situation today. A series of both exogenic and endogenic changes—such as the cost of raw materials, technological developments, changes in the labor market, and more—make it very difficult to conduct a valid comparison of the two eras. Thus, for example, research studies into reforms in the electricity sector claim that the structure of the market does not explain the price of electricity (O'Mahoney and Eleanor 2013). Studies of the electricity sector in the United Kingdom (where the earliest and most comprehensive reforms in this sector were carried out) from 1998 to 2002—when UK electricity prices fell for several consecutive years—in comparison to countries in which prices rose as a result of reforms, identified several factors involved: the price of natural gas, differences in production efficiency among different forms of production (nuclear, fossil fuels, clean energy), changes in the cost of CO<sub>2</sub> emissions (in Europe), regulatory changes, and an increase in supply relative to demand (Joskow 2008; Bower 2002; London Economics 2012). Support for the claim that there is no clear link between market structure (competitive vs. monopolistic) and electricity prices can be found in the fact that prices in the United Kingdom have risen steadily since 2002.<sup>9</sup>

A cost-benefit analysis of the proposed reform in Israel's electricity market, according to which electricity generation will be privatized while the government's vertical monopoly will be preserved and performance-based regulation introduced, shows that it will lead to increased

profits for private electricity generation companies and increased tax income for the state, but also to a reduction in consumer surplus (Tishler et al. 2006).

Given the difficulty of assessing the impact of institutional changes using economic indicators, and given the influence of special interest groups on the process of formulating reforms (Mizrahi and Tevet 2014), other parameters should be used to evaluate the impact of these changes. Below, I examine their impact using three different parameters: concentration of control and competition; commodification; and impact on democracy.

### *Concentration of Control and Competition*

One of the results of extensive privatization is an increase in the concentration of market control and a low level of competition. This phenomenon is evidenced by the control over public companies of a small group of owners. A historical review of the development of Israel's main business groups reveals that their economic dominance began in the 1960s, largely against the backdrop of growth in the defense industries. The period of inflation during the early 1980s is considered the glory era of the business groups, which expanded their businesses and grew their revenues. The government stabilization program which was aimed to overcome the high inflation rates at the time included extensive privatization, which reduced government ownership in the business sector from 27% in 1985 to around 6% a decade later (Kosenko 2008, 11–13). The privatization of industrial companies and financial institutions, the sale of Histadrut assets, and reforms in the banking and financial sector led to the expansion and strengthening of the veteran business groups and to the formation of new ones (Maman 2008, 141).

These groups have continued to benefit from privatization processes. Thus, in the transport sector, for example, which is largely characterized by PPPs, the franchise holders in most cases are the same groups that grew out of the privatization of government companies in recent decades. These groups also compete with one another for the purchase of companies privatized by the government, and for the establishment of infrastructure for natural gas, electricity, and water.

At the beginning of 2000, for example, the state issued tenders for new water desalination facilities. The privatization of water production

led to the entry of private entrepreneurs into the water sector, and to a concentration of control by two entrepreneurial groups that together formed a single company; this company is now a partner in three of Israel's five desalination plants and is responsible for the production of about 70% of the country's desalinated water.<sup>10</sup> One of these entrepreneurs also owns natural gas, fuel, and private power station companies. The privatization of the desalination plant established by the government company *Mekorot Enterprises* was planned from the very beginning,<sup>11</sup> but the quantity of water it desalinates does not create a balance between public and private desalination, and does not offer leverage for the reduction of water prices during negotiations with the desalination companies over increasing production quotas (State Comptroller 2012).

There are many economic dangers inherent in the concentration of control: slow growth, barriers to innovation, and damage to public welfare due to the preference given to the interests of the business group over those of the public at large (Morck and Yeung 2004; Morck et al. 2005). In Israel, the level of concentration is relatively high both in certain sectors, such as communications and fuel, and across the economy as a whole (Agmon and Zadik 2010), and has been defined by the Bank of Israel (2009, 155) as a “systemic danger.” There is an inverse correlation between concentration of control and competition. In Israel, the lack of competition and the high level of concentration have an impact on the cost of living. I demonstrate this by looking at the reform of the fuel market and the reform that opened up electricity generation to competition.

Prior to the reform of the **fuel market**, all transactions involved in ensuring a regular fuel supply—from the purchase of crude oil through to the retail sale of petroleum products—were conducted by three oil companies: *Paz*, *Delek*, and *Somol*. The treatment of fuel—from the import of refined petroleum products to the sale of fuel—was carried out by a range of bodies that provided services to the oil companies, including government companies, joint-ownership companies, and private companies. The activity of the oil companies was coordinated and overseen by the Ministry of Energy, which also engaged in the planning of the system. The ministry also worked to maintain relative stability in the prices of fuel products, and ensured uniform gas prices throughout the country. The government was involved in setting the policies for fuel

procurement, in authorizing every deal, in setting the quantity and content of the reserves that oil companies were required to maintain, in setting the order of recognition of fuel costs, and in setting consumer prices of fuel products, including the taxes and levies applied to them.

The reform of the fuel market began in 1988, with the aim (over several stages) of reducing government involvement and allowing market forces to operate freely, so as to attain greater efficiency in the sector and lower prices. Liberalization of the sector was combined with privatization processes which, as already noted, were carried out both at simultaneously and in later years. These processes affected the price of gas to the consumer; despite the liberalization and competition in the sector, the price of gas in Israel is higher than in Western European countries.

At the end of 2010, the four largest fuel companies controlled around 86% of all public gas stations in Israel, an indication of the level of concentration of power in this sector, which operates as an oligopoly. *Paz* holds the greatest share of gas stations at 26.7% (Agnon 2011, 7). The purchase of the *Ashdod refinery* improved its position further, as it controls some 40% of the refinery market, and sells most of the product of its refineries to its own gas stations. *Delek* improved its position in the market when it bought the government storage company *Pi Glilot*, allowing it to import and store refined petroleum products on a large scale and to reduce its dependence on the Haifa Refinery (Ibid.). In light of these developments, the level of competition in the refined petroleum market is low. The other fuel companies are still dependent on products from the Haifa Refinery and on their own direct imports. Meanwhile, the consumer surplus has suffered from this state of affairs.

As for the **electricity market**, prior to the opening of private electricity generating stations in 2013, close to 100% of Israel's electricity was produced by the *Israel Electric Corporation (IEC)*, a government company. The price of electricity was fixed at uniform rates (according to different types of consumers) by the Public Utilities Authority (Electricity), the regulator. The entry of new, private electricity producers, using natural gas in new power stations with advanced technology, and free from the wage agreements and quotas imposed on the government company, was intended to bring down the cost of generating electricity. The private producers could sign contracts to supply the IEC with electricity at a price set by the regulator, or sell electricity directly to end users at a lower price than the IEC. In the main, prices offered to customers are between 5 to 10% lower than those charged by the IEC for electricity



generation. Private manufacturers are, by and large, the largest consumers of electricity. Thus, for example, desalination plants and *Mekorot* have signed deals with private electricity producers and receive a concession of around 10% on the price of electricity generation (which forms around 58% of the overall electricity tariff).

It should be noted that electricity is the main input in all components of the water sector, and is the source of around 40% of overall costs in the sector. Yet, while the cost of electricity has fallen for all components, the price of water has not come down. The same is true for major food producers, drug companies, hotels, supermarket chains, banks, and others. All of these have enjoyed the fruits of a fall in the cost of electricity, but have not passed the savings on to the public. The effect of the entry of private producers into electricity market has not brought down the cost of living or increased competition, but instead has benefited the large business groups.

The new structures of the electricity generation and fuel markets in Israel, following the privatizations and reforms carried out, have not achieved the goals that are at the heart of the idea of privatization—decentralization, increased competition, and lower prices (Butler 1988; Vickers and Yarrow 1988; Savas 1987, 2005). Replacing the government monopoly over these infrastructure areas, according to economic theory, was supposed to improve the electricity and fuel markets, and make them more efficient. But the regulation put in place in the electricity sector and the concentrated structure that has resulted raise fears of an overconcentration of economic power in the hands of a small group of owners (who between them control all the relevant private companies), posing a threat to the stability of the market and to the public interest—and also, as demonstrated below, to Israeli democracy.

### *Commodification*

All the infrastructure sectors have undergone institutional changes in recent decades. The shift of the boundaries between the public and the private, between the responsibility of the state and the responsibility of the free market, continues. This trend represents a deepening process of commodification, that is, growing dependence of individual citizens on the market to supply their needs. This is particularly true of electricity and water, two essential and basic products that the courts consider a fundamental right.<sup>12</sup> Israeli legislators have been slow to recognize the

danger of this trend and have provided only partial responses. Below, I demonstrate this using the legal changes that have accompanied the regulation of the activities of the IEC and the water corporations.

In both the electricity and water markets, the transition to a business orientation in recent years has led to an increase in the number of clients disconnected from these essential services due to an inability to pay for them. Both the IEC and the water corporations have outsourced segments of their collection processes and use external legal firms to collect debts. These firms receive a fee for every debt they collect, which has led to an increase in court claims against debtors, worsening their financial situation even further. These private agencies do not take into account the customer's situation nor do they seek social solutions to help debtors, as was practiced in the past by the municipal water departments or IEC representatives. In an attempt to address this trend of commodification, the Electricity Law was amended to define categories of vulnerable populations who pay a reduced rate for the first 400 kWh. The total concessions to all of those eligible are limited to a sum not larger than 1.5% of the total sum paid by all customers for electricity consumption.

The water market has undergone far-reaching changes in recent years: the replacement of dedicated local authority departments by water and sewage corporations, and the transition to desalinization. As a result, water prices have risen significantly. Despite these increases, government policy currently includes reduced rates only for a select few (people with disabilities, Holocaust survivors, IDF veterans with disabilities, victims of terror attacks, and elderly people in poverty). Until recently, the water corporations were quick to disconnect homes that did not pay their bills on time, and did so frequently. Following a court case brought by civil rights organizations, and the involvement of a number of members of Knesset, the rules governing water disconnection were changed. The new regulations forbid water corporations from disconnecting a customer because of a debt without the express approval of the director of the Water Authority.

Extensive privatization has had a direct impact on commodification, on poverty, on socioeconomic gaps, and on equality. Michael Sandel (2012) shows that those who rely on public services are the first to suffer from this process, because these services become inaccessible. A continued process of privatization and commodification harms the quality of life of more and more people, and institutionalizes a reality in which money is the answer to everything—every appointment, every

conversation with a public official, or any attention from a teacher, doctor, or police officer becomes saleable to the highest bidder (Sandel 2012). In most cases, commodification relates to the privatization of services that were provided as part of the welfare state. Here, however, I seek to draw attention to the commodification that also results from privatization of infrastructure.

As against this position, there are those who argue that regulation imposed following privatization sets standards of service and quality that the companies are required to meet, which was not necessarily the case when they were government companies (Prosser 2000). Haber (2011) presents cases in which, following privatization, the state intervened in order to prevent disconnection of water or electricity in Israel and in Britain, whereas in Sweden, the state did not interfere—and thus claims that privatization does not have an unequivocal effect on the welfare of citizens, and in fact, in some cases, regulation strengthens aspects of the welfare state.

The responses of the Israeli legislator, as described above, have provided a partial solution regarding electricity and water consumption. Price concessions in Israel are provided via cross-subsidization, meaning that additional costs are shifted to the entire body of consumers, and as a result, the available income of the most vulnerable populations is reduced even further. And when it comes to products not defined as essential—such as natural gas, communications, and the increasing prominence of toll roads—the dependence of individuals on the market for their most basic needs is total.

### *Weakened Democracy*

Milton Friedman claimed that political freedom is linked to free markets, and called for limits to be placed on government in order to protect the liberty of citizens. He argued that a reliance on free cooperation and private enterprise in the economy (and in other areas) ensures that the private sector acts as a bulwark against the government sector, providing an effective defense of freedom of speech, religion, and thought (Friedman 1962). Sandel, like Friedman, is in favor of free-market economies, but in his (2012) book, he distinguishes between the market economy and the market society. He argues that the privatization of production has resulted in the privatization of such values as solidarity, compassion, and generosity. The market economy undermines our relationships with each

other and erodes the link between individual and society (Sandel 2012). As I show below, it appears that the reality in Israel inclines toward the direction described by Sandel—weakened democracy.

In Israel, some 20 business and family groups with pyramidal structures own around 25% of the companies listed on the stock exchange. The fact that ten major families own, between them, close to 30% of the total value of the market (Bank of Israel 2009) raises concerns over damage to the development of the economy and to the quality of democracy and government: immense economic power is concentrated in the hands of a relatively small group of owners who control most of the public companies, and who thus wield considerable political influence (Hamdani 2009, 10–14).

An example of this can be seen in the Israeli communications market. As described above, this sector was opened to competition when *Bezeq* was privatized, but not all of the market was regulated, and the regulation laid down is not enforced in practice. One of the main reasons for this is the fact that *Bezeq*'s owners belong to this group of “major families”. In recent years, the Ministry of Communications advanced a reform of the cable communications network, including internet infrastructure, which is *Bezeq*'s most profitable market. According to this reform, *Bezeq* must allow free access to its infrastructure to companies that do not have their own and duly did so in February 2015. But when, three months later, it was required to open up its cable communications network, *Bezeq* refused, and demanded that the structural division it had previously been required to effect between its various companies (in international phone services, cellular services, and satellite television) be rescinded. This, despite the fact that the cancelation of this structural division had been recommended by a professional committee that reviewed the communications market, and agreed to by the minister of communications at the time, on the condition that *Bezeq* agree to cooperate with the reform in the cable communications market. In practice, the Minister of Communications agreed in 2013 to cancel the structural division (Peretz 2016) without *Bezeq* agreeing to allow free access to its infrastructure.

This behavior of *Bezeq*'s owners and of politicians fits the description of Morck et al. (2005) regarding owners' efforts to increase their political influence far beyond the scale of their financial worth, by investing in political relationships in order to maintain their special status. The consequences for the economy can be severe: low innovation, inefficient

allocation of resources, low growth, and capital markets that do not function effectively.

Eyal Peleg argues that the implications of privatization should not be limited just to action that transfers public property to private ownership, and that privatization should not be seen as the sale of goods in the usual sense of the term, but rather as an ongoing situation that affects us all (Peleg 2005). Discourse that focuses on questions of efficiency ignores the threat to democracy that results from privatization which does not preserve the public dimension of the service or product in question. The overriding commitment of the new companies is to their shareholders, not the public welfare.

Privatization, according to Peleg, undermines the most fundamental idea of democracy—that the public can influence government by means of its right to vote. As soon as the government sells parts of itself to private bodies, it has divested itself (and thus also the public) of its ability to wield influence, and handed over control (or at least, significant elements of it) to a small group of wealthy individuals who own corporations, as described in the section above on concentration of control and competition. This concentration of capital inhibits competition and blocks the entry of new actors into the sectors controlled by the wealthy few, who use their economic power to influence the government, encouraging continued sale of companies and the application of regulation that suits their interest, among other things (Nitzan and Bichler 2002).

In recent years, this issue has been evident in Israel in relation to three main issues: taxation of oil and natural gas production; royalties paid for the extraction of natural resources; and the “natural gas agreement,” which I will use to illustrate the danger to democracy.

The “natural gas agreement” comprises a series of government decisions regarding reserves of natural gas that were discovered in the last ten years. One of these decisions concerned “ensuring a stable regulatory environment,” which implies tying the government to the terms of the plan, including a commitment to leave existing legislation unchanged and to oppose any relevant legislative initiatives for a period of ten years. However, the Supreme Court, sitting as the High Court of Justice, struck off this “stability clause,” stating that it contravenes the fundamental rule of administrative law against the inability of a government to bind itself. In his ruling (*Movement for Quality Government in Israel et al.* 2016), Justice Elyakim Rubinstein wrote:

When a branch of government is given an authority by law, this authority comes with a duty to employ judgement; simply put, the government does not have the authority to decide not to decide and not to act ... This is especially true for an issue that is the subject of real political debate, and when the executive branch is seeking to restrain its successor's use of judgement, given that this successor's composition and ideology may be different from those of the current government.

The government, by adopting the stability clause, sought to deny its citizens the ability to wield influence using their right to vote, and handed over parts of the governmental rule to a small group of wealthy individuals.

## CONCLUSION

Up to the beginning of the 1980s, most of the activity in infrastructure sectors was carried out directly by government companies or by administrative units in government ministries. In recent decades, these sectors have undergone numerous changes, and now include government companies, private companies, and PPPs. Most of these changes in recent years were "foundational changes," which laid the ground for the next wave of privatization. These saw the establishment of many government companies in infrastructure sectors that were slated for privatization from the moment they were created. Over the last 30 years, these developments have reflected shifts in the extent of the state's responsibilities toward its citizens and in the limits of privatization, and thus also have consequences for the issue of regulation.

Due to the objective methodological difficulty of comparing the past to the present using economic indicators of the performance of infrastructure companies, I examined the results of the changes described as they relate to three parameters: concentration of control and competition; commodification; and impact on democracy. In each of these parameters, I have shown that the foundational changes have had a negative effect.

These findings do not mean that reforms should not be carried out, but rather, that the burden of proof for the necessity of a given reform and for how it should be carried out should fall on those seeking the reform, and these should examine its impact in terms of these parameters, and not just immediate financial or operational outcomes. Thus,

returning to the example of the privatization of water production discussed in this chapter, there is no doubt that the desalination plants saved Israel from drought. However, other companies could also have been examined as possible concession holders, or the share of the government company *Mekorot* could have been enlarged, so as to avoid the damage described in terms of competition, concentration of control, and commodification, and subsequently, the deleterious effects on Israeli democracy.

## NOTES

1. For-profit companies are mainly large companies employing many workers, which define profit-making as one of the company's goals. Examples include the Israel Electric Corporation, Mekorot—Israel National Water Company, and Israel Aerospace Industries. In recent decades, some 40–50% of all government companies have been for-profit companies. Noncommercial companies were established to serve social needs rather than for business reasons; these include the Israel Association of Community Centers, the Israel Museum, and public savings funds.
2. This data is accurate as of December 31, 2014. See Government Companies Authority (2014).
3. This company's most recent name is Netivei Israel ["Israel Highways"]—National Transport Infrastructure Company Ltd.
4. The company is now seeking to raise NIS 800 million in order to meet the targets of its recovery program (Ziv 2016).
5. In 2015, the production capacity of private companies was around 4100 MW, while that of the Israel Electric Corporation was around 13,600 MW. However, the existing regulation in this sector means that for many hours of the day, the share of the private companies in all electricity produced is close to 50%.
6. See the decision of the Public Utilities Authority—Electricity (in Hebrew): <https://pua.gov.il/decisions/documents/1491.pdf>.
7. For more on the reform of the electricity sector in Israel, see Mizrahi and Tevet (2014). The recommendations of the steering committee of the reforms to the Israel Electric Corporation and the electricity sector (in Hebrew) can be found at: <http://energy.gov.il/AboutTheOffice/SpeakerMessages/Documents/%D7%93%D7%95%D7%97+%D7%99%D7%95%D7%92%D7%91+20032014++%D7%A0%D7%A7%D7%99.pdf>.
8. Before the state was founded, paleontological surveys were conducted by the World Zionist Organization and the Turkish oil company. Under the British Mandate, a daughter company of the Iraqi oil company was given

- a license to search for oil throughout most of the country. The company conducted several exploratory drilling operations in the Heletz region. In the 1940s, additional licenses were awarded to a Jordanian company and to British companies.
9. For statistical data on electricity prices in the UK, see <https://www.gov.uk/government/collections/energy-price-statistics>. Israel has experienced fluctuations in electricity prices over the years; see: <https://www.iec.co.il/homeclients/pages/previoustariffs.aspx>.
  10. <http://www.ide-tech.com>.
  11. "Structural Changes in the Mekorot Group," *Government Decision* no. 2318, August 26, 2007. See: <http://www.pmo.gov.il/Secretary/GovDecisions/2007/Pages/des2318.aspx>.
  12. *Yelizarov v. Israel Electric Corporation Ltd.* (2014).

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PART II

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Privatization of the Israeli Welfare State



# Pension Privatization in Israel

*Lilach Lurie*

## INTRODUCTION

In 1994, the World Bank published an influential report entitled ‘Averting the Old Age Crisis’. In the report, the World Bank recommended that countries adopt a mandatory multi-pillar pension system containing a mandatory private pillar. Namely, employers and employees would have to provide monthly contributions to privately managed Defined Contribution pension schemes (World Bank 1994; Lurie 2017). Following the World Bank recommendations, most Organization for Economic Co-operation and Development (OECD) countries made (and still make) efforts to broaden the coverage of privately managed pensions (Cf. Naczyk and Domokos 2015). Israel’s regulators adopted the World Bank recommendations at a relatively early stage. The case study of Israel enables, therefore, an evaluation of the World Bank recommendations regarding private pensions from a 20-year perspective (Lurie 2017).

Moreover, in the broad context of the current book, the privatization of pensions in Israel was an important step in the larger process of neo-liberalism and privatization in Israel. As will be described below, prior to

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privatization, Israel's major union owned most pension funds in Israel. Pensions (like health care until 1995) were a major source of power for the unions' in Israel. When Israel's major union (the *Histadrut*) lost its control over healthcare and pensions (the Ghent system), it also lost a major source of influence over government policy and a large share of its members. The *Histadrut's* loss of power enabled the government to pass many of the reforms that this book describes.

The paper focuses on the second pillar of Israel's pension system: occupational pension. The first part of the paper will describe the global phenomena of pension privatization as well as Israel's pension system. The second part will shed light on the main aims of Israel's pension privatization. The third part will describe the process of pension privatization in Israel. The fourth part will analyse Israel's pension privatization according to its purposes. At its core, the paper concludes that privatization increases inequality and that, in order to reduce inequality, strict regulation is needed as well as an option of a public pension fund.

## BACKGROUND

### *Pension Privatization—A Comparative View*

In the last few years, various OECD countries have passed reforms to broaden the coverage of private pensions (OECD 2015). Generally speaking, pension privatization comes in three basic forms: substitutive, mixed and parallel (Orenstein 2008, 26–28). Substitutive reforms phase out traditional social security systems and replace them with systems based on private individual accounts. The classic example for a country which replaced its public pension system with a private one is Chile (Mesa-Lago 1994, 1998, 2000; Mesa-Lago and Muller, 2002). Mixed reforms reduce the size of social security systems, while adding complementary systems of private, individual accounts (Orenstein 2008, 26–28)—examples are China, Russia, Romania and Slovakia (Orenstein 2008, 27). Parallel reforms introduce systems based on private, individual accounts but give participants a choice of which system to contribute to and benefit from (Orenstein 2008, 26)—examples are the UK (Minns and Martin 1996, 221; Davies 2000, 11–24; Blake 2004) and Sweden. Many countries privatize their pension systems in an indirect way by broadening the coverage of private pensions without cutting public pensions. These countries hope to cut public pension expenditures in the future.

Countries are distinguished from each other not only in the type of privatization but also in the process of privatization (Bonoli 2000; Reynaud 2000). For example, in some European countries the privatization of the pension system was conducted gradually and in social dialogue among the government, workers' organizations and employers' organizations. In a few of them, nongovernmental organizations and pensioners' organizations were consulted as well. Contrarily, during 1980–1981 Chile advanced pensionary privatization in a very different way: the process was rapid, the media was silenced and the public was not regularly updated on the content of privatization. Privatization was accomplished by means of emergency orders, accompanied by the suppression of workers' and employers' organizations, and without the involvement of the Congress (Ghilarducci and Ledesma Liébana 2000, 753). The different ways in which the reforms were carried out impacted the nature of the privatized arrangement that was eventually adopted (Baccaro 2002, 413; Anderson and Meyer 2003, 23).

### *Characteristics of Israel's Pension System Before the Privatization Process*

Israeli pension system consists of three pillars: a first, public, universal pillar; a second, occupational pension pillar; and a third pillar of private savings. In terms of the first pillar, all residents of Israel are entitled to a basic public pension (unrelated to work status) from the National Insurance Institute once they reach the retirement age (Retirement Age Law 2004, arts. 3–4; The National Insurance Law (consolidated version) 1995, art. 245). The sum of the benefits—equivalent to approximately \$380 a month—is low compared to OECD countries and is not enough by itself to provide an adequate income after retirement (OECD 2010, 188). Therefore, the second pillar plays an important role in providing income security for Israeli retirees.

In recent decades, prior to the privatization of pensions, many problems were evident in pensionary insurance in Israel, including the following:

*Centralization and lack of competition:* Pensionary insurance in Israel was characterized by a high degree of centralism and consequently a lack of competition. The large pension funds were all in the hands of the *Histadrut*. In 2003, three pension funds managed 74% of the financial assets in the pension market. The *Histadrut*, the largest workers' organization in Israel, was simultaneously the manufacturer, marketer

and consumer of the financial services. It held and managed the pension funds; determined which pension fund the workers of each and every sector would be insured by; and as an employee union, the *Histadrut* represented the workers regarding their pension benefits. In the past, then, when the share of organized workers in Israel was about 80%, the *Histadrut* was in almost absolute control of the Israeli pension market.

*Actuary deficit:* Various factors—discussed below—led to the accumulation of huge actuary debts by some of the veteran pension funds, and on the eve of the 2003 reform this deficit amounted to about 110 billion NIS (Yosef and Spivak 2008, 11–12). One of the veteran pension funds, the Construction Workers’ Insurance and Pension Fund, went bankrupt in 1998.

*Defective service:* The high degree of centralization in the pension market led to a lack of real competition in the service provided by the funds. As a result, many beneficiaries suffered from defective service (such as delayed answers to requests of beneficiaries or delayed responses to claims). While special groups of beneficiaries enjoyed special improved treatment and services from the funds, most beneficiaries did not.

*Different rights for different beneficiaries:* Some groups of workers could obtain not only preferential service conditions, but also preferential rights over other workers. The outcome was inequality in rights between beneficiaries belonging to the same fund.

*Low pensionary coverage:* The pension system was also characterized by low pensionary coverage. As of 1995, pensionary coverage stood at only 61% of the *employed* working population (Yosef and Spivak 2008). In 2002 pensionary coverage rose slightly, reaching 73% of employed workers, but nonetheless about 50% of the adult population in Israel was without pensionary insurance (above the first layer). The rate of insured was particularly low among women, Palestinian citizens of Israel, new immigrants, part-time workers and low-paid workers. There was also a low rate of insured among the self-employed (CBS 2002; Lurie 2010).

### *The Goals of Pension Privatization in Israel*

Underlying the privatization of pension insurance in Israel was the desire to address the flaws in the system, some of which were outlined above. This purpose was to be accomplished by the following means: (1) decreasing centralization and increasing competition by introducing new actors into the pension market; (2) ensuring pension payments to retiring beneficiaries through efficient and competitive new management

of pension funds; (3) improving the services provided by the funds; (4) equalizing the pensionary rights among beneficiaries; and (5) increasing the pension coverage rate. These aims could have been achieved by means of various reforms (such as increasing the coverage and the rates of the public pension benefits), but the method chosen was privatization.

In the 1990s and early 2000s, the Ministry of Finance (MoF) leadership thought that remedying the pensionary system in Israel would be achieved through a combination of the free market and governmental regulation. This approach was influenced by a series of pensionary privatizations in South American and East European countries, which were conducted with the support of the World Bank and the International Monetary Fund. In Israel this approach culminated in 2003–2004.

Further below, I examine whether the privatization of employment pension succeeded in leading to a remedying of the pensionary system. For the moment, however, I refer to the MoF's hope that this privatization would serve two additional purposes. The first of these is *liberalization of the capital market in Israel*. The pension funds are major institutional investors that manage money on a grand scale. Prior to the reform, an appreciable share of this money was invested in designated government bonds. The government's bonds (which guaranteed a 4% interest) created a long-term financial burden on Israel's budget. The MoF sought to reduce the pension funds' total investment in these bonds and increase their investments in the capital market. This meant funneling of a great deal of money to the capital market together with increased risk.

Another purpose of the privatization was *changing the employment relations system in the economy*. Control of the pension funds gave the *Histadrut* immense power: the funds served as a means of recruiting members, raising money and exerting influence on the government's socioeconomic policy (Cf. Beland 2001, 155). Public remarks by MoF officials who led the privatization of pension revealed that weakening the *Histadrut* and changing the employment relations system was an aim in itself (Lurie 2015; Ratson 2009–2010).

### PRIVATIZING THE ISRAELI PENSION SYSTEM

The privatization of pensionary insurance is the outcome of past processes and reforms that took place in the welfare and pension field in Israel and around the world. Prominent in the literature dealing with analysis of the decline of the welfare state is the policy feedback or path



dependency theory, according to which it is local politics that determines the nature and intensity of the attempts to harm or slash welfare state institutions, and future steps in the field are dependent on the steps of the past (Pierson 1994, 2000; Orenstein 2008, 3).

Privatization is a major institutional change. Such change is difficult to implement, especially in pension systems, since the logic of the pension system is one of ‘increasing returns’. In an ‘increasing returns’ system or process, the probability of proceeding along the same path (rather than implementing reforms) increases with each step down the path (Pierson 2000, 252). In the old pension system in Israel (old pension funds and budgetary pension) every additional contributor increased the chances that the next potential contributor would also join in. In order to privatize the system, it was necessary first to change it. Moreover, there was also a political aspect, in which the prevailing system created interest groups that would support its continuation. To privatize the system, there was a need of new groups with new interests.

It is therefore necessary to understand current welfare reforms against the background of past reforms, welfare policy in the past and the interest groups that arose in the past in the state. The privatization of pension insurance in Israel in its present form could not have happened three or four decades ago, when the state managed its workers’ pension and efforts were made to extend and increase the National Insurance benefits. Three major reforms, then, preceded the privatization of pension in Israel and made it possible. Likewise, the privatization of pensionary insurance could not have occurred when the *Histadrut* and the leftist parties in Israel were at the height of their strength (Cf. Korpi 1983, 7–25; Myles 1984, 76–99; Esping-Andersen 1990, 105–138).

### *Three Reforms that Preceded Privatization*

*Closure of the older pension funds and establishment of the new funds.* In 1995 the older pension funds were closed to new members and new pension funds were established (Gavious et al. 2009). The older *Histadrut* pension funds were managed as Defined Benefits, guaranteeing the retiree a defined pension on the basis of last monthly salary or an average of the last three years. This financing method led to actuary deficits. For this reason, the decision was made in 1995 to close the older funds to new beneficiaries and to establish new pension funds on the Defined Contributions method, while maintaining the actuary balance.

The balanced management of the new funds, in keeping with free market conditions, later made their sale to private insurance companies possible.

*Transition from budgetary pension to cumulative pension:* During the years 1999–2005 state employees and workers in governmental and quasi-public institutions were transferred from budgetary pension, which were managed and financed exclusively by the state (or the employer in the governmental or quasi-public institution), to cumulative pension that is managed by the private market and cofinanced by the employer and employee. Until the end of the 1990s, the pension scheme of government employees was managed by the state in the budgetary pension framework. In 1999 the move began to close budgetary pension to new joiners, and new workers who joined the state civil service were insured by pension funds and not by the state. This transition of state employees from budgetary pension to cumulative pension increased the number of potential workers to whom the privatized pensionary insurance applies.

*Cutbacks in public old age benefits:* The old age benefits granted by the National Insurance Institute belong to the first nationalized pillar of pension insurance. Theoretically, to expand pension coverage and ensure adequate living conditions for the elderly, the government could decide to increase public old age benefits. The Israeli government chose not to do so. Instead, in 2002 the old age benefits were slashed. During 2005–2006 that cutback was gradually canceled. Nonetheless, in January 2006 the updating mechanism of the National Insurance Institute benefits was altered significantly to the detriment of stipend recipients, as they were linked to the consumer index, whereas previously they rose in accordance with average pay. Moreover, the privatization process, described below, included an increase in the eligibility age for public old age benefits (65/67 Men; 60/62 Women) and therefore included in fact another cut in the benefits. The cutbacks in old age benefits and their low rates exacerbated the need for alternative pension insurance provided by the private market (Table 5.1).

All three reforms prepared the ground for pension privatization. Israel's government managed to pass two reforms (the closure of the older pension funds and the transition from budgetary pension to cumulative pension) through a mechanism of 'layering' (adding new elements to existing institutions) (Cf. Van der Heijden 2011). Both reforms preserved the rights of current workers and dramatically reduced only the rights of new workers (Cf. Thomas and Kleiner 1992). Due to the 'layering' mechanism, the *Histadrut* agreed to the reforms.

**Table 5.1** Public old age benefits as a percentage of the average wage (*Source* National Insurance Institute of Israel 2007b, 2015)

<i>Year</i>	1955	1980	1990	2002	2004	2014
Percentage of the average wage	20.5	17.1	15.9	15.6	15.2	16.7

### *The Privatization Reforms (2003–2008)*

#### *Stage One: Transfer of the Pension Funds from the Histadrut to Private Insurance Companies*

The privatization of pension insurance in Israel took place in a two-stage process. At first, the state nationalized the pension funds out of the hands of the *Histadrut* (Israel's major employee union) and sold them to private insurance companies. Privatization of the new pension funds was a small part of a far-reaching pension reform, addressed below.

Appointed as Finance Minister in February 2003, Benjamin Netanyahu brought with him a neoliberal socioeconomic agenda that included an aspiration to remedy the employment pension system and take it out of the hands of the *Histadrut*. Over the media and in public, MoF officials conveyed a sense that the pension system was on the brink of a disaster and needed to be saved forthwith (Ratson 2009–2010). After a few failed attempts at negotiation between the *Histadrut* and the MoF, the government chose the path of unilateral primary legislation, and on 29 May 2003 the Knesset approved the reform in an expedited legislative procedure. In short, then, the pensionary reform was passed by hurried legislative action, without collective negotiations with the *Histadrut* and without any process of consultation with, or updating of, the general public.

The legislation included several steps: first, it was determined that all of the *Histadrut* pension funds would be transferred to state control and that, second, deficit-ridden older pension funds would be controlled by the state. In addition, the rights of the beneficiaries and retirees covered by the older pension funds were to be slashed considerably. Third, the new pension funds would be transferred from the *Histadrut* to private insurance companies. And so, the state first nationalized the new pension funds out of the hands of the *Histadrut* and afterward conducted a tender to sell them to three large insurance companies. Fourth, the government would appreciably reduce the subsidization it had granted to the

pension funds. This would mean that the pension funds would be forced to invest most of their beneficiaries' money in the capital market rather than in government bonds that yielded a high and certain proceed. Fifth, the Retirement Age Law (2004) determined that the retirement age would rise for all the insured by the older and new funds alike.

Only after the legislation was completed, and implementation of the reform had begun, did the MoF turn to consult with the *Histadrut*.

*Stage Two: Introduction of Mandatory Pension Through the Private Market*

In the second stage of the privatization of pension insurance, mandatory pension through the private market was introduced. In February 2007, a government decision was adopted, determining that the workers' and employers' organizations must conclude by collective negotiations by 2008 on the introduction of mandatory pension, and that if their efforts failed to produce results, mandatory pension would be instituted through primary legislation by the end of 2009 (Government Decision 1134). In March 2007 a government-sponsored law proposal was publicized, which was meant to lend validity to the government decision, but neither one determined anything regarding the nature of the pensionary arrangement. Consequently, the social partners (the Coordinating Bureau of Economic Organizations, the largest employers' organization; and the *Histadrut*, as the largest workers' organization) held negotiations over signing a general collective agreement. This led to the signing of an agreement between the parties in July 2007 as regards the introduction of pensionary insurance. On 30 December 2007, the Minister of Labor signed an extension order of the collective agreement, extending the provisions of the arrangement to all employed workers in the economy.

At first glance, the introduction of mandatory pension appears to be at odds with the processes of withdrawal of the state from the welfare system and its privatization. The introduction of mandatory pension expresses the values of social justice, equality and social solidarity. Furthermore, mandatory pension was instituted in a collective agreement, an expression of the state's corporative nature and of organized labor's strength.

Nonetheless, a deeper inquiry reveals that the introduction of mandatory pension completes the process of privatizing employment pension, and is in fact part of the process of retreat of the welfare state in Israel.

Mandatory employment pension is privatized pension that is managed and financed by the private market; the workers and employers finance the scheme; and the private insurance companies manage it and exercise independent discretion as to how it operates.<sup>1</sup>

The outcome of the two steps described above was a privatized pension system. It is mostly managed by the private market, guarantees the workers limited pensionary rights and requires them to find complementary solutions.

## DISCUSSION

### *The Privatization Process*

Each of the two reforms that led to the privatization of the pension system in Israel—the sale of the new pension funds to private insurance companies, and the introduction of mandatory pension for all through private funds—was conducted in a different fashion. Nonetheless, both were rushed through in a hasty procedure and with very limited cooperation with the public, primarily the clients of the plan.

In the case of the sale of the new pension funds, the creation of a crisis atmosphere led to the passage of a far-reaching lightning reform with no participation of the plan's clients in the process (Cf. Anderson 2001, 1063; Klein 2008). The *Histadrut* was brought into the design of the arrangement only post facto, after the reform's implementation had begun, so it had only a limited influence on it. Furthermore, the *Histadrut's* struggle focused on the reform concerning the older pension funds and hardly referred to the privatization of the new pension funds. Nongovernmental organizations, which could have given voice to the plan's clients, were not included into the process at any stage.<sup>2</sup> The legislation in which the framework of the reform was passed was hurried and hence did not permit customary procedures of public participation.

The mandatory pension reform was passed in a slightly different procedure—negotiations and the signing of a collective agreement between the *Histadrut* and the Coordinating Bureau of Economic Organizations. Nonetheless, this reform too was passed with limited participation of the plan's clients, namely representatives of those who are not insured (such as NGOs). The agreement was signed in the wake of massive pressure on the part of the MoF, which declared that it would introduce mandatory pension by legislation if a collective agreement wasn't reached by the end

of 2008. The *Histadrut* agreed to concessions in the negotiations, in the hope that it would be possible to improve the agreement's conditions further down the road.

The *Histadrut* and the Coordinating Bureau signed a mandatory pension agreement that applies in the main to workers who aren't among their members. Most of the workers represented by the *Histadrut* were covered by pension insurance before the mandatory pension reform, so the reform doesn't apply to them. So too as regards the Manufacturers Association, which had insured its workers even before the reform. The new arrangement therefore applies to workers who weren't represented in the collective negotiations and whose voice wasn't heard there, and as described below, it improved their situation only partially.

### *The Pension Privatization Results*

In this section I examine whether the privatization of occupational pension has achieved its goals, and whether it has led to a remedying of the system. This section shows that the privatization of occupational pension did not achieve its goals: it did not increase the competition in the pension market; it did not increase pension benefits; and it dramatically increased inequality in pension services, pension benefits and pension coverage.

#### *Reduced Competition*

One of the goals of privatizing the new pension funds was to reduce the centralization in the pension market. However, the MoF's efforts to enlist new players in the pension market or to sell the pension funds to foreign investors were unsuccessful. The large insurance companies that bought the pension funds from the *Histadrut* had been active in the pension field even before that. In the wake of the purchase of the pension funds from the workers' organization, the insurance companies' strength grew appreciably, and the pension market in Israel today is a very centralized one. While prior to privatization Israel had a centralized-unionized (and non-profit) pension system, currently the system is a centralized-private one (see also Tevet's Chapter in this volume).

#### *Lower Pension Benefits*

The retirement benefits of the privatized pension appear to be *lower* and *riskier* than those of the nationalized pension. Two major variables

influence the size of the payment that a beneficiary of a pension fund receives: the fund's proceeds and the management fees it exacts from the beneficiary. The higher the management fees exacted by the fund, the lower the payment received by the beneficiary. On the eve of the sale of the new pension funds to the insurance companies, the MoF significantly raised the ceiling of the management fees that the pension funds can exact from their beneficiaries. The goal was clear: to raise the value of the pension funds and thus increase the sum that would enter the state's coffers with the sale. The outcome of this step was also clear: grave harm to the beneficiaries' rights.

Raising the management fee rates doesn't impact all the insured to the same extent. The MoF set the maximum management fees that the pension funds can exact, but the management fees they actually impose are determined in negotiation between the client and the pension fund. Organized workers, with strong workers' councils and more bargaining power, obtain large discounts in management fees. High-paid workers who are attractive to pension funds also obtain discounts. Unorganized, low-paid workers with little bargaining power are those who pay the full management fees.

As noted above, the privatized pension is not only lower but also *riskier* than the nationalized pension. Since the right to pension coalesces with retirement from work, only when the insured retires will she know the size of the payment she will receive. The size of the pension the beneficiary receives is dependent, *inter alia*, on the proceeds the fund achieves in the capital market. In the past, most of the fund's money (70%) was invested in subsidized designated government bonds, which guaranteed a fixed return. One of the steps of the 2003 reform was to reduce the weight of the designated bonds in the asset portfolio, so today a pension fund is required to invest only 30% of its money in such bonds. The remainder of the money is exposed to the fluctuations of the capital market: in years when the capital market is booming the pension funds achieve high proceeds, and vice versa.

The pension funds compete among themselves over the rate of proceeds they will succeed in obtaining for their beneficiaries. In the past, the funds were controlled by the *Histadrut*—a workers' organization with an interest in having the pension funds put their money in solid investments that would guarantee regular payments to the beneficiary in old age, and in having the money invested in companies with ties to

the *Histadrut* (or which belonged to it). Today the pension funds are managed for profit, and therefore have an interest in putting their money in riskier investments, with a greater chance of yielding higher proceeds. The MoF is quite satisfied with the transfer of responsibility for risk management to the insured, i.e. the beneficiaries, who may choose their preferred investment course. However, as most beneficiaries lack the knowledge and understanding as to pensionary investments, their ability to make sound decisions on the course of pensionary investment is very much in doubt. In a domain which is characterized by lack of information and high degree of uncertainty, even experts have little information on their pensions (Kogut and Dahan 2012). An even greater doubt arises regarding the ability of those among the insured who belong to the weaker strata of the population to choose successful investment channels (Moore 2000, 366). Privatized pension is riskier than nationalized pension also because of the state's refusal to place a security net at the disposal of beneficiaries of the new pension funds.

#### *Unequal Service*

The privatization of the pension funds has not led to a noticeably improved service for all the beneficiaries, but rather to the provision of differential service to different beneficiaries according to their profitability to the funds. Under free market conditions, one of the client's considerations when choosing a pension fund is supposed to be the quality of the service provided by the fund. The privatization of the financial services was supposed to lead to increased competition among the pension funds and, therefore, to improved service. However, what emerges from the literature discussing the privatization of welfare services is that such privatization leads to an improvement in service for only some of the clients (Cf. Van Slyke 2003; Lacireno-Paquet et al. 2002). Privatized bodies have an incentive to provide good service to clients that are easy to handle and able to pay for the service provided to them at the price determined by the market. This effect, i.e. the provision of service to a select group of clients, has been termed "creaming" (ibid.).

The privatized pension funds in Israel have an incentive to provide preferential service to workers belonging to organized groups, since workers covered by group insurance are much more profitable than workers covered by individual insurance. A workers' group is heterogeneous and therefore less risky to the fund than solitary individual



workers. Likewise, handling workers together is cost-saving to the fund. As a result, large organizations, in which many workers are insured, may be entitled to special services that are not provided to individual members, including pension education and training, personal service and counseling by a permanent representative of the pension fund who comes to the workplace, and the purchase of complementary products at competitive prices. It is worth noting that at least in one component of service there has been a significant improvement due to the regulation—increased transparency and mobility. However, transparency and mobility are helpful only if the customer knows how to choose, which is doubtful in this case.

### *Unequal Pension Benefits*

The privatization of pension was intended to (and did) lead to equality in pension rights, by dint of the prohibition on granting pensionary rights to groups of workers not in accordance with the pension fund's rules (Supervision of Financial Services Law (Provident Funds) 2005, par. 16). Nonetheless, the privatization of pensions has led to a new kind of inequality in the amount of the monthly payments—between men and women. In the case of unmarried men and women who work the same number of years, accumulate the same sums and retire at the same age—unmarried women are eligible to a lower monthly payment than unmarried men. The new inequality is based on estimations of the life expectancy of men and women. Unmarried women live longer on average than unmarried men, receive payments for a longer period, and therefore the monthly payment they receive is likely to be lower.

Reliance on actuary assumptions does not always work to the detriment of women. Since pension insurance is not only old age insurance but also disability and survivor's insurance, in calculating the rights there is significance also to the sex of the spouse and the period in which he/she will receive survivor's insurance. Widowers live on average less than widows. For this reason, in the case of married men and women who work the same number of years, accumulate the same sums and retire at the same age—married men are liable to receive a lower monthly payment than married women.

The method of calculating pension benefits demonstrates the problematic nature of the privatized pension system. The MoF requires the funds to operate in accordance with economic considerations and the actuary assumptions concerning life expectancy. The retirement benefits

are calculated, then, according to economic considerations, without considering the needs—different or identical—of men and women retiring from work. The legality of the arrangement determining differential pensionary rights for men and women is an issue that has recently come before the courts (Tel-Aviv Labor Court 1742/08 *Tuti Ashbal v. Harel* (17.8.14)).

### *Unequal Pension Coverage*

The privatization of the pension system was supposed to appreciably increase the pensionary coverage rate. The mandatory pension arrangement was intended to cover the million employees who were not covered prior to the scheme. In actuality, 64% of Israel's residents (and 86% of Israel's employees) are now covered under pensionary insurance. Apparently, one of the reasons why the number of those joining the privatized arrangement is relatively low is because it applies in the main to workers who are profitable for the privatized pension funds to insure. The profitable workers are mainly "typical" workers—full-time workers in a single workplace at average and above salaries. Most of these workers were covered by pensionary insurance even before the mandatory pension arrangement. The privatized arrangement doesn't provide an adequate answer for "non-typical" workers, who aren't profitable to the privatized pension funds—men and women caring for children, unemployed, temporary workers, independent workers, low-paid workers and workers with chronic diseases. As will be explained below, some of the unprofitable workers have been entirely removed from cover of the arrangement, while others are ostensibly subject to the arrangement's coverage but find it very difficult to buy pensionary insurance in the private market.<sup>3</sup>

*Unprofitable workers who have been removed from the privatized arrangement's application:* As elsewhere, employment modes in Israel and around the world have undergone far-reaching changes in recent decades, among others a transition from the traditional employment model of a salaried worker who spends his/her working life in a single workplace, working for a single employer (Cappelli et al. 1997, 17–43), to flexible and non-typical employment modes. These non-typical employment modes include, amongst others, temporary work and work as an independent contractor. The labor market today is characterized by numerous transitions from being employed to not being employed,

including transitions from being employed to caring for family members and unemployment (Schmid and Gazier 2002). Interruptions in pensionary insurance are liable to lead to grave harm to the pensionary rights of the beneficiaries. Nonetheless, *the unemployed and men and women caring for children* are not insured by dint of the privatized arrangement. Exceptions to this are workers (women and men) on maternity leave. Likewise, the privatized arrangement was determined as a collective agreement that was extended by a general extension order, and therefore it doesn't apply to *self-employed workers*, to whom the insurance requirement doesn't apply. In addition, since workers are covered by pension insurance only after six months on the job, this stipulation also removes many *temporary workers* from the arrangement's application. Nonetheless, workers who had pensionary insurance coverage in a previous workplace and moved immediately to a new employer, or alternatively retained their pension insurance during the period they weren't employed, will be insured from their first day at work. The removal of many temporary workers from the arrangement's application encourages employers to save on the costs of pension insurance by employing workers for a period of not more than six months.

*Unprofitable workers who have difficulty buying private pensionary insurance:* Although the privatized arrangement applies to workers with chronic diseases and to low-paid workers, these workers find it very difficult to buy pensionary insurance, because insuring them isn't profitable to the pension funds. In the past the pension funds insured beneficiaries mainly on a group basis, by contracting with a factory or with an employee union. Within that framework, the pension funds undertook an obligation to accept any beneficiary belonging to the workplace or sector, regardless of their health status or pay. Therefore, low-paid workers and workers with chronic diseases belonging to a large organization didn't encounter any problem in buying pension insurance. In the wake of the mandatory pension arrangement, a growing number of solitary individual workers and employers interested in buying pension insurance are turning to the pension funds.<sup>4</sup> As explained above, solitary individual workers are "riskier" for the pension funds, and therefore they are often not interested in insuring them. It bears mention that while pension funds are not required by law to accept any beneficiary, the case-law has found that they are private bodies with quasi-public attributes, therefore duties from the field of public law apply to them, including the duty

to act equitably (the *Elchanani* case). Nonetheless, workers with chronic diseases encounter great difficulty buying pensionary insurance.

### CONCLUDING REMARKS

More than twenty years have passed since the World Bank published its influential report ‘Averting the Old Age Crisis’ (World Bank 1994) recommending that countries adopt a mandatory multi-pillar pension system containing a mandatory private pillar. The case study of Israel, which adopted the recommendations, enables an evaluation of pension privatization done according to these recommendations. The case study of Israel shows that privatization leads to inequality: inequality of benefits; inequality of services; and inequality of pension coverage.

These results are, partly, an inherent problem in pension privatization and have nothing to do with regulation or regulators. Nonetheless, proper regulation of the private pension market would have been able to decrease the system’s problem. For example, the establishment of a public pension fund—which would insure workers who cannot be insured in privately managed funds—would solve part of the problems discussed above.

The pension market in Israel is highly regulated. In fact, frequently pension regulators introduce new reforms.<sup>5</sup> However, the prominent regulator of the pension market in Israel is the Ministry of Finance. Its main interest is to keep the pension market efficient (but not necessarily just or egalitarian). Most reforms focus on ensuring the stability of the funds and their transparency. Other reforms aim to increase the competition between funds (by bringing new players to the market). None of the reforms focus on equality or distributive justice.

The lack of proper regulation exacerbate inequality. The case study of Israel, therefore, emphasizes the need for strict public regulation. Moreover, the case study of Israel shows the importance of reforming pension systems through an inclusive process that includes consultations with unions, employers and NGOs.

### NOTES

1. As Brender shows, mandatory pension is not even beneficial for its beneficiaries (Brender 2011). Moreover, the description above seems to fit Wendy Brown’s explanation as to the difference between a liberal

- economic policy and neoliberalism. While the former is an expression of government retreat from the market, the latter suggests involvement of the government in a way that benefits big business (Brown 2015).
2. For a discussion on the participation of nongovernmental organizations in welfare reforms, see Anderson and Eliassen (1998) and Reale (2003). In Germany, before pensionary reforms ad hoc committees were established that included representatives of the interest groups relevant to the process. See Steinmeyer (2000, 44–45).
  3. Moreover, with regard to low wage workers, contribution to pension funds is problematic from another aspect. A mandatory contribution shrinks their salaries which are low anyway (Brender 2011).
  4. Moreover, due to processes of outsourcing, many workers are employed by contractors and not by the company or factory itself (or by the civil service). Cf. Paz-Fuchs in this book.
  5. For example, in 2016 the Ministry of Finance introduced a ‘default pension fund’ reform. The Ministry of Finance chose two pension funds (through a government tender) which will insure workers who do not have a pension fund. The funds are committed to charging relatively low management fees. The Ministry of Finance deliberately chose small pension funds in order to increase competition in the pension market. It is not clear yet if the funds will insure workers with chronic illnesses.

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# Transformation and Commodification of Healthcare Services: The Israeli Case

*Dani Filc*

## INTRODUCTION

In the mid-1980s, Israel began an ongoing process of neoliberalization. As with neoliberalization worldwide, the privatization of welfare services—social services, long-term nursing, education, health care—was a central feature of this process. Healthcare services represent a preferred aim for privatization, but also a conflictive one. On the one hand, healthcare services are the most expensive area within welfare state sectors, thus the incentive to privatize is great, both in terms of reducing state expenditures and in terms of opening new areas for capital accumulation. On the other hand, privatization of health usually meets great opposition. Even orthodox economists recognize that the healthcare sector presents significant market failures that justify state intervention. More importantly, health inequalities, and unequal access to health care—an unavoidable consequence of privatization—are widely considered to violate our deepest intuitions about justice. Moreover, as Norman Daniels (2008) argued, good health is a condition for fair equality of opportunities.

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Thus, in most cases—and the Israeli case is no exception—privatization processes tend to be complex and entangled.

The starting point for our discussion is the National Health Insurance (NHI) Act 1994, which transformed the Israeli health regime from a corporatist/social security system, into a universal one. However, and as against the NHI Act's aims, the last two decades the Israeli healthcare system underwent a process of privatization. As defined by Galnoor and Paz-Fuchs (2015), privatization in its broad sense includes the redefinition of the state's responsibility, in our case for the provision of health care. Redefining responsibility means transferring responsibility to either the private or the "third sector" of one or more of the following: privatization of ownership, privatization of financing, abolition of state supervision, or changes in the mode of regulation. In a second sense, not contradictory with the first, privatization means that services or products follow the logic of profit that drives capitalist societies. In this sense, privatization takes place when products and services are not provided as a public good, but as a commodity to make a profit.

To better understand the processes of privatization of the Israeli healthcare system, it is useful to consider it within the more general context of the welfare regime. Following the classification of Esping-Andersen (1990) of welfare regimes as liberal, conservative/corporatist, and social-democratic (based on universal citizenship), Wendt et al. (2009) proposed a classification in the form of a matrix that combines three types of regime—private, corporatist (or social security), and universal (or state); and what they consider the three major components of healthcare systems—financing, provision of health services (who owns the services), and regulation (or governance). They argue that their classification allows for "capturing the wide variety of uniform or ideal, as well as mixed types" of healthcare systems (*ibid.*, 71). Moreover, and important for the discussion of the process of privatization, they propose a framework for understanding reforms in healthcare systems, that can be classified as "systemic" (the infrequent transformation of, for example, a state system into a private one), "internal system change" (transformation of one of the dimensions of the healthcare system, but not of the other two dimensions) or "internal change of levels" (a transformation in which a shift *within* one or more dimensions takes place without leading to any exchange in the system's overall features) (Wendt et al. 2009, 72).

The Israeli case challenges Wendt et al.'s model, since—as will be argued—it is characterized by "internal system change" at the three levels,

resulting not in a “systemic” change (since the Israeli single-payer system has not been transformed into a private one), but in the blurring of the boundaries between public and private, a blurring that represents a significant threat to the public healthcare system. The Israeli case thus represents an example of a significant change in the healthcare system that cannot be explained in terms of a transition from one ideal type to another. The Israeli healthcare system underwent a significant process of commodification and privatization at the different levels (financing, provision of services, and governance), while the legal-institutional form still belongs to the universal type. On the one hand, the NHI Act 1994 ensured universal health care and emphasized equality of access and quality of treatment. On the other hand, since the mid-1980s both the private share of the national health expenditure and the commodification of health care have increased.<sup>1</sup> The transformation of the Israeli healthcare system took place on three different levels: privatization of the financing of healthcare services, privatization of ownership of healthcare facilities and services, and market-driven regulation, which included the adoption by the public healthcare system of a business managerial organizational culture.

Before we turn to analyze these processes, a birds-eye overview of the Israeli healthcare system is warranted: the Ministry of Health (MoH) is responsible for planning and supervision, but it also runs hospitals, is in charge of preventive medicine, and runs psychiatric services. The sick funds are basically nonprofit health maintenance organizations (HMOs) responsible for the provision of health services—“health care basket” as defined by law—to their members. They administer and provide almost all primary and secondary care, and they finance (and sometimes provide) hospitalization services. Voluntary nonprofit organizations run hospitals and provide emergency care. City councils oversee some of the preventive care and public health services, and some even run hospitals. In parallel with the public sector, there exists private provision of hospital, specialists’ and primary care services. In the next three sections, the paper will analyze the privatization of the three levels presented above: financing, ownership and regulation.

### THE TRANSFORMATION OF FINANCING

Prior to 1995, the Israeli healthcare system maintained the fragmented character of the pre-State period. In that period, most of the Jewish population were members of one of the several voluntary, non-for-profit sick

funds (usually associated to a workers' union or producers' union), and the Arab population received services run by the British mandate, by religious institutions or by the private sector. With the establishment of the state and until the NHI Act was passed in 1994, health care in Israel was organized mostly as a corporatist social insurance system. The main healthcare organizations were the sick funds. Until the late 1980s, most Israelis (85–90%) were members of a sick fund known as *Kupat Holim Clalit* (*KHC*), which belonged to the *Histadrut* (the General Federation of Labor), the largest trade union in Israel. Some 10% of the population was insured by three smaller sick funds and 4–7% were uninsured. This corporatist system was funded in a highly pluralistic way (Bin Nun and Chinitz 1993).

Public financing took two main forms: direct government funding (from general taxation) and social insurance. Private financing was quite marginal, consisting of a minor system of private insurance and “out-of-pocket” payments.

The sick funds were financed mostly from social insurance (an employer-paid, earmarked tax, which amounted to about 5% of taxable income, distributed to the sick funds based on a formula that gave a weight of 75% to the income of a fund's member and 25% to the size of a fund's enrollment; and a membership fee adjusted to the member's wage). Additional sources were government subsidies from general taxation and co-payments, mostly for prescription drugs.

This corporatist healthcare system was in step with the welfare regime adopted with the establishment of the State of Israel in 1948. Within the framework of the Fordist/Keynesian organization of the economy and society, Israel's welfare regime corresponded to the conservative regime of Esping-Andersen (1990) and played a role in nation-building. However, from the mid-1980s, Israel began to undergo a process of neoliberalization, which included the partial transition from a conservative to a more liberal welfare regime.<sup>2</sup> This transition included the partial commodification of services, the constriction of transfer payments, and a decrease in the state's share of the national health expenditure. The transition to a neoliberal socio-economic model affected the entire organization of health care, and from the mid-1980s to the mid-1990s, the Israeli healthcare system underwent a process of privatization of financing. Government financing of health care decreased from 34% of the total national healthcare expenditure in the late 1970s to 21.6% in the 1990s.

Table 6.1 shows the decrease in government funding and the increase in out-of-pocket expenditure and members' fees during the 1980s and early 1990s. In parallel, private expenditure increased faster than total health expenditure. National health expenditure, at fixed prices, rose 43% between 1986 and 1994. During the same years, spending on dentistry grew by 62%, and private expenditure (drugs, physicians, and equipment) by 59%. Expenditure in private medicine rose 102% in the 1980s and another 32% by 1994 (Chernichovsky 1991; CBS 2003).

The shift of funding from government to private citizens, the switch to the smaller sick funds from *KHC* by the wealthier population (discussed below), and the expansion of private insurance schemes, increased the inequality of access to health care, and promoted the emergence of a multi-tiered system. The Palestinians of the Occupied Territories and the foreign workers with no health insurance occupied the lowest level of the system, since they had very limited access to hospitalization, and almost no access to ambulatory care. Israeli citizens without health insurance (4–7% of the Israeli population) occupied the next level. The third level of the multi-tiered system was comprised of members of the *KHC*, where per-capita spending was NIS 2533 to cover an older, poorer, and sicker population. The fourth level was occupied by members of the smaller HMOs—*Maccabi*, *Me'uhedet*, and

**Table 6.1** Percentage of the national health expenditures in Israel by financing sector (*Source* Bin Nun and Chinitz 1993; Central Bureau of Statistics 2003)<sup>a</sup>

<i>Year</i>	<i>Government</i>	<i>Members fees</i>	<i>Out-of-pocket payment</i>	<i>Other</i>
1980	60	12	19	9
↓				
1984	53	15	23	9
1985	54	14	25	7
1986	54	8	27	1
1987	59	10	29	2
1988	50	19	29	2
1989	47	20	28	5
1990	45.9	47.5		
1991	46.2	49		
1992	45	52		
1993	44	52		

<sup>a</sup>The Central Bureau of Statistics provides only government expenditures for years 1981–1983, and it considers members' fees and out-of-pocket expenditures as a single sector for years 1990–1993

*Leumit*—where per-capita spending was NIS 2970 for a younger and healthier population. The highest level was occupied by the very rich, buying private, fee-for-service health care.

The reduction of direct government financing put serious pressure on the public healthcare system, especially on *KHC* (Chernichovsky 1991). The financial strain on *KHC*, combined with its socio-economic composition and case-mix (as well as its bureaucratic organization), led to a decrease in the availability of services, which increased the switch of its younger, healthier, and wealthier members to the small sick funds, which further worsened services, increasing the incentive for the young and the healthy to leave.<sup>3</sup> The smaller sick funds applied several forms of “cream-skimming”—the selection of younger and healthier (and hence potentially cheaper) members—and “negative selection”—the rejection of potentially expensive members—which deepened the differences among the sick funds.<sup>4</sup> Between 1981 and 1994, the membership of the smaller sick funds increased from 8 to 37% of the insured population, while membership in *KHC* decreased from 82.3 in 1981 to 62.1% in 1995 (Bin Nun and Greenblat 1999).

Since *KHC* was by far the largest sick fund, its financial crisis also extended to state-owned hospitals, to which *KHC* owed huge sums, and to the corporatist healthcare regime as a whole. The crisis caused by the underfunding of the health system led to growing public dissatisfaction with the system, and public and political pressure for fundamental healthcare reform. To cope with the crisis, the Israeli Parliament (*Knesset*) passed the NHI Act 1994, which organized health care into a universal, state-funded, system.<sup>5</sup> In Wendt et al.’s terms, the NHI law can be considered a systemic change, the transformation of the healthcare system from a corporatist system to a universal one.

The NHI Act recognized health care as a right, stressed the importance of equality in healthcare access, and guaranteed a universal “basket” of services to every Israeli resident. To finance the system, an earmarked citizens’ “health tax” (4.8% of income) was added to an already existing earmarked employer tax. The National Insurance Institute (NII) collected both taxes and distributed them among the sick funds, according to a capitation formula based on the number and ages of members in each sick fund. If collected funds fell below “the cost of the basket of services”, the government would cover the gap from its budget. In other words, the government asserted responsibility for financing healthcare services included in the “health basket”.

This brief portrayal indicates that the law increased equality of access to health care by ending sick-fund cream-skimming, improving services in geographic periphery, and redistributing funds more equally between the four sick funds. Revenues as stipulated by the NHI Act increased, in per-capita terms, by 11% for *KHC*, and 7% for *Leumit*, while declining by 15% for *Maccabi* and 7% for *Mehuhedet*. Between 1994 and 1996, age-adjusted per-capita operating expenditure dropped in three of the four sick funds—by over 8% for *Maccabi*, almost 5% for *Mehuhedet* and almost 9% for *Leumit*, while for *KHC* there was an increase of almost 5%. The law ended cream-skimming and improved service levels in the geographic periphery.

By acknowledging health care as a right, severing the link between ability to pay and entitlement to health care, stressing equality of access and stating government responsibility, the NHI Act deepened the degree of healthcare decommodification. While provision remained the responsibility of the four public sick funds, the state functioned as the single-payer agent, thus taking responsibility for health care. However, even though the NHI legislation restrained the commodification process, it did not bring the public/private rate in the financing of health expenditure back to the level of the early 1980s. In 1995, household “out-of-pocket” spending still represented 25% of the national health expenditure (CBS 2003).

The legislation of the NHI Act that transformed the Israeli health-care system into a universal single-payer one, ran against the general trend toward the privatization of welfare in Israel. There were significant forces within the state apparatus (especially the Ministry of Finance), the political system and the healthcare sector that were interested in deepening the privatization of health care that begun in the mid-1980s. Thus, following the legislation of the NHI Act, we can assess privatization trends at the three levels: financing, ownership, and regulation. With regards to financing, only two years after the legislation of the NHI Act, the government passed an Arrangements Law that eliminated employers’ contribution to health care. In 1998, the government passed another Arrangements Law that shifted the government’s commitment to bridge the gap between the cost of the health basket and the funds distributed by the NHI to the provision of a significantly lower nominal sum to be established yearly. Significant increases in co-payments and cost-containment measures would cover the diminishing funding by the government.

Since 1998, the government's share of the national health expenditure has declined steadily, shifting costs to the public in the form of "out-of-pocket" payments or private insurance (Table 6.2).

By 2012, public financing of national health expenditure had reached an unprecedented low of 61.3%, while private spending represented 36.8% of national health expenditure (CBS 2013). The high share of private expenditure and the low share of public expenditure compared to OECD countries are expressions of the commodification of the Israeli healthcare system. Where access to health care requires payment, it becomes more dependent on individual success in the market (whether labor, financial, real estate or other market), commodification's par excellence feature (Esping-Andersen 1990). Between 1995 and 2010, public financing of healthcare services increased by 11.7%, while the private share increased by 51.6% (Chernichovsky 2013). Private spending is constantly rising, and in 2012–2013 out-of-pocket spending rose almost 10%, while in those two years government spending marked a reduction in spending in per-capita real terms (OECD 2015). As a consequence, in 2012, health spending reached 5.5% of household expenditures from disposable income (CBS 2013). In 1997, healthcare expenditure

**Table 6.2** National health expenditures in Israel by financing sector (Source Central Bureau of Statistics 2014)

<i>Year</i>	<i>% contribution to national expenditure</i>	
	<i>Government</i>	<i>Households</i>
1995	75	25
1996	74.5	25.5
1999	63.7	33.6
2001	61.9	36.2
2002	63.1	34.8
2003	64.1	34
2004	63.5	34.3
2005	61.8	36.2
2006	61.6	36.3
2007	60.5	37.6
2008	61.3	36.8
2009	62	36.5
2010	60.8	37.7
2011	60.8	37.8
2012	60.8	37.6
2013	60.8	39.2



represented 3.8% of total household expenditure. By 2001, this expenditure rose to 4.9%, and to 5.1% in 2009. This rise in private health-care expenditure affected equality in access to health care. Household expenditure on health was significantly higher for the wealthiest 20% of the population than for the poorest 20% of the population: 2.9 times higher in 1997, 3.5 times higher in 2001, 3.6 times higher in 2008. (Horev and Keidar 2010; Table 6.3).

Not only have out-of-pocket payments increased significantly, so did private insurance. In Israel, private health insurance combines supplementary and duplicate insurance. Insurance schemes cover diagnostic procedures, pharmaceuticals and other kind of treatments not included in the public health basket, including alternative and cosmetic medicine. They also cover surgical procedures or second opinion consults for conditions covered by the public health basket, allowing for choice of surgeon and jumping the queue. In Israel, two kinds of private insurance exist. The first includes insurance schemes marketed by for-profit commercial insurance companies. Those schemes may be individual or collective, premiums are related to age and health conditions, and the insurance company may choose not to sell insurance to a specific person.

**Table 6.3** Household expenditure in health 1997–2012 (*Source* MoH 2014)

<i>Year</i>	<i>Total expenditure (NIS)</i>	<i>Total expenditure in health (NIS)</i>	<i>Health expenditure as % of total expenditure</i>
1997	8110	305	3.8
1998	8577	339	4.0
1999	9345	385	4.1
2000	9749	445	4.6
2001	10,053	495	4.9
2002	10,450	498	4.8
2003	10,139	485	4.8
2004	10,441	519	5.0
2005	10,816	556	5.1
2006	11,190	570	5.1
2007	11,584	619	5.3
2008	12,324	633	5.1
2009	13,009	667	5.1
2010	13,496	674	5.0
2011	13,966	741	5.3
2012	14,272	784	5.5

The second type of insurance includes insurance schemes sold by public, nonprofit, sick funds. Premiums are only age-related, using a community-rated system, and the sick funds must sell insurance to any of their members who wishes to take part in the scheme. Income from insurance schemes must be reinvested, and the sick funds cannot make a profit. In fact, the loss ratio of private insurance companies is much lower than for the sick funds' schemes: approximately 50% for individual insurance and 80% for private insurance (MoF 2012), compared to around 95% for the sick funds' insurance. However, in a report on the healthcare system, the State Comptroller considered the sick funds' insurance programs as part of the private insurance scheme, and statistics about private and public expenditure in health also consider them as part of the private expenditure. This is so since, while lacking the for-profit motive, they still contribute to the commodification of health care, insofar as access is not universal but depends on ability to pay (both premiums and co-payments).

Both kinds of insurance grew significantly in the 2000s. As Fig. 6.1 shows (OECD 2013, 139), today Israel has one of the highest private health insurance ownership rates in the world (Bin Nun 2013), with some 80% of the population owning private insurance and 35% of the population owning both commercial and sick funds' insurance schemes.

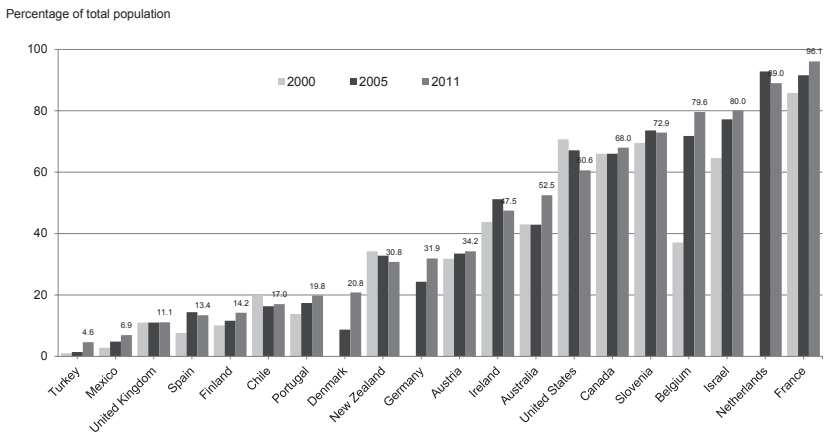


Fig. 6.1 Share of the population owning private health insurance

Between 2000 and 2011, revenues of private insurance companies from health insurance grew more than fourfold, from 700 million NIS to 3.1 billion NIS (Bin Nun 2013). Between 2003 and 2011, total gross insurance premiums of commercial insurance companies showed an average annual increase of 12%, while gross insurance premiums for the sick funds' private insurance grew 75% between 2005 and 2010 (MoF 2012; Bin Nun 2013).

In sum, today Israel has a high share of private expenditure and a low share of public expenditure compared to other OECD member countries (Chernichovsky 2013). The increase in private spending is taking place at one of the fastest rates in the world, negatively affecting the public healthcare system. Since human resources in the health sector are limited and their growth does not match the needs of a growing and aging population, the quick development of a private sector funded mainly through duplicate insurance brings hospitals' physicians to reduce their work within the public sector, increasing queues. Moreover, this way of developing the private sector functions as a political buffer (since those who own private insurance are less affected by attrition), allowing the state not to invest in health infrastructure, without paying a political price.

### THE TRANSFORMATION OF PROVISION

During the pre-state years, three of the four current sick-funds (*KHC*, *Leumit*, and *Maccabi*) were created. The fourth—*Me'uhedet*—resulted from the 1974 merging of two sick funds created in the 1930s. In the pre-state years—and in fact until the legislation of the NHI Act—sick funds were nonprofit, public, voluntary organizations (belonging to workers' unions, farmers' association, a political party, or their members). While they did not belong to the state, they were not private in the market-based sense, since profit was not their aim, and allocation of resources and access to services did not answer to market criteria. Most hospitals were also public, belonging to the state, city councils or to *KHC*—the biggest sick fund. The differences between the sick funds made for differences in access to health care contingent not on the market but on what Esping-Andersen (1990) referred to as status differences, aligning the pre-1994 Israeli healthcare system with the corporatist regime. With the legislation of the NHI Act, the system became a universal, single-payer one, and status differences disappeared. While the sick funds maintain their managerial autonomy, they clearly belong

to the public and not to the private, sector. In discussing similar cases, Paul Starr argued that the conversion of a state agency into an autonomous authority is not privatization (Starr 1988). The central questions to discriminate are whether health care is a commodity produced to make a profit, and if distribution of resources and access to care are subordinate to market criteria. Both answers are negative in the Israeli case. The sick funds are public, nonprofit organizations, mostly financed by the state.<sup>6</sup>

However, in parallel with the transition from a corporatist to a universal regime, in the mid-1980s begun a process of privatization of provision. Most of this process of healthcare privatization in Israel belongs to what Starr (1988) denominated “privatization by attrition”, i.e., the emerging of services provided by the private sector due to the stagnation or slow growth in the public sector, when government lets services run down. A second mode is what Starr calls “privatization by contracting out”, i.e. the public sector pays private providers for some of the services (diagnostic procedures, laboratory tests, ancillary work).

In Israel, the share of private sector provision from the national expenditure in health rose from 18.9% in 1984 to 23.3% in 1993 (Central Bureau of Statistics 2003). The number of private hospitals increased from 57 in 1980 to 94 in 1993, even though their share of the total number of hospitals did not change. Yet the private sector’s share of general hospital *beds* did rise, from 2.9 to 3.6% between 1980 and 1989, and in 1993 it reached 4% of the total; private geriatric beds grew from 29 to 34% in the same period (Bin Nun and Chinitz 1993), reaching 37% in 1993. The number of hospital beds serves to illustrate the rate of growth in the private sector: while the number of hospital beds in the public sector grew by 14.4% in the 1980–93 period, the number of beds in the private sector grew by 50%.<sup>7</sup> In areas such as nursing care, privatization has been the preferred trend, and plans for the construction of new units were—and still are—focused mostly on the private sector. Table 6.4 shows the increase in the share of the private sector from the national healthcare expenditure.

Between 1995 and 1997, the services provided by the private sector represented 23% of the national health expenditure. Following the 1998 Arrangements Law there was a sustained increase in the private sector share, which reached 27% in 2003.

In 2003, toward Israel’s expected entrance into the OECD, the Central Bureau of Statistics modified its classification of the different sectors, adopting the System of National Accounts (SNA) definition, which

**Table 6.4** Percentage of national expenditure in Israel on health by operating sector (*Source* Central Bureau of Statistics 2014)

<i>Year</i>	<i>Government</i>	<i>Sick funds</i>	<i>Nonprofit</i>	<i>Market producers</i>
1995	22	43.5	12.0	22.5
1996	21.9	43.2	12.0	22.8
1999	21.7	43.7	12.2	22.4
2001	21.3	42.7	12.1	23.9
2002	20.6	43.1	12.8	23.5
2003	6.5	34.9	6.0	52.6
2004	6.9	34.9	5.7	52.5
2005	6.7	35.2	5.2	52.9
2006	6.5	35.2	5.1	53.2
2007	6.2	34.2	4.9	54.7
2008	6.1	33.6	5.0	55.3
2009	6.6	33.8	5.0	54.6
2010	6.2	33.9	5.0	54.9
2011	6.3	33.6	5.1	55.1
2012	5.8	32.9	4.6	56.8
2013	5.9	31.5	4.5	58.1

classifies as “market producers” all institutions that sell their products at full market price. Since, as will be discussed below, during the 2000s, many of the government-owned hospitals were transformed into trusts, which operate in business-like fashion, from 2004 there has been a significant decrease in the share of health care provided as decommodified services, and a major increase in the share of services provided as commodities (called “market producers” in Table 6.4).<sup>8</sup> In fact, the significant increase in the share of market producers in 2003 reflects one of the major forms taken by commodification of health care in Israel: the blurring of the division between public and private and the adoption by the public sector of business criteria and culture.

### THE TRANSFORMATION OF REGULATION

While the NHI law transformed the healthcare system from corporatist to universal, the state (led by the MoF) adopted forms of market-driven regulation, consequently modifying the organizational culture of public healthcare institutions. Competition was the main tool employed in this

market-driven model of regulation. The MoF's view was that the NHI framework did not allow for real competition between the sick funds (since both the price and the content of the healthcare basket were established by the state). Thus, as discussed above, it allowed the sick funds in 1998 to sell private insurance, to enhance competition. The MoF's idea was that the differences between the insurance packages would add an incentive to switch between sick funds, thus increasing the role of market competition in regulating the production and provision of services. In the same vein, state-owned hospitals were transformed into trusts, meaning that financial responsibility was transferred from the state to the hospitals. Moreover, the budget transferred by the state to the sick funds did not cover for the actual cost increases due to population growth and aging, and the cost of new technologies. The MoF saw this gap as a built-in incentive for the sick funds to contain costs. The state curtailed financing of hospitals and did not allow for a real indexation of the public share of sick funds' budgets. Those steps shifted financial responsibility from the state to the hospitals and the sick funds, forcing them to behave in a business-like fashion. Budget constraints pushed sick funds and public hospitals to find alternative, market-related, sources of income and adopt organizational modes (both towards workers and towards users of services) imported from the business world. Yitzhak Peterburg, who served as CEO of *KHC* between 1997 and 2002, exemplified the change in culture clearly when he claimed: "In the last few years *KHC* has undergone a service and strategic revolution.... [it] has evolved into a business organization in every respect...." (Peterburg 2002, 31). *KHC* (as the other three sick funds) now sell services that are not included within the public "health basket", such as alternative medicine and cosmetic medicine. *KHC* and *Maccabi* sick fund provide private dental care and *KHC* and *Maccabi* sick funds own private, for-profit hospitals. The public sick funds run private diagnostic facilities, sell private insurance, and run private diagnostic facilities.

As part of the market-driven form of regulation, government-owned public hospitals had to behave as business entities and "sell" their "products" at full market price, using the existing infrastructure to expand services. Hospitals developed different arrays of private initiatives to replace insufficient funding. Public hospitals began to run private services, such as institutes for plastic surgery; and services not included in the public health basket to patients with commercial insurance, like "check-ups", extra laboratory tests, and "personalized medicine". Moreover, as we saw above, over the last fifteen years, more government-owned

public hospitals are changing to “market producers” (Central Bureau of Statistics 2004). Table 6.4 shows how market producers currently provide the majority of services. Former Deputy General Director of the MoH Professor Gabi Bin Nun estimates that by the late 1990s, the health basket determined 90% of activities, and hospitals “sold” the remaining 10% (Bin Nun 1999). Between 1994 and 1996, the MoH allowed public hospitals to offer private services, accounting for up to 20% of their income (Shirom and Amit 1996). The State Comptroller stated that for certain public hospitals, in 2014 this figure rose to 40% (State Comptroller 2015). The scope of private services provided by public hospitals ranges from private lodging for women [in post-natal care] to medical tourism (Committee for the Strengthening of the Public Health System 2014).

The hospitals incorporated these private and semi-private initiatives via three main instruments: *Sharap* (Private Medical Services), *Sharan* (Additional Medical Services), and the operation of private facilities within public hospitals. Within the *Sharap* system, patients choose their physician in a public hospital for an additional fee. *Hadassah* Medical Center in Jerusalem has been operating the *Sharap* system since the 1950s and the *Shaarei Tzedek* Hospital has done so since 1975. However, in 2002, the Attorney General declared the service to be unlawful in government-owned hospitals, a decision sustained by the Supreme Court in 2009 (*Kyriati* ruling; see also Gross 2014). This decision, it should be clarified, was tailored so as not to affect existing arrangements within the Jerusalem hospitals, which are not government-owned. Within the *Sharan* system, public hospitals sell services not covered by the National Insurance to health funds to private insurers or individuals. The sick funds follow a similar logic, providing services such as private dental care and alternative medicine. They also own private medical imaging, laboratory facilities, and private hospitals.

The boundaries between public and private healthcare sectors have become increasingly blurred, to a point that sick funds now sell private insurance for procedures performed in the afternoon in private hospitals owned by those same sick funds, by physicians who work in the public system during the mornings. The construction of the new hospital in the city Ashdod is a good example of the blurring of the boundaries between public and private. The *Assuta* Medical Centers, a for-profit corporation owned by the public nonprofit *Maccabi* sick fund, has been assigned the construction of the new hospital, with construction costs shared by the state and the *Assuta* corporation (Bin Nun 2013).

To conclude this section, we find that in the last decades the Israeli care system underwent significant changes at the three levels. On the one hand, the legislation of the NHI Act transformed the system from corporatist into universal. On the other hand, we witnessed strong privatization trends in the financing, providing, and regulating of services. Instead of system transformation, as assumed by Wendt et al., privatization trends at the three levels produced a kind of positive feedback system in which privatization blurred the boundaries between the private and the public systems, which in its turn increased privatization of financing, provision, and regulation.

### THE BLURRING OF THE PRIVATE/PUBLIC DIVIDE AND THE CRISIS OF THE PUBLIC HEALTHCARE SYSTEM

We can thus observe that, as against Wendt et al.'s clear distinction between systemic, internal change (changes at one of the levels) and internal level types of change, in Israel we witness internal system changes at the three levels: increasing privatization of financing as expressed by the private share of national health expenditure, increasing privatization of ownership as expressed by the market-providers' share of total healthcare provision, and the adoption of market-driven forms of regulation, based on enhancing competition and the adoption of business-like criteria of efficiency. The result of this transformation has been a crisis of the public healthcare system. Growing deficits in the public sector (sick funds and public hospitals) occurred simultaneously with the rapid expansion of private facilities (often owned by public institutions). Moreover, as a result of the process of privatization that took place at the three levels, the Israeli healthcare system presents both growing inequalities and inefficiencies.

#### *Inequalities in Access to Healthcare Services Between the Better Off and the Poorer*

The reforms facilitated the creation of a tiered system, divided between public insurance holders, sick-fund insurance holders, and private insurance holders (Schwartz-Ilan et al. 2011). According to a survey conducted by the Brookdale Institute, almost 30% of the lower income quintile refrained from buying drugs or visiting a specialist due to co-payments (Gross et al. 2007).



Waiting times are considerably higher for those in the public system, compared to the patients accessing the public system through *Sharap*. A study conducted in 2012 and 2013 showed that in the *Hadassah* hospital, the largest in Jerusalem, waiting times for public patients were 11.8 to 13.5 times longer than those experienced by patients with *Sharap*. In another large Jerusalem hospital, *Shaarei Tzedek*, waiting times for public patients were 2 to 4.8 times longer than for private ones (Brezis 2014). Patients who are members of a private insurance scheme can choose surgeons and specialists for a second opinion, while those without insurance do not. As could be expected, the percentage of private insurance ownership among poorer sectors (such as Israeli Arabs or people receiving social security transfer payments) is lower than among those who are better-off<sup>9</sup> (Tofer-Haver Tov and Bartov 2014). Among Israel's wealthiest 20%, 86% hold sick-fund-sold private insurance, while 57% own commercial private insurance. Among the poorest 20% of the population, the respective percentages are 66 and 17% (Bramli-Greenberg and Keidar 2012).

### *Inequalities Between the Center and Periphery*

Decreased public investments meant that the criteria for developing new infrastructure is subject to the market (those who are willing to pay), and beholden to private donors. For this reason, private services have significantly improved in the better off center area of Tel Aviv and its surroundings. For example, from a total of 100 million NIS in private donations in 2013, 60% went to projects at the *Sheba* hospital, located in Ramat Gan, a suburb of Tel Aviv, while only 10 million NIS were donations to hospitals in the periphery (MoH 2013). Consequently, disparities between the number of healthcare workers and access to services between the center and the periphery grew significantly (Chernichovsky 2013).<sup>10</sup> In a national survey evaluating waiting times, 56% of patients in peripheral settlements reported waiting times longer than a month, while 38% of patients in the center reported waiting more than a month (Bramli-Greenberg and Weizberg 2014).

### *Inequalities Between Physicians*

While there are no available data on private physicians' income, there is indirect evidence that physicians who work both in the private and private sectors experience a greater increase in their income compared to

those working only in the public sector. Physician salaries benefit from the potential of combining work in the private and public sectors, primarily financed by sick-fund-sold private insurance (Chernichovsky 2013). In the meantime, those working only in the public sector experienced a significant increase in workload without increased wages (Chernichovsky 2013; Porat and Regev-Rosenberg 2013). Porat and Regev-Rosenberg (2013) display a positive correlation between the fact that physicians in Tel Aviv and Jerusalem earn significantly above-average wages and the number of medical procedures compared to the rest of Israel.

### *Inefficiencies Due to Duplicate Insurance*

34% of Israelis have both commercial health insurance and sick-fund private supplementary insurance schemes. Duplicate insurances promote an inefficient system, since those insured pay twice for similar and many times identical products. Moreover, commercial insurance companies do not only benefit from the premiums, but are also spared the expenditure, since sick-fund schemes pay for most of the services. This fact is expressed in the lower loss ratio for private commercial insurances (Simon-Tuval et al. 2015).

### *Inefficiencies Due to Duplicate Use of Services*

Patients holding both public and private health insurance visit specialists both in the public system and privately for the same problem, increasing the phenomenon of “doctor shopping” (Chernichovsky 2013). A recent research showed that 63% of patients searching for a second opinion did so in the private system. Fifteen percent of the whole sample reported consulting with three or more doctors for the same problem (Shmueli et al. 2016).

### *Inefficiencies in Technology Use*

The MoH is not involved in the direct regulation of the services provided by the sick-fund-sold private insurance. For this reason, the inclusion of new drugs, treatments and diagnostic technologies do not abide by criteria such as need or cost-effectiveness, but by marketing considerations, media pressure, pressures from the healthcare industry or from healthcare professionals (Horev and Keidar 2010).

## LOOKING FORWARD: RISKS AND ALTERNATIVES

The current situation represents a real threat to the public system, and the risks will increase as the number of physicians relative to the population will decrease in the next two decades (almost 50% of physicians will retire in the next 15 years, and the rate of new graduates per population is the lowest among OECD countries), putting further stress on the public sector and creating more incentives for patients to go private. Enhancing both efficiency and equality would require the public system to receive enough funds to cover real costs, and to redraw a clear boundary between the public and the private sectors. While the MoH and the MoF are planning steps in that direction (such as capping of private services, investment in reducing queues, and limits on physicians treating privately patients that they met in the public system), those steps are insufficient to cope with the magnitude of the problem, which requires a bolder approach. To redress the damages of privatization, it is imperative to correct for the decrease in public funding, correcting the current indexation formula so as to reflect real increases in health costs stemming from a growing and aging population and from the introduction of new technologies and treatments. As both the Israeli Supreme Court and the State Comptroller have asserted, since 1995 there has been an ongoing erosion of the public funding of health care (due to the lack of correction for demographic changes, and only a partial correction for technological advances). The second step must be the clear separation of the public from the private sector. To achieve that goal, sick funds should stop selling private insurance. Services that are considered important should be included in the public health-basket, while the non-important ones (cosmetic medicine, some me-too drugs), do not have to be provided by the public sick funds at all. As for the duplicate element of the insurance, which is a major source of both inefficiency and inequality, transparency, a national policy aimed to reduce queues and some choice of surgeon, provide an answer. All public institutions—sick funds and hospitals—should not be allowed to own or provide for-profit facilities or services.

Thirdly, physicians (and all other healthcare providers) should be confronted with the choice to work within the public healthcare system or the private one, provided they are fairly paid for their work in the former. These steps are surely costly, but could be financed in two ways. First, a 1% increase in the health tax.<sup>11</sup> Since citizens would not have to pay for the sick funds' private insurance schemes, the health tax rise will not

significantly (if at all) increase families' health expenditures. Second, by the reinstallation of the employers' health tax. Currently Israel is among a few OECD countries in which employers do not contribute at all for health care for their employees, even though they benefit from a healthy working force. Reinstalling the employers' tax would add funds into the system in a manner that would significantly contribute to pay for the actualization of the public budget.

While, as Mike Dent and Rothgang et al. showed for European countries (Dent 2003, 2005; Rothgang et al. 2005) commodification processes do take place within universal care systems, the Israeli case is illustrative, not only for the degree of privatization (deeper than in most European countries), but also for the form it took: blurring of the boundaries between the public and private sectors.

## NOTES

1. Clare Bamba has defined commodification in health care as the extent to which an individual's access to health care is dependent upon their market position and the extent to which a country's provision of health is dependent from the market (Bamba 2005).
2. There are authors (Gal 2010) who consider Israel as belonging to the Mediterranean regime. A more thorough elaboration on this question exceeds the limits of the present paper.
3. Until the beginning of the 1980s, there was no difference in the age-mix of the different sick funds, but between 1981 and 1994, the percentage of members older than 65 in *KHC* rose from 9.4 to 13%, while in *Leumit* it fell from 8.7 to 7.2%, in *Maccabi* from 6.1 to 4.8%, and in *Me'uhedet* from 8.3 to 4.1% (Rosen et al. 1995).
4. As Rosen et al. (1995) show, 4% of all those interviewed had wanted to move to another sick fund but were rejected, while another 8% did not even try to transfer—despite their wish to do so—because they thought they would not be accepted. Of all those rejected by a sick fund, 75% had applied to *Maccabi* and had been denied entry, mostly because of their age and health status. *Maccabi* did not enroll members over 60 and required potential members to undergo a medical examination, the results of which could be used to bar enrollment. All sick funds restricted the admission of chronically ill applicants.
5. Addressing the reasons for the apparently paradoxical transition to a universal system during a period of neoliberal reforms exceeds the scope of the present paper. For possible explanations, see Filc (2004).

6. Thus transferring to the sick-fund services such as mental health, dentistry and/or preventive care cannot be considered a form of privatization.
7. Between 1993 and 2000 the number of public beds increased another 16% compared to 35% for private beds (CBS 2003).
8. This change does not include the services provided by the sick funds, which are still considered part of the public sector.
9. While some 80% of the Jewish population owns private insurance sold by the sick funds, only 40% among Israeli Arabs do.
10. In 2012 in the Tel Aviv area there were 2.4 hospital physicians per 1000 inhabitants, while in the southern periphery 1.2 and in the northern one 1 hospital physician per 1000 inhabitants.
11. Currently, the 5% health tax is low when compared with other countries with similar earmarked taxes (usually within the 8–10% range).

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# Privatization of Education in Israel

*Tammy Harel Ben Shabar*

## INTRODUCTION

This chapter presents and analyzes the processes of privatization that have dominated the Israeli education system in the past 30 years.

Over the past 30 years, in line with similar developments around the world, Israel's education system has undergone processes of privatization. Several related causes have been documented as responsible for triggering privatization. First, the rise of neoliberal ideology and approaches of new public management that posit that the private sector has the tools to improve government, and education specifically (Osborne and Gaebler 1992). This may be viewed as 'top-down' privatization.

Second, beginning in the 1980s, dissatisfaction with the public education system led to a 'bottom up' form of privatization in which private entities including parents, organizations, and commercial companies became increasingly involved in education. This intervention, which took on different forms, including financial investment and involvement in educational content and practice, was not prevented by the government and was often even encouraged (Svirski and Dagan-Buzaglo 2009). Permissive rules for establishing non-state schools and the generous public funding they receive also encouraged opting out of the

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state education system altogether in favor of new non-state schools that would, supposedly, supply better education (Ichilov 2010).

Finally, whereas education was traditionally viewed as having a social function in promoting solidarity and common values, a fragmented approach toward education emerged (Scott and DeMartino 2009). This consisted of an individualist-consumerist ethos according to which education is a market-oriented private good that should be controlled by its consumers (students, families), rather than a public good with primarily social and political goals such as promoting solidarity and social cohesion and educating citizens (Boyd 2003; Ichilov 2010). From a different angle, ideals of multiculturalism contributed to the fragmentation of education by supporting the delegation of control from the state to communities and to their specialized schools. Education's role within the multicultural approach is to accommodate the particularistic beliefs, culture, and language of communities, and as a result, educational diversity and privatization is encouraged (Wolf and Macedo 2004).

As can be expected, the changes in social ethos and values relating to education drive privatization and enable it; these changes are also reinforced by privatization, as the new practices penetrate the educational landscape and mold the meaning of education in citizens' minds. The involvement of new players in education further steers the change of common perceptions of education's social role.

Privatization of education in general, as well as specific aspects of it, are heavily contested. This chapter aims to offer a description of the processes of privatization of education rather than an evaluative discussion of it. It does, however, mention some of the central concerns triggered by the different forms of privatization as well as some of the potential benefits. Steering clear from ideological controversies is only one of the challenges that arises in the discussion of privatization of education. Another involves defining the boundaries of privatization—which of the many related practices and processes that continuously affect education policy constitute privatization. Defining privatization is not a simple task; there is no single, agreed meaning of it, and the usage varies according to context. Most broadly defined, privatization in education (and in other domains) is the transfer of various activities from the public to the private sector. This includes contracting out provision of different services and goods; deregulating entrance to the education markets that were monopolized by the state; charging payment for education services;

initiating voucher schemes that allow choice between both public and private schools; transferring educational projects to private contractors; initiating partnerships between public and private entities; and more. There are other kinds of policies that do not involve transferring activities to the private sphere, and therefore do not constitute privatization in the strict sense, but since they support reforms of privatization and complement them, they can be viewed as part of the processes of privatization. Examples include decentralization of education control, school choice and competition between public schools, and the introduction of standards and accountability to educational governance.

Given that privatization is comprised of exceedingly complicated and interrelated practices, policies, and reforms, presenting these in a concise form within the limits of this chapter is especially challenging. Therefore, I do not purport to offer an exhaustive description of the different aspects of education privatization, and instead highlight its central manifestations in the Israeli context. As a result, there will inevitably be issues missing from this overview. For example, it will not be possible to discuss the historical aspects of privatization despite their importance for understanding how privatization evolved in Israel. Instead, I focus largely on contemporary issues and examples.

The chapter proceeds as follows: following a brief introduction to the Israeli K-12 education system, the section “[The Distinction Between Private and Public Education](#)” introduces the distinction between public education and private education, a useful, yet problematic, starting point for the discussion of privatization in education. The section “[Privatization of Education in Israel—An Overview](#)” surveys the processes of privatization that pervaded Israeli state education system in the past three decades. These are analyzed in three categories—privatization of funding, privatization of provision, and commercialization of education. The final section addresses an intriguing process that has taken place in the past 10 years in which government policy and regulations increasingly restrict the non-state education sector, thus diluting their “private” characteristics. Stripped of its traditional advantages, many of which are now available in state schools due to privatization, the private sector has gradually started to shrink. The result of the two (seemingly contradictory) processes, namely the privatization of state education and the restrictions imposed on private education, is that the distinction between “private” and “public” in education are becoming largely obsolete.

## K-12 EDUCATION IN ISRAEL

Education is a fundamental right granted by law to every child residing in Israel. Children in Israel are entitled to 15 years of free and compulsory education—two years of preschool, one year of kindergarten, and 12 years of school (The Compulsory Education Act 1949). The right to education is provided through a system of state schools that are established, funded, and run jointly by the central government (through the Ministry of Education—MoE) and by local authorities. The state education system is divided into sectors: a general sector that includes Jewish secular schools and Arab state schools (that are institutionally subordinate to the general sector but comprised of all-Arab separate schools that teach in Arabic), a Jewish religious sector, and two smaller sectors that were established in the past 10 years: the “integrated” sector in which religious and secular students learn together, and the Ultra-orthodox state sector.

Alongside the state education system, several types of non-state schools operate, differing in institutional status, degree of public funding, and the measure of autonomy they enjoy. The largest category of non-state schools (about 25% of the entire school population) are Ultra-orthodox schools. Another smaller category includes church schools that are autonomous, owned, and run by the churches. Other non-state schools include privately owned specialized schools of different pedagogical characteristics.

All non-state schools in Israel must be issued a license by the MoE to operate legally (The Supervision over Schools Act 1969). Notwithstanding extraordinary cases (referred to below), non-state schools are publicly funded, though the share of the public funding varies according to the legal status of the school (including “recognized”, “exempt”, and “culturally unique” (Perry-Hazan 2013)). State funding also depends on compliance with certain conditions, and can be decreased when rules are violated. Local authorities are also required to fund non-state schools in their jurisdiction and to supply them with buildings and infrastructure. All non-state schools are also subject to the regulation of teaching material, are supervised by the state, and are not allowed to discriminate against students on the basis of ethnicity, socioeconomic status, partisanship, sex and sexual orientation, nationality, age and personal status (The Student’s Rights Act 2000; The Prohibition of Discrimination in Goods, Services, and Entrance to Places

of Entertainment and Public Places Act 2000). However, the degree of state supervision over schools and intervention in their practices varies significantly. One category of Ultra-orthodox schools, for example, is completely exempt from teaching the core curriculum and schools are merely prohibited from teaching material deemed inconsistent with Israel's values as a Jewish and democratic state (Harel Ben Shahaar 2009).

### THE DISTINCTION BETWEEN PRIVATE AND PUBLIC EDUCATION

The starting point for my discussion of privatization in education is the distinction between private and public education. Privatization exists when a characteristic of education that was public (funding, management, teacher employment, etc.) becomes private. Public education in its most vigorous and comprehensive form has been described as (Boyd 2003, 5):

a democratic system of 'common' public schools, operated as well as financed by the government, that provides a standardized curriculum, treats everyone equally (irrespective of social class, culture, race, or religion), and is accountable to a publicly elected school board.<sup>1</sup> As part of a nonprofit public service, public schools are (ideally) supposed to be insulated both from politics and competition. They should not compete with one another for students or resources, or use selective or 'elitist' admission policies, and all schools should be treated alike and provide a "one best system".

Private education, according to this account, is the inverse: not publicly funded, is not bound by a state-set curriculum, is not accountable to a school board, is selective, unique, and competes over students and resources (Hess 2002; Boyd 2003).

Education reality (in any system) is, however, far less dichotomous. Public schools do not supply public education in this robust meaning, and private schools are usually not fully autonomous to do as they please. This lack of dichotomy should not be attributed to processes of privatization of the last three decades or so; public and private education, in the "pure" forms described above have never existed (Ball 2007, 187).

Since its establishment, and even more so following 30 years of privatization, the Israeli education system demonstrates this blur between public and private. State education is not exclusively publicly funded—a portion of schools' budgets has always been invested by parents; private entities have long supplied various services to state schools; and some

state schools select their students and are not open to all on an equal basis. Non-state schools, too, are not fully “private”: when the young state of Israel established universal compulsory education, and especially in post-elementary grades, there was a shortage in classrooms and teachers, making the state unable to supply the demand. Therefore, private schools, some belonging to chains associated with workers’ unions or local government, were used to disseminate public education—maintaining their non-state status, but serving the public in free, open to all, fully funded, and supervised schools. To this day, all high schools in Israel hold non-state, recognized status, and are owned and run either by local authorities or by private entities. Additionally, as noted, all non-state schools in Israel are financially supported by the state and regulated in areas such as curriculum, teacher employment, and antidiscrimination.

Processes of privatization over the past 30 years have blurred the distinction between public and private even further, as state education is gradually taking on characteristics traditionally associated with private education. Recently, in addition to privatization of the state sector, the MoE is implementing measures to restrict non-state schools in various areas of their activity, stripping them of the features that characterize private education. Taken together, these two processes weaken the distinction between private and public education in Israel even more. The next section describes the processes of privatization of state education; the restrictions on private schools will be discussed in the section “[Restricting Non-State Schools](#)”.

## PRIVATIZATION OF EDUCATION IN ISRAEL—AN OVERVIEW

### *Privatization of Funding*

Perhaps the most fundamental characteristic of public education is that it is publicly funded and supplied for free. However, a large and growing share of state schools’ budget stems from private resources—households, philanthropy, and commercial entities. The share of private funding of state schools has grown from 18% in 1996 to 24% in 2007 (Svirski and Dagan-Buzaglo 2009; Tzadok and Schwartz 2009). The increase in private funding leads, inescapably, to educational inequality, as wealthy households invest more in their schools than low-income families. Resources from other private sources, such as donations, are also inherently unequal because no central planning exists to ensure their equal

distribution. And indeed, up to five times more is invested in primary school children from higher socioeconomic status than is invested in children from lower socioeconomic status (Heller et al. 2007; Svirski and Dagan-Buzaglo 2009).<sup>2</sup>

The Compulsory Education Act 1949, which entrenches children's right to free state education also offers a few exceptions to the right. The act details a limited number of categories through which the state may charge payments for services in schools such as insurance, school trips and cultural activities, equipment, and enrichment programs (The Compulsory Education Act 1949; The National Education Act 1953). The specific sums are approved annually by the Knesset and are updated from time to time. In the 2016–2017 school year, for example, the Knesset approved a sum of 260 NIS (approx. \$70) for all categories of payments for children in Kindergarten and up to 1387 (approx. \$375) for 12th grade. Students in state schools may also rent textbooks at subsidized prices and enjoy school lunches, both of which are contingent on parents' contribution (The Book Rental Act 2000; The Warm Meals for Students Act 2005).

In addition to the standard parents' payments detailed above, multiple additional avenues allow private resources to infiltrate state schools. First, the MoE supervises the collection of payments from parents only to a limited degree, so parents invest in schools significantly more resources than officially permitted. According to the State Comptroller, an excess of 1 Billion NIS of parents' payments were collected in 2011 (Comptroller 2011), and similar figures were reported for previous years (Michaeli 2012). In a survey conducted in 2011, more than half of the heads of education departments in local authorities stated that schools in their jurisdiction operated specialized programs for which parents were required to pay (Vorgan 2011).

Since 2014, the MoE has expressly given up on preventing most of the flow of unauthorized payments into state schools. Instead, the MoE has chosen to regulate parents' payments, legalizing them to a large extent, while placing certain limits on the sums charged. A new circular allows schools, especially those that the MoE labels "specialized", to charge exceedingly large sums—up to 6500 NIS per year (approx. \$1750), for unique educational programs (MoE 2016a, b; Winigger 2016). Schools are also allowed to charge up to 1500 NIS (approx. \$400) for studying extra courses for matriculation exams (MoE 2016b; Winigger 2016). By increasing the sums schools may charge, the MoE

responded to the demand from schools and parents who wished to supplement the educational resources supplied by the state, while increasing supervision and transparency. This also, arguably, enables the MoE to make scholarships available to students from low-income families and therefore ensure equal access to educational programs. Additionally, the MoE contended that by regulating parents' payments they would be able to gradually decrease the amounts charged, although no clear explanation was offered as to how this would come about.<sup>3</sup> In addition to legalizing payments, the new circular also establishes a special committee that is authorized to allow schools to charge even higher sums than those stated in the circular (MoE 2016b). Various local authorities have also introduced Bring Your Own Device (BYOD) programs requiring parents to purchase laptop computers or tablets for their children to use in schools (MoE 2016a). While the regulations concerning parents' payments and BYOD programs purport to solve financial inequality by creating a system of scholarships and discounts, these can only address some of the concerns that privatizing funding raises. First, the scope of the scholarships is limited and not all those who need them actually receive them, partly because this requires disclosing the family's financial statements which some families prefer to avoid. Additionally, they do not apply to all programs and payments, and therefore inequality in educational services remains a significant concern.

In addition to parents' payments, private funding enters schools through donations from parents, philanthropists and commercial companies, in money, goods or services—including educational programs offered in schools. The entities offering these funds usually do so while also influencing and dictating educational content and agenda, an aspect that will be discussed in detail in the next section. It is quite hard to estimate the scope of donations in schools as they are underreported, however the figures supplied by the MoE show a huge increase in 10 years—from 100 million NIS in 1993 to 450 million NIS in 2002 (Michaeli 2012). Donations by commercial companies are permitted subject to the approval of a designated committee that examines whether the programs have educational value and whether they involve excessive advertising (Stein 2010).

Finally, schools that participate in the 'self-management program' are allowed to rent out their facilities for commercial use (such as conferences or after school activities), and use the revenue for school needs (Svirski and Dagan-Buzaglo 2009).

Private funds have become, over the years, an indispensable source of the education budget. Without it, the school day would be shorter, enrichment activities and reinforcement of the core curriculum would be cut, and crucial supplies might be unavailable. However, partnering with private entities (parents, non-profits and commercial companies) in financing schools has also led to a much more comprehensive involvement on their part, in all aspects of education—choice of content, pedagogy and management. This will be examined next.

### *Privatization of the Provision of Educational Services*

Privatization of provision occurs when private entities undertake the actual supply of education—operating schools, supplying educational programs and services within schools, as well as providing auxiliary services such as teacher training or computing. When they do so for a fee, this constitutes also privatization of funding. However, privatization of provision can also occur without privatizing of funding, as is the case with charter schools (or in British parlance—academies), that are operated by private entities while maintaining state funding.

#### *Private Schools*

The first form of privatization of provision concerns private schools. Israel's non-state sector is comprised of several kinds of schools, which differ in terms of legal status, state funding, and educational mission. The non-state sector was historically comprised mostly of religious schools geared toward answering the educational needs of the Ultra-orthodox and Arab-Christian communities, alongside a handful of veteran elitist non-state schools. Over the past 30 years, an increasing number of non-state schools outside these communities have been founded. Groups of parents dissatisfied with state schools organized and founded specialized schools with diverse educational missions: democratic schools, Waldorf schools, Zionist-Religious schools, bi-lingual schools, and schools that specialize in nature, science, and arts, and others (Hoss 2011; Michaeli 2012). In addition to the generous financial support that non-state schools receive, the MoE's licensing and recognition policy was, for some 20 years, supportive of non-state schools, and did not place substantial burdens on their establishment (Dahan and Yonah 1999). In several cases, legal challenges were made concerning the academic



quality of non-state schools or arguing that their establishment will cause damage to local state schools. Courts faced with these legal challenges were equally supportive of private schools, stating that accommodating parental autonomy was of paramount importance (Gibton 2003; Dahan 2013). As a result, for two decades, during the 1990s and the 2000s, non-state schools (mostly schools of “recognized” legal status) thrived, peaking at about one third of students in K-12 (Michaeli 2008; Ichilov 2010; Gibton 2010; Meron 2015; Weissblei 2012).

Gradually, the growing numbers of private schools became a real concern, not only for scholars or ideological opponents of privatization, but also for local authorities and the MoE. Two related concerns triggered the objection: the first was that a growing number of students, and especially students from high-income background, would desert the local state schools in favor of the newly founded non-state schools, causing the former’s decline. Another concern, which explains mainly the local authorities’ objection, originated in a 2007 legislation amendment called the Nahari Act (as is the name of the Ultra-orthodox member of Knesset who initiated it) that compelled local authorities to fund all non-state schools in their jurisdiction equally to state schools, in addition to the existing duty to supply buildings and equipment to non-state schools (Perry-Hazan 2013). This placed a growing strain on the local authorities’ limited education budget, requiring them to deduct from the funds allocated to state schools, for which they are in charge, in favor of privately owned and funded schools established without the local authorities’ approval.

These considerations motivated the MoE in the first years of the new millennium to deny several applications of new non-state schools. These decisions, however, were repeatedly overturned by courts,<sup>4</sup> which asserted that the technical requirements for recognizing schools—holding a license, teaching the core curriculum, enlisting a minimal number of students, teaching a certain number of school days, minimal training of teachers, and assuring adequate physical conditions in the school (The National Education Regulations (Recognized institutions) 1953)—were an exhaustive list.<sup>5</sup> Courts stated that the concern that establishing private schools would exacerbate educational inequalities was not an acceptable legal consideration. Attempts by local authorities to hinder the development of these schools through other routes, by withholding the funding and allocation of buildings, proved equally unsuccessful, and were struck down by courts.<sup>6</sup>

In 2008–2009, the MoE amended the regulations concerning recognized non-state schools to allow the Ministry to consider these issues when granting schools legal status and funding. The amended regulations authorize the MoE to decrease the funding of a non-state, recognized school if its student admission policy fails to promote integration between students from diverse social classes and academic abilities, or if the schools' student composition does not reflect that of the local authority in which it operates. Additionally, according to the regulations, the MoE may decrease funding and even deny recognition (which is tantamount to closing a school) if it has a negative impact on state schools in the area which includes closing of classes or schools; a decline in the number or percentage of students in public education; or damage to the integrative composition of public schools. The implementation of the regulations, however, was fraught with difficulty, as courts continued to strike down decisions to limit funding and recognition (Harel Ben Shahar 2012; Dahan 2013). Despite this, there are cases in which courts accepted the MoE's position to decrease, and even deny altogether, the funding of recognized schools.<sup>7</sup> These bureaucratic and legal hurdles have made the founding of non-state schools harder, and as a result fewer non-state schools are established. Moreover, a growing number of existing non-state schools are absorbed into the state school system. This will be detailed in the section “[Restricting Non-State Schools](#)”, below.

#### *Private Service Providers in State Schools*

Privatization of the provision of education is not limited to private schools, and occurs in state schools too. In the public sector, privatization of provision includes the infiltration of private service providers into schools and into the education system more generally. Numerous private entities, for profit and not-for-profit, operate educational programs in state schools meant to enrich and supplement the basic education supplied by the state (Dagan-Buzaglo 2010; Vorgan 2011). The content is not supervised by the MoE, and the instructors are employed by the private entity (Michaeli 2012).

Private educational programs have been operating in state schools for approximately three decades now. The initiative, originally and to this day, is usually the parents', their schools, and now also private entities that reach out and market their programs. For the better part of this period, these activities took place with little regulation and oversight by the MoE.

In 2008, an estimated 600 private nonprofit organizations worked in 90% of state schools (Michaeli 2008), on average 3.5 private programs per school operating at any time (Weinheber et al. 2008). As this estimate does not include for-profit corporations, the total is inevitably higher (Weinheber et al. 2008; Stein 2010). Some of these programs, and especially those operating most widely, such as the *Karev* Foundation's project, are directly supported by the MoE, through fund matching schemes (Michaeli 2012). Recently, the MoE created an online database in which all educational programs are detailed and users can evaluate and rank them.<sup>8</sup> The database currently includes 1777 programs that schools can choose from, sorted by topic, age of students, and whether or not they are offered for a fee; it also indicates specific programs that are prohibited in schools (MoE 2015c). The database does not offer a conclusive indication concerning the number of private programs in schools, as it does not include programs that consist in a single meeting or activity; on the other hand it does include programs operated (either free or for a fee) by the MoE itself as well as by other governmental units. It is also possible that there are further entities that work with specific schools and are not included. The database's main aim is to facilitate informed decision-making by educators; to enhance transparency by offering information about the program, the suppliers and users; and to enable users to rank the programs and supply detailed evaluations. It is not designed, therefore, to restrict the number of private programs or suppliers operating in schools or to offer any official centralized regulation of its content.

Some of the private programs offer, no doubt, high quality educational content and methods previously unavailable in schools. However, under existing regulations it is also likely that inadequate programs may operate for some time before market forces drive them out of business. Another worry is that some of the entities offering the services are driven by religious, political or commercial interests that may be undesirable in schools and unwanted by parents (Dagan-Buzaglo 2010; Michaeli 2012). For example, "Orange", an Israeli telecommunications company, funded the renovation of a sports field in a Tel Aviv school, and was consequently allowed to paint walls in the school orange, the color of the brand; Lev Lebayev, an Israeli philanthropist dedicated to reinforcing ultra-orthodox Jewish studies offered schools Jewish enrichment programs for free; A network of supermarkets offered a branded program for consumer education. These programs and others like them sparked opposition, and as a response to these growing concerns, the MoE issued

several circulars attempting to regulate the involvement of private entities and increase the supervision over them (Michaeli 2012).

Additionally, in 2007 the Prohibition of Commercial Activity in Schools Act was legislated, and later regulations were issued to implement it (MoE 2007, 2015b). These rules do not prevent the involvement of commercial companies in schools, but they condition their involvement on demonstrating that the programs have educational value. Still, doubts persist as to whether these rules are sufficiently restrictive, and accordingly whether commercial companies are still excessively involved in schools (Stein 2010). Recently, Israeli media criticized an initiative promoted jointly by the MoE and Israel's leading banks for financial education in schools (Datal 2017). Another potential worry involves the instructors employed in private programs. Unlike teachers, they are not employed by the local government or the MoE, but rather by the private entities or by contractors. As a result, the MoE lacks the ability to supervise their competence and training. Additionally, worries have been voiced concerning inadequate employment conditions of these instructors and infringement of their workers' rights, such as the lack of job security, and especially the practice of employing instructors for only ten months a year, when schools operate (Davidov 2010; Michaeli 2012; Paz-Fuchs, this volume).

Another concern involves the inequitable distribution of private programs. Private programs add a second tier of education, in addition to the curriculum supplied for free in all state schools countrywide. The infiltration of private programs, in a two-tiered system, creates educational inequality between schools that operate private programs and those that do not. When the programs are for a fee (constituting also a privatization of funding), this is especially disturbing, as they enable children from privileged backgrounds to receive advantageous education, similar to that of private schools (often also socially segregated like private schools), without bearing the full cost. The basic curriculum, infrastructure and management expenses are all borne by the state, and parents merely have to fund the additional programs. Thus, advantageous and segregative education for privileged children is subsidized by the state (Harel Ben Shahr 2017). Weinheber et al. (2008) corroborate this claim, demonstrating disparity between schools in the number of programs that operate in them. In approximately 50% of the schools that Weinheber surveyed there were between 0 and 2 private programs, whereas 9% of schools had 8 or more different programs operating simultaneously.

Even when private programs are offered for free (by organizations with ideological, philanthropic or commercial motivation), or purchased by local authorities, the decentralized nature of these programs, and the “bottom-up” mode of their initiation entails that their distribution is unequal, at least absent significant state intervention. While inequalities between schools in access to free educational programs does not always track socioeconomic class, it still undermines the values of equality that underlie public education.

In addition to allowing private educational programs in schools, the MoE contracts out various services that were previously performed by its employees (Dagan-Buzaglo 2010), such as finances and accounting, HR services, medical services in schools, computer, and technical support. Core educational functions (apart from traditional classroom teaching) are also contracted out, such as writing curricula, operating the educational services for sick children, programs for promoting students from disadvantaged families, programs for loaning textbooks, testing and evaluation, and more (Svirski and Dagan-Buzaglo 2009; Dagan-Buzaglo 2010; MoE 2015a). The scope of activity contracted out to private companies is massive, nearing one quarter of the MoE annual budget (Datal 2014). Alongside possible financial benefits, outsourcing core educational services, and especially those that have consequences for the realization of education rights, creates concerns that providers’ financial considerations may compromise the level of services students receive. For example, there have been repeated complaints that, as a cost cutting measure, the contractor in charge of supplying education services at home for sick children failed to recruit an adequate number of teachers, and that those hired were inadequately certified and did not cover the required topics (Weissblei 2015).

### *Private Management of Public Schools*

The final aspect of the privatization of provision relates to state schools whose whole operation and management are performed by private entities. Internationally, the best-known example for this type of school is the American Charter School—publicly funded schools of choice that are licensed by an authorized governmental agency, open to all, and accountable for students’ achievements. They are run by private entities and exempted from some of the regulation imposed on traditional public schools allowing them autonomy in designing their missions and

teaching methods (Buckley and Schneider 2002; Murphy and Shiffman 2002; Lubienski and Weitzer 2010). Similarly, the increasingly prevalent ‘academies’ in the UK are public schools run by private entities.<sup>9</sup>

The provision of public education by private entities is not a new phenomenon in Israel. When compulsory education was widened to include post-elementary education, the state partnered with non-state entities and authorized them to supply public education in schools that were fully funded and supervised by the state, open to all and taught the common curriculum (Ichilov 2010). The non-state entities included public entities such as local authorities, semi-public entities such as Israel’s largest worker union, mostly oriented toward vocational education, but also private education chains. As a result, even today, all high schools in Israel are non-state schools, owned and run by private bodies or local authorities.

Since the turn of the century, there has been a sharp increase in the number of schools that supply “public” education while being operated by private entities, and there has also been a significant change in their characteristics. While, traditionally, private entities supplied high school education, the new cohort of schools established or transferred to private management are middle (junior) schools and even elementary (primary) schools. Also, while high schools are managed and owned by the private entity (or local authority), the state maintains ownership of the middle and elementary schools and continues to employ the teachers.<sup>10</sup> The private entities, on the other hand, are given full charge of the schools’ operation, finance and even pedagogy: they determine the school’s mission; are involved in hiring staff; manage its budget; raise funds; the school uses the private entity’s letterhead; and the leadership of the private entity is consulted in any decision concerning the school. According to any practical criterion, therefore, the private entity owns and runs the school.

This structure, which applies to hundreds of schools, has evolved without appropriate legal regulation, as existing law authorizes only the MoE and local authorities to operate schools. With no rules to guide the process, many local authorities have entered into contracts with private entities (mostly the large education chains) to establish new state schools or run existing ones. In 2016, the MoE issued a circular which requires a tender as part of the process when choosing the operator of high schools, and details the criteria according to which the ministry should choose the entity (quality of the offer, price, and experience of

the private entity) (MoE 2016b). The circular does not address elementary and middle schools, and unlike Charter legislation in the United States that regulates every aspect of the Charter school's application, authorization and operation, the Israeli circular lacks detail and specificity. Correspondingly, some of these contracts lack provisions concerning termination of the contract, or criteria for evaluating success in the privately-run school. And while private chains may be able to supply quality education, they are unlikely take into consideration the wider principles of public education, unless properly regulated. Of course, dense legislation does not, by itself, guarantee the realization of public goals, and law-based educational reforms encounter various other challenges (Gibton 2013). Nonetheless, such minimal regulation is surely unsatisfactory.

### *Commercialization of Education*

Commercialization, the third category of privatization of education, involves the aggregation of several processes and reforms that import behavior and norms from the market into the educational sphere. These processes transform education from a service that is provided centrally by public agencies, using centralized decision-making processes and a common public policy into a private good consumed by individuals (primarily parents and children, but also communities) using market-oriented methods, such as choice between providers, competition and market accountability, and the use of educational standards.

Not all definitions of privatization include these processes of commercialization, liberalization and de-centralization. As long as the service is still provided by public institutions and is publicly funded, some argue, education is public. On the other hand, these processes involve altering fundamental characteristics of public education, and transferring them from the public, political realm, to the sphere of private interactions between consumers and providers. The ideology and interests driving the other forms of privatization are key to understanding these processes too, and they often occur concurrently, as part of the same processes.

The main educational reform associated with commercialization is school choice. Underlying the policy is the market assumption that one of the central ways to improve schools (like other goods and services) is to open it to competition by enabling parents to choose the school their child will attend. School choice was recommended by several

governmental committees that discussed education reform in Israel since the 1980s, most notably the 2005 Dovrat Report (Yonah and Dahan 2005, 2006), which was, incidentally, led by a prominent high-tech entrepreneur (Shlomo Dovrat) rather than an education expert. The Israeli choice scheme is called “controlled choice” because the local educational authority is required to consider, alongside parents’ preferences, additional factors such as the social composition of schools (Compulsory Education and National Education Regulations (Student Assignment) 1959). Controlled school choice was first introduced in the 1990s in Tel Aviv (Michaeli 2012) and in 2004 was applied nationally through the Assignment Regulations, to middle schools. It is an elective policy, meaning that local authorities can choose whether to opt in or assign students through the traditional catchment areas. In 2012 the program expanded also to elementary schools, starting with five towns in what was defined as an experimental program (MoE 2011). By 2014, 33 local authorities adopted school choice programs for elementary schools (MoE 2015). Special education assignment is also heading toward school choice, as a governmental committee that discussed reform in special education recommended allowing parents to choose between schools that offer similar services (Dorner 2009).

School choice reforms in Israel, as elsewhere, are largely accepted with satisfaction by parents who welcome the possibility to choose their children’s school. Notwithstanding this support, there is still insufficient evidence as to whether school choice improves schools, in Israel and beyond. Scholars also warn that school choice aggravates inequality, inducing the concentration of students from low-income families in underperforming schools (Ichilov and Mazawi 1997; Heiman and Shapirah 2003; Gibton 2005; Svirski and Dagan-Buzaglo 2009; Almog-Barkat and Inbar 2010). The public committees that recommended adopting school choice stressed the need to implement measures that will increase access to schools for students from low-income families, by supplying free transportation to schools, preventing academic sorting, and ensuring easy access to information regarding schools and regarding the process of choice. These measures, unfortunately, have not been implemented comprehensively (Almog-Barkat and Inbar 2010; Heiman and Shapira 2003). Additionally, to increase their competitiveness, schools often introduce specialized programs for a fee, thus creating barriers that exclude children from low-income families from quality schools and aggravates class segregation. School choice, together with



other forms of commercialization, can also be criticized on a more principled basis. Education is, arguably, a public, even political matter: the state has an interest in educating future citizens, and has a duty to ensure all children receive an education that prepares them for participating as autonomous individuals in a democratic society. Educational decisions are, therefore, not merely a private matter meant to pursue private ends; instead education is “other regarding”, it is meant to promote both private and public ends. According to this view, even if commercialization produces certain benefits, it involves a loss of the crucial political value of education.

In addition to school choice, de-centralization of educational decision-making exists in Israeli state education in other forms as well. Thus, 25% of Israel’s state schools’ curricula can be chosen by the parents of students in each school (National Education Act 1953), allowing for diversification of educational content and adapting it to the schools’ community. A majority of parents in a specific school can also elect to join the integrative sector of state education (National Education Act 1953), or adopt a specialized mission for the school, which is often then associated with private educational activities.

Two further educational reforms, which often accompany school choice and facilitate it, should be mentioned. The first is standardized testing, which helps the state supervise over an increasingly fragmented system, and therefore is a natural development in an era of privatization. In addition to being a form of state control, it also serves as a means to generate information required for parental decision-making (Michaeli 2012). The problem is that scores on tests (and other outcomes) present a skewed picture of education, as they do not distinguish between high achievement caused by the schools’ work, and high achievement that simply mirrors children’s pre-existing advantage. Standardized tests, especially when the results are made public, also create incentives for schools to exclude low-ability students from tests or from the school altogether. Tests, especially when they are high-stakes, also “corrupt” teaching, pushing schools to teach to the test thus crowding out other valuable content. To contend with some of these problems, the MoE decided not to publicize individual schools’ scores in the *Meitsav*, the Israeli National Assessments. This decision, however, was overruled by the High Court of Justice in a petition by the Movement for Freedom of Information,<sup>11</sup> and as a result schools’ test scores and local rankings are publicly available.

A second reform that may facilitate school choice is self-management of schools, mentioned above in the context of the privatization of funding. The idea that schools should have more managerial control was introduced to Israel's education system as early as the 1970s, and while several committees and Ministers tried to promote it, it has never been fully implemented nationally (Michaeli 2012). Self-management operates mostly in wealthy local authorities, transferring a range of decisions from the local and central government to schools, including managing school budget, choice of educational programs, hiring staff, and more (Michaeli 2012). The commercial ethos underlying this reform likens schools to organizations (MoE website) and reinvents the role of the school principle as a CEO, in charge of increasing competitiveness and raising funds rather than focusing on pedagogical, civic and ethical leadership.

The description of the three categories of privatization demonstrates the processes of privatization that pervade Israel's state education system in the past 30 years: education is becoming exceedingly privately funded; private entities are involved in schools and in educational bureaucracy making the operation of schools wholly dependent on them; and gradually the goals, rationale and practices of a market are endorsed in the educational domain. The final section of this chapter highlights another, more recent educational process, namely the restrictions placed on non-state schools. While this process may seem at odds with the values and rationales of privatization, I demonstrate that it complements privatization, by largely eliminating the distinction between public and private education.

### RESTRICTING NON-STATE SCHOOLS

Over the past 10 years regulation is intentionally eroding the non-state sector's traditional "private" characteristics, and especially non-state schools' ability to select students and to enhance their financial advantage.

The 2008–2009 amendments to the National Education Regulations (Recognized Institutions) 1953, described above, limited non-state recognized schools' ability to maintain selective admission policies, one of the main characteristics of private schools. The regulations authorize the MoE to penalize non-state schools (in terms of funding and recognition) if their admission policy is not integrative or if it causes damage to state schools in their geographical area.

In 2014, a further, important policy change limited another signature characteristic of private education, namely their ability to charge fees. In the same circular mentioned above, which increased the sums that schools are allowed to charge parents (MoE 2016a, b), a cap was set for fees in recognized schools. According to the provision, fees in non-state recognized schools may supplement state funding (which is lower, as a rule, for non-state schools than for state schools), however both components together may not exceed the resources available to state schools.<sup>12</sup> The circular, therefore, effectively deprives non-state schools of one of their most attractive traits—their advantageous resources. In fact, the new rules place non-state schools at a *disadvantage*, because although parents who enroll their children in them pay (much) more than parents whose children are enrolled in state schools, the resources that non-state schools ultimately have at their disposal are equal to those of state schools.

The same circular also details the parental payments allowed in schools (payments that are supposed to fund school trips, parties, enrichment activities, etc.). As described in detail above, the payments that the circular authorizes are exceedingly high, and therefore uncharacteristic of an ideal public education system. But what is especially telling is that the rules in the circular concerning parents' payments address state and non-state schools alike, and for the most part do not distinguish between the two, signifying yet again the convergence between private and public in the Israeli education system.

Restricting the fees that recognized schools may charge and placing limits on their admission policies significantly decreases the attractiveness of non-state education, and the number of new schools being opened is steadily dropping. Moreover, numerous existing non-state schools are being voluntarily incorporated into the state education system, a process celebrated by the MoE as a victory for public education. Thus, an agreement was reached between the MoE and the union of Waldorf and Democratic schools according to which they will all transform into state schools (MoE 2017). Similar agreements have been reached with the Jewish Religious *Noam-Tzviya* network, and others. Non-state schools are making this transition because the restrictions on non-state schools are eroding their unique characteristics, and making it extremely difficult for them to thrive.

However, the 'public education' system that non-state schools are joining is suspiciously similar to the "private education" it replaced. As privatization of state education deepens, non-state schools transforming

into state schools can maintain many of the desired traits of private education—private funding, autonomy in educational programs and management, and even segregative student composition (by selective assignment policy or by discouraging disadvantaged students from enrolling because of high fees)—within publicly funded state education.

Transforming non-state schools into state schools while maintaining their “private” characteristics, and allowing increasing numbers of existing state schools to adopt these “private” characteristics, further dilutes the distinction between private and public in education.

## CONCLUSION

Processes of privatization in Israel’s education system deserve a much more detailed and nuanced discussion than I have been able to perform within the confines of this chapter. Yet this admittedly sketchy description suggests an interesting conclusion. It seems that processes of privatization have permeated Israel’s education system so thoroughly, that the distinction between private education and public education has become wholly obsolete. As a result, discussions concerning education policy can no longer rely on the traditional public-private distinction. Instead, debates regarding education policy must begin with a more fundamental discussion of the appropriate role of education in modern society, what is it about education that is valuable for individuals, for parents and for communities, and examine whether a specific education policy promotes these values or hinders them. If, as a society, we still view education as a social institution meant to ensure equal opportunity, social solidarity, and democratic citizenship, alongside human development and individual growth, it is crucial we find new ways to incorporate these values into an increasingly consumerist and individualistic state education system.

## NOTES

1. Israel does not have elected school boards and the local education authorities are appointed and employed by the local authority.
2. The disparity in educational resources caused by the infiltration of private funding aggravates the inequality caused by disparity in funding between different local authorities (Ben Basat and Dahan 2008). State funding also has certain structural inequalities, that result in discrimination against Arab state schools, as is openly admitted in a report published by the MoE (2015d).

3. HCJ 6214/15 *Salomon v. Ministry of Education*. The MoE presented this in their written arguments, on file with the author. The case is pending.
4. Administrative Appeal (Jerusalem) 111/03 *The Zichron Ya'akov democratic school association v. State* (2003); Administrative petition (Nazereth) 1112/06 *Yehi Hassdecha association v. Hatzor Haglilit local council* (2007); Administrative Appeal (Jerusalem) 35243-03-10 *The followers of Housni Elqawasmi Organization v. The ministry of Education* (2011).
5. See for example Misc (local court Ma'ale Edumim) 27/05 *Pitbey Olam v. CEO of the ministry of education* (2001); Administrative Appeal (Jerusalem) *Zichron Ya'akov Democratic School Association*, *supra* note 3.
6. *Yehi Hassdecha*, *supra* note 3; Administrative petition 2316/04 *Local council Arabe v. Badarne* (2004); Administrative petition (Jerusalem) 8899/08 *Zimmerman v. ministry of education* (2009); Civil Case (Jerusalem) 1509/84 *Jerusalem township v. Efrayim*; But see Administrative petition (Tel Aviv) 1404/02 *Neot Rosh Ha'ayin association v. Rosh Ha'ayin township* (2002).
7. HCJ 282/14 *Elbiwar v. MoE* (2014).
8. <http://cms.education.gov.il/EducationCMS/Applications/TYH/hp.htm>. Accessed 30 October 2017.
9. <https://www.gov.uk/types-of-school/academies>. Accessed 30 October 2017.
10. According to a study performed by the Clinic for Law and Education Policy, The Faculty of Law, University of Haifa, there are several hundreds of state schools that are run by private entities. All relevant materials, including about 50 contracts between local authorities and private entities, on file with the author.
11. Administrative Appeal 1245/12 *Movement for Freedom of Information v. MoE* (2012).
12. In addition, recognized schools are allowed to charge overhead that covers their management expenses.

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# The Privatization of Social Services in Israel

*Avishai Benish*

## INTRODUCTION

Social services evolved as part of the grand vision of the “provider” welfare state, according to which states should assume responsibility for the well-being of their citizens (Titmuss 1968). The public delivery of services in the social realms was perceived as a main vehicle for promoting values of equality, solidarity and social justice—as captured in Marshall’s concept of “social citizenship” (Marshall 1981; Doron 2013). This approach emphasizes the role of the welfare state in the de-commodification of social services and the place of the public sector as the main arena in which welfare can be adequately and fairly delivered as public, nonprofit, noncommercial services, available to all at a uniform standard irrespective of means (Marshall 1981). However, the influence of neoliberal ideology, along with criticism on “government failures” and the inefficiency of public bureaucracies, has led to major transformations in the governance of social services. A key component in these transformations is the privatization and marketization of social services, part of a larger trend of public administration reforms often referred to as New Public Management (NPM) reforms (Hood 1991). As a result, private

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actors and market logic occupy a rapidly increasing role in the funding and delivery of social welfare (Gilbert 2005; Brodtkin 2007; Leisering and Mabbett 2011).

This trend toward privatization and marketization of social welfare is also dominant in the Israeli context. While in the three first decades after its establishment, Israel developed a welfare state with a relatively strong commitment to state-provided benefits and services, in recent decades, it has become increasingly committed to market solutions in social welfare (Gal 2010; Doron 2016). The fields of personal social services and social assistance, which are at the core of this chapter, were always a weaker branch of the Israeli welfare state in terms of public expenditure (Zeira 2013), and private actors took a significant part in the delivery of personal social services from the early days of the state. However, since the mid-1980s, the scope of outsourcing of services to private—nonprofit and for-profit—providers and the scope of the use of competitive tendering and performance-based contracting have increased dramatically. Joseph Katan, one of the leading Israeli scholars in this field, has described this process as “massive privatization” (Katan 2008).

For a long time, the trend of privatization in social welfare in Israel has flown under the radar of public attention, as in many other fields of public services (Galnoor and Paz-Fuchs 2015). However, in recent years, and in particular after the 2011 social protests in Israel, public debate on the appropriateness and effectiveness of privatization of various public services is growing, including in the realm of social welfare. And indeed, the social protests sparked a lively public debate on the implications of the massive privatization of social welfare services. The issue of privatization of public services in general was central in the report of the Trajtenberg Committee—a public committee established by the government as a response to the social protest (Trajtenberg Committee 2011). It was also central in a report that academics and social welfare professionals prepared for the protesters’ leadership, though interestingly, there was a divide in the report on whether outsourcing in the realm of social services is inappropriate per se and should be totally reversed, or whether the problems of outsourcing can and should be resolved through better regulation and accountability arrangements in the privatized services (Davidson-Arad et al. 2012).

Against this background, the purpose of this chapter is to present the privatization of social services in Israel and to examine the Israeli experience regarding the implications of privatization to the characteristics of

services, to the recipients and providers of the services, and to the public at large. The chapter will rely mainly on the fields of personal social services and “welfare to work.” Section 2 will provide an overview of privatization in these fields; the subsequent section will present lessons and dilemmas from the Israeli case that might be of interest in both the Israeli and the international context. The concluding Sect. 3 will revisit the consequences of the privatization of social services in light of the social protest and the Trajtenberg report and will look forward to the future of privatization in this field.

### THE PRIVATIZATION OF SOCIAL SERVICES IN ISRAEL: AN OVERVIEW

Personal social services in Israel include a range of social services, which aim to help individuals, families, groups, and communities at risk to overcome their problems and to improve their integration into society (Katan 2008). The services include both community-based and residential services, such as: after-school programs and day care centers for children at risk, residential care for at-risk youth, foster care, nursing care services for the elderly, rehabilitation centers for the disabled, centers for drug addicts, women’s shelters, and services for the homeless. The Israeli Ministry of Social Affairs and Social Services (hereinafter—the Ministry of Social Services or the Ministry) is in charge of most of these services, though the municipalities play a significant role by administrating the local social services offices and by assuming responsibility for 25% of the funding of the services. Despite the importance of these services, the legal framework for delivering personal social services in Israel, which was enacted in 1958, is outdated and highly discretionary (Yanai 2006). A significant exception is the service of home nursing care for the elderly, which was enacted in 1986 as an explicit social right and is under the responsibility of the Israeli National Insurance Institute (NII).

As mentioned above, social services in Israel have always been provided through a mix of public (state and municipal) and nongovernmental (usually voluntary) organizations (Ajzenstadt and Rosenhek 2001). In his comprehensive research, Ralph Kramer (1989) described the arena of personal social services in Israel in the 1980s as characterized by a “high degree of interpenetration of institutional sectors, dominated by central government, with voluntary agencies as complementary but not necessarily as the preferred provider” (p. 135). However, the nature of this

public–private mix has changed dramatically over the last three decades in several dimensions. First, the scope of outsourcing has increased continuously. Currently, about 80% of the budget of the Ministry of Social Services is devoted to purchasing services from nongovernmental providers, and the NII entirely purchases elderly home care services from nongovernmental agencies. Indeed, from a budgetary perspective, personal social services are the most privatized services in the Israeli welfare state. Second, while initially contracting out was almost always with nonprofit organizations, over the years, the portion of for-profit actors in the service arena has grown constantly, and for-profits currently provide about 50% of the services for the Ministry of Social Services and about 75% of the elderly home care services for the NII (Madhala-Brik and Gal 2016). Third, while in the first decades, the purchase of services from nonprofits was based on an ongoing relationship between the Ministry and the service organizations, the enactment of the Israeli Mandatory Tenders Act 1992 led to a strong push toward more formal and competitive contracting arrangements, which attempt to mimic the market environment so as to allow the government to buy better services at a lower price (Benish 2012a; Maron 2015).

A significant milestone in the privatization and marketization of social services in Israel, as in other fields, was the 1985 Stabilization Plan that set strict restraints on both public expenditure and the expansion of public-sector employment. The most dominant actor in pushing toward these restrictions was the Ministry of Finance (MoF), which gained significant institutional power to control the expenditure of other ministries after the economic liberalization program in the mid-1980s (Mandelkern 2015). Often motivated by the aim of restricting the expansion of the public sector, the MoF conditioned any increase in the budget of the Ministry of Social Services with the privatization of services and the use of competitive tendering. At times, in order to establish new services, the Ministry and local municipalities even took an active role in initiating new nongovernmental organizations to deliver these services without extending the public sector. This engagement of the Ministry of Social Services with the grand project of privatizing personal social services was partly a pragmatic compromise with the MoF's requirements, but at least partly driven by the belief of the Ministry's senior staff that private organizations, due to their expertise, can deliver better and more innovative services (Katan 2008). Moreover, after failed efforts to initiate reforms in the public-sector run services—largely due to strong union

opposition and collective bargaining protections—the senior staff in the Ministry was captivated by the more flexible and controllable nature of contracting, which was perceived as a more practical way to advance reforms and improve services for citizens (Katan 2008; Paz-Fuchs, this volume). Thus, as a result, during the 1990s, the delivery of most of the personal social services of the Ministry of Social Services was devolved to nongovernmental providers.

The case of elderly home care services reveals similar dynamics (see Ajzenstadt and Rosenhek 2001; Borowski and Schmid 2001; Schmid 2003; Asiskovitch 2013). The Elderly Home Care Insurance Act 1988 establishes elderly home care services as an in-kind social entitlement for the frail elderly who are completely or partially dependent on assistance to carry out daily activities. It was enacted in response to substantial growth in the percentage of elderly persons living alone and expressed increased professional support for treating older people in their own homes and communities rather than in institutions. Contrary to the general trend of stagnation and cuts in social welfare expenditure, this enactment extended public expenditure in this field. Although eligibility is means tested, the threshold is relatively high, so the service is not targeted only to elderly persons living in poverty. However, one of the conditions of the MoF for supporting the legislation was that the provision of the services would be contracted out to private organizations. It promoted this approach as a means of reducing costs and delivering services within a relatively short period without adding employees to the civil service payroll (Ajzenstadt and Rosenhek 2001). Over the years the number of service recipients increased significantly, and in terms of both expenditure and number of clients, this has become the largest personal social service in Israel.

Another significant milestone in the privatization of social services in Israel was the initiation of the Israeli welfare-to-work program. The program was driven by rising spending on social assistance and enduring dissatisfaction with the Israeli Public Employment Service (PES) in conducting the “employment test” for social assistance eligibility. It was also inspired by the global trend of welfare reforms, but it was particularly inspired by Wisconsin’s model, and, therefore, became known as the “Wisconsin Program.” The program was enacted in December 2004 and became operational in August 2005. Under the influence of the MoF, the program adopted a strong market-oriented governance structure: it created a mandatory requirement to contract out the operation of the

program to private providers based on competitive tendering, and the main steering mechanism for the contractors was a performance-based payment model. However, this market-oriented governance approach of the program underwent significant transformations during its implementation due to widespread public concerns about contractors' trustworthiness and fairness (Benish and Maron 2016). Although the program ended in April 2010, when the Knesset (the Israeli Parliament) refused to extend it, it still provides an excellent case study for better understanding the effects of market-type strategies in the realm of social welfare.<sup>1</sup>

## THE PRIVATIZATION OF SOCIAL SERVICES IN ISRAEL: LESSONS AND DILEMMAS

After presenting the privatization in the fields of personal social services and welfare-to-work, this section will elaborate on the lessons and dilemmas that emerge from the Israeli case and might be of interest in both the Israeli and the international context. It focuses on eight central and often interconnected elements of the privatization of social services and the adoption of market logic in their delivery: competition, performance-based management, choice, quality and price, workers' rights, professionalism, public values and accountability, and the regulatory role of the government.

### *Competition*

The introduction of competition to social services as part of NPM strategies is intended to mimic market economy in their delivery and to allow better quality of services while reducing their cost. One major mechanism for this purpose is the use of competitive tendering. In recent decades, a global trend to make tenders mandatory in the procurement of public authorities became evident, and as mentioned, in Israel this was done through the enactment of the Mandatory Tenders Law 1992 (Shalev 1999).

The examination of the Israeli experience shows that the use of tendering does not necessarily create competition. This is most apparent in the tenders of the Ministry of Social Services, in which there have often been a very limited number of contestants. Indeed, in some services,

there has been almost no turnover of service providers over the years. This lack of competition is probably best seen by the fact that 46% of the expenditure of the Ministry for purchasing social services is paid to 2% of the providers (Madhala-Brik and Gal 2016), and in some areas, such as homes for the developmentally disabled, there have been almost no changes in service providers for over 20 years (Mandelkern 2012). This high concentration and low level of contractor turnover in service provision within a limited number of large providers probably stems from the relatively high entrance barriers for new providers in this field (often requiring considerable service-specific expertise) and from the convenience to public officials of working with known providers (Handler 1996). Furthermore, there are examples in some areas of social services of providers acting together through associations that act as a sort of cartel to undermine competition (Mandelkern and Sherman 2015).

The obvious question is, of course, how competition in these tenders can be promoted, but two additional, more profound, questions should also be raised. The first is whether competition is inevitably limited in the “market” for personal social services due to the unique characteristics of these services, particularly the difficulty of defining clear standards of service delivery in care-oriented human services (Hasenfeld 2010). The second question is whether a market logic is well-suited or appropriate in the field of social services. For instance, in some services, the instability that is inherent to competition may be in tension with the professional logic of care, which often prefers long-term and stable environments and relationships. Moreover, under the threat of losing the next contract, providers may be reluctant to share their best practices, something crucial to the development of services, with other service providers for fear of losing their competitive advantage. Finally, the fact that some of these services are “too important to fail” (and indeed in some instances, providers have been “bailed out” by the government) may undermine the effectiveness of market discipline and lead to opportunistic behaviors on the part of the contractors.

Another important issue that has emerged in this context of competitive tenders is the problem of unrealistically low bids. The competitive tendering process is designed to allow public authorities, as the purchasers of goods and services, to get the “optimal deal” (Shalev 1999), which in most cases, means purchasing the service at the lowest possible price. However, in some instances, the competitive tendering process



has triggered a “race to the bottom” dynamics in bid levels, leading to bids considered unrealistically low, at a level that endangers the integrity of service provision in terms of workers’ rights (discussed below) and in terms of service quality. As a result, the Ministry of Social Services decided to shift its policy from “competition on price” toward “competition on quality.” This means that the price for the services is administratively set by the Ministry, and providers compete for the quality of the services they provide. This method of tendering has mitigated some of the problems but has also created a series of new challenges. First, determining the winning bid by reference to quality is subject to criticism of subjectivity, at best, and potential corruption, at worst. Moreover, administratively setting the price does not necessarily guarantee that this price is sufficient to provide the services required under the contract. For example, in a case of quality-based tendering in the field of residential elderly care that reached judicial review, the court ruled that the price set by the government was unrealistically low.<sup>2</sup> Nevertheless, despite these shortcomings, it seems that for the Ministry of Social Services, quality-based tendering is the lesser evil, and it has become the prominent method of tendering in the field of personal social services.

These limitations of the competitive model in the context of personal social services create a dilemma in the prevailing logic of social services contracting. Should it be based on the logic of “competitive contracting” that underlies the Mandatory Tendering Act, which relies on periodic tendering, or on the logic of “relational contracting,” which relies on long-term, close, and cooperative relations with service providers? Each of these logics of contracting has both strengths and weaknesses. The latter is less competitive, but is based on the assumption that such a structure creates stewardship relations that may be more suitable in hard-to-define, long-term, and dynamic services (Van Slyke 2007; for the application of such an approach in the field of residential homes for people with intellectual developmental disabilities, see Mandelkern 2012). It may also provide a more stable framework for service delivery, which is necessary to achieve the care-oriented goals of some social services. At the same time, such an organizational structure is prone to political and administrative corruption and stagnation. Quality-based contracting tries to balance these models by maintaining the competitive framework while redirecting its focus to quality. However, further research is needed to ascertain whether and when this model works in an effective and stable manner.

### *Performance-Based Management*

A second major dimension of NPM reforms is the effort to mimic the “bottom line” culture of private corporations by adopting performance-based steering in the governance of social services. Thus, while “old” public administration was mainly input—and process-oriented, NPM reforms often opt for incentives and performance-based payments in order to strengthen the motivation of service providers and to increase the efficiency and effectiveness in terms of results.

In the Israeli context, the most ambitious attempt to incorporate performance-based steering into the governance of social services was the Israeli welfare-to-work program. The program designers, relying on economic logic, assumed that shifting the “risk” for benefit payment to the contractors would create the right incentives for the providers (Benish and Maron 2016). Therefore, the program adopted a strong business-like payment model. Contractors were paid based on reductions in income support expenditures in their region beyond a 30% threshold, and additional bonuses were paid for decreasing the number of beneficiaries. The contractors were also rewarded with 5% of their savings on work support services.

However, this performance-based payment model encountered widespread public criticism. Claims were made that the rights of welfare recipients were secondary to the contractors’ economic interests. The clear linkage between contractors’ profits and the decrease in benefits and services gave rise to the argument that, as the CEO of one of the advocacy groups put it, “the money taken from welfare recipients is transferred into the pockets of the corporations running the program” (Benish 2014a). This criticism trickled into the report of a special committee of the Israel Academy of Science and Humanities, which was asked by the government to evaluate the program. In its report, the Committee emphasized the perverse incentives that could emerge when applying market logic in the realm of welfare:

[W]e are dealing not with privatization of a purely economic activity, but the outsourcing of a basic social service ... The way risk is allocated may affect the behavior of the contractors: when most of the financial risk is imposed on them we should expect more vigorous activities of the contractors to score high compared to the performance indicators, and that might come at the expense of safeguarding the rights of the participants. (IASH 2007, 92)

As a result of the mounting criticism, particularly in order to mitigate the conflict of interest concerns, the initial performance-based model was profoundly revised. At first, the payment model was restructured so contractors could not directly profit from actively imposing sanctions on participants; later, the payment model was further revised to focus on job placement and retention rather than on decreasing welfare rolls. Moreover, the bonus to contractors for saving on work support services was omitted in the second contract. This highlights that beyond the more general debates on the relative strengths and weaknesses of performance-based strategies, the *details* of the performance targets and incentives can be of crucial importance to the logic that will dominate service delivery and to its legitimacy.

Performance-based steering is far less developed in other fields of social welfare services, but it is interesting to note that in 2007, the Ministry of Social Services initiated a project—"The Outcomes Initiative"—that strove to improve social care services by incorporating outcome-oriented thinking as part of the professional standards of service delivery. The project tried to encourage defining services according to the outcomes they need to achieve and to routinely measure these outcomes. In that respect, this fits well with the results-oriented logic of NPM. However, this project was initiated as an internal *professional* effort of social workers to better articulate and reflect on their professional skills and values. Thus, it is different from most NPM-oriented performance-based initiatives, in which the targets are often set externally by policy makers, managers, and audit-oriented professionals, who are usually more concerned about cost-effectiveness, financial integrity, and legal accountability. This highlights again the importance of the details of the performance measurements and the importance of who is designing them (Brodkin 2007, 2011).

### *Choice*

The third central feature of NPM is the introduction of choice into the delivery of social services. Choice-based services—such as vouchers—are designed to allow service users the right to choose in relation to the identity of the provider and the content of the service (Greve 2011). According to Le Grand (1991), by imitating the market, such arrangements should improve the allocative efficiency of public budgets, create competition among suppliers, and increase the responsiveness to the

needs and desires of citizens-customers, thereby empowering them and enhancing their individual freedom and autonomy (Le Grand 1991, 1263).

However, in most social services in Israel, clients are not offered any choice, particularly in terms of choosing their service provider. For instance, in the Israeli welfare-to-work program, despite its strong NPM orientation, giving participants the right to choose their job center was never even considered as a policy option. Quite the contrary: policy makers explicitly tried to limit the ability of participants to move out of their regions for fear that participants might try to evade the program. This seems to reflect a general assumption of policy makers that benefit recipients will choose to evade their responsibilities (Benish 2012b, 274). In the field of personal social services, there are instances when service recipients can—formally or informally—move from one provider to another. However, they do not have the *right* to choose; switching to another provider, if such a provider is available in their area, is usually subject to the approval of a governmental committee. Moreover, “choice” per se, from a consumerist stance, is generally not something that policy makers, as well as street-level workers in the Ministry of Social Services, would consider central to service delivery. Nevertheless, it is interesting to note that the idea of clients’ participation in decision making is increasingly gaining the attention of the Ministry, as a professional, rather than consumerist, approach (Levin 2012; Levin and Weiss-Gal 2009), though recent research suggests that the idea of participation is still far from integrated into social workers’ professional practices (Alfandari 2015).

The most significant exception is the field of elderly care, as the elderly can usually choose their service agency (State Comptroller 2011). However, a survey of 184 elderly people entitled to the service (held for the NII in 2007) found that about 20% of the service clients wrongly believed that they did not have the right to choose their provider, and an additional 38% replied they did not know whether they could or could not choose their provider (Werner 2007, 20). Moreover, only 38% were familiar with the kind of services they might expect under the law (Werner 2007, 20). These findings, though limited in scope, clearly indicate that the ability to exercise choice is severely limited at the outset for a large segment of the service users. In addition, the NII does not systematically publish information about providers’ performance or indicators of service quality or customer satisfaction statistics, so to exercise

their choice, individuals and families need to use anecdotal information based on their own informal networks.

Therefore, while choice is highly celebrated as way of increasing efficiency and quality and empowering service clients, it is rarely available in Israeli social services, and even when it is available, service users are not always aware of their right to choose. The dilemma for policy makers is thus twofold: first, when is it appropriate and practical to give social services clients the right to choose and, second, what should they actively do to overcome the various—informational, educational, economic, cultural, lingual, and geographical—barriers to exercising choice?

### *Service Quality and Price*

As mentioned, the privatization and marketization of social services are intended to deliver better services at lower costs. Improvement in quality and reduction of cost are supposed to stem from clear definitions of the services in the contracts (preferably in terms of results) and from the competition among suppliers for government contracts or for individual clients (when choice for service users is available).

In the field of personal social services, despite the widespread use of privatization, almost no comprehensive research has been conducted to evaluate the effects of privatization on service quality and price. One significant exception is an evaluation in the field of residential homes for people with intellectual developmental disabilities that was published in 2012 (Zemach-Marom et al. 2012). The research examined the quality of service in governmental, nonprofit, and for-profit institutions in various aspects, such as the offered activities, living conditions, work practices, personnel, buildings and maintenance, and health. The study found that in these aspects, the quality differences between the three types of organizations were relatively small but significant differences existed within each type of service delivery. The most obvious difference was that services by nonprofit and for-profit institutions received higher scores in overall client satisfaction (Zemach-Marom et al. 2012, 6–9). However, other research that examined well-being perceptions among service recipients in the same field found better results in homes run by government and nonprofit organizations (Levite Brenstein 2011). Beyond these studies, there is some anecdotal evidence of both improvement and deterioration of service. For instance, on the one hand, officials in the Ministry of Social Services reported significant improvement

in service quality in foster care services following the contracting out of these services (Korazim-Korosy et al. 2005). On the other hand, another study, based on interviews with social workers in privatized personal social care services, concluded that the erosion of working conditions had negative implications for the quality of services due to poor motivation and a high turnover of workers that affected the stability of care relations and staff professionalism (see Paz-Fuchs and Shlosberg 2012).

In the field of home elderly care, a comprehensive evaluation of the efficiency and effectiveness of the services published in 1993 (five years after the service was started) found a high level of customer satisfaction (about 3.9 out of 5) in both for-profit and nonprofit providers (Schmid 1993). No similarly comprehensive surveys on customer satisfaction have been carried out in the last 15 years, but a smaller survey in 2007 found that about 80% of clients were satisfied with their service (Werner 2007, 18). However, clients also mentioned a problem of caregivers not arriving regularly, particularly that caregivers did not actually work all the assigned hours (Werner 2007, 18). The latter problem was described by the NII as “theft of working hours” and “the cardinal problem of service provision,” resulting in the elderly not receiving the services to which they were entitled by law and in the NII paying for services which were not actually provided (State Comptroller 2011, 248). Moreover, as a result of low working conditions, home caregivers report low levels of job satisfaction, less commitment, and less motivation to provide efficient and effective services to their clients. In addition, there is considerable anecdotal evidence that workers may try to compensate themselves by devoting less attention to the elderly client, reducing the actual number of hours of work, inflating the number of work hours reported, arriving late at the client’s home, and changing care schedules. This obstructs the continuity of care, impairs relationships with clients, and lowers the quality of services (Schmid 2005, 196–197).

In the field of welfare-to-work, an evaluation report on the program by the Brookdale Institute and the NII found better performance of the privatized program in terms of reduction in social assistance payments and placement rates (NII 2010). For instance, in the privatized program, about 41% of program participants stopped receiving income support payments within eight months of the date of referral, compared to 23% in the PES. In terms of placement rates, in the privatized program the placement rate was 9.6% higher than in the PES. However, the validity of the comparison was questioned because the PES and the

private operators delivered considerably different programs. It is reasonable to assume that much of the “success” in the privatized program can be attributed to the significantly harsher requirements of “employment test” and the greater flexibility case managers had in treating the welfare recipients (Mandelkern and Sherman 2015). Moreover, the Wisconsin program was the target of an unprecedented volume of complaints from participants and advocacy groups on unfair treatment by the contractors and their workers (Benish 2014a, b; Maron 2014).

Turning now to the cost of privatized services, here again, there has been no comprehensive and systematic evaluation of the cost saving in the delivery of social services due to privatization. In fact, the shift to privatization in Israel was quite dogmatic. This is best reflected in the response of the Ministry of Social Services to an inquiry of the State Comptroller on whether there was any research on the prospects of cost saving due to privatization. The response of the Ministry was that there was no need for such research since “there is a consensus that the privatization of government institutions has advantages in terms of cost” (State Comptroller 2007a, 644). Nevertheless, the above-mentioned 2012 research on residential homes for people with intellectual developmental disabilities supports that assumption, finding that the cost of service per-client in the public-sector run care homes was higher by about 42% than in homes run by for-profits and by 55% than in homes run by nonprofit organizations (Zemach-Marom et al. 2012, 11). However, it is important to note that a significant part of this “cost gap” represents lower salaries and reduced rights of the workers in the nongovernmental care homes and the fact that the public homes were not used to their full capacity (Mandelkern and Sherman 2015).

As for the relative cost of service in the Israeli welfare-to-work program, while a research firm hired by the government to evaluate the program argued that the cost of an “effective placement” in the PES was higher by 17–44% than in the private job centers, the research center at the PES argued that a single placement of an unemployed person in the private job center was about 23 times more expensive than a placement in the PES. These enormous gaps in the estimates are a result of disagreement as to the methodology of such a comparison and claims that these programs cannot be really compared because of the above-mentioned profound differences between the public and the private programs.

### *Workers' Rights*

Since the 1985 Stabilization Plan, the Israeli government has implemented a policy of freezing public-sector employment and replacing public-sector workers with temporary manpower and workers from contractor companies (for the dynamics of this policy, see Paz-Fuchs in this volume; see also Davidov 2009). This entailed a move from a bilateral to a trilateral employment structure. While in the traditional welfare state, the government was the direct employer of the workers who deliver social services, in the privatized model the private contractors become the employers of the workers while the government is presumably only the purchaser of services, not the employer. Although these arrangements were contested in Israeli labor courts, the courts tend to approve such “indirect” employment arrangements as long as the government contracted with a contractor for the whole service (see Paz-Fuchs this volume). As a result, employment through contractors has become widespread in the delivery of social welfare services, as in many other public services.

Not surprisingly, research indicates that this trilateral employment structure has led to more precarious working conditions: lower salaries, lower level of unionization of employees, no job security, and increased wage inequality among workers (Kaufman 2008; Paz-Fuchs this volume). And often, the dynamics of “unrealistically low bids,” described above, combined with lax enforcement of employment laws (Eliav et al. 2010), has led even to violations of the statutory labor laws, which prescribe minimum rights. For example, in the field of elderly care,

the workers [home caregivers] come mainly from low socio-economic groups... most of them work part-time, and their annual earned income is very low. As a class of workers, they do not belong to a labor union. Thus, they have little job security, few fringe benefits, no opportunities for advancement, and their work is usually undervalued by their employers. Notably, the employers often disregard the law and deny home care workers some of the social benefits they are entitled to by law. (Schmid 2005, 196)

This demonstrates how much of the reduction of the cost of service delivery is due to the reduction in workers' rights. Moreover, the fact that about 90% of the home caregivers are female highlights the often-overlooked issue of gender inequality, which is embedded in the privatization of social care services (Benjamin 2015).



For a considerable time, the working conditions of contract workers flew under the radar of public debate. But this has changed over the last decade, with the government taking more responsibility as the service purchaser of the contractor workers' rights. For instance, in 2008, in the field of home elderly care, the NII required the providers to pay home caregivers salaries that were higher than minimum wage by 4%, as well as some other fringe benefits, despite strong resistance from private contractors. Moreover, in a 2011 strike, public-sector social workers demanded, *inter alia*, that working conditions of social workers in privatized services be equalized to those of social workers in the public sector. While this demand was rejected by the MoF, it agreed to create a special contractual "minimum wage" provision for contracted out social workers, about 75% above the general minimum wage. After further pressure, in July 2015, the MoF agreed to extend many of the rights of public-sector social workers to social workers in privatized services. The agreement became effective in March 2017, and it remains to be seen whether and how these agreements will be implemented. Nevertheless, it seems that after years of repudiating any responsibility for the working conditions of contractors' workers, the MoF—due to mounting public criticism and in an effort to mitigate pressure to directly hire all of these workers—is willing to take some responsibility for the working conditions of these workers, albeit still indirect and limited.

### *Professionalism Under Privatization*

The new structure of service delivery significantly changes the role of the professionals who run social services. Social services in the provider welfare state were often designed as "professional bureaucracies" (Mintzberg 1979), relying heavily on social workers, nurses, and other care professionals or semi-professionals for service delivery. In the Israeli case, the privatization of social services has dramatically transformed the role of care professionals in both the public and the private sectors. In the public sector, for example, street-level social workers more often assume the role of "case managers," referring clients for treatment in contracted organizations, rather than providing treatment directly. This often generates motivation problems, due to the gap between the care-oriented training of these workers and the more administrative nature of their day-to-day realities. As for the management levels, public

officials are now occupied with setting and managing tenders and contracts with private suppliers and regulating them, rather than directly managing service delivery through their departments. In that regard, service managers often point to their inadequate training in managing tenders and contracting required by their new role (Mandelkern and Sherman 2015).

In the private sector, care professionals continue to fulfill their more traditional care roles, but at the same time, the incorporation of market logic in service delivery transforms their work environment, pushing them more vigorously toward cost savings and increasing revenues. For instance, in the context of elderly care, qualitative research has identified that social workers working in the private elderly care agencies, besides implementing public policy, also have a “new job”: recruiting and retaining clients (Cohen et al. 2016; see also Paz-Fuchs and Shlosberg 2012). The research illustrates how managers in these agencies use various techniques to pressure the professional workers to attract and retain clients and to increase the number of billable treatment hours. It shows that the choice-based nature of the service pushes the workers to develop new practices and coping mechanisms that go beyond but often also counter formal policy. Examples include providing better treatment to clients who are tough negotiators, breaking privacy laws to get information on new potential clients, or supplying cleaning services instead of nursing services to patients but reporting to the government that the services provided are nursing services. The research also suggests that the choice-based setting increases responsiveness to clients’ preferences, but at the same time, these preferences of the clients are subordinated to the economic interest of the providers. Yet there is a continuous process of proceduralization of private agencies’ practices at the regulatory level (Schmid 2003), exacerbating the tensions between the regulatory, professional, and market logics of service delivery even further.

Moreover, in the Israeli welfare-to-work program, as mentioned above, the use of a performance-based payment model has undermined the acceptability of professionals’ decision making (Benish 2014a). Interestingly, this model of payment has eroded trust not only in the professional judgment of case managers (whose professional status is relatively weak), but also in the professional judgment of medical doctors, who are considered the prime example of professionalism.

*“Publicness”: Public Values and Accountability in Privatized Services*

The new structure of social services provision blurs the traditional public/private distinction, creating ambiguity about the norms that should prevail in the provision of privatized services. Traditionally, the provision of public-sector services was based on the ethos of serving the public interest and was subject to public service norms (such as equality, due process, and transparency), which are anchored in public law and the ethical codes of public servants. In contrast, provision of services in the market was based on the idea that service producers and consumers promote their private interests, in accordance with market values (such as choice, competition, efficiency, and “consumer sovereignty”), which are anchored in private law and market regulations. Privatization produces normative and practical uncertainty as to whether private providers of publicly mandated and funded services should treat service users as “customers,” in accordance with market principles, or as “citizens,” in accordance with the norms of public law (Benish 2010; Benish and Levi-Faur 2012).

In Israel, questions regarding the “publicness” of privatized service have been prominent in the case of the welfare-to-work program. These questions were central because of the significant discretionary powers that were devolved to the programs’ case managers, including the power to sanction welfare recipients and require personal information (Benish and Tsarfati 2008; Peleg 2005). Interestingly, public law norms were extended to these contractors through legislation and through the programs’ administrative regulations and contracts (Benish 2014a, b), as well as through judicial decisions. For instance, relying on a legal doctrine developed by the Israeli Supreme Court, the National Employment Tribunal held that the welfare-to-work contractors were obligated to follow administrative law norms as if they were public agencies.<sup>3</sup>

This suggests that public expectations do not arrange themselves only according to the formal status of the actors but also according to the essence of their powers. It seems that decades of public-sector welfare delivery have created certain public expectations as to how discretionary powers should be operated and how they should be accounted for, and these expectations remain when these functions are privatized. However, the level of public law norm extension in Israel’s privatized services varies considerably, and in other areas, the scope of “publicization” appears to be much more limited (Peleg 2005). Moreover, in many jurisdictions, courts have refrained from applying public law norms to private

social care suppliers (Donnelly 2011). And even when public norms are extended to the private providers by courts or by regulators, this new body of administrative law differs in important ways from administrative law as it usually applies to public agencies (Benish and Levi-Faur 2012). First, it is much more fragmented. There are no generic provisions that apply public law norms systematically to all privatized services. Instead, they are applied piecemeal through a variety of legislative and regulatory mechanisms. Moreover, norms are not always fully applied to contractors. Second, the norms undergo some transformation in scope and meaning during this process, sometimes narrowing the scope of constitutional protection of individuals. Therefore, the potential resurgence of administrative law norms in privatized service must be examined with considerable caution; it must raise a set of new critical questions; in particular, do private actors truly internalize these norms, or are we witnessing merely symbolic measures of ritual accountability (Brodkin 2011; Braithwaite et al. 2007)?

### *The Regulatory Role of Government*

The shift away from the direct provision of social services raises the importance of the regulatory role of the state in setting the standards of service delivery (through laws and contracts) and their monitoring and enforcement (Braithwaite et al. 2007). It is apparent in the Israeli case that regulation has significantly lagged behind the pace of privatization of social services (State Comptroller 2005; Levi-Faur et al. 2015), and difficulties in this aspect have arisen across all the social welfare services (Lahat and Talit 2012).

In the case of elderly care, the NII conducts administrative reviews of the providers' agencies and financial audits of their accounting and relies on social workers and nurses in the local municipalities to visit the homes of the elderly. However, as the State Comptroller's report on this issue notes, the NII does not systematically inspect the providers and mostly reacts to complaints. The Comptroller found that the frequency of the inspections is relatively low. For instance, in 2008, the NII inspected 15% of all the providers' agencies, and in 2009, only 0.5% of these agencies were inspected (State Comptroller 2011, 224). The Comptroller also reported that social workers and nurses in the municipalities do not comply with the NII's standard of two home visits per year. The report stresses, for example, that, during 2008–2010, in several municipalities

no home visits were conducted in 34–52% of the cases, and in one municipality, there were no home visits at all during this period (State Comptroller 2011, 242). Moreover, the Comptroller found that problems raised in the financial audits were not followed through by the NII. For instance, although the auditors had recognized incorrect reports of the hours of treatment already in 2004, the NII did not work to find technological solutions for this problem.

The Israeli welfare-to-work program started with a very small regulatory agency based on the belief that performance targets would provide the necessary control over the contractors (Maron 2014). This changed over time, as policy makers recognized that outcome-based monitoring was insufficient. The State Comptroller, in his report on the program, determined that the scope of supervision over the job centers was insufficient and did not allow adequate monitoring of service operators (State Comptroller 2007b). Critics also argued that the model of public–private partnership, in which the regulatory department was in charge of both steering the program and regulating it, was prone to “regulatory capture” and undermined the department’s capacity to maintain its regulatory role. As a result, the regulatory department increased its control of the contractors by increasing both rule-based regulations and site visits. The latter was done, ironically, by contracting out the inspection site visits to private firms, thereby adding an additional layer of contracting out.

In the field of personal social services, the picture is even more complicated, given the great diversity of services in terms of size, target populations, and the power exercised over clients. Data collected by the State Comptroller show that despite the increasing regulatory role of the government, the number of inspectors at the Ministry of Social Services has actually declined over the years by 16% in the division surveyed (State Comptroller 2005, 725). Since the mid-1980s, a formal quality assurance tool (known as “the RAF method”) has been introduced into some of the services, and the Ministry is still in the process of extending it to all its services. Research evaluating this method in the context of care homes for youth at risk (based on interviews with key players) found that, by and large, this method improved inspection, mainly by systemizing the process; but at the same time, the research highlighted the lack of adequate enforcement tools and inappropriate computer systems (see Spiro and Fromer 2010). The research also raises the dilemma as to whether the consultancy and the enforcement components of inspection should be separated due to the tension between these tasks, reaching the

conclusion that integration of these functions is preferable (Spiro and Fromer 2010). Another study of this issue pointed to the gap between the care-oriented education of social workers and the regulatory skills needed for the inspection mission (Lahat and Talit 2012).

Thus, it seems that the greatest challenge for the Ministry of Social Services remains in reaching an agreement on the appropriate goals and means of its regulatory mission. Most of the inspectors at the street-level are social workers by profession, and their regulatory role perception relies strongly on the principles of professionalism; many of them tend to prefer a relational approach to regulation, which is based on cooperation, learning, dialogue, and trust rather than on strict enforcement and punishment. At the same time, the heads of the Ministry, in true NPM spirit, often push for greater relational distance between inspectors and providers and stricter enforcement of regulatory standards. Thus, although there is wide consensus on the need for improvements in the regulatory function of the Ministry of Social Services, these different conceptions of the appropriate regulatory role create an impasse and internal unrest that make it difficult to advance the regulatory role of the Ministry.

### RETHINKING THE PRIVATIZATION OF SOCIAL SERVICES

The Israeli experience illustrates both the potential and the limits of the adoption of market logic and practices in the fields of social welfare. It shows that privatization solves the problems of the “old” public sector but also creates new problems on both the normative and institutional levels. It appears that the market-like model of social welfare services delivery offers improvements in terms of service responsiveness to performance standards and to clients’ needs and preferences. This is most evident when clients can choose their providers, as in the case of Israeli domestic services for the elderly. Moreover, the Israeli welfare-to-work case demonstrates that, in principle, public norms and accountability can be extended to private actors in a meaningful way, reemphasizing the greater importance of fairness and democratic citizenship over values of efficiency and consumerism.

However, these improvements are somewhat modest when compared to the high expectations of NPM supporters. Competition is often lacking or limited, and, at times, it comes at the price of causing unstable care relations and risking professional and public service ethics. Moreover, lowering the cost of service delivery often comes at the

expense of street-level workers' salaries and job security. Paradoxically, in the effort to sustain the welfare state by delivering social services more efficiently, the government has become a major producer of precarious jobs, which evidently undermine the same vision. In addition, the Israeli case indicates that a strong approach to competitive contracting and strict regulatory enforcement, which require clear criteria for evaluating compliance, are often incompatible with the inherent discretion embedded in many social services, particularly in services with "people changing" rather than "people processing" tasks (Hasenfeld 2010).

The question is, therefore, what should be the future of privatized social services in Israel? After the 2011 social protests, the Israeli government has increasingly signaled its commitment to welfare state values, including its responsibility for the delivery of social services. This message is most prominent in the report of the Trajtenberg Committee following the 2011 social protest. The Committee's report supports the outsourcing of social services, but stresses that "is important to ensure that the *overall responsibility of the Government* for providing the public service, for its quality and availability does not diminish regardless of whether it chooses to provide the product itself or via an external entity" (Trajtenberg 2011, 19; emphasis in original). The report adds that the implementation of the privatization policy should be "centered upon the recognition that it is *not a matter of reducing the role of Government, but rather of changing the way in which it fulfils its responsibility*" (ibid., 23; emphasis in original).

This approach of the Trajtenberg Committee resonates with the idea of the "regulatory welfare state," according to which welfare state values can be maintained under the new structure of social services delivery by regulatory means (Gilbert 2005; Levi-Faur 2014). However, despite these declarations of the government's commitment to uphold and improve social services, by and large, the driving forces for privatization in Israel have been economic and budgetary—rather than the social—interests. The government was mostly inspired by the neoliberal agenda of reducing public spending and shrinking the public sector, rather than improving the quality, scope, and access to social services. Therefore, to fulfill a vision of a regulatory welfare state, Israeli privatization policy needs to radically "recalculate its route" and to rethink the values and the practices of privatized social services.

A policy that takes seriously the task of maintaining the welfare state within the regulatory state should consider the following four principles.

First, it should put the egalitarian values of social justice at the forefront of social policy, promoting the de-commodification of social services by safeguarding equal (or at least affordable) access to adequate social service as a social right. Toward this goal, a combination of fiscal and regulatory tools should be used (see, for example, Benish et al. 2016; Haber 2011, 2015). These values should be safeguarded with respect to both service users and street-level workers who provide the services, ensuring the latter decent living wages and adequate working conditions. A central concern in this regard should be to counter the strong inequality effect of privatization, which increases social gaps and social unrest. Second, the shift toward privatization and marketization should take into account the unique characteristics of social services. Market and private-sector logic and practices cannot simply be copied and pasted into the realm of social services. The extension of these ideas to the welfare sector must be made carefully, making the needed adjustments and adaptations. Third, the fact that the government's contracting practices became a major generator of low income and precarious jobs and social inequality (see Paz-Fuchs this volume) should be a central consideration of this policy. Fourth, it should be recognized that privatization should have its limits. The determination of "inherently governmental" functions is not an easy one, but some of the functions privatized in Israel—such as the power to sanction welfare recipients—seem to go beyond those limits for both normative and pragmatic reasons. This, of course, can be debated, but the point here is that the assumption that *everything* can and should be privatized must be reconsidered, and the decision to privatize should not be considered self-evident but a matter of a rigorous public debate.

## NOTES

1. In 2014, the Israeli Public Employment Service started a pilot contracted-out welfare-to-work program under the title "Employment Circles" (Adut 2017). This program is more moderate in terms of privatization, and it has not yet been comprehensively researched. This chapter will focus on the lessons from the "Wisconsin Program."
2. Administrative petition 2724/07 *Ateret Avot vs. the state of Israel*, decided May 23, 2011.
3. *Lugasy vs. the Ministry of Industry, Trade and Labor*, 2007.



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# Privatization in Israeli Integration Policy: When Zionism Meets Neoliberalism

*Ilana Shpaizman*

## INTRODUCTION

The immigration of Jewish people and the gathering of exiles is part of the Israeli national ethos. From its establishment, the state of Israel provided comprehensive integration services for newly arrived and veteran immigrants, aiming at facilitating their social and economic integration. In 1986, a significant change in Israeli integration policy took place, as the state shifted from a prescriptive to a *laissez-faire* policy, in which the immigrants were expected to integrate on their own using the private market. This policy is termed “direct absorption.”

Although this change was the first time that the state gave up its role in dictating the integration process, and exposed the immigrants to the market from day one, it did not lead to a linear dynamic of privatization and reduction in state responsibility. In fact, when closely examining Israeli integration policy of the last 30 years, we find contradicting dynamics of increasing and decreasing state responsibility. This is a result of the effect that national ideas of immigration and integration have in the Israeli polity, which often prevail over the neoliberal ideas on which

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the direct absorption policy was built. Nonetheless, even when state responsibility increases we find evidence for the effect of neoliberal ideas, mostly in the policy tools selected.

This chapter aims at demonstrating and explaining this nonlinear dynamic. Specifically, it examines gradual institutional changes taking place in the Israeli integration policy from 1987, when the direct absorption policy was first implemented, to present day. Based on this analysis, the chapter argues that by the end of the period examined one can identify a thin layer of universal integration services and two thicker layers of selective integration services for needy immigrants and for skilled and/or wealthy immigrants.

Given the important role that ideas play in Israeli integration policy, the chapter uses an ideational framework to explain the content and the direction of change (Béland and Cox 2011). As detailed below, the degree of state responsibility for immigrant integration depends not only on the provision and funding of services but also on the extent to which the state regulates immigrants' behavior during the integration services—in other words, the freedom of choice they have. Therefore, to fully capture the Israeli dynamic, the chapter uses a broader lens of state responsibility.

The rest of the chapter continues as follows. First, the main concepts used in this chapter—policy ideas, state responsibility and immigrant integration policy—are presented. Second, a description of the Israeli integration policy prior to 1986 and the ideas it was based upon is given. Following the theoretical and historical background, changes in Israeli integration policy are presented. Lastly, conclusions are discussed with a specific emphasis on the uniqueness of integration policy compared both to other social policies and to other integration policies in the world.

## IDEAS AND POLICY

Ideas are causal beliefs (Béland and Cox 2011). Ideational scholars believe that actors have nonmaterial interests and goals that affect the way they act. In addition, there are times when ideas restrict actors' behavior even if the actors do not hold these ideas. Thus, ideas can influence political behavior and outcomes, both by helping to determine actors' motivations, interests and goals, and by shaping institutional constraints and opportunities (Béland and Cox 2011; Berman 2013). In addition, ideas provide cognitive and normative causal propositions that help define the problem, exclude other problem definitions, direct

attention and act as roadmaps for decision makers, helping them to choose from among different alternatives (Berman 1998; Béland 2005, 2007; Béland and Cox 2011).

In order to understand how ideas affect policy dynamics, we should examine ideas at three levels of generality (Mehta 2011; Schmidt 2011). *Policy solutions* are the means for solving problems and accomplishing related objectives. These ideas can change relatively quickly when a window of opportunity opens for a new agenda. *Problem definitions* frame the policy goal and the scope of possible solutions and are located on the same analytical level as programmatic beliefs (Berman 1998) or paradigms (Hall 1993). These ideas usually change during periods of crisis when one paradigm is replaced by another (Schmidt 2008). Finally, *public philosophies* are beliefs about the purpose of government or public policy in light of a certain set of assumptions about society and the market. These ideas are also called core values (Cox 2004) or worldviews (Campbell 1998). They are often independent of agency, since they include societal values (Kuisma 2013).

While ideas at the first two levels are “foreground ideas,” because they tend to be constantly discussed and debated, public philosophies usually remain in the background. They act as underlying assumptions that are widely shared, rarely contested or changed, and are not open to criticism (Campbell 1998; Schmidt 2008). Public philosophies are the slowest to change since they include changes in the core values of the society (Schmidt 2008). Moreover, they limit significant policy change, because each change is evaluated according to a “logic of appropriateness” (March and Olsen 2004)—whether or not it fits these ideas. Hence, policy makers will not pursue a change that contradicts these ideas, either because they think the public and the political system will consider it illegitimate, or because they themselves consider it so.

## STATE RESPONSIBILITY

State responsibility is a dynamic concept, ranging along a continuum from full responsibility to none. It can be examined from three different perspectives. The first is the extent of government involvement as a provider of funds, a regulator or a producer of certain services or benefits: the more the state is involved, the greater its responsibility (Starr 1989; Savas 2000). For example, when the state both funds welfare services and provides them to the public, its responsibility is greater than



when it only funds the services and the provision is made through private organizations. The second perspective is an elaboration of the first and refers to the division of labor and social responsibility between the private and the public sectors in different spheres (Clarke 2004). For example, when the state intrudes in areas previously reserved for civil society or the private market, its responsibility increases. The third perspective is the universality or selectivity of a given policy. The more universal the policy, i.e., the more services are provided to all citizens regardless of their economic situation, the broader the state's responsibility (Gilbert 2002). For example, when the state changes the eligibility for child benefits from all citizens to citizens with low socioeconomic status, its responsibility decreases. These perspectives imply that when examining state responsibility, one should look at more than just the amount of government spending and examine also the degree of de-commodification, i.e., the degree of individual independence of the market (Esping-Andersen 1990). Thus, the less de-commodification there is, the more state responsibility decreases. Examining changes in state responsibility from various perspectives is appropriate when examining integration policy.

#### IMMIGRANT INTEGRATION POLICY AND PRIVATIZATION

The immigrant integration policy addressed in this chapter is what Hammar (1985) calls “direct immigrant policy”—“special measures on behalf of immigrants” (Hammar 1985, 10). These measures include a wide range of services, for example language classes, vocational training, general counseling, civic integration courses and other services. One of the main components of integration policy is settlement packages. These are sets of social services or benefits, aimed at assisting immigrants in the first period after arrival. In some countries, these packages are available to all immigrants, while in others they go only to refugees or to the main breadwinners. Two main dimensions differentiate between the packages: degree of choice and the conditionality of the services offered. The first refers to the level of discretion immigrants have over the way they provide for their own needs. The main distinction here is between “in-kind” and “in-cash” benefits. In the former, the service itself is provided to the recipient. In-kind benefits limit the recipient's degree of choice while granting the provider broader discretion. The justification for in-kind services is usually greater efficiency and better protection for recipients who are unable to ensure that their needs are properly met. In-cash

services, on the other hand, are direct money transfers, giving recipients almost total discretion over how the money is spent (Gal and Leshem 2000). The conditionality dimension refers to conditions which differentiate between those included and excluded from the services or benefits. Such conditions include, for example, means tests, participation in certain programs, and labor market status. In most immigration countries, settlement packages comprise mostly conditional in-kind benefits and services (Gal and Leshem 2000; Paz-Fuchs 2007).

State responsibility for immigrant integration refers not only to the funding and provision of services but also to the degree in which it interferes with and regulates the choices made by the immigrants during their integration. The degree of regulation is based on the state's assumptions regarding the immigrants' capability to calculate their integration process, i.e. make rational decisions regarding the course of integration, given that immigrants are, by definition, less familiar with the policies and the society of the receiving country. Specifically, immigrant integration policy can take various approaches to intervention. In the *prescriptive* approach, the government makes immigrants follow certain steps during their integration process. This policy is mandatory, so that the benefits and services provided are often conditional upon cooperation. In such an approach, the immigrant's freedom to calculate his/her integration process is limited, mostly because the benefits and services in question, such as a basic living allowance, work permit or permanent residence status, are essential for the immigrants. In the *proactive* approach, the government encourages or discourages, but does not require, the immigrants to follow certain steps during the integration policy. In this approach, the policy tools will often be economic incentives. Finally, in the *laissez-faire* approach, the government leaves the matter of immigrant integration entirely to the immigrants, the market, or the host society's private sector. While it can fund integration services, it does not interfere with their consumption (Schmidt 2007). This distinction is not mutually exclusive: states can apply different approaches to different immigrant populations or different types of assistance. The shift from a prescriptive to *laissez-faire* approach increases the sway of the private realm at the expense of the public (Clarke 2004). While increasing freedom of choice, it also privatizes some of the risks embedded in integration, of which the immigrants are not aware due to factors such as lack of information.

As in other social policies, integration policies are also affected by neo-liberal ideas and economic reasoning. The aim of immigrant integration

policy in the Western world today is to make the immigrant self-sufficient and as independent of the state as possible. The immigrant's integration is seen through the perspective of economic instrumentalism. The more autonomous the immigrant, the more competitive the state will be in the global economy (Joppke 2007). The immigrants are expected to "hit the ground running" (Arat-Koc 1999) and integrate as fast as possible so that they can contribute to the economy. As a result, many countries have cut funding for various integration services aimed at assisting immigrants in the first period after arrival. This tendency can be found in countries with large-scale immigration, such as Canada, Australia and the Netherlands (Arat-Koc 1999; Bruquetas-Callejo et al. 2007).

At the same time, many immigrant-receiving countries take part in "the race for talent" (Shachar 2006), promoting selective immigration programs designed to attract high-skilled and wealthy migrants who will contribute to the receiving country's knowledge-based economy. This group gets special treatment in visa, citizenship and employment opportunities. This process began in the United States, Canada, and Australia, and today most of the EU countries apply such an approach (Mahroum 2005; Shachar 2006). Promoting self-sufficiency and encouraging high-skilled immigrants can be also found in the Israeli integration policy. Yet in Israel, along with this trend, the policy is also significantly affected by the Zionist ethos toward Jewish immigration and integration.

### INTEGRATION POLICY IN ISRAEL

Israel is defined as an ethnic immigration state—it "welcomes newcomers as immigrants ... only if they qualify ex-ante as co-ethnics, that is, members of the state defining majority nation" (Joppke and Rosenhek 2003, 1). Israeli integration policy addresses only Jewish immigrants, their spouses, and dependents. It is characterized as "categorical universalism"—every member of that category is entitled to some benefits regardless of economic status (Gal 2008). Therefore, the terms "integration policy" and "immigration" used in this chapter address only Jewish immigrants and their dependents.<sup>1</sup> Immigration and integration policies are rooted in Zionist ideology, which views the State of Israel as an asylum for all Jews and considers immigration as the main instrument of nation-building (Hacohen 2003). State responsibility for immigrant integration is part of the national ethos and can be seen as part of the state's public philosophy. The power of this idea can be seen, for example,

during the 1990s, when due to a large number of immigrants from the Former Soviet Union (FSU) (500,000 between 1990 and 1994), the government imposed an additional tax for a three-year period in order to finance integration services. Nevertheless, there was no significant opposition to this policy, mostly because the (Jewish) public strongly identified with it (Gal and Leshem 2000). Moreover, despite the constant and large numbers of immigrants arriving, there is no demand to decrease the number of immigrants or government spending on integration. On the contrary, immigrant integration is, for the most part, a highly consensual and depolarized issue.<sup>2</sup>

The ministry in charge of integration services is the Ministry of Immigration and Absorption (MoIA), which may be seen as a kind of “government for immigrants,” since it has departments parallel to other government ministries, such as employment, education, welfare, and housing (Mashal 1971). Most of the policy is based on internal regulations made within MoIA and cabinet decisions. These regulations determine the eligibility criteria and the level of benefits provided. They can be periodically changed, based on changes in the number of immigrants coming, their profile, budgetary restrictions, or changes in government priorities (Gal and Leshem 2000).

Starting from the 1970s, most immigrants arriving in Israel were settled in “absorption centers” that provided for their basic needs during the first period after arrival. Their placement in the centers was based primarily on availability and not on the immigrants’ will. Correspondingly, in many cases the state decided the place of residence for the immigrants. This decision had significant implications for the immigrants’ futures, because the initial place of residence often becomes the permanent one. In the absorption centers, immigrants received housing, various in-kind services such as Hebrew classes and employment counseling, and a living allowance for the first six months. The policy was prescriptive, such that MoIA decided for the immigrants which services they needed, and the living allowance was conditional on participation in Hebrew classes. All the services were publicly provided and funded, either by MoIA or by other ministries, such as the Ministry of Education or the Ministry of Labor. After the initial period in the absorption centers, those who were not able to buy their own houses received public housing. This entire policy was based on the paradigmatic idea that newly arrived immigrants were incapable of managing their integration process without the state’s guidance (Gal and Leshem 2000).

An immigrant's stay at an absorption center was supposed to last six months. However, in practice, most immigrants stayed there much longer. This created a bottleneck for the integration of newly arrived immigrants. In addition, from the beginning of the 1980s, policy makers started questioning the paradigm that immigrants could not manage their own integration process, and argued that staying in absorption centers created dependency and prevented immigrants from becoming self-reliant. This questioning also resulted from the broader influence of neoliberal ideas that spread in the Israeli social policy, thereby changing the policy tools. Lastly, regulated integration created a bureaucratic load which was found by the State Comptroller to be inefficient. All this led policy makers to develop a new integration model—direct absorption (Gal and Leshem 2000).

### INTEGRATION POLICY 1987–1993

The aim of the “direct absorption” policy was to integrate the immigrants directly into Israeli society and to allow them freedom of choice in their integration process (Leshem 1986) and, specifically, the freedom to choose where to live, their apartment and the course of their integration process. The MoIA's role in this policy was mostly reactive: to address specific problems when asked, such as directing the immigrants to the appropriate vocational training or social services. This policy was put into practice in 1987, and from 1990 it became the main integration track for 90% of the immigrants (Doron and Kargar 1993; Gal and Leshem 2000; Gal 2008). The policy was based on a new problem definition idea (paradigm), that immigrants were rational human beings that could decide on their integration process on their own; e.g., when to study Hebrew or take a vocational training course, what kind of living arrangement to choose, etc. The metaphors used by decision makers to rationalize the policy were “the immigrant is not a child,” and does not need a “big brother” to tell him/her what to do. The causal logic was that immigrant satisfaction would increase if government involvement decreased (interviews with directors in MoIA, Leshem 1986).

The major policy tool used in this policy was the “absorption basket,” which provided in-cash benefits to facilitate economic integration during the first year after arrival. The grant was given upon arrival. It was unconditional and paid to every immigrant family. The amount was a function

only of family size, independent of the immigrants' economic status. The grant was aimed to enable immigrants to rent apartments in the private market, purchase basic equipment, and provide income support for the first period after arrival to allow immigrants to study Hebrew without having to go to work. Policy makers termed this "integration through the airport ATM" (Leshem 1986, interview with director in MoIA). Along with the absorption basket, each immigrant was entitled to other benefits, such as tax exemptions in the first years after arrival, educational assistance for children, Hebrew lessons, and vocational training programs, all publicly funded and provided. These were also universal and were given to all immigrants who had been in Israel for less than a year (Gal 2008; Gal and Leshem 2000). Lastly, starting from 1991, immigrants received a grant that gave them seed money for a mortgage. This enabled more than 52% of the immigrants to buy their own houses (Borukhov 1998).

The new policy instructed that the state's responsibility for funding services remained intact, and its responsibility for the provision of services was shifted to the private market only in the field of housing, in accordance with its general minimal involvement policy in the housing market (Borukhov 1998). Yet, the significant change was in the shift from a prescriptive to a more flexible policy with minimal government regulation. As a result, the state shifted responsibility for integration onto the immigrants and their families. The design of the direct absorption can be seen as a combination of neoliberal ideas emphasizing the importance of the free market, individual freedom, and a limited state role, with the Zionist ideology of state responsibility for immigrant integration (Doron and Kargar 1993; Gal and Leshem 2000).

Two groups of immigrants were exempted from the direct absorption policy: wealthier immigrants and very poor immigrants. The former were immigrants from Western countries who received various tax exemptions and in-kind services in lieu of an absorption basket. The latter were immigrants from Ethiopia who were absorbed through the old system of absorption centers and received additional benefits, such as additional assistance hours for school children and longer eligibility periods for employment support, as well as more guidance (Gal and Leshem 2000). These two groups constituted less than 10% of all the immigrants.

One of the main policy ideas that the direct absorption policy was based upon was that the market could handle the integration process better than the government. Once the mass immigration wave from the FSU began in 1989, this idea was tested. The large number of people arriving

during a short period of time (~200,000 in 1990 and ~176,000 in 1991, about 5% of the population, compared to ~8,000–10,000 in the 1980s) created a shortage in apartments for rent and significantly raised the unemployment rate. Given the embedded responsibility for immigrant integration and in accordance with the Zionist public philosophies, the state temporarily abandoned the ideas of minimal government involvement and market superiority. Alongside the rented apartments in the private market, the state started providing temporary housing for immigrants by contracting with hotels and later building trailer house neighborhoods for immigrants. In addition, it offered incentives to contractors to build new neighborhoods and to enable the permanent integration of the immigrants (Borukhov 1998). The state increased its funding for subsidized employment in the public sector, mostly for teachers, doctors, and other immigrants with an academic degree. The budget allocated for this program increased fourfold between 1989 and 1994. This increase in government funding and the provision of services was seen by policy makers as temporary, given the extreme situation of the mass immigration wave. From 1993, the state began gradually evacuating the hotels and trailer neighborhoods, and the incentives for the contractors were cleared as well. Even though the direct absorption model was proved to be incapable of handling mass immigration properly, policymakers did not question its paradigm and did not suggest abandoning it.

### INTEGRATION POLICY 1994–2000

From 1994, the state's attention turned from newly arrived immigrants to more veteran immigrants and the difficulties they faced in their integration process. Although the absorption basket was designed to enable the immigrants to study Hebrew for the first six months without working, the direct absorption policy was based on the idea that immigrants, in general, were rational and could manage their integration process. As such, the policy was not prescriptive and allowed the immigrants a large degree of discretion. Correspondingly, many immigrants decided to start working before enrolling in Hebrew classes and either postponed their Hebrew studies or did not study the language at all. This was a result of both the actual and perceived insufficiency of the sum of the absorption basket, which increased the immigrants' concern over their future, pushing them to find a job as soon as possible. The lack of knowledge of Hebrew created a significant barrier to finding proper employment,

leading to large-scale underemployment among the immigrants. Another problem was that immigrants used their entitlement for vocational training before understanding which type of training will be the most efficient for them. This was mostly due to lack of familiarity with the Israeli labor market.

By the mid-1990s, these adverse consequences had become visible. However, this did not lead policy makers to question the ideas behind the direct absorption policy or, specifically, the immigrants' rationality. Rather, policy makers modified their problem definition ideas, arguing that while immigrants could make rational decisions regarding their integration, in the first period after arrival they were short-sighted and so were likely to make irrational choices. Correspondingly, policy makers decided to extend the eligibility for Hebrew classes and vocational training to three, five and later ten years after arrival (Prime Minister Office 1998, 1999a, b, 2001a, b). In addition, the funding for employment services increased by 84% between 1994 and 1999 (even though the number of immigrants coming did not change significantly). At the same time, the MoIA decided to privatize the provision of vocational consultation services and contracted out with several employment centers. This move was based on policy ideas which gave preference to market-based solutions. The funding for these centers increased fivefold from 1994 to 1999. Since policy makers remained committed to the idea of freedom of choice and minimal government intervention, they did not make Hebrew classes mandatory or change the reactive MoIA employment policy so that it would be more proactive.

With time, another problem with direct absorption climbed up the agenda—the integration of the elderly, the disabled and single parents. As many immigrants started to purchase their own houses and the unemployment rates decreased, policy makers saw that while the direct absorption model worked for most immigrants, the weakest immigrants (the elderly, the disabled, and single parents) could not integrate on their own and required more government assistance, especially in housing. As a result, the MoIA increased its responsibility for these groups. First, it started to fund permanent public housing for the elderly and the disabled, initially by building special hostels and from 1998 by renting apartment buildings from private companies. Second, it provided single mothers with additional rent assistance for seven years, as well as additional vocational training and consultation (Ministry of Immigrant Absorption 1995; Prime Minister Office 1993). Lastly, it added benefits



for immigrants who were imprisoned in the FSU due to Zionist activity or had been injured in the Chernobyl nuclear disaster.

Two main factors can explain the above-mentioned dynamics. First, by the mid-1990s there were nearly half million immigrants from the FSU. This made them a powerful interest group. Moreover, in 1996, following the large immigration wave, an immigrant party, “*Israel Bealiya*,” received seven seats in the parliament, and one of its members became the minister of absorption. This enabled the immigrants to pressure policy makers to extend the period of eligibility and provide additional housing and employment assistance. Second, even without the immigrants’ party, there was a consensus around integration issues in the Israeli parliament. Coalition and opposition members advocated the expansion of existing integration services once the problems with the existing policy became salient, using the Zionist ethos of immigration as their main justification.

Interestingly, while all agreed that there were some inherent problems with the direct absorption model, policy makers and even immigrant interest groups did not suggest abolishing it altogether but rather adding to it. Even then, they championed market-based solutions in the provision of services, as seen in housing for the elderly and assistance with employment. Moreover, when the government’s reactive approach was questioned, this was done only with reference to the needy immigrants. In this period, in the struggle between the Zionist ethos (the public philosophies) and neoliberal ideas (problem definition ideas), we find that the Zionist ethos dictated the direction of change (expanding government responsibility), while neoliberal ideas dictated its form—the expansion took place only toward the weakest fragments of the population, in accordance with the ideas of the liberal residual welfare state (Esping-Andersen 1990).

### INTEGRATION POLICY 2001–2017

At the turn of the century, the number of immigrants coming decreased significantly, from 61,000 in 2000 to 44,000 in 2001 (especially from the FSU—from where most immigrants arrived since 1989) and continued to decrease afterward to about 20,000 immigrants per year. Correspondingly, the MoIA’s budget was reduced, since most of it was allocated to entitlements aimed at assisting newly arrived immigrants. At the same time, cuts in MoIA’s flexible budget were made as part of the broader cuts in social services endured by most ministries.

Specifically, the absorption basket, which was scheduled to be annually updated, was not updated in 2000–2010. This significantly eroded its value, exposing newly arrived immigrants to economic risks (Gal 2008). In addition, in 2002 the mortgage grant for almost all immigrants was eliminated, making it difficult for immigrants to purchase houses. Lastly, the funding for employment services also decreased by 50% from 2000 to 2017. The most significant cut was seen in the scheme which subsidized employment in the public service, which decreased by more than 30% from 2002 to 2004. This was despite the fact that the target population did not decrease significantly during that period. These changes further shifted the responsibility for integration from the state to the market.

Moreover, in 2005, MoIA decided to further expand the market's responsibility for vocational training and introduced the "Voucher Project" where, instead of contracting out training schemes with set agencies, each immigrant received a voucher worth 10,000 NIS for any vocational training offered on the private market. The immigrants were expected to pay 20% of the costs of the training out of their own pockets. Given the broad range of options for training, MoIA regulation of the providers decreased. Thus, responsibility for finding appropriate vocational training and for some of the funding was transferred from the government to the immigrant. The decision to introduce vouchers for vocational training was based on the neoliberal ideas of increasing the immigrants' freedom of choice and reducing government involvement and administrative load. After several years, the funding for this project decreased by more than 60%, and the value of the voucher was reduced to 7000 NIS for newly arrived immigrant and 5000 NIS for veteran immigrants (over five years in Israel). This further expanded immigrants' responsibility for the funding of the training.

The decrease in funding for the integration services resulted from the Ministry of Finance's (MoF) objection to the MoIA's policy. The MoF viewed an entitlement period of ten years as too extensive and argues that after several years the immigrants should either become self-reliant or the case load should be moved to the general ministries for welfare and labor. In addition, subsidized employment for immigrants was seen by the MoF as inefficient, because it decreased the responsibility of the agencies receiving the subsidy, preventing them from integrating the immigrants as part of the workforce. As such, they pressured for minimizing the subsidies.

By the end of the examined period, the MoIA's universal services eroded significantly but were not abolished. Moreover, most cuts were made in the universal services and not in the selective services for needy immigrants. This was so because the integration of immigrants continued to be a broadly supported issue, as it corresponded to the Zionist public philosophy; this was especially true for the integration of the neediest, who were seen as more deserving. Thus, every time that the MoF wished to make a more significant decrease in funding, policy makers from various parties were able to oppose the cuts. For instance, while the mortgage grants were abolished for all immigrants, immigrants coming from Ethiopia continued to receive them. The selective services, especially in housing, were relatively expensive so their maintenance was not obvious, especially given the erosion of various social services for the veteran population.

The decrease in the number of immigrants led the MoIA to shift its attention to immigrants from Western countries—the largest source of potential Jewish migration (Della Pergola 2010). Traditionally, immigrants from Western countries were more skilled and wealthier than immigrants from other countries and suffered less from persecutions and antisemitism. Therefore, their decision to immigrate to Israel was driven by pull and not push factors—the advantages in the country of destination and not the disadvantages, such as economic crisis or antisemitism, in the country of origin, which were usually paramount reasons for Jewish immigration to Israel. In order to encourage wealthy and skilled immigrants to come to Israel, the MoIA decided to provide the immigrants with various incentives and benefits, as had been done in other immigration countries which wished to attract such migrants (Shachar 2006). In addition, the MoIA also changed its integration approach toward these immigrants so as to make it easier for the immigrants to integrate into the society and the economy. Interestingly, in this process, the state increased its funding and regulation but at the same time privatized the provision of services.

These changes were manifested in a series of group immigration programs launched since 2004. In these programs, the immigrants received additional assistance in employment, provided through an enlarged voucher, additional Hebrew hours (also provided through a voucher, with private agencies teaching Hebrew, in addition to the Hebrew classes provided by the Ministry of Education), and a personal guide to help the immigrants in their first year. The guide was not an employee of the MoIA, rather an employee of one of the private agencies with which the MoIA contracted for this task. In addition, the MoIA

changed its approach by combining inducements and conditional measures. Specifically, the immigrants arriving through these programs could settle only in one of the places decided on by the MoIA. This significantly reduced their freedom of choice, which was one of the main cornerstones of the direct absorption policy. In addition, the MoIA induced immigrants to settle in the state's periphery by providing additional rental assistance. Furthermore, in 2010 the government decided that immigrants coming through the special programs would also receive an additional adjustment grant, conditional on their participation in Hebrew lessons (Ministry of Immigrant Absorption 2010). Lastly, as opposed to the reactive approach, ministry officials contacted each immigrant personally a few days after their arrival to find out what services and assistance they required (Interview with director in MoIA).

In addition, from 2005 the state contracted out with several organizations to provide integration services for immigrants from North America, the UK, and France. One of the main criteria for government support was that the supported organization provided additional financial assistance during the initial settlement process. Here again, there was an expansion in state funding along with privatization of the provision of services.

This dynamic was guided by a mixture of public philosophies, i.e., a Zionist commitment to immigration and integration, and problem definition and policy solution ideas, i.e., neoliberal ideas and economic reasoning seeing the immigrant as a tool for economic growth. The Zionist ethos guided the state's efforts to increase the number of immigrants coming by providing various incentives even during periods of severe budget cuts. At the same time, the market was seen as superior to the government in the provision of services. Therefore, every expansion of services was provided through the market. Lastly, the main goal was to integrate the immigrant as fast as possible and as well as possible, in order to fulfill his or her economic potential. Given the outcomes of the direct absorption, MoIA policymakers knew that the market alone could not produce the optimal result. Therefore, to improve the integration, the ministry was forced to reduce the level of flexibility and increase the level of state involvement, even at the expense of reducing the immigrant's freedom of choice.

Consequently, by the end of the period examined, we find a thin universal layer of services and benefits and two thicker selective layers for the needy and for the skilled and wealthy immigrants. The summary of the dynamics in state responsibility for integration is set out in Table 9.1.

**Table 9.1** Shifts in state responsibility in integration policy

	<i>Until 1988</i>	<i>1988–1994</i>	<i>1994–2000</i>	<i>2001–2017</i>
Funding	Funding for purchase of basic equipment and monthly allowance	Basic income for all immigrants (absorption basket), publicly funded Hebrew classes and assistance in employment services. The basic income funding gradually decreases	Increase in funding for the needy immigrants in housing and employment. Maintaining the level of funding for services for other immigrants	Decrease in funding for initial absorption and employment services for most immigrants. Increase in funding for skilled and wealthy immigrants. Increase in funding for the needy (elderly and disabled)
Provision	Public provision of all the services, including housing, Hebrew classes, employment consultations	Private provision of housing with a temporary shift to private housing, outsourcing of employment services. Hebrew classes are publicly provided	Public provision and contracting out of housing arrangements for the elderly and the disabled. Private provision of housing to other immigrants. Contracting out of employment services, Hebrew classes are publicly provided	Similar arrangements for the elderly and the disabled. Shift to employment vouchers. Outsourcing of some of the integration services for wealthy and skilled immigrants. Outsourcing of Hebrew classes for wealthy and skilled immigrants
Regulation of the consumption of services	All the benefits are conditional. The policy is prescriptive with high government regulation and intervention	Shift to a flexible policy, minimum involvement and regulation	Same as in the previous period	Flexible and minimal involvement policy for most immigrants. Expansion of the private realm in employment. Beginning of conditional services for wealthy and skilled immigrants. The policy is proactive

## CONCLUSION

Israeli integration policy is an interesting case of social policy. Despite significant erosion in services and the effect of neoliberal ideas, state responsibility for integration has increased in some areas and not only decreased. However, while at the beginning of the relevant period the increase was in services for all the immigrants, from 2000 we find a decrease in state responsibility for funding and provision of services for most immigrants, and an increase in state responsibility for the strongest and the weakest populations. Moreover, we see that even when state responsibility increases, and policy makers decide to expand existing services, the market logic remains prominent, and so along with expansion in funding, we also have privatization of the provision of services. Lastly, one of the significant privatizations taking place in the Israeli integration policy is a shift in the regulation of the integration course so that the responsibility for the choices immigrants make during their initial integration is shifted from the state to the immigrants themselves. However, even here we find that the process is not linear, so that over time the state takes a more proactive role in integration, moving toward a more prescriptive policy when integrating the skilled and the wealthy immigrants.

The Israeli dynamic is unique not only when compared to other social policies but also when compared to integration policies in other immigrant-receiving countries. There, the state's role in integration has been scaled back, shifting responsibility to the immigrants; when the state increases its regulatory involvement, it is targeted at *weaker* immigrants. Many European countries (for example, the Netherlands, Finland, France, Denmark, Austria, and Germany) have introduced mandatory civic integration policies whereby immigrants must enroll on a course or take an exam upon arrival, and sometimes even before entering the country, in order to obtain a permanent residency permit (Joppke 2007). The shift in Israel to a more proactive policy regarding wealthy and skilled immigrants might demonstrate that when neoliberal ideas of minimal intervention meet economically instrumental thinking, the latter might prevail.

This mismatch of increase and decrease in state responsibility reflects the combination of Zionist national ideas with neoliberal ideas. The first sets the direction of change, expanding state responsibility, the second limits the change, restricting it to specific groups; this approach maintains limited government involvement and sets the policy instruments

used to instruments with a market-based logic. Using an ideational perspective enables us to understand the content of change and its direction. What is more interesting is that it reveals that even in an era where neoliberal ideas have spread across countries, the national public philosophies still remain more powerful. In the Israeli case, Zionist ideas can be seen as a barrier which has prevented a broader erosion of services and made room for some deviations (even if in some cases temporary) from the minimal government doctrine.

The power of Zionist public philosophies explains not only the content and the direction of change but also its form. Following the direct absorption, all the shifts in state responsibility took place gradually, adding to existing structures and not replacing them. This structure can be also explained by the power of Zionist public philosophies. Since public philosophies act as a barrier to policy change, actors wishing to promote change will have to bypass these powerful ideas. Adding new practices without replacing the old may be a good strategy. If this is true, we can expect that in the future most changes in state responsibility for immigrant integration will be gradual as well. Although the logic of action might change, the core responsibly will remain in place.

## NOTES

1. Israel does not have a formal immigration or integration policy for non-Jewish immigrants such as refugees or economic migrants.
2. While there were periods of contestation over immigration in the 1950 and 1960s, it has since remained broadly supported policy.

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PART III

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Privatization of the State



# The Privatization of Regulation in Israel

*Yael Kariv-Teitelbaum*

## INTRODUCTION

In recent decades, Western liberal democracies have gradually entered a new era of governance (“New Governance”), in which hybrid and private become important stakeholders and active participants of the expanding governmental process (Rhodes 1996; Salamon 2001; Elliott 2002). Both in global and in local governance, states have been losing their exclusive status and allowing other actors—including private companies, nonprofit organizations, and private individuals—to participate in the process of rule setting, supervision, and enforcement (Scott 2004; Avant et al. 2010; Büthe and Mattli 2011; Levi-Faur 2012; Ruggie 2014).

In new governance, legal mechanisms transform the governmental process into a more sharing, decentralized, diverse, dynamic, and flexible practice. The governance paradigm which underlies this form of control is also compatible with a participatory approach that perceives government, industry, and society as entities that share responsibility for achieving policy goals. This paradigm seeks to replace the hierarchical approach that sees government as solely responsible for achieving policy goals by imposing them on the private sector (Lobel 2004).

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Many scholars perceive the integration of nongovernmental entities into governance as a positive development that increases governmental efficiency (by expanding mechanisms of sharing information), reinforces political legitimacy (by strengthening the public's trust through designing a more transparent, responsive, and diverse governmental process), and empowers civil democracy (by encouraging civilians to participate in the governance process on a daily basis) (Lobel 2004; Levi-Faur 2011). However, the mirror image of this portrayal raises concerns about fragmentation, dismantlement of authority, and the loss of the state's responsibility.

This chapter will address a relatively new phenomenon that can be seen as a rather extreme example of integrating private entities into the act of governance: the privatization of the authority to regulate. In this process, the government not only cooperates with private entities, but also practically transfers the operation of the authority to regulate into the hands of private bodies, thus privatizing regulation.

To date, research on privatization has focused mainly on processes of privatizing public assets and services. As a result, most of the research has dealt with the privatization of *the power to execute* (see, for instance, Verkuil 2007; Freeman and Minow 2009), and not with the power to *regulate*. Similarly, regulation scholars have devoted little attention to this phenomenon, focusing mainly on practical questions such as how mechanisms of contracting out regulatory authorities should be designed in order to maximize the effectiveness of regulation (Seiftei 2006; Tremolet 2007; McAllister 2012; McAllister 2014). On a related note, a primarily theoretical study was recently published on the role of those privatized bodies as “intermediaries” between the regulators and the regulated industry (Abbott et al. 2017). By looking at intermediaries, Abbott et al. open a new perspective on the privatization of regulation, focusing on the use of intermediaries and mainly private strategies such as certification and accreditation.

Against this background, the purpose of this chapter is to provide an initial overview of the Israeli phenomenon of privatizing the authority to regulate, focusing on the most common form of those privatization initiatives in Israel—the authority to supervise, monitor, and control using *inter alia* mechanisms of certification, accreditation, and auditing. The first section will establish the theoretical framework required to understand the concept of “privatization of regulation” and its uniqueness, portraying it as a new “generation” of privatization. The second section will introduce

the phenomenon in Israel—mapping its main patterns and forms, discussing its scope, presenting selected examples, and describing factors that led to its rise. Finally, the third section will present common concerns that have occupied policymakers and the legal mechanisms designed to address them, and will outline new regulatory challenges that provoke a substantial discussion of the regulator’s expertise and the role of the state.

## THEORETICAL FRAMEWORK: PRIVATIZATION OF REGULATION AS THE “NEW GENERATION” OF PRIVATIZATION IN ISRAEL

### *Defining “Privatization of Regulation”*

Before addressing the phenomenon, a general theoretical framework of privatization and regulation must be established. Offering a comprehensive definition of the privatization of regulation requires identifying what is meant by “regulation”. This has been the subject of numerous discussions in the literature in recent decades (A Reader on Regulation 1998; Black 2002; Parker and Braithwaite 2003), ranging from broad definitions that identify regulation as any mechanisms of social control; to narrow definitions that include only the promulgation of an authoritative set of rules, monitored and enforced by a public agency. For the purpose of this chapter, three commonly cited and widely accepted definitions are preferred: regulation as “sustained and focused control exercised by a public agency over activities that are valued by a community” (Selznick 1985); Regulation as a “specific form of governance: a set of authoritative rules, often accompanied by some administrative agency, for monitoring and enforcing compliance” (Baldwin et al. 1998); and regulation as “any process or set of processes by which norms are established, the behavior of those subjects to the norms monitored or fed back into the regime, and for which there are mechanisms for holding the behavior of regulated actors within the acceptable limits of the regime” (Scott 2001).

By combining these definitions, I shall refer to regulation as any mechanism driven from either primary or secondary law which involves rule setting, supervision, and enforcement that is operated by a governmental agency to direct private activity valued by the society. Regulatory authorities will, therefore, include any executive power driven by a legislative mandate to command, monitor, or enforce the law to direct valuable private activity. The three central regulatory roles are (a) rule setting, (b) supervising, monitoring, and controlling, and (c) enforcing.

Accordingly, privatization of regulation relates to any process in which the operation of regulatory authorities is transferred from public to private hands. This definition captures a wide range of privatization mechanisms, as described in detail in the introduction to this book. These mechanisms may range from “full privatization”, in which the regulatory authorities are transferred completely to the private sector (e.g., private regulation), to “partial privatization”, in which the government transfers the operation of the authority to private hands but continues to fund it (e.g., outsourcing/contracting out regulatory authorities). They may range from an active, formal and deliberated process of privatization (e.g., privatizing regulation through law or contracts) to privatizing by omission and withdrawal (e.g., reducing the budget of a regulatory agency and thus encouraging the rise of private regulation as a substitute). Finally, they may include a variety of regulatory roles from rule setting to supervision and enforcement.

To a degree, examples of almost all forms of privatizing regulatory authorities can be found in Israel. However, this chapter will focus mainly on the most common form of privatization in Israel, namely, partially privatizing supervisory authorities through legislation or tenders.

### *Theorizing the State's Role in an Era of Privatization and Regulation*

Regulation and privatization have been significant policy tools in Israel since the 1980s, preceding the dawn of “New Governance”, when a clear and hierarchic line existed between private and public. To fully comprehend the phenomenon of privatizing regulatory authorities and its potential far-reaching implications, it is important to understand it within its theoretical and historical context. The following section will briefly locate the change on the historical timeline of privatization processes in Israel. It will focus on its unique aspects and the way it seems to stand in contrast to the original intentions of the “founding fathers” of privatization in Israel. Thereby, it will establish an initial framework for understanding this phenomenon as a new “generation” of privatization, raising dilemmas that touch on core questions of the state's roles and responsibilities.

### *The Spread of Privatization Processes in Israel and the Concept of State's Role*

During the past four decades, Israel has gradually moved away from a social-democratic (or, as others would argue, corporatist) model of

a state that controls and activates many of the central manufacturing means and directly supplies most of the public services. This change has been accompanied and promoted by extensive and deep privatization processes (Mandelkeren, this volume). At first, mostly government companies were sold to private companies in a process that can be characterized as “full privatization”, i.e., a complete transfer of both control and ownership from the state to the private sector (Tevet, this volume). This was followed by a process of outsourcing public services in a manner that can be characterized as “partial privatization”, i.e., transferring the government’s responsibility for supplying public services into the hands of private entities by outsourcing, while retaining the responsibility for funding them (Katan 2008; Benish, this volume).

Thus, since the end of the 1970s, the privatization of government companies and public services in Israel marked the decline of the “Positive State” or the “Welfare State” which was deeply involved in the economy by owning, controlling, and operating extensive manufacturing means, infrastructures, and public assets, and supplied a large portion of services, specifically social services, directly to its citizens (Feigenbaum et al. 1998; Majone 1997; Kamerman and Kahn 2014).

Through these extensive privatization processes, the common perception of the state’s role has undergone dramatic changes. One metaphor that captures this transformation is the transition from “rowing the boat” to “steering and commanding the ship” (Osborne and Gaebler 1992). If, previously, the state’s role was to execute all major tasks in the economy on its own (including manufacturing, public resource utilization, and supplying services), now its main role was perceived as setting the priorities, managing and regulating the market. The civil servant was no longer the rower of the ship but solely the one steering it to safe shore.

In freeing the state of its executive duties, privatization sought to enable the civil service to focus purely on its management and regulatory roles. Thus, privatization was perceived as a significant tool to transform the public sector into a small and efficient body that specialized in setting priorities, rulemaking, monitoring, and enforcing.

This new perception describes well the actual changes in the Israeli governance, but due to the somewhat casuistic and incoherent nature of the decision-making process that has accompanied this change, it is difficult to address it to a clear governmental vision of the new role of the state. However, looking back at the “founding fathers” of privatization policy in Israel, we find that this approach was made explicit



by the Kovarsky committee, whose recommendations established the partial privatization policy of public services in Israel at the end of the 1980s. In its final report, the committee emphasized that “transferring services to bodies outside the government will not impact government’s powers, its authority to set national priorities and policies, conduct good governance and the possibility to supervise the provision of the services” (*The Kovarsky Report* 1989). Protecting the state’s regulatory authorities through privatization processes was held to be important not only because they were considered core authorities but also because of their role in minimizing the potential damage of privatization (Levi-Faur et al. 2015). Hence, regulation was partially perceived both as the solution to the problems arising from privatization and as occupying a central role that had to remain in the hands of the state after dispensing with its executive role following privatization.

*The Rise of “the Regulatory State” Alongside the Privatization Processes*

As described above, regulation—setting the rules, supervising, and enforcing—was perceived as one of the state’s central roles in this new era. Privatization processes were not intended to reduce the regulatory role. On the contrary, by transferring executive authorities to the private sector, privatization was to strengthen this role by enabling the public sector to become a small and efficient body that could focus most of its resources on regulation. It is therefore not surprising that the privatization processes went hand in hand with the nascent rise of the “Regulatory State” in Israel.

Like many countries in Europe, though in a much more casuistic and unintentional process, Israel has gradually moved from the model of a “Positive State” or “Welfare State” toward the model of a “Regulatory State” since the 1980s. As Giandomenico Majone (1994, 1997) described this transition more generally, rulemaking replaced taxing and spending. Throughout this transition, countries adopted economic liberalization and privatization reforms that led to structural changes in governmental institutions and increased use of regulation as a governance tool. “The Regulatory State” relies on regulatory means as a substitute for public ownership, services provision, and centralized bureaucracy. It is characterized by an increase in the extent of administrative legislation, in the establishment of new, independent regulatory agencies, and in the influence of judges, experts, regulators, and single-issue movements on public policymaking processes.

Even though it is difficult to identify a clear and systematic Israeli concept of the state's role, Majone's observations correspond with the actual changes in the Israeli governance since the 1980s: a rapid increase in the number of independent regulatory agencies, a significant reinforcement of the authority of existing regulators, a substantial growth in the extent and complexity of administrative ordinances, and an expansion of the influence of courts and experts. Privatization processes occurred simultaneously alongside these developments and often expedited them. The use of regulation grew, *inter alia*, to minimize the potential damages of privatization.

As for the privatization of government companies, new regulatory authorities were created and reinforced to maintain public control over privatized companies, substituting ownership with supervision. Scanning the phrase "...authority is hereby established" in Israeli legislation reveals that between 1980 and 2016, 37 new statutory authorities were founded (1950–1959—2; 1960–1969—4; 1970–1979—2; 1980–1989—6; 1990–1999—12; 2000–2009—14; 2010–2016—5). Many of these statutory authorities were established as bodies that enjoy a certain degree of autonomy from the government. Those regulators were designed, among other things, in a way that enables them to reduce problems caused by privatization. The Antitrust Authority, for example, which became a strong and independent agency in 1994, was assigned to deal, *inter alia*, with the abuse of power by strong monopolies that were transferred from public to private hands. The Electricity Authority was founded in 1996 to increase competition in the sector, while keeping private companies, which entered a field previously controlled solely by a government monopoly, under strict supervision. The Capital Markets, Insurance and Savings Authority was founded as an independent regulator only in 2016, as a complementary act, among others, to the massive privatization in the sector, carried out during the previous decade.

As for privatizing public services, contracting out the authority to supply services demanded the establishment of a complex regulatory mechanism over the contractors that operate them. Regulation was perceived as a response to the loss of control over the supply of those services. In practice, however, the Israeli civil service constantly fails to supervise the provision of those services (Mandelkeren and Paz-Fuchs 2013). Just recently, a government report on outsourced social services noted that the government office conducts inspections only once a year in 60% of the cases; performs satisfaction surveys in only 17% of the cases; and it

uses enforcement tools against the contractor in only 4% of the cases (*The Outsourcing Government Report 2016*, 11). One of the central recommendations of this report was, therefore, to expand and reinforce the regulation over the provision of services, by appointing more supervisors and establishing training programs for regulators (id., 34).

*The Privatization of Regulation as the “New Generation” of Privatization*  
From the processes described above, it can be concluded that the initial privatization processes advanced the gradual growth of “the Regulatory State” in Israel. They were based on the somewhat implicit idea that transferring executive roles to the private sector would allow the public sector to focus on and specialize mainly in regulatory duties. The government’s role in performing regulatory duties was therefore expected to be reinforced and expanded alongside the privatization processes. Against this background, it is clear why privatizing regulatory authorities—the main function that was supposed to remain in the hands of the state in the post-privatization world—is a new phenomenon that seemingly stands in contradiction to the original intentions of the “founding fathers” of the privatization in Israel.

As the following section will elaborate, privatizing regulatory authorities started during the 1990s as an incremental and largely unnoticed process, using both “full” and “partial” privatization methods. Unlike the privatization of public services that privatized the state’s power to *provide* services regarding “positive” social rights such as the right to health care, education, etc., the privatization of regulation included the privatization of *coercive* powers that potentially might infringe “negative” civil rights such as the right to freedom of occupation, privacy, etc. As stated, privatizing regulatory authorities indicate a substantial change in the character of “the Regulatory State” that was to address market failures and advance public goals by regulating the private sector using rule setting, supervision, and enforcement tools. Against this background, the privatization of regulation can be viewed as the new generation of privatization.

## THE PRIVATIZATION OF SUPERVISION IN ISRAEL: AN OVERVIEW

### *Describing and Mapping the Privatization of Supervision*

Over the course of the past decade, the first signs of a new phenomenon in Israel can be identified: the privatization of supervisory roles. In

an incremental, and largely unnoticed, process, administrative authorities have made greater use of private entities in supervising, monitoring, controlling, and verifying compliance of regulated markets. The following analysis reveals three main methods of privatizing the supervision and control of supervisory authorities in Israel (for a summary illustration see Table 10.1).

The first method emerged at the end of the 1990s when the government began privatizing governmental bodies that operated technical control mechanisms. For example, the Institute of Quality and Control (IQC) was established in 1959 as a public body under the Ministry of Industry and Trade to verify that products met local and international standards and to provide certification and accreditation (e.g., for quality management of food, pharmaceutical products, industrial safety and hygiene, information security, cosmetics products, the environment, good agricultural practices, etc.). It was privatized in 2003 and became a private for-profit company. Another example is the Israel Laboratory Accreditation Authority (ISRAC) that was set up in 1997 to license private laboratories to perform tests in accordance with local and international standards.

**Table 10.1** Models of privatizing supervisory and control authorities in Israel

	<i>Control Institute</i>	<i>Control Contractors</i>	<i>Control agencies</i>
<i>Privatization method</i>	“Full Privatization”: transferring control and ownership	“Partial Privatization”: Contracting out	“Full-Partial” privatization
<i>Emerging period</i>	1990s	2000s	Mid-2000s
<i>Funding</i>	The industry	The government	The industry, according to strict supervised fees stated by the government
<i>Controlled body</i>	The private sector	The private sector; private contractors that supply public services	The private sector
<i>Legal mechanism</i>	Government act (sale)	Government tenders and contracts	Legislation promoted by the government
<i>Example</i>	IQC	Tender no. 26/12-2015 for “comprehensive monitoring of schools in the education system”	Control agencies for construction quality; Control agencies for toddlers’ daycares

This first method involves the selling of a public control institute to a private company (e.g., the IQC), which can be described as active full privatization by deliberate action (selling). This is contrasted with passive full privatization by withdrawal, allowing private bodies to rise and replace a role previously designated to a public institution (e.g., authorizing laboratories). The economic model of this method is based on the free market: the private control companies are free to charge any price from the regulated industry that seeks their services. Privatized control is mostly over bodies from the private sector that are in charge of technical examinations.

The second method emerged during the 2000s alongside the general growing practice of outsourcing, when government offices started to contract out various control and monitoring roles. By means of government tenders, ministries and other regulatory agencies, contract with private for-profit companies to send inspectors and supervisors “to the field” on behalf of a public agency to check its compliance. In most cases, the aforementioned tenders dictate a “checklist” that the private inspectors have to follow, and a fixed timeline for performing the controls and sending back periodic reports with the results. Usually, the government office pays the private contractor a fixed price for each control or report. The winning bidder of these tenders is chosen on the basis of price (the lowest bid) and quality (the experience and professionalism of the proposed staff).

By means of these tenders, supervisory roles in Israel have been partly privatized. Examples include the supervision and control over private corporations such as water suppliers, natural gas facilities, electricity manufacturers, and insurance companies. In some cases, the tenders outsource control over private bodies that supply privatized public services, such as public transportation systems, foster families for the mentally disabled, rehabilitative institutions, programs for small and medium-sized businesses, housing companies that manage development projects, non-profit organizations (NGOs) that train national service volunteers, companies that develop Israel’s tourism infrastructures, and so forth. In rare cases, the privatized control is over public services that are still provided directly by public entities, such as Israel Railways or elementary and junior high schools. Since the official governmental database is partial and does not include tenders before 2009 or contracts exempted from tenders, it is difficult to ascertain the exact scope of this phenomenon. However, it can be stated that in recent years the effect of these tenders

has not been marginal or insignificant. Thus, between 2009 and 2016, Israeli ministries published an average of about 45 outsourcing tenders per year with titles that included the term “control services” or “supervisory services.”

The frequency of this practice varies between ministries. The ministries that lead the trend are the Ministry of National Infrastructures, Energy and Water Resources and the Ministry of Construction and Housing (each published about 50 tenders for “control/supervisory services” between 2009 and 2016). Those ministries are not the largest government offices in terms of budget or manpower, but their responsibility for developing and managing complicated national construction and infrastructure projects creates the need to operate an extensive control mechanism. Other ministries that publish these kinds of tenders quite frequently (20–30 tenders between 2009 and 2016) are ministries with significant regulatory roles (e.g., the Ministry of Economy and Industry, the Ministry of Environmental Protection, etc.) and the two largest ministries in the government (the Ministry of Finance (MoF) and the Ministry of Justice).

Interestingly, some of these tenders also require a private contractor to supply not only “control services” but also “support and consulting services”, such as providing recommendations to improve regulation, investigating events of regulatory failures, participating in relevant government forums, and even writing new governmental guidelines on the subject. For example, the tender titled “Guidance, Consultation and Monitoring Regarding Safety in Educational Institutions”, published by the Ministry of Education in 2015, required the contractor to provide “assistance and professional guidance on the content of this tender, formulating recommendations for action, providing a professional opinion on different topics of safety, investigating safety events, analyzing and presenting data from the operating safety system, preparation of professional infrastructure, writing instructions and circulars, and participating in various forums and discussions regarding safety issues.” It can thus be argued that in those tenders the privatization in question is not only the privatization of supervisory authorities, but also moves into privatization of an even more core regulatory authority: the authority to set rules and priorities.

This second method involves the contracting out of control and supervisory authorities and can be defined as active partial privatization by means of tenders and contracts. Its economic model is based on full government funding for each control or report by the bidder who won

the competitive procedure. This mechanism serves the government ministry that issues the tender as a mean to control private contractors and other entities from the private sector that supply privatized public services on its behalf. Some of the tenders privatize merely technical control authorities, far from the ministry's core responsibilities,<sup>1</sup> while others privatize more fundamental supervisory authorities.<sup>2</sup>

The third method of privatizing supervisory authorities emerged only recently: the establishment of "control agencies", operated by private companies to perform monitoring and controlling tasks by government bills. The basic concept of establishing control agencies is to transfer control, monitoring, and supervisory roles, previously operated by civil servants at the regulatory agency, into the hands of private companies that received licenses from the ministry to operate those authorities. Unlike contracting out, control agencies are usually designed to operate a self-containing budgetary regime, based on collecting fixed fees from the supervised industry, without government funding. The ministry thus authorizes private for-profit companies to operate the control agencies and compete against each other in supplying "control services" to the supervised sector. The control agencies are themselves subject to governmental supervision and are required to operate according to a detailed set of rules. Usually, the supervised industry will receive a license from the ministry based on the recommendation of the control agencies. One prototypical model that this method of privatization followed was the private vehicle licensing agencies that were established during the 1960s. Such agencies test vehicle compliance with safety and environmental standards, and grant or deny licenses accordingly. They operate as private for-profit companies authorized by the Ministry of Transportation. In that spirit, between 2008 and 2016 four government bills were advanced in the *Knesset* (the Israeli Parliament), with the purpose of establishing "control agencies" in different areas, including construction, fire and rescue, business licensing, and daycares for toddlers (henceforth, "the Daycare Bill"). Of these four bills, only one—regarding the quality of construction—passed and became law. After a long process of implementation, the first control agencies for construction quality are expected to start operating in 2018. The other bills have failed to pass to date.

In a way, this third method is a hybrid mechanism, combining full and partial privatization. The government does not fully fund the operation of these control agencies, but seeks to regulate their operation quite strictly. The economic model of these control agencies is based on private

for-profit companies that receive a franchise from the ministry and compete with each other to provide control and monitoring services to the supervised industry, according to a concrete set of rules and fixed fees.

It is interesting to note that, unlike social services, which are frequently privatized into the hands of NGOs, supervisory and control authorities are usually privatized into the hands of private for-profit companies. However, as mentioned, some of these new private control bodies are fully funded by the state, while others are mostly funded by the supervised industry but according to strictly supervised fees.

### *The Policy and Politics that Facilitated the Privatization of Supervision*

The process of privatizing supervisory authorities started as an anecdotal development advanced below the public radar. Each public agency independently published its outsourcing tenders, which increasingly included tenders for control and supervisory “services”. Some ministries shared the same private companies that drafted these tenders, resulting in many cases in a similar format. These tenders were perceived as part of the general trend of outsourcing public services and passed unnoticed. Arguably, this phenomenon became a more deliberate government policy with the attempt to establish “control agencies” through government bills. Naturally, this process was considerably more thorough and demanded the ministries to collectively design a comprehensive mechanism that would become a legitimate policy tool. To this end, foreign models were studied and sometimes even copied (e.g., the “control agencies for construction quality” were based on the British model of “Building Controls”).

While the use of tenders to privatize regulatory authorities continued relatively unnoticed, the government bills caught the public eye and raised concerns when they reached Parliament. Thus, when the Supervision over Daycares for Toddlers Bill (2008) was first tabled, it sparked a heated debate in the Committee on the Rights of the Child. During the discussion, the idea of establishing private “control and supervision centers” was strongly opposed by some *Knesset* members, who criticized it as “the privatization of regulation” and “an Israeli fabrication” and claimed that it should be rejected out of hand for that reason alone (MK Shelly Yacimovich of the Child’s Rights Commission 2008). As mentioned, to this day only the Planning and Building Bill Amendment became law. In this context, it can be argued that the other



bills have so far failed, to some degree, due to the strong opposition to the idea of privatizing regulatory authorities.

The various processes that preceded different cases of privatizing supervisory authorities suggest several factors that facilitated its rise in Israel. The common pattern unfolds as follows:

- (a) A national disaster occurs and/or a private activity that requires tight regulation develops rapidly.
- (b) A demand to expand government supervision arises.
- (c) The number of civil servants in the regulatory agency cannot be augmented due to strong objection of treasury officials or due to concerns of regulatory officials from becoming accountable for supervision failures.
- (d) Supervisory authorities are being privatized.

National crises can often enable the use of controversial policies (Klein 2007; Mandelkern, this volume). Thus, in many cases in Israel, the initial demand to expand government supervision was triggered by a major disaster or tragedy that raised the issue to the public agenda. For instance, the demand to expand and improve regulation over the quality of construction was raised after the “Versailles Hall Disaster” (2001), in which a dance floor collapsed during a wedding, resulting in the death of 23 guests and the injury of another 380. Following the disaster, a national commission for building safety was established (“the Zeiler Commission”), leading to the reform of the Planning and Building Law that included the establishment of private control agencies. Similarly, the idea to use private controllers as part of the reform of the Fire Authority was raised after the “Carmel Fire Disaster” (2010), in which a massive forest fire caused the death of 44 firefighters and police officers, the evacuation of 17,000 residents, and the destruction of millions of trees. Even the bill regarding the establishment of private control agencies for toddlers’ daycare was first drafted in a period of a heated public debate that was triggered after a journalistic investigative report (2007) revealed severe abuse and neglect at daycares.

The encounter between the growing demand to expand regulation and a strong objection to enlarge the public sector can lead to the extension of regulation by private means (Levi-Faur and Jordana 2005). Thus, privatizing supervisory authorities was often proposed as a solution to the demand to expand government regulation, once the possibility of

increasing the number of supervisors and controllers who work as civil servants at the regulatory agency was dismissed.

One of the dominant factors in this process was the MoF, a key player in the Israeli administration that advances a liberal economic policy (see Mandelkern 2015; and this volume). MoF officials tend to agree to increase the budget of a regulatory agency to fund a private controller, but not when asked to hire additional manpower that would increase the number of civil servants. The reform of daycare supervision is a good example of the MoF's central role in these processes. During the Parliamentary debates over this reform, Knesset members (MK Moshe Gafni and MK Michael Melchior of the Child's Rights Commission 2008) stated that:

“our proposal was that the Ministry of Industry [...] will itself perform all the supervision and controls. They came back and announced that if we want the bill to pass – which is difficult enough given the circumstances – they will not allow increasing the number of civil servants for the ministry to do the monitoring. [...]. In the end, the alternative was [...] to go along with that thing [establishing private control agencies] [...] I don't know whether the question I ask is rhetorical or not – but why does the Treasury refuse to let the ministry of industry hire even two more civil servants, but approves the budget for private control centers?”

Another factor that contributed to the tendency to favor private controllers over civil servants as supervisors can be attributed to the attempts of regulatory agencies to avoid being held responsible for regulatory failures. For instance, it was argued that the idea to privatize the supervision over the safety of connecting factory infrastructures to natural gas reservoirs was raised due to the persistent refusal of the public official in charge of the matter at the Ministry of Energy to approve any request to connect. The idea of transferring the supervisory responsibility into the hands of private authorized laboratories was offered, arguably, as a solution to the regulator's fear of public implications in case of a disaster caused by supervision failures.

In addition to the general concern about public accountability, regulatory agencies have more concrete legal concerns about being held liable for damages caused by negligent supervision or being held accountable for violations of supervisors' rights as their employer. On that issue, Mandelkern and Paz-Fuchs (2013) demonstrated that the concern about

legal responsibility causes governmental bodies in Israel to recoil from operating supervisory authorities over outsourced public services. In a nutshell, it can be similarly argued that the Israeli legal system, which tends to impose liability on bodies that operate supervisory authorities, motivates regulatory agencies to distance themselves from direct supervision. The fear of responsibility is reflected, *inter alia*, in the common format of tenders for supervisory or control services. Thus, many of these tenders include sections that are clearly meant to separate and distance the regulatory agency from the supervisors and controllers that operate “in the field”. For instance, a tender published by the Ministry of Education for “comprehensive monitoring of schools in the education system” declares that “the contractor employees are forbidden to sit in the offices of the ministry and/or use the official letterhead of the ministry and/or sign documents in the name of the ministry and/or use titles reserved for the ministry’s officials.”<sup>3</sup> Those restrictions were clearly designed to prevent Israeli courts from attributing any liability to the regulatory agency.

### THE PRIVATIZATION OF SUPERVISION: FROM COMMON CONCERNS TO REGULATORY CHALLENGES

The privatization of supervisory authorities had decision-makers in Israel somewhat concerned, mostly due to the need to adjust the process to existing legal constraints. Having introduced the central traditional concerns and the legal mechanisms designed to address them, in what follows I present some new regulatory challenges raised by the privatization of supervisory authorities and propose the initial direction for future research that is needed on the issue.

#### *Common Concerns and the Legal Mechanisms Designed to Address Them*

The different arrangements for privatizing supervisory authorities in Israel reveal four central concerns that frequently preoccupy policymakers in general and government lawyers engaged with those processes in particular: dismantling authority; democratic deficit; normative deficit; and human rights infringements. In an attempt to address those concerns, intriguing legal mechanisms were designed.

*The Concern About Dismantling Authority: Narrowing Discretion*

One of the common legal concerns that privatizing supervisory authorities raises in Israel relates to the fundamental principle of separation of powers and the relevant doctrine expanding the restrictions on delegation. This doctrine dictates, *inter alia*, that public officials must not transfer or renounce an authority granted to them by the legislative branch that is mandated by the people (Zamir 2010, 228–230; Barak-Erez 2010, 201–205).

Thus, according to one of the derivatives of the “non-delegation” doctrine in Israeli Administrative Law, a public official holding statutory powers must exercise his/her discretion independently (*Michlin vs. the Minister of Supply and Budgeting*) and cannot shed those powers (*The Movement for the Quality of Government vs. the Minister of Transport*). Section 33(c) of the Israeli *Basic Law: The Government* states that a minister legally empowered to conduct a certain action is not allowed to delegate that authority to an entity outside the civil service. In general, an authorized public official can delegate to private entities only technical-assistance authorities that do not impact his/her discretion (*Philipovitch vs. the Registrar of Companies*). Based on these norms, Israeli courts have repeatedly barred administrative authorities from transferring supervisory authorities that required the exercise of broad discretion into the hands of private controllers (*Mayor of Ashdod vs. Henfling; Histadrut Labor Federation vs. Bank of Israel*).

Bearing in mind this legal background, it is clear why privatizing supervisory authorities—which generally requires the exercise of broad governmental discretion that cannot be delegated to private bodies—can raise substantial difficulties. The main legal mechanism that is commonly used to address this concern is the “checklist”. Thus, many tenders for control or supervisory “services” include a section that sets a concrete checklist, detailing the criteria that the private control must follow in evaluating the compliance of the supervised industry. This mechanism was designed to narrow the discretion of private supervisors in an attempt to transform their privatized roles into merely technical-assistance authorities.

*Democratic Deficit: Direct Authorization from the Minister*

Another common problem that arises when supervisory authorities are privatized is the democratic deficit. In a nutshell, the democratic principle mandates that those who are impacted by decisions of the

community should be able to participate in its designing (Dahl 1989). One of the derivatives of this idea is the principle of democratic accountability, which requires government authorities to be operated by entities that are accountable to the people. For instance, the operation of supervisory authorities by civil servants secures basic democratic accountability: public officials are accountable to the minister, who is accountable to the government, which is accountable to Parliament, which is accountable to the people. At any given moment, each link in the chain can guide the preceding one, demand explanations regarding the use of the supervisory authorities, and impose sanctions in case of misuse. As Dorfman and Harel argue (2013, 2016), this chain of subordination, which ensures basic democratic accountability, can be infringed in cases of privatization.

Following this argument, when supervisory authorities are operated by private entities, the chain of democratic accountability is broken. Unlike civil servants who work as supervisors, private controllers are a separate unit from the executive branch that is not directly subordinate to the minister and carries no accountability. The minister cannot demand explanations or impose sanctions other than what was formally stated in the law or contract. In that sense, privatizing supervisory authorities leads to a democratic deficit (see also Marciano, this volume).

In an attempt to address this concern, several mechanisms are occasionally integrated in arrangements of privatizing supervision. First, a provision is included requiring the control agency to report regularly to the ministry regarding its control activities. Second, a detailed mechanism of supervision over the private controllers operated by civil servants is designed. Third, it is stipulated that the private controllers will be authorized to operate and receive accreditation directly from the minister where privatizing substantial supervisory authority requires broad discretion (e.g., the Daycare Bill suggested using private controllers to supervise the quality of education and care at toddlers' daycares). Such legal mechanisms can be observed as means to draw the private controllers closer to the executive branch and thus increase their accountability and decrease the democratic deficit.

#### *Normative Deficit: Applying Public Norms*

A slightly different deficit that is frequently raised in the context of privatizing supervisory roles concerns the legal norms that govern privatized controllers. This deficit is a result of the establishment of new

entities that can be perceived as partially private and partially public. On the one hand, most control contractors and control agencies are private, for-profit companies, which are clearly rooted in the private sector. On the other hand, they are authorized to perform core governmental authorities such as supervising, monitoring, and controlling, and therefore characterized with clear public features. The operation of these authorities by entities that do not act in accordance with the same public purposes, incentives, or ethos as civil servants and do not answer to the same norms, raises a fundamental problem (Peleg 2005; Harel 2008).

Over the years, the Israeli Supreme Court developed legal doctrines designed to narrow this gap between private controllers and public servants. The “hybrid bodies” doctrine suggests that the court can impose public norms on nongovernmental entities that execute public roles (*Jerusalem Community Jewish Burial Society [Chevra Kadisha] vs. Kestenbaum*). However, the norms usually implied under this doctrine are only general, public norms such as non-discrimination and natural rights (e.g., the right to a hearing prior to the imposition of a sanction) and, in any case, it is impossible to know in advance which of them will be applied to a given body and to what extent.

A common legal mechanism that is used to overcome this normative deficit includes listing detailed provisions that require private controllers to uphold the same norms as civil servants. For example, the Daycare Bill determined that all private supervisors will be considered as “public/civil servants” for the purposes of the Penal Code, 1977; the Public Civil Law (Gifts), 1979; and the Public Civil Law (Restrictions after Retirement), 1969. It also included a section concerning the Minister’s duty to set ordinances to prevent conflicts of interest and an additional section that asserts a duty of confidentiality that prohibits revealing or using any information that was obtained while exercising statutory obligations. The legal mechanism that is commonly used to narrow the normative gap between public servants and private controllers is, therefore, the application of specific norms through legislation or tenders.

### *The Concern of Human Rights Infringement: Receiving Consent*

Outsourcing supervisory roles risks the infringement of human rights: freedom of employment can be infringed when a supervisor limits private activity (for instance, by revoking a license to operate a private business), basic liberties can be infringed by regulatory actions (such as entering private property, searching, or seizing), and so forth. Israeli

Constitutional Law allows such infringements only when they meet the standard of proportionality (*United Mizrahi Bank Ltd. vs. Migdal Cooperative Village*). In its most influential ruling on cases of privatization, the Supreme Court of Israel struck down a law that enabled the establishment of a private prison after declaring it as unconstitutional (*Academic Center of Law and Business, Human Rights Division vs. Minister of Finance*). Here, the court found that the prisoners' rights to freedom and dignity were disproportionately violated *ipso facto* by the transfer of powers to manage and operate a prison from the state into the hands of a private for-profit entity (see Galnoor, this volume).

The most common legal mechanism designed to address this problem is to include an explicit provision that emphasizes the private controllers' duty to operate in a way that will protect the dignity and privacy of those supervised by them. A more exceptional mechanism was designed in the Daycare Bill, requesting the regulatees' consent to be supervised by private controllers to allegedly minimize the infringement of their rights.

*Potential Remedies: Can Legal Mechanisms Bridge Substantial Gaps?*

Each of the aforementioned concerns and the mechanisms designed to address them raises a series of important questions that require a thorough discussion. However, within the limited boundaries of this chapter, the following paragraphs will briefly focus on the unifying concept that substantial gaps can be bridged through technical-legalistic means.

The substantial concern of dismantling authority—transferring governmental discretion to a nongovernmental body—is dealt with by using “checklists” in an attempt to narrow the discretion of the privatized bodies. The concern about a democratic deficit—breaking the chain of authorization and accountability—is managed by technical means designed to pull the private supervisor closer to the ministry, such as direct authorization by the minister, tight governmental supervision, or a reporting duty. The normative deficit—the absence of public norms applying to private supervisors—is addressed by listing specific rules and principles that are imposed on them. And finally, the concern about disproportional infringement of human rights—transferring coercive governmental authorities into the hands of motivated profit-making bodies—is allegedly reduced by a concrete provision to respect human rights and in exceptional cases by a technical mechanism of signing a consent form.

However, it is clear that these technical-legalistic means cannot fully bridge the substantial gap between private and public supervisors. First, the use of “checklists” cannot abolish the concern about dismantling authority. In general, not all controls can be reduced to a concrete checklist, and even those that can still require the controller to exercise some discretion, even minimal, while following the checklist in situations that are indeterminate. Moreover, as detailed below, in practice the regulators sometimes seek control agencies that have the knowledge and expertise based on their work in the field to draft the criteria for the checklists themselves. In those cases, the control companies clearly exercise broad substantial discretion in determining the rules. Second, the complicated mechanisms designed to overcome the democratic deficit, assuming that they are actually enforced (which is not a realistic premise; see *The Outsourcing Government Report 2016*, 11), hardly overcome the gap. Thus, even with mechanisms such as direct authorization by the minister or close governmental supervision, the minister is bound to what is stated in the contract or franchise and therefore cannot instruct the private supervisors freely at any given moment as civil servants. The same may be said of the opposite side of the accountability chain: reporting duties are limited to the written contracts and concessions. Third, imposing concrete rules on private supervisors does not overcome the normative deficit. It does not imply the complete set of public norms that obligate civil servants, including general principles such as the obligation to act with reason, proportionality, and decency. Moreover, it does not extinguish substantial differences in incentives, ethos, ethics, and character between civil servants and employees of private for-profit companies. In the same way, including an obligation to protect human rights in the agreements with the control companies hardly places private controllers’ and civil servants’ commitment to human rights on an equal footing. As for the consent mechanism, even if we assume that it is truly given freely, it is seriously doubted that consent can prevent human rights infringement (Tamir and Harel 2009).

On a higher level, focusing the discussion solely on those traditional concerns and mechanisms that are equally relevant to other privatizations, distracts attention from the unique challenges posed by the privatization of regulatory authorities. As the following section will elaborate, privatizing supervisory authorities can deeply affect the regulator’s expertise and consequently its ability to perform its essential roles, thereby raising significant regulatory challenges.



### *The Privatization of Supervision: Regulatory Challenges*

Thus far in our analysis, policymakers were mostly concerned with the aforementioned traditional dilemmas that have characterized previous generations of privatization, focusing mostly on the *privatized bodies*, meaning the private entities that execute the privatized functions, and the way to bring them closer to and equalize them with the public sector. However, once dealing with the privatization of regulatory authorities, specifically supervisory authorities, this approach is no longer sufficient. Given the unique characteristics of the “new generation” of privatization, a different set of dilemmas emerges regarding the implications for the *privatizing bodies*—in this case, the regulators. Here, a fundamental question arises regarding the way privatization influences the regulator’s ability to maintain its regulatory expertise and perform its roles. Since one of the basic goals of previous privatization processes was to narrow the state’s role to allow it to focus on and specialize mostly in regulatory duties, when regulation itself is being privatized, one must examine how privatization affects the regulator’s ability to perform those basic duties.

As described above, the main regulatory function that is privatized at present in Israel is the authority to supervise, control, and monitor. In most cases, private supervisors not only act as a separate unit but are also physically distanced and disconnected from the regulatory entity and its employees. Thus, the regulator’s supervisory arm is “cut off” and transferred to private bodies that execute on its behalf the day-to-day “field regulation” involving most of the face-to-face interaction with the regulatees. Initial findings indicate two intriguing directions that require a thorough examination in future research:

#### *Bottom-Up Processes*

Through bottom-up processes, endless types of information make their way up from the field level of the regulatees to the highest level of the regulator, where rules and priorities are set. Data, requirements, requests, opinions, and so forth are gathered from multiple sources and transferred upward toward the heads of regulation. Those processes are an important part of the act of regulation. Initial findings from the privatization of supervisory authorities in Israel indicate several aspects that may have a significant influence over these bottom-up processes and consequently affect the regulator’s expertise.

First, as described, in most cases private controllers receive a concrete “checklist”—a closed list of yes-or-no criteria—to narrow and guide their discretion. Thus, as the use of private control agencies increases, the character of the controls is reduced to a technical one-way inspection that leaves little room for any information that exceeds the answers to the predefined list. This substantial change can significantly narrow the quantity and quality of the information that is gathered in the field and transferred to senior regulators at the top of the chain.

Another characteristic of the world of privatized supervision is the attempt to use formal reporting obligations as a means to collect and transfer the information gathered by the private supervisors to the regulator. Thus, many arrangements of privatizing supervisory authorities include a detailed obligation of the private control agency to submit routine reports on the results of the controls to the regulator. Regardless of the degree to which these obligations are fulfilled (*The Outsourcing Government Report 2016*, 11), many regulators do not enforce these obligations and even if they do, they hardly ever read and monitor the reports: the reduction of conveying information to purely formal methods of reporting can significantly influence the information making its way up the ladder.

In light of the above, the privatization of supervisory authorities can reduce the information that is gathered in the field and transferred to the heads of regulation to technical and formal pieces of data. Future research should, therefore, focus on this possible change in bottom-up processes and its effect on the regulator’s ability to maintain its expertise.

### *Top-Down Processes*

In the opposite direction, through top-down processes, varied information flows down from the head of regulation, where rules and priorities are set, to the regulatees in the field. Orders, instructions, values, etc., are formed at the top and transferred down the chain to the entities that execute the regulation and the regulatees that are subject to it. The focus on top-down processes characterizes the traditional way of thinking about regulation, where the regulator is seen as a centralized and hierarchical body commanding its subordinates. Naturally, top-down processes are a significant part of the act of regulation. Initial findings from the Israeli experience of privatizing supervisory authorities point to several potential influences over top-down processes that require further research.

As detailed above, in some cases, tenders for control services explicitly demand that the control agency supply extensive “consulting services” including, for instance, drafting, organizing, and editing administrative circulars and guidelines, taking part in governmental discussions or forums, assisting in the formulation of recommendations and plans of action, providing professional opinions, and so on. In other cases, “consulting services” are subsequently requested from the control agencies and form a new engagement. Thus, the regulator finds itself depending on private controllers not just for the act of supervising but also for the act of rule setting. These initial findings suggest that cutting off the regulator’s “supervisory arm” can influence its expertise and therefore decrease its ability to execute independently substantial tasks such as setting rules and policy. The fundamental question that requires further research in this regard is the identity of the dominant factor that designs regulation.

Another potential challenge posed by the privatization of supervisory authorities regards the regulator’s ability to transfer values and rationales through top-down processes via private controllers. Thus, privatizing the regulator’s central executive arm that interacts face-to-face with regulatees might decrease its ability to connect them with the regulation’s main goals. Taking as an example the use of technical “checklists” described above, which were designed to restrict private controllers’ discretion, one can understand how the use of yes-or-no questions might limit the ability to transform abstracts themes as values and rationales. The central question on that issue concerns the contents that are transferred during the act of supervision—whether they include merely concrete, narrow messages or abstract, broad norms.

In light of the above, the privatization of supervisory authorities can potentially decrease the regulator’s ability to set rules and priorities independently and to transfer values and rationales down the chain toward the regulatees. Hence, future research should target those top-down processes and their influence over the regulatory functioning and expertise.

To conclude, initial findings from the privatization of supervisory authorities in Israel indicate a substantial change in regulatory top-down and bottom-up processes. This change creates a potential dependence on the private controllers and decreases the regulator’s expertise. Thus, the theoretical concern described above of losing the state’s seemingly last significant role that had justified previous privatizations receives a more

concrete face. In a world where privatized regulation is slowly eroding the regulator's ability to perform its duties, the larger question of the state's remaining role arises. As private bodies take an increasingly significant role in the acts of governance and regulation itself, the state departs from the familiar model of "the regulatory state" toward a new perception that needs further thought and development. This perception can be portrayed either positively as a "Collaborative State," where private entities are an integral part of the act of governance, or negatively as a "Remote-Control State," which does not take a direct and exclusive role in the ownership of the means of production by supplying public services or regulating, but focuses merely on determining the basic rules of the game.

### CONCLUSION

The era of New Governance, in which private bodies collaborate in the act of governance, has the promising potential to increase the efficiency, democracy, and legitimacy of the governmental process. However, this new form of governance also challenges the state's ability to maintain its central roles and responsibilities. A significant though unnoticed process that is an integral part of this transformation is the privatizing of regulatory authorities, in which rule setting, supervision, and enforcement functions are transferred into private hands.

In Israel, during the past two decades, a growing number of regulatory authorities have used private bodies to supervise, monitor, control, and verify compliance in regulated markets. Whether by selling control institutes, enabling their establishment, outsourcing supervisory authorities to control companies, or providing franchises to operate control agencies, regulators in Israel are gradually privatizing supervisory authorities. This process is being expedited by an increasing demand for government supervision, by MoF officials' objections to enlarging the civil service, and by regulators' concerns about bearing the responsibility for supervision failures.

Throughout the entire process of privatizing supervisory authorities, policymakers were mostly concerned with designing mechanisms that would overcome traditional legal limitations, including the dismantling of authority, democratic deficit, normative deficit, and infringement of human rights. However, beyond the obvious limitations of the attempt to bridge substantial gaps through technical-legalistic means, the focus

on traditional concerns that arise in other types of privatization distracted attention from the unique challenges posed by the privatization of supervisory authorities.

Focusing attention not on the privatized bodies and the ways to place them on par with public bodies, but on the privatizing bodies, the regulators, reveals important regulatory challenges. Initial findings from the privatization of supervisory authorities in Israel indicate a potential change in regulatory top-down and bottom-up processes and require further research. Thus, cutting off the regulator's supervisory arm, which is engaged in most of the face-to-face interactions with the regulatees, might decrease both the transference of values and rationales from top senior regulators down to regulatees and the information gathered in the field from regulatees and transferred up to the top. Future research is needed to explore the degree to which those changes create a dependency of the regulator on private control agencies and decrease its regulatory expertise.

The threat to regulatory expertise that slowly decreases the regulator's ability to perform its duties harks back to the fundamental discussion on the state's new role in an era of privatized regulation. In this era, regulation is neither a key function that must remain in the hands of the state nor the solution to the problems of privatization, but another element in governance that can be easily transferred into private hands. This potential contradiction with the original intentions of the founders of privatization policy raises a series of questions regarding the remaining roles of the state, questions that for now are left unanswered.

## NOTES

1. E.g., tender no. 26/12-2015 published by the Ministry of Education for "guidance, consultation and monitoring regarding safety in educational institutions".
2. E.g., tender no. 12/8-2015 published by the Ministry of Education for "comprehensive monitoring of schools in the education system" requiring the private contractor to monitor both the pedagogic and administrative operation of schools.
3. Section 5.2 in tender no. 12/8-2015 for "comprehensive monitoring of schools in the education system" published by the Education Ministry in August 2015.

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# “Penny for Your Thoughts”: Outsourcing Public Policy Formulation, the Israeli Case

*Reut Marciano*

## INTRODUCTION

Policy formulation is considered a core capacity of a functioning public administration and is at the heart of the democratic process. Ample research focuses on different modes in which the public sector utilizes non-state players in the process of policy formulation. Notably absent from this research is a focus on the use the public sector makes of private consulting services for policy formulation. While some empirical research addresses the use of consulting firms for other services—namely, management and organizational consulting—there is little empirical research regarding the outsourcing of public policy formulation in Israel and abroad (Beveridge 2012; Speers 2007; Vigoda-Gadot et al. 2014).

While recent decades have seen massive processes of privatization and outsourcing of public assets and services in Israel, their proclaimed goal was the increase of service efficiency and the decrease of public expenditure, while leaving core roles of the public sector, and its discretion, in the hands of the state. However, some evidence indicates that

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these processes were accompanied from the beginning by the outsourcing of policy design. The “master plan for privatization” launched in 1988 and viewed by many as one of the first major steps in the above-mentioned processes, was forged with the use of a private company. In 1988, the Israeli government hired First Boston Bank, a US firm, to prepare a detailed plan, setting the roadmap for the privatization of over 25 governmental companies (Vigoda-Gadot et al. 2014). Other evidence of privatization of public policy formulation in Israel can be found sporadically, mostly in journalistic work. This evidence indicates externalization of various consulting projects to the private sector, often in matters of strategic importance, such as strategic economic policy and military financial reorganization. According to this evidence, the work of policy formulation is outsourced to private (sometimes international) consulting firms, which often simultaneously consult private clients. In 2015, expenses on these services amounted, according to some reports, to as high as 179 million NIS (Hazani 2011; Ilan 2016; Rozner 2011).

While some discussion addressing this aspect of outsourcing in Israel can be found in the literature, a systemic review of this phenomenon is still missing. The work presented here fills some of this gap, as it seeks to identify, describe, and characterize the willingness of the Israeli government to allow private companies (a) to define its policy agenda at the national level, and (b) to form the policy to address this agenda. This inquiry is carried out by examining public tenders, issued by the Israeli government, seeking consulting services. Potential ramifications of this phenomenon for the state of democracy, as well as for the Israeli public sector, are further discussed.

The chapter begins with setting a conceptual framework, presenting the concepts of policy formulation and problem definition. This is followed by a review of the scarce existing empirical research regarding policy formulation outsourcing, and the existing theoretical discussion of possible implications of such processes. This review focuses on the implications on two main areas: *democracy* and *public administration*. This conceptual discussion is then applied to the Israeli case, as the main findings of this work are briefly presented. The chapter then proceeds to discuss issues raised in the opening sections, considering the findings, and the main conclusions stemming from them.

## CONCEPTUAL FRAMEWORK

### *Policy Formulation and Policy Problem Definition—Conceptual Framework*

Public policy formulation is the process of creating, inventing, or changing a plan or a course of action to address a public policy problem. This follows Dryzek's (1983) definition for policy formulation as "[t]he process of inventing, developing and fine-tuning a course of action, with the amelioration of some problem or the achievement of some target in mind" (p. 346); and Howlett (2010) definition: "A process of identifying and assessing possible solutions to policy problems or, to put it another way, exploring the various options or alternatives available for addressing a problem" (p. 30).

These definitions stress that forming policy seeks to ameliorate, to change, or to improve a situation which is currently perceived as a (public policy) *problem*. Defining a policy problem is considered to be a pivotal stage in the policy process. Dery suggests that we understand "problem definition" as an instrument to solution: "The process of problem definition... [is] one of search, creation and initial examination of ideas for solution until a problem of choice is reached", incorporating "*opportunities for change*", and "*feasible, possible directions for solutions*" (1984, 27). Incorporating these elements in the definition of a "policy problem" makes this stage significant in the policy process.

The way a policy problem is defined inherently influences the perception of its ramifications, causes, and possible solutions. The process of problem definition involves elements of prioritizing interests; assigning responsibility and blame for the creation of the problem and its ramifications; pointing toward possible sets of solutions; defining the desired goals; identifying relevant players expected to take part in solving the problem; and even choosing the relevant concepts and language that will be used in its analysis. Some view the very existence of a policy problem as stemming from its definition. According to this view, the definition of a problem transforms it from a collection of facts and views about a situation to an actual issue—a problem—demanding the address and attention of the public (Brewer and DeLeon 1983; Dery 1984; Hogwood and Gunn 1984; Rochefort and Cobb 1993; Weiss 1989). Since problem definition carries with it strong features of prioritizing interests, it is considered to be a process with distinct effects in the political sphere

(Dery 1984). Indeed, some see the conflict between interest groups as part of their effort to influence how a policy problem is defined, hoping to establish their preferred version, thus promoting their desired solutions (Rochefort and Cobb 1993). In this sense, problem definition has an important role in the process of public deliberation.

### *Outsourcing Public Policy Formulation—Existing Research*

Recent decades have seen an increase in the influence of private consulting in the public policy sphere. This rising influence is often linked to the rise of the New Public Management (NPM) approach and the efforts to reform the public sector in its light (Beveridge 2012; Kettl 1993; Guttman 2000; Saint-Martin 1998a). Much of this reformative work has been forged with the advice of private consulting firms. Indeed, in their review of such reform processes in the UK, Lapsley and Oldfield (2001) relate to management consultants as the agents of change for this transformation. While these firms have played a significant role in designing extensive reform programs, they have also influenced policy areas related to these reforms (Guttman 2000; Lapsley and Oldfield 2001; Saint-Martin 1998a). Furthermore, the influence procured by consulting firms has been sustained even after their official role was concluded. The extensive knowledge that they acquired, along with the acquaintance with the policy field, has enabled them to develop expertise on issues of public policy, positioning them as relevant actors in relevant policy networks (Saint-Martin 1998a).

The existing literature lacks a clear definition of outsourcing of public policy formulation by the state. Vigoda-Gadot et al. (2014) state that “in general, this approach [for outsourcing of public policy formation] advocates using private, external consulting companies to make public policy and to prioritize and allocate resources” (p. 485). Though some theoretical discussion of privatization of public policy formulation can be found in the existing literature (Beveridge 2012; Boston 1994, 1995; Halligan 1995; Speers 2007; Vigoda-Gadot et al. 2014), the supporting empirical research is limited. Relevant research mostly examines processes and outcomes of hiring private firms for organizational and management consulting. While some of this research reviews the side-effects that such contracts may have on policy formulation (Lapsley and Oldfield 2001; Saint-Martin 1998b), it hardly focuses on outsourcing aimed specifically at procuring advice for that purpose.

### *Outsourcing Public Policy Formulation—Level of Work Outsourced*

When discussing state-outsourced consulting work, the existing literature provides a rough distinction between (1) outsourcing policy formulation at the strategic level and (2) outsourcing consulting regarding policy implementation or technical-professional assistance. Boston (1994) suggests a distinction between two main categories of policy advice. The first is “strategic” policy advice, given to the executive level on various matters of public policy, concerning core roles of the state as a funder, provider, regulator, etc. Such advice involves setting out policy issues and exploring solutions. A second category Boston discusses comprises “operational” policy advice that concerns “issues of implementation”, and mostly involves legal and technical advice on drafting laws and regulations, monitoring policy outcomes, etc. A subcategory of such operational policy advice consists of surveys or purely technical advice. Addressing the same issue, Halligan (1995) distinguishes between different kinds of advice given at different stages of the policy process: the stage of formulating policy and stages of its implementation.

It is easier to justify the use of external consulting for matters of implementation and technical work. In these cases, the government uses the expertise of the private sector in methods of management and organization, cost efficiency, risk management, accounting, etc. Like in other services purchased by the government, in this case it uses the professional expertise developed in the private sector to achieve a state-defined objective. While the peripheral impact of the use of private firms for these issues might extend to matters of strategic public policy, the initial need for such advice relies on professional, relevant knowledge, which is presumably not held by the state to the same degree of expertise (Saint-Martin 1998a, b; Speers 2007; Vigoda-Gadot et al. 2014).

However, the use of private consulting firms in order to form the state’s primary and declared public policy is less easily justified. Setting policy and policy goals for the state seems to be the state’s work—and is indeed often referred to as an “inherently governmental” task (Chesterman 2008; Halligan 1995). Furthermore, expertise regarding policy formulation is expected to be more salient in the public sector, as this is one of its core purposes and roles. Moreover, policy formulation issues often have unique characteristics that are not ordinarily present in matters handled by the private sector, such as regulatory policy; redistribution of income; prioritizing of cultural values; mitigating ethnic tensions, etc. Thus, unlike technical, professional, or managerial issues,

there is no reason to assume that the private sector would have greater expertise in the work of public policy formulation; and there is ample reason to suppose that it is the public sector that is more experienced in formulating public policy (Boston 1994; Halligan 1995; Vigoda-Gadot et al. 2014). The outsourcing of public policy formulation thus presents a unique case, with unique practical and theoretical implications.

## OUTSOURCING POLICY FORMULATION: UNIQUE ASPECTS AND POTENTIAL RAMIFICATIONS

### *Unique Aspects of Using Private Firms for Policy Advice*

Using private consulting firms in policy formulation differs from using other advice sources, in a number of aspects: the *public nature of the process*; its *transparency*; and the aspect of *knowledge acquisition over time*. Clarifying these aspects will help set the ground for discussing the ramifications of policy formulation outsourcing.

The public sector utilizes different methods of acquiring advice for policy work that allow it to gain knowledge and analysis that it did not hold previously. Some of the more commonly examined forms of advice include the use of think-thanks, policy research institutes, and academic scholars; use of public committees appointed to advise the public sector; and the use of public participation methods (see for example Abelson 2000; King et al. 1998; Stone 2000).

All these methods of seeking advice operate, to different extents, *within the public sphere*. Public committees' discussions and reports are usually open to the public (unless confidential). Think-tanks and policy research institutes, though their influence and style of work greatly differ in different countries, usually publish their work and take part in the public debate in matters concerning their areas of expertise (Abelson 2000). Public participation methods are by definition public, and though these methods are still evolving, they are carried out by and for the public (Rowe and Frewer 2000). The public nature of these methods normally also implies (at least some level of) *transparency*, in the sense that the advisory work is available to the public; and in the sense that the public can perceive who took part in influencing the chosen policy.

However, private companies are under no obligation to share their work with the public, and often work under "commercial secrecy" codes. Thus, their work is neither public nor transparent. Another issue is that

of *knowledge acquisition* over time. Policy research institutes and think-tanks usually develop expertise based on research on specific issues, thus maintaining relevant and profound knowledge of them (Abelson 2000). Members of public committees are also (ideally) appointed based on their relevant experience. Consulting firms, however, often develop knowledge by demand and, therefore, may have little expertise on relevant issues. Outsourcing policy formulation to private firms is, therefore, unique in matters of publicness, transparency, and the utilized knowledge base. This potentially carries significant implications.

### *Outsourcing Policy Formulation—Implications for Democracy*

Outsourcing policy formulation raises democratic concerns. These concerns relate to the publicness of the public policy formulation process, and to a potential “democratic deficit”. Deliberation surrounding the public policy formulation process is fundamental to the democratic process. The process of bringing different interests, positions, and views into deliberations regarding policy formulation, is often considered as reflective of the quality of the democratic process itself (Bessette 1994). Therefore, outsourcing the process of policy formulation is essentially a step toward taking it out of the public sphere, and into a sphere hidden from the public eye. Reviewing the work of private consulting firms in Germany, Beveridge regards the “emergence of [such] new political spaces” as an “institutional void”, where it is unclear which of the common rules of policy making process are still at play (2012, 48). This significantly diminishes the ability of different groups to take part in the process, and is considered as hindering the democratic quality of the policy process. Vigoda-Gadot et al. (2014) consider relying on the work of consulting firms in policy formation as “circumventing the democratic process” (p. 490), since it materially undermines the processes of exchanging standpoints regarding public issues and striving to reach consensus or compromise.

The ramifications of relocating the process of policy formulation outside the state can be further viewed as leading to a “democratic deficit” (Speers 2007). Though not well defined, the term is usually used to describe the situation in which decisions of international bodies and institutions materially affect interior matters of states, even though the citizens of these states had no part in electing these bodies.<sup>1</sup> Here it refers to a situation in which public policy affecting the public is formed



by entities which have not acquired public legitimacy to do so via appropriate democratic mechanisms. To better apply this term to the current discussion, it is fruitful to review Strøm's (2000) analysis of accountability and delegation of authority (to make political decision and formulate policy) in parliamentary democracies. Strøm's definition of the chain of delegation is depicted in Fig. 11.1.

In this process of delegation, the voters (by voting) allow a party to act on their behalf, through the democratic mechanism. The democratic institutions transfer this authority further along in this chain, to the executive branch, and from there to the civil servants. This chain of delegation, according to Strøm, is mirrored in the chain of accountability, running in the reverse direction. Each link in the chain is accountable and answerable to the prior link. Democratic institutions, such as state comptroller & ombudsman, freedom of information acts, parliamentary committees, etc. can be seen as mechanisms that enable and enforce this chain.

The outsourcing of policy formulation virtually creates another "link" in the first chain, transferring delegated authority to design policy to the contracted firms. However, it isn't clear what democratic mechanisms allow for this transfer. Indeed, Vigoda-Gadot et al. (2014) raise the concern that transferring the point of formulating policy outside of the democratic institutions may cause voters to doubt the value of voting, since it is unclear how their values and views are represented in forming policy. Furthermore, the reverse chain—i.e., the chain of accountability—is not fully functional when policy formulation is outsourced. Vigoda-Gadot et al. (2014) argue that allowing private firms to create policy removes the element of public accountability, as politicians and executives can attribute their decisions to external work (and not to their reasoning, set of values, and decision-making processes).

Public accountability is diminished much more substantially through policy outsourcing. Private firms do not take part in the accountability chain presented here, since they are not *answerable* to the relevant

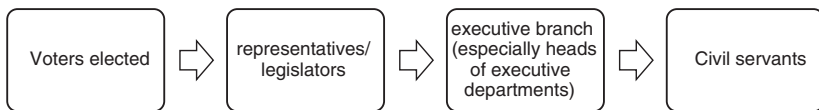


Fig. 11.1 Chain of delegation (Source Adapted from Strøm 2000)

democratic mechanisms mentioned above. They do not have the legal obligation to report to the parliament or to relinquish information by demand to the state comptroller or the public. Although some accountability can be instituted by contracts, firms are primarily answerable to interests of their owners or shareholders, and those direct them in making decisions. Furthermore, such results can be realized years after the policy planes have been forged by private companies. Unlike public agencies, which remain accountable over time, private firms can even cease to exist by the time the public becomes aware of relevant policy ramifications. Consider: who will be held responsible if a policy that was designed by a private firm proves destructive, and how? This transfer of policy design out of the public sphere might even allow for a deflection of blame away from the public sector, in such cases. At the very least, it creates ambiguity as to who is primarily responsible, and accountable, for the policy formed. The added link of private consulting firms thus creates a chain of delegation that does not correspond with the democratic chain of delegation, and is not continuous with the chain of accountability. It is this lack of correspondence and continuity in the chains that amounts to a democratic deficit in the context of outsourcing policy formulation. Namely, the authority to form public policy (and thus to affect the public in the various fields in which the state operates) is delegated to those external suppliers (that constitute the additional link), (a) without being accountable to the public and (b) without the proper democratic mechanism (i.e., the accountability chain) that allows for this delegation. This deficit might be enhanced insofar as the strategic level of outsourced issues rises, since the outsourced work would hold greater potential influence over the public. Understanding the level and content of work the state is willing to outsource to the additional "link"—which is the main focus of this chapter—can help in better defining the magnitude of the democratic problem discussed here.

### *Outsourcing Policy Formulation—Implications for Public Sector*

Outsourcing the function of policy formulation to private consulting firms carries further implications for public administration, with respect to its status in the public policy process, and to its ability to perform its role. The literature on external policy advice discusses multisource advisory systems, containing external policy formulation sources, which compete with (or work alongside) the public sector, and supply advice

to decision-makers (cabinet minister, PMs, etc.). This discussion often focuses on the relative influence these sources might have, depending on their proximity to decision-makers, the level of control the government might have over them, etc. (Boston 1994; Halligan 1995; Howlett 2010; Wilson 2006). The availability of various sources for policy analysis is often perceived as an opportunity to raise debate concerning policy issues, thus improving the policy process. The element of competition over possible influence is further perceived as an inducement to raise the quality of policy work in the public sector.

However, it seems that a necessary condition for competition between the public sector and external providers is that the public sector should be highly capable in policy analysis and formulation. Outsourcing policy formulation and analysis—*by and for* the public sector—means relocating processes, once carried out by the public sector, elsewhere; namely, to the private sector. The product of this work is then used by the public sector in its role as a policy formulator and advisor to higher levels of governance. It is, therefore, not at all clear that this kind of outsourcing creates competition. Instead, such outsourcing can be viewed as maintaining one source of advice (i.e., the public sector) which receives its input—analyses and research done elsewhere—from external (alternating sourced) work. This, in fact, can work to impede competition, since the public sector stands to become less of a competitor.

With this in mind, we should consider two contradictory influences that outsourcing of policy formulation may have over the public sector. On the one hand, this process can enrich public service in knowledge, insights, and perspectives created externally (Boston 1995; Halligan 1995). This is perceived as improving the abilities of the public sector, and as potentially strengthening its status. The reverse potential effect is the gradual undermining of the public sector's knowledge base and analytical capacity. Continual transfer of policy issues and the development of relevant knowledge outside of the public sector, when carried within the wider context of privatization and reductions in the size and roles of the public administration, pose a potential risk to the proficiency of the public sector. In the long run, areas of expertise might disappear completely from the public sector, and remain solely in the hand of specialized consulting firms in the private sector.

Another capacity in danger is the acquaintance with the relevant policy field. The continuing outsourcing of policy design might damage the degree of acquaintance of the public sector with stakeholders in the

outsourced policy fields. It thus hinders its ability to utilize these relations for the public interest. As these abilities erode, the public sector’s ability to develop internal consultation mechanisms may also become impaired (Halligan 1995; Paz-Fuchs 2011 and this volume; Speers 2007; Vigoda-Gadot et al. 2014).

The cumulative effects of these potential processes on the public sector threaten its position as a policy advisor to decision-makers, and its role as a policy formulator. Furthermore, externalizing the task of formulating policy (on top of the work of gathering and policy analysis) deprives the public administration of one of its fundamental roles, essentially “robbing the government of what is rightfully considered ‘governmental by nature’” (Vigoda-Gadot et al. 2014, 494; see also Halligan 1995). Two potential ramifications, then, appear to follow from the outsourcing of public policy design. The first is a “democratic deficit”, stemming from the relocation of public debate and decision-making process out of the public sphere. The second is the potential effect of hindering the public sector’s capacity vis-à-vis the policy formulation process. These are related to the erosion of knowledge and capacity of the public sector that could result from continuing outsourcing.

Further exploration of the magnitude of these potential ramifications requires a closer investigation as to the strategic level of the issues outsourced. The next segment of this chapter provides a close analysis of outsourcing policy design to private firms in Israel, which demonstrates empirically the theoretical arguments elaborated above.

## METHODOLOGY AND RESEARCH DESIGN

The work presented here seeks to identify, describe, and characterize the willingness of the Israeli government to externalize the work of defining policy issues and to form policy to address them. It uses content analysis for government tenders, published between the years 2007 and 2013, aimed at seeking external consulting work. As government tenders constitute formal documents, intended to clearly describe the services the state is planning to purchase, they provide a clear indication of the state’s intentions and plans (Roodhooft and Van den Abbeele 2006).

Covering 13 Israeli government ministries (see Table 11.2 in the Appendix),<sup>2</sup> the work presented here initially collected 245 tenders that were published between the years 2007–2013,<sup>3</sup> and contained the word “*advising/consulting*” in its title in all its possible variations. A second

screening located tenders which their titles did not contain these words, but still indicated that they may relate to consulting work (i.e., contained words such as *formulating, research, developing, surveys*, etc.). Following the initial gathering of the tenders, an additional screening was conducted, in which the 245 tenders were sorted into three categories, as depicted in Table 11.1, based on the distinctions presented by Boston (1995) and Halligan (1995) discussed earlier:

A total of 63 tenders were compatible with the first category, and these were analyzed in this research.<sup>4</sup> Of the 13 ministries reviewed, 7 contained 5 or more relevant tenders, while the rest ranged between 0 and 4. Tenders were analyzed using a qualitative content analyses method. Each tender was reviewed to locate requests for components of *policy problem definition* and *policy formulation*. Requests for policy problem definition were located through reviewing the requested services for components of problem definition, as discussed in this work. Thus, each tender was reviewed to check whether it contained a policy problem definition, *formulated by the ministry*; and if it did, whether it was *formulated in terms of opportunities for change*. Each tender was further reviewed to contain a *request from the future supplier to locate and define opportunities for change*, or to *define and locate issues in which the state should operate*. Finally, tenders were reviewed for the existence of a request to *define goals and objectives for the ministry in the relevant policy field*, or *set priorities*. Similarly, the existence of requests for external suppliers to perform policy design was conducted by reviewing each tender

**Table 11.1** Categories for secondary classification of government tenders

<i>Category</i>	<i>Definition</i>
Strategic level (“Formulation”)	Tenders in which potential suppliers were asked to analyze a policy issue at the strategic level; or to propose a comprehensive policy plan for such an issue
Operative level (“Implementation”)	Tenders in which potential suppliers were asked to propose professional tools for the implementation of a well-defined policy program
Technical level	Tenders in which potential suppliers were asked to propose focused surveys or researches or to supply professional advice in matters of engineering, accounting, legal advice, organizational changes, etc.

to examine whether it contained a request to *invent, develop, or select a course of action*, in order to address the policy issue. This included: *suggesting policy alternative(s)* and *composing strategic plan(s)*; *directing the allocation of resources*; and *defining principles for policy*. The following section presents the main findings of this work, and describes some of the salient examples discovered in the research.

## FINDINGS

The findings indicate that Israeli ministries search for external suppliers to define policy problems on various issues and to form public policy to address these problems. Most of the tenders indeed contained a clear request from the future supplier to take part in main aspects of the problem definition: locating and defining opportunities for change or issues for the state to address and setting goals and objectives for the policy issue. These requests were usually accompanied by requirements to develop knowledge regarding the policy issue and to supply that knowledge to the state. These tenders occasionally included requests to develop and coordinate with other actors (state and non-state) in the policy field. The scope of policy measures in which the state requested consulting includes: preparing comprehensive strategic planes; setting principles for directing policy on different issues; planning international interactions regarding the policy issue; setting budgetary moves or legislative agenda; and defining target populations for recommended programs. Issues covered in the tenders reviewed vary, and span from issues of national economic policy, through issues of public resources management and environment protection, to issues of internal security and foreign policy.

### *Problem Definition*

Two main modes of requesting assistance in problem definition were identified. The first mode is a request for a *fundamental analysis of a policy issue*. A second was characterized by a request for *long term guidance and assistance* in completing a variety of tasks of policy analysis and problem definition for a *policy field*, without a focus on a single issue.

The request for the work of problem definition was articulated in several forms in the tenders. Some contained explicit requests to *define the policy problem*. For example, in tender no. 10/2, "Request for Guidance and Consulting in Matters of Public Order and Fighting Crime in Routine and

in Emergency” (Ministry for Homeland Security (HS) 2010), the future supplier is required to “prepare work plans containing *problem definition*, gaps between current and *desired situation*, *targets*, *objectives*, indicators, and monitoring and measuring processes for the formulated programs”. The supplier is further requested to “propose thoughts and directions for action for improving the HS ministry work in the mentioned fields”.

Other tenders contained clear requests for *identifying and defining opportunities for change* (and for pointing out ways to utilize these opportunities). In the economic sphere, for example, tender 10/43, “Consulting Services to Formulate Economic-Social Strategy for the State of Israel” (Prime Minister’s Office 2010), contains a request from the future supplier to specify “what are the *strength points*, *weaknesses*, *threats* and *opportunities*, (“SWOT” analyses) *faced by the Israeli economy*, in the next 15 years, and what are their effects for the short and medium term”? This is expected to be grounded in a “mapping and analysis of local and global economic trends, affecting the status of the Israeli economy; *locating* and *analyzing barriers* to utilization of *opportunities* and ways to *overcome threats* in the economic level”. Similarly, tender no. 20/09, “Economic and Accounting Consulting Services” (Ministry of Economy (MoE) 2009), contains a request for permanent assistance for the chief scientist in the MoE, in forming “micro and macroeconomic tools regarding government’s R&D policy; *analyzing* the *effectiveness* of existing and proposed programs; conducting sector-specific analyses, including sector *mapping* in Israel and abroad; *identifying barriers*, *failures*, and *opportunities*, and providing *recommendations* for the desired policy”. Another interesting example is tender no. 14/10, “Strategic Consulting Services” (Ministry of Economy (MoE) 2010), aimed at establishing a comprehensive work plan for the Small Business Agency. The future supplier is requested to create a “strategic plan that will include detailed *multi-annual goals and objectives*; as well as an *examination of areas and sectors on which to focus the agency’s activities* in the various stages”. The supplier is further requested to define “failures and barriers affecting business development and realization of agency’s aims”.

*Defining policy targets and objectives* was also recognized in different forms in reviewed tenders. For example, in tender 21/12, “Guidance, Implementation and Evaluation of the National Program for Oil Substitutes” (Prime Minister’s Office 2012), the future supplier is required to assist the Oil Substitutes Administration in “*formulating policies* on various issues in the field” and to consult in “*setting goals and policy objectives*”, according to which the government will evaluate its success.

### *Policy Formulation*

Many of the tenders requesting policy design in one policy issue (rather than a scope of issues), requested a comprehensive policy plan from the supplier. In tender No. 18/2013, "Consulting Services for Strategic Agro-ecologic Policy" (Ministry of Agriculture and Rural Development 2013) the supplier is required to prepare a "*comprehensive strategic plan*" for the Ministry of Agriculture's policy, with regard to environmental issues. Following a thorough mapping of the policy field, the supplier is requested to "examine options for overall strategy", and offer a "*blueprint according to... three budget options, including identifying the most feasible alternative*" (i.e., "*best available practice*"). In addition, the supplier is required to prepare a "*five-year work program that includes the feasible alternatives, budget details and risk analysis*". Similarly, Tender No. 11/2011, "Consulting and Guidance for Budget Division in the Ministry of Finance" (Ministry of Finance 2011), requires the supplier to suggest a comprehensive policy for agricultural support by preparing a "model for quantifying total external benefits arising from agriculture in Israel... a thorough comparison of international support mechanisms for agriculture in developed countries... [and an] in-depth analysis of existing and past subsidies in agriculture in Israel and their effects". The supplier is then required to provide a "*recommendation for the composition of agriculture support in Israel*".

Another interesting request by the Ministry of Finance is tender no 20/12, "Regional Clusters and Cooperation between Local Authorities" (2012), requesting consulting in designing cooperation clusters in economic matters and in provision of service for local authorities in Israeli periphery. The supplier is required to provide "mapping and analysis of needed and existing services in local authorities in the periphery, in the following areas: education, welfare, transportation and employment". Following this work, the supplier is to make "*recommendations regarding the desired clusters: number of local authorities and their populations; socio-economic level of the authorities' composition in each cluster, etc.*", as well as "recommendations for desired corporate structure for the cluster" and its "*set of powers and authorities*".

An example of a request for policy formulation regarding the prioritizing of values can be found in tender No. 1/2011, "Providing Strategic Development Plan for National Heritage values" (Prime Minister's Office 2011). Here, the supplier is requested to analyze "the values and themes that can be included in a national heritage program, including



a historical overview of the various issues in need of strengthening; and present an initial recommendation for a strategic plan". Later, the supplier is expected to prepare a call for offers for such sites and assets, "*present various alternatives* for the development of multi-year legacy assets program", and prepare a "comprehensive multi-year plan".

## DISCUSSION

### *Possible Democratic Implications*

The findings of this work point to two types of democratic implications. First, an essential part of the deliberation process that is attached to problem definition is taken out of the public sphere. This potentially suppresses the ability of various groups in society to participate in it, since it takes place in a private sphere, unaccountable to the public. Second, we see that policy formulation is outsourced at the highest strategic level. This adds to a "democratic deficit", described earlier.

The findings demonstrate that the state is willing to outsource the definition of policy problems and the forming of policies to address them. These tasks involve setting priorities, sorting conflicting interests, and allocating resources according to those determinations. These are some of the main features and roles of the political deliberation process. For instance, designing "economic clusters of local authorities"<sup>5</sup> (setting desired socio-economic characteristics for them, planning the relevant legislation, etc.) entails multiple socio-economic and geo-ethnic implications. As local authorities in the Israeli periphery<sup>6</sup> differ in socio-economic status and ethnic and national composition, setting a framework for their economic cooperation is expected to involve conflicting interests and values. In this case, part of the process of discussing and prioritizing groups' interests is relocated outside of the public sphere. Similarly, determining a "strategy to develop national heritage assets"<sup>7</sup> by analyzing "the values and themes that can be included in a national heritage program" involves—by definition—prioritization of cultural values. The implication of such outsourcing should be considered in light of the constant public debate regarding the budgeting of cultural assets in Israel—a debate fueled by existing conflicts between ethnic, national and religious groups. In this case, the opportunity of these groups to debate an issue with direct impact on their heritage development is impeded. Another interesting example is the outsourcing of policy formulation

regarding the “composition of the agriculture support” (and subsidies)<sup>8</sup>—an issue often surrounded by public debate, involving the farmers and the Kibbutz<sup>9</sup> lobbies, environmental groups, and food importers. Significant economic interests conflict in this policy issue—and yet their prioritizing is to be determined outside of the public sphere.

The findings further demonstrate that policy formulation at the national level is outsourced to non-state players. Given the theoretical discussion presented earlier, this can be described as creating another “link” in the “delegation chain”, and transferring to it the function of forming policy, thus, potentially creating a “democratic deficit”.

This can be seen in various tenders reviewed in this work. The work of “formulating policy and action principals for homeland security regarding the non-Jewish<sup>10</sup> sector”<sup>11</sup> involves directing the state’s “monopoly over the use of violence”. The work requested in this tender has the potential to shape the way the state treats members of the non-Jewish population in Israel in matters of homeland security, thus directly affecting their lives. Keeping in mind the chain of delegation described earlier, this is a delegation of authority to direct force, out of the state and to an “additional link”, thus potentially creating the described deficit. This can also be seen when the state outsources the “mapping of target population for development programs in the Negev and in the Galilee and suggesting the desired treatment for them”.<sup>12</sup> This work involves determining “who gets what and how”: which population is affected by state policy and by the allocated resources attached to it. This has direct influence over the population covered (and not covered) by these programs. It similarly transfers the authority to direct and allocate public resources outside the state. Another prominent example is the request for consulting in “Formulating Economic-Social Strategy for the State of Israel”,<sup>13</sup> which includes determining “strength points, weaknesses, threats and opportunities, faced by the Israeli economy”. In this case, policy formulation at the highest national and strategic level, spanning and influencing various economic issues, is relocated out of the state. Since it concerns the highest strategic and national level of economic policy, it has the potential to widely affect the public in various areas.

In these and other cases reviewed here, policy formulation at the highest level—which has substantial potential influence over the lives of the public—is transferred outside of the public sphere, thus contributing to the “blurring of the lines” between the private and public. This transfer creates a democratic deficit. As the issues externalized concern

core tasks of the state in forming policy (allocating resources, directing the use of violence, prioritizing cultural assets, determining which population would benefit from public resources, defining principles for cooperation with other countries, etc.), the democratic deficit created can be viewed as both deep and broad, pertaining to various areas of the affected population's life.

It can be argued that the work done by external firms merely offers advice and possible solutions, while leaving the decision in the hands of the state, thus avoiding (at least to some degree) this democratic problem. This is, in part, an issue for further empirical investigation. However, in light of the immense influence attributed to the process of problem definition (which—as demonstrated here—is indeed outsourced) over the chosen policy, we cannot maintain that the outsourced work is merely technical. The definition of the policy problem and the setting of the framework for possible solutions set the boundaries of the discussion regarding the policy issue. Therefore, even if the final decision is left at the hands of the state, the definition of the problem—provided by the external supplier—materially affects the formed policy. Evidence for this can be seen where policy formulation externalization includes a request for a few possible policy alternatives (and an indication of the favored one) by creating a “blueprint according to the three budget options, including identifying the most feasible alternative”,<sup>14</sup> or a request to define “areas and sectors on which to focus [the agency's] activities in the various stages”.<sup>15</sup> By setting the alternatives' scope or defining the issues that should be handled by the state, the external supplier also sets the scope of the possible policy, even if the final decision on what policy to finally form is left at the hands of the state. When the definition of the policy problem is outsourced, then, even if the final decision is at the hands of the state, it seems that—in an important sense—the state's hands are already tied.

### *Possible Implications for the Public Sector*

The main concern raised earlier regarding possible implications for the public service is the potential damage to its knowledge base and policy-analysis capabilities, as well as to its acquaintance with the policy field. Together with the outsourcing of “inherently governmental” tasks (i.e., policy formulation), these implications seem threatening to the public sector's capacity and role as policy formulator and advisor to

decision-makers. Some implications regarding this issue can be derived from this chapter, as well as directions for future research.

The services requested in tenders reviewed here imply procurement and development of knowledge by external suppliers and delivery of this knowledge to the state. This does not necessarily lead to deterioration of the knowledge level and base of the public sector. As it is the main client of the research, the product may lead to integrating more knowledge into the public sector's work. However, the extensive field-analysis required by the suppliers indicates that this proficiency in policy analysis may deteriorate over time. Further empirical research is needed to ascertain this aspect. As to the concern regarding potential damage to the level of acquaintance of public sector with other policy players, the findings do not provide clear evidence for the validity of this concern. Indeed, only some of the examined tenders requested external suppliers to develop working relations with different stakeholders in the policy fields. However, the fact that these services are not explicitly requested does not imply that they are not in fact executed by the suppliers. Here as well, further empirical research is needed to measure the effect that such outsourcing has on the public sector's capacities.

A final concern is the potential damage that the described outsourcing processes may have on the capacity and role of the public sector as a policy advisor and formulator. It appears that the content reviewed in this work indeed gives rise to such a concern. It is evident that various segments of the public policy formulation process are outsourced: gathering information and facts, defining the problem, designing alternatives, and indicating the preferred solution. Going back to the discussion of these tasks as "inherently governmental", the findings indicate that these core tasks are indeed taken away from the public sector. This can further threaten its position as policy advisor to decision-makers, as it undermines its status as the primary experts in the relevant field.

## CONCLUSION

This chapter presented and analyzed Israeli government ministries' willingness to allow private consulting firms to define policy issues for them to handle and to form policies to address them. These findings point to a potential threat to the quality of democracy: a "democratic deficit", stemming from the formulation of public policy at the highest level by private firms; and the relocation of democratic deliberations regarding policy

issues, outside of the public sphere. The findings further indicate that core tasks of the Israeli public administration—policy analysis and policy formulation—are taken out of the state, which point to a possible undermining of the status and role of the public sector in the public policy process.

These findings add to the limited existing empirical research concerning outsourcing of policy formulation, by demonstrating the content being outsourced. They provide an empirical base for the theoretical discussion in the literature surrounding this issue. Concerns for democratic problems stemming from these processes, presented in existing literature, receive grounding in this work. The findings demonstrate this by revealing the tasks required from external suppliers: problem definition, prioritization of interests, and policy formulation. The content revealed here also provides some basis for the theoretical discussion regarding potential effects such outsourcing may have on the public sector. Although further empirical work is needed to assess these ramifications, the findings here suggest that “inherently governmental” functions are outsourced, thus providing an initial empirical basis for concerns raised regarding the threat such outsourcing places on the public sector’s status as policy formulator, and on its policy capacity.

Outsourcing of public policy formulation in Israel can be described as part of a general trend toward the transferring of power, authority, and funds from the public sector to the private and third sector. Unlike many other cases described in this volume, outsourcing public policy design relates to the role that is at the very heart of government work: setting policy goals and crafting the way to achieve them. It involves the outsourcing of discretion in matters of public policy, one of the strongest assets of the public sector. This outsourcing receives little public discussion in Israel, and does not follow any clear government or parliament decision. Unlike other cases of privatization, the parties potentially suffering from it are not well defined, and thus it also raises little public protest. Such an unusual act of the public sector, relinquishing one of its strongest assets—discretion—begs the questions of motive and calls for further research.

Considering the weakening status of the Israeli public sector, some hypotheses can be ventured. One possible explanation can be the need of government ministries for an external, professionally perceived body, to back-up their pre-designed policy direction, when approaching negotiation with stronger public agencies, such as the Ministry of Finance.

Another explanation may lay in the need for an alternative party to which the blame can be shifted in case of policy failure. A third, somewhat disheartening explanation that should be considered, to wit—the diminishing capacity of the Israeli public sector to perform, with its own resources, such policy work.

When considering the course of many other cases of privatization in Israel, there appears to be a process of “incremental privatization”. This occurs when public agencies in charge of delivering the relevant services are slowly weakened and under-budgeted, until outsourcing appears to be the obvious answer, thus further weakening those public agencies (Mandelkern in this volume). In this manner, what sometimes begins as a minor privatization of one service, can progress over time to an overall transferring of services to private hands. Against this background, the question of the future of public policy formulation in Israel arises. From the evidence presented in this work, it is not clear how the public sector determines what issues can be outsourced. Other questions should also be considered: are there any issues *too* strategic to be moved out of the public sector? Will we be witnessing private firms handling Israel’s security policy, or its diplomatic relations? These questions, both in their normative and the empirical aspects, deserve further research.

## NOTES

1. For a discussion of the various uses of this concept, see Follesdal and Hix (2006).
2. The number and titles of ministries in the Israeli government varies, depending on the composition of current coalition and government’s agenda. The 13 ministries listed in Table 11.2 were selected based on Galnoor’s (2007) list stating the “permanent” and “core” ministries of the Israeli government.
3. Tenders were collected from ministries’ websites, from the Government Publishing Bureau website ([www.michrazim.lapam.gov.il/LAPAM](http://www.michrazim.lapam.gov.il/LAPAM)) and from the Government Procurement Administration website ([www.mr.gov.il](http://www.mr.gov.il)). All translations of titles are by the author.
4. All cited tenders are available in the database assembled for this research: [https://www.dropbox.com/sh/e44f8i81d782q3h/AABEH88CSr\\_YMk8c2mjfbNj1a?dl=0](https://www.dropbox.com/sh/e44f8i81d782q3h/AABEH88CSr_YMk8c2mjfbNj1a?dl=0), in Hebrew.
5. See: tender 51/12 “Regional clusters and cooperation between local authorities” (2012), published by the Ministry of Finance.

6. Geographic areas to which the tender relates.
7. See: tender No. 1/2011 “Providing Strategic Development Plan for National Heritage values” (2011), published by the Prime Minister’s Office.
8. See: tender 11/12 “Consulting and guidance to the budget division” (2012), published by the Ministry of Finance.
9. As kibbutzim in Israel are the main source of agriculture produce in Israel.
10. The term is mostly used to refer to the Palestinian-Israeli population.
11. See: tender No. 6/10 “Request for guidance and consulting in fields on the non-Jewish sector” (2010), published by the Ministry of Homeland Security.
12. See: tender 54/09 “Economic Consulting and Conducting Supporting Research and Surveys” (2009), published by the Ministry of Economy, focused on economic and employment development in the Israeli periphery.
13. See: tender 43/11 “Consulting Services to Formulate Economic-Social Strategy for the State of Israel” (2011), published by the Prime Minister’s Office.
14. See: tender 18/13 “Consulting Services for Strategic Agro-Ecologic Policy” (2013), published by the Ministry of Agriculture and Rural Development
15. See: tender 14/10 “Strategic consulting services” (2010), published by Ministry of Economy.

## APPENDIX

**Table 11.2** Number of tenders sorted to level 1: “Strategic level”, by ministry (*Source* the Author)

<i>Ministry</i>	<i>N</i>	<i>Ministry</i>	<i>N</i>
Environment Protection Ministry	15	Ministry of Interior	3
Ministry of Economy	10	Ministry of Foreign Affairs	1
Ministry of Agriculture and Rural Development	8	Ministry of Health	1
Ministry of Homeland Security	8	Ministry of Justice	1
Transportation Ministry	6	Ministry of Education	0
Ministry of Finance	5	Ministry of Welfare and Social Services	0
Prime Minister’s office	5		

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PART IV

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Social and Political Aspects



## Privatization, Outsourcing, and Employment Relations in Israel

*Amir Paz-Fuchs*

Over the past three decades, most industrialised nations have been increasingly using private intermediaries in the provision of public services. This trend is noticeable in the social services (health, education and welfare) but is also common in areas that were traditionally viewed as “inherently governmental”, such as security, justice, and immigration. Such reforms are referred to as “partial privatization”, “outsourcing”, or “contracting out”, the latter indicating the legal nature of the relationship between the government and the private provider.

It is difficult to overstate the importance and ramifications of contracting out as a policy, in light of its depth and breadth. In the United States, for example, over 50% of publicly funded government services are provided by private intermediaries (Minow and Freeman 2009). In Britain, as early as 1995, Mark Freedland noted the British Civil Service was reduced to its lowest level since the Second World War, and the expectation was that this fall would continue (Freedland 1995a). Elsewhere, Freedland expressed concern that, under the guise of a “little and mechanical” reform, the British government managed to change

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constitutional aspects of governance through the seemingly innocuous policy of contracting out (Freedland 1995b, 23).

So while “pure” privatization of public companies has attracted attention and appraisal, the silent, partial privatization of public (and especially—social) services has continued and expanded without the same level of scrutiny (Donahue and Zeckhauser 2012). Outsourcing has now been implemented in highly sensitive areas, such as child protection and probation services; in areas of governance, such as regulation and supervision; and, somewhat ironically, in the preparation of the outsourcing and procurement process itself (Diller 2000; Freeman 2003; Marciano, this volume; Kariv, this volume). Another aspect of the expansion of outsourcing concerns the identity of the private entities with which government engages to provide the service. While, in the past, partial privatization referred to government funding of non-profits, contemporary outsourcing includes a significant increase in the number and weight of for-profit companies providing services (Gilman 2001; Salamon 2001).

Far from being an exception to the rule, Israel has embraced these policies with almost unparalleled enthusiasm (Dotan 2015). In practical terms, this has meant incrementally replacing government employees with workers employed by intermediaries. Nurses, social workers, teachers, engineers, environmental technicians, and numerous others are now more likely to be employed by non-governmental and for-profit organizations than by the Israeli civil service.

How did this come to pass?

### LABOUR LAW AND THE OUTSOURCING OF PUBLIC SERVICES

Accepted wisdom suggests that the neoliberal streak, which was latent and disparaged in Israel’s first 30 years, gained credence, ideologically and professionally, following the financial meltdown that occurred in the early 1980s. Shafir and Peled, for example, suggest that such a significant institutional change is likely to take place at times of a “punctured equilibrium” because the crisis of the state provides institutional entrepreneurs with more autonomy and incentive to satisfy their mobilised constituencies. They argue that the economic crisis of the early 1980s created the sort of “puncture” that enabled the re-evaluation of the incorporation regime itself (Shafir and Peled 2002, 19, 240). Emergency powers were employed to order the government and local authorities to reduce the number of public employees immediately,

and significantly.<sup>1</sup> Regulations provided that collective agreements and Civil Service Commission regulations will not apply. Challenges in the National Employment Tribunal (NET) and in the Supreme Court were not successful.<sup>2</sup> And so, in the first instance, ancillary services, such as security, construction, and cleaning were transferred to private contractors. In the 1990s, pressures increased to expand the use of outsourcing (Galnoor 2011). Government departments and municipalities began outsourcing services that ranged from court secretarial services to nurses, dentists, social workers, and teachers. Unlike their government-employed co-workers, these service providers are commonly employed on a “zero hour contract” basis, do not benefit from employment-related social benefits, annual leave, educational funds, protection against unfair dismissal and so forth (Harel Ben Shahaar, this volume). The use of intermediaries expanded to such a degree that teachers were employed through non-governmental entities to teach all subjects, including core courses, in contravention of the Ministry of Education’s directives (Wergen 2011; Davidov 2015; Harel Ben-Shachar, this volume).

The study of outsourcing provides in Israel thus provides a fascinating case study for rapid policy and institutional change, which has an important effect on Israeli labour relations, all of which we address in this chapter. But less obvious, the legislation and litigation over the rights of workers who are subject to outsourcing offers insights into legal action, industry reaction, legislative and judicial responses, and so forth. It is, in other words, a lesson in the role of law in society, and the role of the social in law.

The social and economic trends of the 1980s and 1990s have, perhaps, changed the background for labour law in a manner that has not been visible since the industrial revolution. Indeed, one may view current trends as a counter-revolution. If mass production led to the decline of intermediate forms of labour sub-contracting (Deakin 2002), and even to the outlawing of such relations (Freedland 2003), the current trends seem to view the engagement of sub-contracting as a necessary strategy in a globalised, specialised world, and labour law, for its part, all but embraces and encourages such structures.

What are the motivations behind such changes? Despite it being a global phenomenon, at least in industrialised nations, different legal backgrounds, social cultures, and economic forces in each nation lead to important differences in the motivation for the turn to subcontracting and thus, to important nuances in the way outsourcing is regulated. But

across nations, it is easy to identify the role of employment relations, and employment law, as a strong facet in arguments for and against outsourcing in the public sector. Most obviously, civil service constraints, such as post limits, do not apply in the private sector. The role of unions is much more visible in the public sector, and therefore reducing their power and role is much more apparent as a motivation there (McCrudden 2007). Through outsourcing of social services, governments try to “remove that workforce from the ambit of public sector bargaining” (Davies and Freedland 1993, 622). And deriving from these two concerns, the public sector is viewed as far less flexible, and managers’ ability to adapt to a rapidly changing economic and technological environment as far more limited (Deakin and Walsh 1996; Savas 2000). New public management theories and policies have thus been advanced to increase managerial flexibility, which has at its heart employment flexibility, into the public sector (Deakin and Reed 2000).

How does outsourcing lead to flexibility? Outsourcing changes the employment relationship, from a bilateral relationship to a trilateral one. While, in the past, those employed in a wide range of services were employed directly by the principal, or end-user (e.g., the bank, or the government), this structure has been replaced with a triangular employment relationship (Prassl 2016). Following outsourcing, the employees will often be considered to be employed by the contractor, who has a contractual, business relation with the end-user.<sup>3</sup> The business contract between the end-user and the contractor may be renewed or terminated according to the terms set therein. In addition, the terms of the contract between the contractor and his employees commonly offer more convenient clauses for the termination of the employment relationship, when compared to the typical employment contracts in the government sector. The flexibility is achieved, per the theory, on both sides of the triangle.

This is not the place to ascertain whether outsourcing indeed leads to the desired flexibility. As we see below, there are, in fact, claims that the end-user (in this case—the government) becomes increasingly dependent on the contractor, thus replacing one form of inflexibility (due to the constraints laid by collective agreements) with another.

And so, as the motivation for governments to engage in outsourcing becomes clearer, courts may become increasingly occupied with the need to look beyond the contractual framework, and to differentiate between “authentic”, bone fide outsourcing and fictitious, or “sham”

constructions (Davies 2009; Bogg 2012), that are created with no true institutional objective (such as making use of business expertise that does not exist inside the government) but deprive employees of rights that otherwise would have been granted to them. The tests employed by Israeli courts to differentiate between the two forms of outsourcing, and the government's response, frame the legal focus of this chapter.

## THE LEGAL TRAJECTORY, AND TRAGEDY OF GOOD INTENTIONS

### *Two Types of Outsourcing*

The term “outsourcing” contains two main sub-categories. The first may be termed as the “outsourcing of personnel”, and is often associated with *temporary* agency workers. An agency, in this case, supplies workers to assist a client with a temporary need due to maternity leave, annual leave, unexpected resignation, etc. In the second case, “outsourcing of services” occurs when identifiable sectors are transferred to a private company as a whole. Where outsourcing of services is concerned, sectors, such as cleaning, IT services, or maintenance may be carried out by private companies. These examples are not completely arbitrary. The sectors that were originally most prone to outsourcing were those that do not constitute part of the enterprise's core operations.

In the early twenty-first century, the distinction between the two types of outsourcing became crucial in the Israeli legal context. The reason for this is that the *Manpower Act 1996* regulates Temporary Work Agencies, guarantees temporary workers a right to equal terms and conditions when compared to those employed directly by the end-user and, crucially, from 2008, section 12A mandates that agency employees who have been assigned to an end-user will be deemed as the end-user's employees after 9 months. It should be stressed that this act (and, of course, this section) applies solely to the outsourcing of personnel, but not to the outsourcing of services.

On the face of it, the distinction between outsourcing of personnel and outsourcing of services is clear. The first involves the temporary employment of individual workers through an intermediary to address a particular business need (employee on maternity leave, sudden influx in demand, etc.). The second refers to the permanent transfer of an identifiable segment of the company, government department or government



agency, to a private entity, which will be tasked with producing outputs: e.g., a clean a building, provide lunch, or maintain security. In Israel, the distinction with regard to workers' rights is also very clear. Workers in one, highly regulated form of triangular employment—outsourcing of personnel—have legally guaranteed rights to equal treatment when compared with workers employed by the end-user (the government or local authority, in this case), and may hope to gain full status as government employees, including job security, if they are employed in this role for over 9 months. In contrast, workers in the other, highly deregulated form of triangular employment—outsourcing of services—are denied all these rights. While this portrayal may suggest a clear delineation between the two types of outsourcing, in reality, things are far more complex.

Let us start at the outset. When section 12A passed as an amendment to the Manpower Act in 2000, the Israeli government, by far the greatest employer of agency workers, was anxious about its ramifications, since its immediate implementation would mean a massive extension of the public sector (those employed over 9 months will be incorporated into the end-user—the civil service itself). It therefore opposed the section, and deferred its entry into force for 8 years. The reason for the state's objection is thus apparent. What could explain the sudden withdrawal from years of opposition?

The reason is legalistic, and simple: the government re-categorised the workers as “service providers”, which are not under the scope of the *Manpower Law* and cannot benefit from its provisions. The numbers tell a very clear story. While 10,000 “outsourced personnel” were employed by the government in the year 2000, by early 2009, there were only 150 such workers in *all* government ministries, and they were employed only as a last resort, for up to 6 months. For the first time, the State Accountant began publishing detailed numbers of “outsourced personnel” in all ministries (State Accountant 2010). The State Accountant directed all government entities (ministries and corporations) that “in general, no employment of agency workers will be authorized” (State Accountant 2008, sec. 1.1).

The situation regarding employees in the “outsourced services” is dramatically different. As they are not covered by the Manpower Act, there are no sanctions for their long-term employment. Therefore, no account is needed for their identity, number, rights or cost. In fact, the State Accountant's report, just noted, states explicitly that the government

entities were not asked to report the number of employees employed through service providers (as opposed to those employed through “personnel contractors”). One may think that this change of direction, problematic as it may be, was effected by government agents discontinuing contracts with personnel contractors, and transferring the activities to service providers. However, in many cases, the “reform” had a much more legalistic, and even cynical, character: personnel agencies of yesteryear began branding themselves as service providers. Thus, when the Israel’s Ministry of Health (MoH) was asked by the State Comptroller how it plans to restructure its engagement with the Association for Health Services, a contractor which provided 4500 workers to the MoH, the latter’s General Manager replied that the MoH plans to “move from a ‘personnel contractor’ to a ‘service provider contractor’ model” (State Comptroller 2009, 474). Needless to say, the change of models did not require changing the identity of the (personnel/service) provider.

So outsourcing of services has expanded from the periphery of public services into their core, carrying with it tens of thousands of workers—teachers, nurses, psychologists, civil engineers—employed on a long-term basis to perform a public service, whilst being denied the rights of civil servants. While this would, facially, be a case of outsourcing personnel, government departments and agencies categorised it as outsourcing services, so as to avoid the reach of the Manpower Act. As Avilés notes, “in quite a few cases the contracting-out is essentially reduced to the labour force alone, [thus raising] the old problem of pseudo-contracting and of labour-only contracting” (in Freedland and Kountouris 2012, 115). Moreover, it should be stressed that this case of camouflage was motivated by the desire to circumvent regulation (of personnel outsourcing) that itself was designed to secure agency workers’ rights. Perhaps even here this experience is not limited to Israel, as others have commented on the Sisyphean process that “every time law manage(d) to regulate an employment relationship, another atypical employment relationship (would come) immediately into being, frustrating the restraints envisaged by the regulations” (in Kountouris 2007, 44). One may argue, at this point, that it is for the courts to stand fast against such attempts. However, the truly good intentions of the courts, we find now, have led to similar, more unfortunate results for workers and for the services they provide.

*The Challenge for the Courts: Socio-legal Dynamics  
of Employment Relations*

Israeli workers who were subject to these reforms were not oblivious to the government's true intentions, and on more than a few occasions brought legal challenges, the essence of which suggested that their employment should be perceived as personnel, and not as service, outsourcing. In determining these challenges, the Israeli Employment Tribunals developed a jurisprudence that distinguishes between an "authentic" triangular business relationship and a "fictitious" triangular relationship. In the former, the end-user truly requires the services of an external provider for the performance of a designated task and the provider is expected to produce an output. In the latter case, the structure of service provision is, to use the British terminology, a "sham" that masks the fact that the intermediary serves as a manpower agency as "little more than a funnel for the transfer of wages" (Davidov 2015, 10), so as to deny employees their rights. While the former is legitimate, employment tribunals found that the latter is not, as it constitutes "contracting out of the collective agreement, in a manner which conflicts with the fundamental notions of labour law".<sup>4</sup>

As the parallel to British jurisprudence in this area has already been noted, it is interesting to note that two early cases reveal striking similarities not only in the judicial approach, but even in the facts of the case. In both cases, a triangular relationship was established by the government to *assist* workers who would otherwise not manage to find suitable employment in the free market, on their own. In the Israeli case of *Hersbkovitz*, a 71-year-old immigrant was found employment in a government hospital as a pharmacist, despite having minimal command of (Hebrew) language and a different professional background.<sup>5</sup> His wages were paid, in part, by a corporation set up by the government to assist the disabled, Hamshakem, which operates as a sheltered workshop. In the British case of *Bearman*, two disabled workers were found employment with the Employment Service through the Sheltered Protection Scheme operated by the Royal British Legion Industries.<sup>6</sup> In both cases, the workers demanded status as government employees, with all the rights that such a status entails. In both cases, their requests were denied, with very similar reasonings.<sup>7</sup> Both judgments made note of the general public benefit of such schemes, which includes the benefit to members of the same group to which the plaintiffs belong. They suggest that this

form of triangular employment is not meant to disenfranchise workers, but rather to benefit them in a manner that would not have been possible under the traditional, market-based contract of employment. Therefore, there is “nothing in this structure that negates the foundational elements of labour law”.<sup>8</sup>

But as outsourcing became more prominent, and less benign, Israeli employment tribunals have moved from submissiveness (to government policy) to scepticism (as to government’s intentions). Tribunals were no longer willing to view all triangular relationships as “authentic”, and were increasingly ready to view them as “fictitious”. The result of such an assertion would be that the claimant would be entitled to almost all rights of civil servants, despite the fact that she did not pass entry exams. Indeed, in some such cases, the NET held that the state cannot bar “insourcing” of employees by arguing that they did not pass the entry exams after years of employing these workers in such fashion, since holding otherwise would allow it to benefit from its own wrong.<sup>9</sup> And yet, in other cases, the same court held that the workers will be entitled to most rights as those employed directly in the civil service, but not to all. Thus, tenure and access to a generous (“budgetary”) pension scheme will not be awarded, since the workers did not enter their role in the public service via the civil service recruitment route.<sup>10</sup>

But before discussing possible remedies, analysis of the court’s approach in determining the distinction between authentic and fictitious outsourcing is crucial to understanding the dynamics that followed. In general, the tribunals developed a series of tests, which revolve around one simple principle: **the stronger the association of the employee to the end-user’s workplace, the stronger the tendency to see her as the employee of the end-user.** In contrast, **the greater the distance between the employee and the daily routine of the workplace, the more the court will be inclined to treat the worker as employed by the service provider.** This rationale seems reasonable, and a matter of common sense. If the worker is subject to the control of the end-user,<sup>11</sup> takes part in day-to-day activities of the organisation, is integrated in the end-user’s hierarchy, and is subject to its policy and disciplinary procedures, then the formal, contractual structure may be regarded as fictitious, or a “sham”. In contrast, increasing the “distance”—physical and managerial—between the end-user and the worker by “the displacement of employment contracts by commercial contracts” (Atkinson 1987, 87) will disconnect the legal responsibility of the end-user to the worker, since it reduces the likelihood that an employment relationship exists between the two.

Though this rationale was never declared in such a straightforward fashion, it may be traced back to the leading judgment of *Kfar Ruth* (Ruth Village),<sup>12</sup> the first case of a trilateral employment relationship which demonstrated the NET's sceptical approach. Towards that end, the court identified a series of tests: who has the power to dismiss the worker and who should receive notice of resignation; who hired the worker; who sets the terms of employment, including payment and benefits; who supervises the worker's work; who authorises the worker's leave and vacations; who *truly* (and not as a channel) bears responsibility for the worker's pay; who owns the equipment, the material, and tools that the worker uses in his work.

Following *Kfar Ruth*, the employment tribunals followed these tests to determine whether outsourcing was authentic or fictitious. Thus, the NET found the outsourcing initiated by the Department of Education (in *Aloni*<sup>13</sup>) and the National Insurance Institute (in *Dayan*<sup>14</sup>) to be fictitious, based on the original *Kfar Ruth* tests. Justice Davidov-Motola explains in *Aloni*:

Application of the *Kfar Ruth* tests reveals, therefore, that the selection of instructors was made, in effect, by the Department of Education; the power to dismiss was, substantively, in the hands of the Ministry of Education; and the wages and terms of employment were set, in effect, by the Ministry of Education. ... The government decided on the material that the instructors were to work with, conducted training and supervised their work...<sup>15</sup>

Similarly, in *Dayan*, Justice Davidov-Motola relied on the fact that “the National Insurance Institute set the acceptance exams for workers; it decided on their posting and transfer based on need; it set the wages and fringe benefits; it directed the respondents [the workers] professionally on a daily basis ... the contact between the respondents and the Institute was continuous and uninhibited, even when the contractors were replaced”.<sup>16</sup>

But, well beyond the legal developments, it is important here to note their impact on employment reality. For the *Kfar Ruth* judgment was not perceived solely as a static tool to assess a given employment situation; rather, it has become an **employers' directive to plan their employment relationship in a manner that will knowingly distance themselves from the agency workers** (Weil 2013, 188, 196). Concretely, end-users, including government departments and agencies, now seek to avoid

professional or personal contact with agency workers so as not to create the appearance of a worker's association to the workplace. One example of such a state of affairs became evident during the litigation brought by several secretaries who were employed, through a service provider, at the Israeli Revenue Service.<sup>17</sup> Justice Rosenfeld describes how, "prior to the claim brought by the plaintiffs, some of the secretaries who are plaintiffs in this case, sat in the same room as secretaries who are government employees. Immediately following the submission of the motion to the court, ... six secretaries who are government employees were placed in the "small room", while the plaintiffs were moved to the "big room".<sup>18</sup> Ten years later, the present author was approached by workers employed, through an agency, by the Department of Social Services in Tel-Aviv. Upon hearing of the approach, the municipality's legal counsel instructed the department not to allow agency workers to enter the department building, to use department computers or to participate in staff meetings. The municipality was clear as to the aim of this instruction: workers cannot be perceived as having obtained the relevant ties to support the claim that they are employed directly by the municipality. These examples are part of a wider trend, in which employers began denying agency workers access to facilities enjoyed by regular staff members, such as eating in the canteen, transportation to and from the workplace, use of staff showers, and so forth (Weisberg 2012; Rabin-Margaliot 2009).

The force of the incentives set by the judicial tests was made manifest in the most significant school reform implemented at least since the turn of the century. As part of the Israeli government's reforms following the 2011 social justice protests, free after-school activities were set up for preschool and grades 1–3. Since it did not wish to expand the number of teachers employed by the Ministry or by local authorities, the government decided that they will be employed by a contractor. And so, the tender documents state that the contractor is the employer of the teachers, that no employment relations will exist between them and the Ministry, and that they will not be entitled to rights as government employees. Furthermore, the tender documents state that the contractor will operate from his office,<sup>19</sup> and that he will be responsible for recruiting and placing personnel, at his expense. The contractor's employees may not sit in the Ministry's offices, may not use government equipment, may not use official government letterhead, and may not sign documents in the name of the ministry.<sup>20</sup> Most tellingly, the effort to distance the contractor and his workers from the government was brought to an extreme by clarifying that the body responsible

for **supervising** the effective execution of the project is ... the contractor himself!<sup>21</sup> Since close supervision by employees of the local authority at the school could lead to the conclusion that the authority has outsourced the personnel, and *not* the services, the government had to distance itself even from the “inherently governmental” task of supervising the work engaged by the contractor.

In summarising this section, we find that the combination of two factors lead to an inherent failure in the framework of social services in Israel. First, the *institutional constraints* are such that government entities choose not to employ workers directly, but rather through contractors. The two main reasons, as indicated by local authorities and ministries in their responses to legal challenges, is cost awareness and post limits. Second, in the current *legal state of affairs*, the greater the control and supervision of the government authority over the work of outsourced employees, the greater the likelihood that the end-user will be considered the actual employer.<sup>22</sup> Correspondingly, it is suggested that the effects of outsourcing are both rights-based and institutional (Barak-Erez 2009). In the next section, it is argued that the strong divide between workers employed directly by the government, on the one hand, and outsourced workers, on the other hand, has widened the gap in the two-tier economy, and has had a profound impact on minority and disempowered workers. In the section that follows, we assess the institutional consequences for Israeli public services that result from this state of affairs.

## HOW OUTSOURCING CREATES A TWO-TIERED ECONOMY THAT DISENFRANCHISES WORKERS

Discussion of outsourcing of public services tends to focus on their costs and quality as sole indications of their success, or failure. Far less attention is paid to the individuals immediately affected by the outsourcing, and instrumental in making it a success or failure—the workers involved. And yet, there is evidence that “agency work in inherently precarious” (Davies 2016, 506) and that outsourcing has contributed to the creation of a two-tiered workforce, and where it existed, to the widening and deepening of the gaps between the tiers (Flecker and Hermann 2012; Schulten and Brandt 2012).<sup>23</sup> This consequence is realised through the undermining of both collective and individual employment rights, with a particular focus on the right to equal treatment.

*The Collective Perspective: Outsourcing and Effects on Unions  
and Collective Bargaining*

Outsourcing is often perceived as one prong in the general scheme of new public management, which has at its heart the aim to increase flexibility in the workforce. In this context, unions are portrayed as the main inhibitors of flexibility, since collective agreements limit the government's ability to dismiss workers, employ them on a casual basis, move workers from one task to another, and so forth. It is important to note that advocates of this position admit, implicitly, that outsourcing is not an end in itself. Rather, the important goal is weakening the influence and power of unions to bargain collectively. For if the unions remain as influential following outsourcing, the aim (of flexibility) will not be achieved. And so, both advocates and opponents of outsourcing agree that outsourcing does manage to undermine union power. They differ, of course, as to whether this is a positive result.

Indeed, "breaking" the unions is often stated by scholars, civil servants, and politicians as one of the central aims of privatization and outsourcing (van der Hoeven and Sziraczki 1997). Margaret Thatcher stated that she views privatization as an important step to weaken trade unions to "reverse the corrupting effects of socialism" (Thatcher 1993, 676). The unions, for their part, were not oblivious to this position, stating at the time that "amongst the tactics that the current Conservative government employs to attack British workers, privatization seems to be the most fatal" (Bickerstaffe 1983, 7). In Israel, former Prime Minister Itzhak Rabin dismissed fears that the largest trade union, the *Histadrut*, will militate against planned privatization reforms, stating that he's "not worried about trade union objections to privatization, just as [he's] not worried about Islamic terrorist groups seeking to derail the peace process" (cited in Katz 1997, 175). Note the striking parallels here, between trade unions and terrorist groups, on the one hand, and between privatization and the peace process, on the other. The head of the Budget Division in the Ministry of Finance (and subsequently Head of the Prime Minister's office), Uri Yogev, noted as his greatest achievement his success in "breaking organized labor in Israel" (Arlozorov 2004). As for education sector, Yogev noted that there is still work to be done: "I think that we should push forward very aggressively towards abolishing all collective agreements for teachers" (ibid.; also Katan 2007, 121).



It is true that collective agreements serve as the “regulatory engine” (Davies and Freedland 1993) that limits the freedoms that parties to an employment contract have to negotiate, and usually guarantees workers’ rights beyond those secured by statute (Raday 1989; Summers 2001). Increasing flexibility, in the sense of expanding the parameters for contractual negotiation, could logically include limiting the coverage of collective agreements and the power of unions. But doing so has immediate effects for the power of workers in the employment relationship. Otto Kahn-Freund memorably highlighted the “inequality of bargaining power which is inherent and must be inherent in the employment relationship” (Davies and Freedland 1993, 18), leading him, and many others, to argue that it is collective bargaining that acts as a “countervailing power in the process of bargaining” (Langille 2011, 105–106). Indeed, reducing the power of unions undercuts the role of workers’ power not only in the process of negotiating their terms and conditions of employment. Unions are instrumental as agents of information: they provide a crucial role not only in bargaining for additional rights but also in distributing knowledge and enforcing existing rights, a crucial function in the Israeli labour market, which exhibits serious flaws in these areas (Davidov 2005). Even more generally, the power of unions correlates to the social power of workers in the political process (Dukes 2014, 212).

Constraints of space bar us from delving into these wider implications. Therefore, focusing on the employment relationship, we note that outsourcing manages to exclude workers in a particular government agency from the ambit of collective agreements that govern employment relations in that agency. Most directly, it thus allows employers to circumvent their obligations as dictated by the collective agreement, insofar as some workers are concerned (Raday 1999). Less obviously, but as important, it splits the workforce and reduces the reach of the relevant union which, following outsourcing, does not represent the outsourced workers.

We find, then, that government outsourcing disempowers unions and shrinks the public sector. Both trends have similar consequences: narrowing the middle class and expanding inequalities. The reasons are simple: first, stronger unions are better placed to bargain for a larger portion of wages for the majority of workers (Kristal et al. 2015; Freeman 2005). Second, outsourcing allows employers to negotiate only with stronger groups of workers, thus creating a strong barrier, or a wider gap, between the primary and secondary labor market.

Third, since, as is often is the case in Israel, stronger groups (Jewish men) are better represented in the union, the union's reaction to outsourcing is far more limited, and far less militant, than its objection to privatisation as a whole. The combination of these factors facilitates the rapid disenfranchisement of the terms and conditions of outsourced workers.

### *The Individual Perspective: The Construction of Legal Discrimination*

Outsourcing may have a particularly detrimental effect on disempowered groups of workers within the industrial unit, for the simple reason that it allows for a selective, targeted reform (Fudge 2008). By separating groups of workers, outsourcing undermines worker solidarity, and differentiates stronger groups of workers, whose negotiating powers may benefit others, from weaker groups.

In the cleaning and security sectors, for example, women, immigrant Jews, and migrant workers are over represented amongst agency workers (Taub 2015). Immigrant Jews, for example, who are commonly exploited in the Israeli labour market, constitute 61.5% of agency workers, almost double their representation in the general population (32%). Similarly, albeit less pronounced, 57.4% of agency workers are women, while their role in the labour market, in general, is 47%. Due to their demographic background, agency workers tend to be less aware of their rights, and even when they are aware, they are often reluctant to confront their employers to enforce these rights.

Against this background, the role of equality and non-discrimination becomes obvious, and multi-faceted. First, prior to outsourcing, individuals suffering discrimination on the basis of sex, race, or disability will be able to present the argument by referring to a relevant comparator that receives higher pay, or better treatment. This prospect disappears following outsourcing, since comparisons across employing entities is not open to workers. To borrow two examples from the UK: in *Lawrence*,<sup>24</sup> following the outsourcing of school meals, "dinner ladies" could not argue that their treatment was discriminatory when compared to those employed by the local authority. And in *Allonby*,<sup>25</sup> the outsourcing of teaching staff in higher education colleges barred female members of staff, employed by the agencies, from presenting equal pay arguments with respect to male members, who continued to be employed by the college (see Fredman 2004).

Second, affirmative action within the public sector for, *inter alia*, women, Arabs, immigrants and people with disabilities, is enshrined in primary legislation.<sup>26</sup> Since private employers are not required to employ affirmative action policies, outsourcing effectively reduces the number of, e.g., female, minority and disabled employees who stand to gain. A similar dynamic was documented in France and in the United States, where Ellen Dannin found that whereas 35% of the US Postal Service office workers had disabilities prior to privatization, no such workers remained following privatization (Dannin 2008, 1348–1349).

Somewhat related, the public sector also has guidelines in place to allow for a better work–life balance, thus making it a more attractive work environment for women. This may be one reason why 60% of public sector workers are women; within social services, they constitute 70% of the workers (Chason 2007); and amongst social and care workers—90%. The strong trend to outsource precisely these sectors thus has, and will have, a particularly detrimental effect on working conditions of women.

To summarise this point and to clarify: outsourcing allows the government to separate strong from weak sectors of the working population, and thus to deny the latter’s right to equal treatment. The lack of union representation also denies agency workers one of its main benefits: knowledge and enforcement of legal rights. Following outsourcing, it is nigh impossible for an outsourced female, Arab or disabled worker to compare herself to a male, Jewish, or able-bodied worker, respectively (see *Allonby*). All these factors combine to increase social and economic inequalities and to hinder social and economic mobility.

### INSTITUTIONAL EFFECTS

Outsourcing is often promoted for its role in improving public services. This is done, it is said, through the division of labour and the development of expertise through economies of scale and specialisation (Schulten and Böhlke 2012). In particular, the government focuses on “steering”—initiating, directing, funding and regulating the policy; while the private contractor “rows”, or implements the policy. Government will develop expertise in strategic management, control of the environment as a whole, while the contractor will be distanced from the political realm.

Against this background, it is quite ironic that there is growing evidence that outsourcing has led to *lack* of organisational control, to *more* politicisation and to the *decline* of expertise, precisely the exacerbation of the problems that outsourcing was intended to address. The reason for this result lies partly in the dogmatic, ideological desire to reduce the number of workers employed in the public service in Israel. The 1985 Economic Stabilisation plan, and the *Budget Fundamentals Law* (1985) that followed, mandated a 1–2% yearly reduction of civil service posts. However, as the population grew (the 1 million strong migration from the former Soviet Union on its own led to a 20% increase in the Israeli population), *reducing* the number of civil service posts was unrealistic. Government departments found themselves, in the words of a Ministry of Justice official, in an “impossible bind. On the one hand, government units are mandated, by law, to provide certain services; on the other hand, post limits cast a shadow (to say the least) over the ability to uphold the law” (State Comptroller 2005, 49). Outsourcing thus became a way to circumvent post limits and still maintain the service (State Comptroller 2000, 741). Therefore, the employment of teachers through agencies has expanded as the budget for teaching hours has contracted (Wergen 2011). The proportion of workers in the health service who hold civil service posts dropped from 47% in 1995 to 33% in 2003; and in the care sector from 46 to 35.6%. Simultaneously, the proportion of workers employed through the “purchase of services and commodities” provisions in government budgets grew from 47 to 63% in the health sector and from 45 to 57% in the care sector (Chason 2007).

What have been the institutional consequences of these changes?

### *Loss of Organisational Control, Politicisation, and Decline of Expertise*

We saw that outsourcing created a mechanism to circumvent strict rules concerning minimum job qualifications and limiting political pressures on the civil service. Engaging private contractors, who are not subject to these rules, enables appointing individuals to perform a public service for which they are not qualified. The Deputy State Accountant of the Israeli Civil Service noted that “existing employment practices of outsourcing have created very serious difficulties in management, the use of resources and the effectiveness of government activities. This problem is also manifested by the employment of individuals with political

ties for public services” (State Comptroller 2005, 49). The Civil Service Commissioner has given similar evidence to the State Comptroller, stating that agency workers who did not pass civil service entry exams and are not qualified for the public service are employed at all levels. Practically, they are not eligible for promotion but, because of their family and political ties, and because of their long years of service, cannot be removed from their posts. At times, the civil service decides to simply “insource” these workers as civil service employees, circumventing the entry procedures and requirements. In this way, for example, 950 postal workers were made part of the Israeli Postal Company, a government company (State Comptroller 2008a, 59; Civil Service Commission 2003, 2008).

Loss of control is also attributed to the lack of basic knowledge on personnel. Although outsourcing and privatization is often justified as a means to enhance transparency in an organisation, it is striking to find how scant the data is, in Israel and elsewhere, as to the extent of workers employed by agencies, and the costs involved. The State Comptroller has repeatedly (1992, 1996, 2005) cautioned that “the Civil Service Commission does not collect information on those employed [indirectly]. In fact, information on their employment is not held by the departments, by the State Accountant, or by any other central body” (2005, 39). According to some estimates, 20% of workers employed by the government are contracted through service providers.

Two cases that reached the Israel Supreme Court offer some indication of the issues that may arise due to the ambiguity that characterises the relationship between government agencies and contract workers. In the first, a private company challenged the MoH’s practice of outsourcing services to only one charity (its “long arm”, according to the Ministry). In accepting the petition to compel the Ministry to hold a competitive procurement, the Supreme Court noted that, notwithstanding the Ministry’s position, the charity’s workers “are not civil servants; are not subject to state discipline or the civil service authority; rules and regulations that apply to employees in the civil service do not apply to the charity or to its workers”.<sup>27</sup> According to this ruling, one may conclude that agency workers are not subject to civil service rules, in any shape or form. And yet, in a very different case, the Supreme Court ruled that a security guard in the Ministry of Interior, who was employed by a private security company, can be held accountable as a civil servant for receiving bribes.<sup>28</sup>

Following on from this troubling case, one may suggest another, more general, negative consequence of outsourcing by government agencies. In the traditional employment regime, employees are owed a duty of loyalty to an employer, coupled with more concrete duties to avoid situations in which conflicts of interest may arise, not to divulge sensitive information, and so forth. In addition, with regard to other workers, social bonds are expected to develop, fostering a feeling of common ethos and shared values (Estlund 2002). In contrast, the fragmentation of the workplace is expected to be not only detrimental to the workplace, but also to the possible development of the positive ethos and public values that the civil service is set to foster and nurture. Workers in outsourced services, after all, owe a duty of loyalty to their employer, which may be a for-profit entity. Thus, we have witnessed social workers in outsourced services in Israel, reluctantly acting in a manner that verges on, and even goes beyond, the unethical and illegal, since they were directed to act in a manner that maximises profits, sometimes at the expense of client welfare (Paz-Fuchs and Shlosberg 2012).

### *Loss of Expertise and Institutional Memory*

In many cases, outsourcing of tasks that require expertise leads to the loss of knowledge that is critical for the task of maintaining and developing an effective service (Dannin 2008, 1372). Moreover, the loss of institutional knowledge and institutional memory may lead to the deterioration of the service. There are several reasons for this dynamic. First, by performing the task, the private contractor may, through her workers, accumulate relevant knowledge that is critical for the task. In one telling example, the State Comptroller noted that the MoH has become completely dependent on a non-government organisation—The Public Health Services Organisation—since the latter “has accumulated medical and paramedical personnel who have expanded its power as almost a monopoly provider of these services” (2009, 477). Over time, the public agency loses its ability to “steer” the contractor and to supervise her actions, simply because the latter is far more aware of the needs of the tasks, and her assessment of the job requirements will go unchallenged. Second, and closely related, even where the private provider is found to be at fault, in a way that cannot be explained away, it holds essential knowledge for the execution of the service that the public service has lost. This dynamic has led, on more than a few occasions, to the inability of the public sector

to impose sanctions on the provider, who holds the key to the service. There has been, in other words, a reversal of power dynamics. Third, new and talented workers who are interested in taking part in meaningful public service roles (such as town planning or environmental engineering) will soon find that the “real” work is being done in the private sector, for the public sector. Thus, the public service will be deprived of a vital new cohort of personnel who are very qualified for the role.

### CONCLUSION

Outsourcing of personnel and outsourcing of services are both reasonable forms of management, when done in a bone fide fashion, to address the true needs of the corporation, or the government agency. Outsourcing of personnel, or the use of “temp agencies”, may be used, as the name indicates, to meet temporary manpower needs. Manufacturers, supermarkets or government agencies may purchase services through outsourcing because there is no expectation that they will employ air conditioning technicians or production designers.

Unfortunately, these legal forms of outsourcing have been used and abused by the Israeli civil service—ministries, agencies, and local government—to circumvent post requirements and collective agreements. The outsourcing structure enables hiring workers at sub-par conditions, thus expanding the gap between the two tiers of the labor market, and creating impoverished public services. As a hybrid creature, this model was challenged quite frequently in employment tribunals, and inconsistent rulings have created a degree of legal uncertainty. The relevant regulatory agencies in Israel—the Civil Service Commission, the State Accountant, the State Comptroller and, to an extent, the Employment Tribunals—are quite aware of the situation and have issued warnings as to current and foreseeable failures since the mid-1990s. And yet, government ministries, agencies, and local authorities follow the guidance of the Finance Ministry and refuse to consider serious changes to employment structures in the public sector.

When section 12A of the *Manpower Act* 1996 came into force, government agencies were forced into making some adaptations, since the law now requires “insourcing” agency workers by the end-user (in this case, the civil service or local authorities) after 9 months of agency employment. And yet, their response is clearly tactical and instrumental, rather than strategic and ideological. Flexibility and cost saving are still

central motivations, and regardless of the fact that they are often not the result of outsourcing, the effects on the rights and dignity of workers who, at the end of the day, provide a public service, are secondary.

Outsourcing in the public service has had significant institutional ramifications. Initially, it facilitated the avoidance of an honest conversation as to the feasible and ideal size of the public sector (Light 2006). Instead, government agencies prefer to change the title of civil service workers to agency workers, and from there—to “service providers”. This change also allows governments to shed responsibility for public services, which should exist as part of their governing ethos, even beyond their legal obligation. Failure to live up to their duties through the engagement of agencies does not only undercut workers’ rights and the ability to sustain a functioning government apparatus; it also misleads the public as to the true size of the public sector.

The challenges that confront those who are engaged with outsourcing of personnel in the public sector—regulatory agencies, employment tribunals, academics and NGOs—are not to be dismissed. The costs of this employment structure may exceed employing workers directly (Bresler-Gonen and Dowding 2008; POGO 2011); the supervision of their work is limited at best; the structure circumvents post limits and enables the expansion of civil service in a way that is unwarranted; the workers’ rights are undermined; the professionalism and institutional memory within the service are endangered; the role of unions is diminished. Confronting these issues, without necessarily resorting to employing all those workers directly by the agencies (an unrealistic aim) is a formidable challenge indeed.

## NOTES

1. Articles 11, 12 of the *Emergency Regulations (Provisions for Economic Emergency)* (1985).
2. Labour Case 46/4-13 *State of Israel v. the Histadrut* LC 14, 181; HCJ 90/86 *The Histadrut v. the National Employment Tribunal* 40(3) 318.
3. An exception to this rule is Britain, where idiosyncratic case law has led to agency workers being denied employment status at all. In other words, neither the contractor nor the end-user is considered to be their employer.
4. LA 57/3-54 *Lankri v. A.N.S. Co for Maintenance of the Disabled* PDA 36, 361, 364–365 (1981).



5. LA 129-3 *Hersbkovitz v. the State of Israel* PDA 12, 255 (1981).
6. *Secretary of State for Education and Employment v. Bearman* [1998] IRLR 431.
7. *Bearman*, at 434.
8. *Hersbkovitz* (note 5) at [8].
9. LA 1189/00 *Levinger v. the State of Israel* (unpublished); see also LA 168/05 *Nakash v. the State of Israel* (unpublished); LA 326/03 *The State of Israel v. Chepkov* (unpublished).
10. LA 273/03 *Schwab v. the State of Israel* (unpublished); LA 410/06 *Fahum v. the State of Israel* (unpublished); LA 1596/06 *Moyal v. the State of Israel—Ministry of Welfare* (unpublished).
11. *Ready Mixed Concrete (South East) LTD v. Minister for Pensions and National Insurance* [1968] 2 QB 497, 515.
12. LA 52/142-3 *Albarniyat v. Kfar Ruth* 535.
13. LA 602/09 *The State of Israel—Ministry of Education v. Aloni* (unpublished).
14. LA 6818-10-10 *The National Insurance Institute v. Dayan* (unpublished).
15. *Aloni* (note 13) at [41].
16. *Dayan* (note 14) at [28].
17. Labour (Jerusalem) 2513/00 *Zerifa v. the State of Israel—Ministry of Finance* (unpublished).
18. *Ibid.*, at [6.4].
19. Procurement No. 17/6.2012 *Operating a comprehensive array of day care centers and additional programs* (7.6.2012), at [6.2].
20. *Ibid.*
21. *Ibid.*, at [5.21].
22. *Dayan* (note 41) at [17], [20].
23. *James v Greenwich Council* CA [2008] at [60].
24. C-320/00 *Lawrence v. Regent Office Care*, ECR I-7325 (ECJ).
25. C-256/01 *Allonby v. Accrington and Rosendale College* [2004] IRLR 224 (ECJ).
26. Section 15A of the Civil Service Act (Appointments) 1959.
27. H CJ 5012/97 *Matan Health and Welfare Services v. Ministry of Health* (1998), 68.
28. ACA 1098/07 *Barak Cohen v. the State of Israel* (2009).

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# The Neoliberal Revolution and Labor's Share of Israeli National Income

*Tali Kristal*

## INTRODUCTION

Over the past three decades the organizing principles of industrial societies have shifted from social protection to economic liberalism, which supports the establishment and maintenance of free and flexible markets. This process, which came to be known as the neoliberal revolution, spread globally, emphasizing the centrality of markets and market-driven solutions, privatization of state-owned economic enterprises, public utilities, and public services,<sup>1</sup> and removal of government protections.

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This is a commissioned chapter that draws heavily on a previous publication (Tali Kristal, "Slicing the Pie: State Policy, Class Organization, Class Integration, and Labor's Share of Israeli National Income." *Social Problems* 60, pp. 100–127. Copyright © 2013 by Oxford University Press. Reprinted by permission of Oxford University Press). The chapter is based on a detailed discussion of the changes that the Israeli political economy underwent in the second half of the twentieth century, and analyses of how these changes affected income inequality. The emphasis here, however, is on the role of state policy, in particular, privatization, in rising inequality since the mid-1980s.

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The neoliberal idea on the societal level was mirrored by the greater role played by market forces within industries and workplaces due to the decline in unionization and the decentralization of wage-setting. Well-known major consequences of the neoliberal revolution are the expansion of precarious work, the takeoff in earnings inequality, and the rise in family income inequality and poverty rates (Jacobs and Dirlam 2016; Kalleberg 2009; Kenworthy 2004; Moller et al. 2003). A less commonly acknowledged outcome, I argue in this chapter, is the decline in workers' share of national income and a rise in capitalists' share.

Recently, the division of national income between workers' income and capitalists' profits has been brought in from the cold (Atkinson 2009; Kristal 2010).<sup>2</sup> Studies show that across rich countries there has been a large and persistent decline in labor's share of national income since the early 1980s, even though class by then was often conceived as a long defunct category (Pakulski and Waters 1996). This recent pattern of income distribution contrasts starkly with that during the two decades following World War II, which exhibited an increase in labor's share. The upward and downward trends in labor's share have largely been found to reflect workers' fluctuating bargaining position in the economic, political, and global spheres (Kristal 2010, 2013).

This chapter goes beyond existing literature by elaborating a class approach to labor's share, which emphasizes the roles of state policy in its dynamics. To date, little attention has been paid to how state policies affect income inequality between workers and capitalists. Sociological research on state policy and inequality generally is built on two distinct research areas: the redistributive consequences of government social policies in capitalist democracies, such as civilian spending, for earnings and family income inequality (Brady 2005; Moller et al. 2003), and how state intervention in the market economy in socialist or "mixed" countries, through redistribution, industrialization, and state-owned firms, modifies market actions and thereby addresses inequalities (Huber et al. 2006; Nee 1989; Walder 1992; Zhou et al. 1996). A key contribution of this chapter is the elaboration of how various aspects of state policy affect income inequality between capitalists and workers based on these two research areas, hitherto unrelated.

Israel presents a particularly illuminating case for testing the above theoretical arguments. Over a very short period of fifty years, Israel underwent a "fast-forward" transformation from a mixed economy to a coordinated market economy, then to a much more liberal market economy. Israel's historical development makes it possible to test general propositions about macro-level outcomes of state policies and social



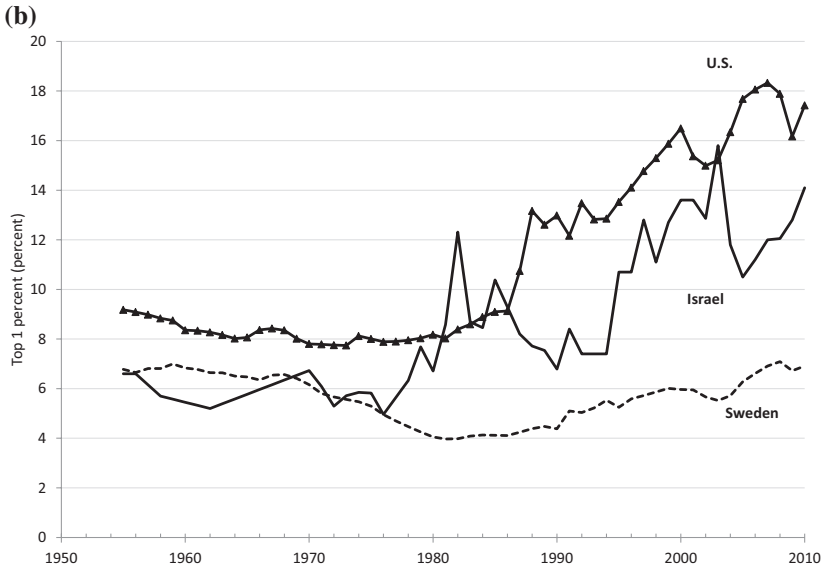
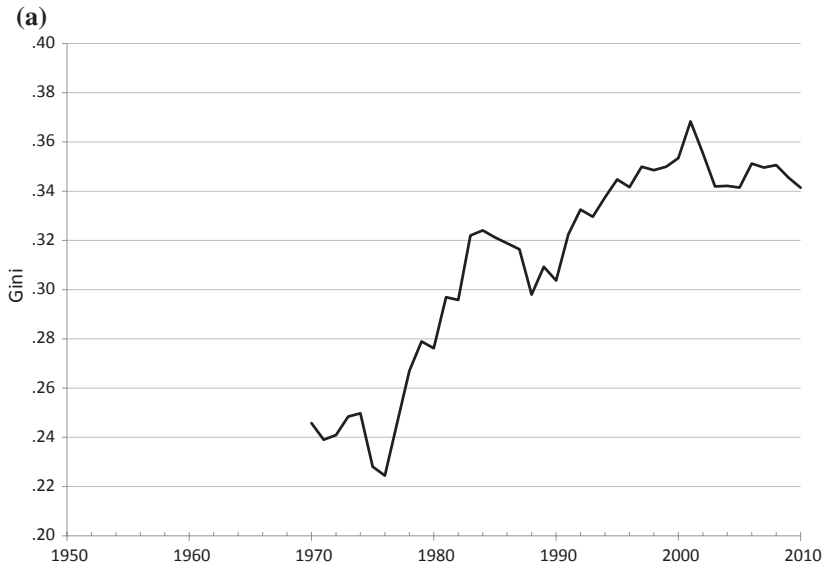
class actions, meanwhile drawing on the in-depth research of the specific Israeli case to make sense of the causal processes.

### THE PUZZLE: RISING INCOME INEQUALITY IN ISRAEL

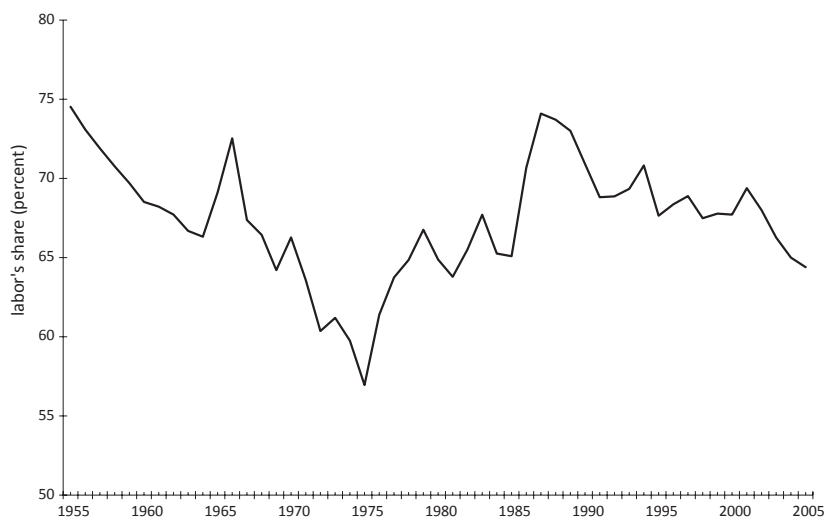
A well-known distributional outcome of the neoliberal institutional transformation is the takeoff in earnings inequality, which has been particularly striking in the UK, the US, and—less commonly known—Israel. In 2005, for instance, Israel had the second-highest inequality levels, behind only the US. The inequality trends presented in Fig. 13.1 demonstrate that while Israel's inequality levels were again similar to those in social-democratic countries, such as Sweden, since the mid-1970s they more closely resemble those in Anglo-Saxon countries such as the US. These trends imply that the institutional transformation in Israel, which lies at the heart of this study, was particularly extensive.

Wages and salaries, however, are only part of the total income generated in the economy, and therefore account for only a fraction of overall income inequality. Most importantly, a large and increasing share of Israeli national income is in the form of capital income—including gross profits of financial and nonfinancial firms, income from rent and interest, and profits of self-employed from their businesses. Over the past 50 years, there has been considerable variation in capital's share of national income compared with labor's share (including wages and salaries, fringe benefits, and the labor income of nonemployees). Three long-term trends are particularly notable (Fig. 13.2). Contrary to the trend in most developed countries, where labor's share increased in the aftermath of World War II until the late 1970s, labor's share in Israel declined from 75% in 1955 to 60% in 1974. From 1975 to 1986 labor's share increased dramatically, much as in other countries, rising to 71%. Since 1987, labor's share in Israel, as in all developed countries, has gradually fallen, to 64% in 2005.

The data presented so far on Israeli income inequality show that although earnings inequality and labor's share are related, they are not identical, and at times are even negatively correlated. These trends suggest that the well-known underlying processes behind earnings inequality do not necessarily explain the dynamics of labor's share, at least not in the first two periods. To solve this puzzle, namely the particular dynamics of Israeli labor's share and the general trend of decline in labor's share across rich countries, the next part employs a class approach.



- ◀ **Fig. 13.1** Rising income inequality in Israel—hourly wage inequality (Gini coefficient) (a) Data on hourly wage inequality are obtained from all available income surveys conducted annually by the Israeli Central Bureau of Statistics (CBS) since 1970. For each year, I calculated the Gini coefficient for the hourly wage among full-time wage and salary workers (25–64-years-old) and the top percentile income share; (b) Data for Israel are based on annual reports of the State Revenue Administration on individual income taxes. These reports include, for most years, statistics on number of taxpayers, their total income, as well as their tax liability. These data are not available for the 1960s, for which I calculate top percentile income share simply as a linear growth. For 1970 onward, in years for which the tax data are not available (i.e., 1970–1976, 1978–1981, 1984, 1992, 2002), I calculate top percentile income share as a linear function of top percentile income share in the CBS income surveys. Data for Sweden and the US are from Atkinson and Piketty (2007)



**Fig. 13.2** Labor's share in Israeli national income (*Source* CBS national accounts). Labor's share is measured as the percentage of GDP that goes to compensate labor (employees and self-employed labor income). The labor income of self-employed is calculated according to the number of work-hours of nonemployees multiplied by the average wage per hour in the industry in which they were employed

## A CLASS APPROACH TO LABOR'S SHARE OF NATIONAL INCOME

My basic premise is that the dynamics of labor's share is determined by class struggle and class compromise that partly shape states' strategies. From this class approach stem the two main arguments of this chapter. My first argument is that state policies structure markets in ways that shape the distribution of national income between capitalists and workers. Since market economies are embedded within social and political structures, governments actually have an enormous range of tools to affect markets' operation, thereby impacting labor's share. One such tool at the focus of this study is governments' establishing, financing, owning, and subsequently selling economic enterprises to private hands, a policy that affects labor market opportunities therefore also income inequality. Second, building on power resource theory (Esping-Andersen 1985; Hicks 1999; Korpi 1983; Stephens 1979), I examine the argument that workers' economic and political organization influence labor's share (Kalleberg et al. 1984; Kristal 2010, 2013; Rubin 1986; Wallace et al. 1999).

While developed countries regulated economies mainly through fiscal policy, developing countries experimented with more extreme forms of state intervention, from various versions of "mixed" economies to outright socialism. One of the more common policies in developing countries is the establishment of state-owned manufacturing enterprises used by governments to foster economic development and as a vehicle for providing subsidies to politically important interest groups such as labor and the middle class (Henisz and Zelner 2006; Zhou et al. 1996). Also common is state protection of domestic industries against foreign imports, through the imposition of high tariff barriers, import controls, and multiple foreign exchange rates. During the post-World War II period, governments in Latin American and East Asian countries pursued various import-substituting programs in an effort to foster economic development by protecting domestic industries, mainly labor-intensive manufacturers, from foreign competition. Hence, net of economic growth, state-owned enterprises, and import-substituting programs should increase labor's share.

The foremost policy instruments for shaping the distribution of national income in developed economies are government expenditures. The possibility of redistribution through state budgetary allocations has been questioned by neo-Marxist researchers who view state budgetary practices as inherently divided. On the one hand, the state is responsible

for fostering and preserving societal wellbeing; hence state fiscal policies must support working class demands (Devine 1985; Griffin et al. 1983; Skocpol 1980). On the other hand, the state must preserve and ensure the viability of the market and support private accumulation; hence state fiscal policies must also support capitalist demands (Devine 1985; Griffin et al. 1982, 1983; O'Connor 1973). The divided process of fiscal policies can be traced in the two major areas of government expenditure: civilian and military. While the effect of civilian spending on labor's share is expected to be positive (Devine 1983; Kristal 2010), the effect of military spending is expected to be negative (Griffin et al. 1982).

My theoretical argument and statistical analyses relate to the combined effect of class organization and state policy on labor's share. Although the effect of class organization on income inequality is partly channeled through state policy, I study the combined effect for two main reasons. First, while workers' organization and big business have an important role in the development of state policy through multiple mechanisms for exerting political influence, they do not always sufficiently persuade the government, and their influence depends on particular features of the political and economic context (Kenworthy 2010). Second, an analysis of the combined effect of class organization and state policy on labor's share reveals whether the distributional outcomes of specific state policies are more congruent with workers' or capitalists' preferences. I cannot demonstrate that the inequality outcomes of state policies result from classes' direct or indirect power, but can test, for example, whether the net outcomes of free market policies are more congruent with capitalist or with working-class interests.

### THREE STAGES IN THE ISRAELI POLITICAL ECONOMY

Israel has its own historical uniqueness with its Jewish-Arab conflict, but its rapid institutional restructuring makes it an especially suitable case for testing the above theoretical arguments. The major changes in Israel since statehood are detailed below, and most of the recent changes are also described by Ronen Mandelkern and Amir Paz-Fuchs in the introduction to this volume. In short, over the past six decades, the Israeli economy has transformed from a "mixed" economy with characteristics of both capitalism and socialism, to a variant of coordinated capitalism as in much of northern Europe, then to a much more liberal capitalism as in Anglo-Saxon countries.

*Israel's "Mixed" Economy Stage (1948–Late 1960s)*

Israel's political economy dates back to the period of the British Mandate in Palestine. During this period labor movement organizations were established, including the largest workers' political party *Mapai* (Party of the Eretz Israeli Workers) and a large and influential labor union—the *Histadrut* (General Federation of Jewish Labor). Both *Mapai* and the *Histadrut* deemed class formation and nation-building closely linked, and advanced a socialist version of nationalist ideology (Sternhell 1998). In practice, the labor movement was committed to developing the economic, demographic, and political infrastructure for a future Jewish state (Shalev 1992); it engaged in the establishment of economic enterprises, communal agricultural settlements, social insurance institutions, and one of Israel's three largest banks (*Bank Hapoalim*—The Workers' Bank).

Even as the workers' organization was winning its hegemonic position, the 1930s and 1940s were also the incubation period of Israeli capitalism. The private sector evolved, capitalists gained some legitimacy, and the Jewish middle class enhanced its power vis-à-vis the hegemonic Labor Zionist movement (De Vries 2010; Kalev et al. 2008). The shift from a socialist to a capitalist state was intensified with the state's establishment in 1948. During the first decade of statehood, the Labor Party discarded its traditional national socialist ideology and espoused a statist, capitalist-oriented ideology. The establishment of the State of Israel was followed by the War of Independence and massive waves of Jewish immigration. It is therefore not surprising that in the early days of the state, with its socialist past and under the economic circumstances, government involvement in the economy was extreme, but not exceptional compared with other states newly formed after World War II.

The first Israeli labor governments advocated an orchestrated and aggressive development policy. The Government was massively involved in the economy through direct ownership of infrastructures such as postal and telephone services, railroads, water, and electricity (Tevet, this volume) and enterprises in the chemical, basic metal, and electronics industries. These state-owned enterprises provided jobs and relatively high wages and benefits in labor-intensive factories that mutually guaranteed each other's debt and subsidized the loss-makers. The Israeli state was also committed to assisting the private sector, and an assertive interventionist policy was pursued in the field of industrial development (Levi-Faur 1998). This policy aimed at protection of domestic industries against foreign imports by means of high tariff barriers, customs and other taxes on imports, export incentives offered to Israeli employers,

generous subsidies granted to domestic production, and government development loans to “approved” firms. Arms production accounted for a large share of overall industrial activity and government military spending was used to stimulate the economy (Mintz and Ward 1989) and boosted the profits of the large corporate conglomerates (Bichler and Nitzan 1996).

### *Israel's Coordinated Capitalism Stage (Late 1960s–Mid-1980s)*

After the first two decades of statehood, rapid economic development accomplished through substantial supportive state policies and the institutionalization of class compromise under democratic capitalism led to the second stage of the Israeli political economy, more similar to the European model of coordinated capitalism. The Israeli labor government was committed to full employment and job security, sustained a large public sector, formed a welfare state on the European model which protected the working population from dependence on the market to achieve a minimum standard of living, and advanced legal protection for organized labor through extensive labor legislation.

The *Histadrut* played a central role in the Israeli economy's coordinated capitalism stage. *Histadrut* activity was based on organizational unity and centralization and was organized by its Trade Union Branch. About 80–85% of Israeli workers were members of the *Histadrut* and covered by collective wage agreements. The *Histadrut* controlled and operated two of the country's most important social service providers: a group of pension funds and the main healthcare insurer in the economy (Filc and Lurie, this volume). The pension funds and the health tax collected by the *Histadrut* served as a major recruiting tool and played a central role in financing the *Histadrut* and its enterprises. The useful relationship among the *Histadrut*, the Labor Party, and the employers' associations enabled labor relations to be constructed on the corporatist model (Mundlak 2007).

In the second half of the 1970s, the Israeli corporatist system began to disintegrate, reflecting the erosion in workers' organizational unity. At the start, the entry of Palestinian noncitizen workers into the Israeli labor market after the 1967 war created a lower caste of unorganized and cheap labor (Semyonov and Lewin-Epstein 1987), later facilitating split labor market strategies (Farjoun 1980). In 1974, the *Histadrut's* wage policy was split between private and public sector workers. In the private sector, where the weaker unions were concentrated, the *Histadrut* practiced wage restraint. By contrast, in the public sector, where the strong professional unions and national workers' committees were concentrated, the *Histadrut* supported

demands for wage rises in an attempt to secure the support of these powerful labor organizations (Grinberg 1991; Shalev 1992). As a result, labor militancy reached new heights between the mid-1970s and the mid-1980s, when privileged public sector workers fought for wage increases.

A decline in nationwide sector-level collective bargaining also began in the late 1970s, in tandem with the rise of independent wage policies at the occupational and workplace levels, and with a sharp drop in the proportion of national agreements extended to nonunion workplaces by the government (Kristal and Cohen 2007). The last peak-level wage-increase agreement between the *Histadrut* and the employers' association was signed in 1987, the same year the minimum wage law was passed, expropriating the determination of a national minimum wage from the realm of collective bargaining (Mundlak 2007).

### *Israel's Liberal Capitalism Stage (Mid-1980s—Present)*

State policy took another turn in the mid-1980s, one very similar to the liberalization of the British and American economies under Margaret Thatcher and Ronald Reagan, although it initially derived more from economic conditions than from ideological forces (Fourcade-Gourinchas and Babb 2002). The neoliberal restructuring was most evident in the adoption of the Economic Stabilization Program in July 1985 and the structural reforms that followed (Filc 2004; Ram 2008). The stabilization program was aimed at reducing the three-digit inflation and included a cut in government spending, opening the economy to international trade, and a wage freeze. In the years since, government involvement in the financial markets has decreased, the process of liberalizing imports from developing countries has intensified, state-owned corporations and government welfare services have been privatized, and the government goal of full employment has been replaced by a target of low inflation rates, advanced by the increasingly independent central Bank of Israel. The stabilization program, some would argue, helped to accelerate an economy increasingly based on market forces that advanced economic growth and economic efficiency (Ben Bassat 2002). Others emphasize business's interests in the neoliberal transition (Bichler and Nitzan 1996; Shafir and Peled 2000) and the dominant role played by "Chicago" economists working in state organizations (Grinberg and Shafir 2000; Levi-Faur 2000; Maman and Rosenhek 2007; Mandelkern 2015; Shalev 1999).

Even prior to the Economic Stabilization Program, the Israeli labor movement was a much weakened player in the Israeli economy. The



Labor Party's first electoral upset came in 1977 when an alignment of rightist and religious parties was able to oust it due to the rise of a third, centrist, party *Dash*, which drew votes away from Labor. Although *Dash* soon disintegrated, during the 1980s and most of the 1990s Labor and the *Likud* (its main opposition since then) remained evenly matched, forming ruling coalitions together. Conventional wisdom in Israel explains the decline in mass support for the Labor Party by the defection of many former Labor voters of non-European origin to the *Likud*, in retaliation for their low socioeconomic status which they blamed on government absorption policy. Others explain the *Likud's* dramatic takeover in 1977 as due to Labor Party corruption or a shift in Israel's political culture to the right following the occupation of the Palestinian territories. A political economy approach advanced by Michael Shalev (1992) suggests that by the mid-1970s the labor movement no longer possessed the capacity to reproduce the political-economic keystones of its hegemony, due to the militancy of public sector workers on the one hand and the rise in capital concentration on the other.

Following the disintegration of the corporatist system, the *Histadrut* underwent a gradual loss of its sources of power. In the early 1980s, the *Histadrut's* industrial concerns fell into a financial crisis as a result of a government decision to terminate their subsidy agreement. The *Histadrut* was forced to lay off many of its workers, and afterward to close or sell its construction companies and industrial enterprises. In 1995, the *Histadrut* lost its two remaining economic sources of power due to the withdrawal of the Ghent system through privatization of the pensions market and detachment of healthcare provision from union membership. Employers' active endorsement of the previously common collective relationship also fell into decline in the 1990s, when many employers ended collective agreements that were signed at the enterprise level or withdrew from employers' associations to avoid the continuation of the collective agreement. As a result, union density decreased from 79% in 1981 to 68% in 1988 and to 34% in 2006, while the decline of membership in employers' associations was even steeper (Cohen et al. 2003, 2007).

Concomitant with the erosion in the labor movement's power and position, the ownership map changed significantly. A spate of mergers and acquisitions in consequence of business collapses in the 1960s recession shifted the economy to a dual structure in which several corporate holding-groups dominated the "Big Economy" and a multitude of smaller, largely independent business entities constituted the "Small Economy" (Maman 1999). Capital concentration continued to increase

in the late 1980s when most state-owned and *Histadrut*-owned enterprises were privatized and rapidly transferred into the hands of a few large business ownership groups. The latter enlarged their foothold in the economy by means of joint directorships in affiliated companies and by gaining control of manufacturing industries as well as real estate companies, media companies, and holding companies.

In sum, the comparison of the three stages in the Israeli political economy reinforces the study's basic premise that the dynamics of labor's share are determined by class struggle and class compromise that partly shape the strategies of states. Initially, the institutionalization of class compromise in the developmental stage of the Israeli economy led labor unions to impose wage restraint, while it also provided significant gains in productivity due to high levels of cooperation between workers and capitalists and an enhanced capacity to solve macroeconomic problems. This, in turn, led to rapid economic growth and a decline in labor's share until the early 1970s. Nevertheless, real wages increased significantly and most Israeli workers benefited from this wage rise since income inequality among workers was fairly low. Throughout the coordinated capitalism stage, the powerful labor movement and the militant demands for wage rises by strong professional unions led to an increase in labor's share. Yet, the rise in wages did not benefit all equally and wage inequality began to rise. Labor disorganization and free market policies in the liberal capitalism stage were related to a decline in labor's share since the early 1980s and the rise in wage inequality. In the next section, I empirically analyze the effect of changes in indicators for the Israeli political economy on income inequality between capitalists' profits and workers' income.

### DATA, METHOD, AND VARIABLES

The data include yearly observations for each variable from 1955 (or earlier) to 2005. The analysis begins in 1955, not in 1948 with the establishment of the Israeli state, for a methodological reason: data for calculating labor's share are available only from 1955 in Israeli national accounts that are prepared and published by the Israeli Central Bureau of Statistics (CBS).

The dependent variable in the analysis is labor's share of national income. *Labor's share* is measured as the percentage of Gross Domestic Product (minus net indirect taxes) that goes to compensate labor. Thus, the numerator is labor income including wages, salaries, and fringe benefits,

and the denominator is GDP. One possible criticism of analyzing the distribution of national product between the aggregate categories of capital and labor is that in so doing we ignore the likelihood of “contradictory locations within class relations” (Wright 1978: 61), that is, of workers whose interests may be more aligned with capitalists than with workers. Sure enough, labor’s total compensation includes CEOs who extract wages, salaries, and fringe benefits while also drawing capital income such as dividends. To test the robustness of the results, I calculate a modified measure of *workers’ share* by subtracting an approximation of the top 1% earners’ income from aggregate labor’s compensation and divide that amount by GDP.

Government development policies are measured by *state-owned production*—the product of state-owned establishments and *Histadrut*-owned establishments as a percentage of total manufacturing product. The state sector includes establishments owned by the government, local authorities, or national institutions. The *Histadrut* sector is composed of establishments owned by the *Histadrut* or its subsidiary companies, establishments owned by kibbutzim, and cooperative societies affiliated with the *Histadrut*. Data on manufacturing industries by sector are derived from industrial surveys carried out regularly by the CBS. A second indicator for government development policies relates to state protection of domestic manufacturing industries against foreign competition. I measure this policy by its outcome, *import penetration*—manufactured imports from non-OECD countries as a percentage of GDP. Data for the period 1962–2005 are drawn from the United Nations Commodity Trade Statistics Database.

Data for government *civilian spending* as a percentage of GDP are drawn from Israeli national accounts, category “civilian public consumption.” The value for this category, defined as the value of civilian purchases of goods and services, represents the expenditures on direct social services like education and healthcare and is an approximation of the size of the public sector. *Military spending* is measured as government military expenditures as a percentage of GDP. Data are drawn from Israeli national accounts, category “defense public consumption.” This category covers both domestic consumption and defense imports. Since capital-intensive domestic consumption is likely to be the main driving force in the effect of military spending on labor’s share, I subtracted defense imports from the calculations.

*Union density* is measured as the percentage of wage and salary workers who are union members out of the total number of wage and salary workers in each year. Data are drawn from Cohen et al. (2003, 2007). Labor-affiliated political parties' strength is measured by *Leftist cabinet*—the proportion of cabinet seats held by leftist parties (data are drawn from the Israeli parliament website). As leftist parties, I include labor parties and the parties to their left. To ascertain that the findings are not singular to this measure, I also examine the number of seats in the parliament held by leftist parties. The results are generally the same. As an indicator of employers' organizational strength, I use *manufacturing concentration*, which is measured as the percentage of manufacturing workers employed by private-owned enterprises with 300-plus workers. Data on manufacturing industries are derived from the annual industrial surveys.

Data on strike activity are drawn from the CBS Statistical Abstracts. The principal measure in this analysis is (ln) *strike volume*, calculated as the number of days lost to strikes and lockouts relative to the total number of wage and salary workers in each year. This measure represents the total economic damage suffered by employers due to strikes, and the economic costs incurred by workers who engage in strikes. *Strike volume*, however, confounds strike duration with the number of strikes. During the 1990s, for instance, strikes became increasingly rare and the few prolonged general strikes may convey a misleading picture of strike activity. I therefore also analyze *strike frequency*, measured as the number of strikes per 1000 workers.

*Economic growth* is measured as the change in log real per worker GDP (NIS millions). The rate of *Unemployment* is measured as the percentage of civilian unemployed in each year. *Inflation* is measured as the annual percentage change in the consumer price index. Data for *inflation*, *unemployment*, and *economic growth* are drawn from the CBS Statistical Abstracts.

## RESULTS

### *Descriptive*

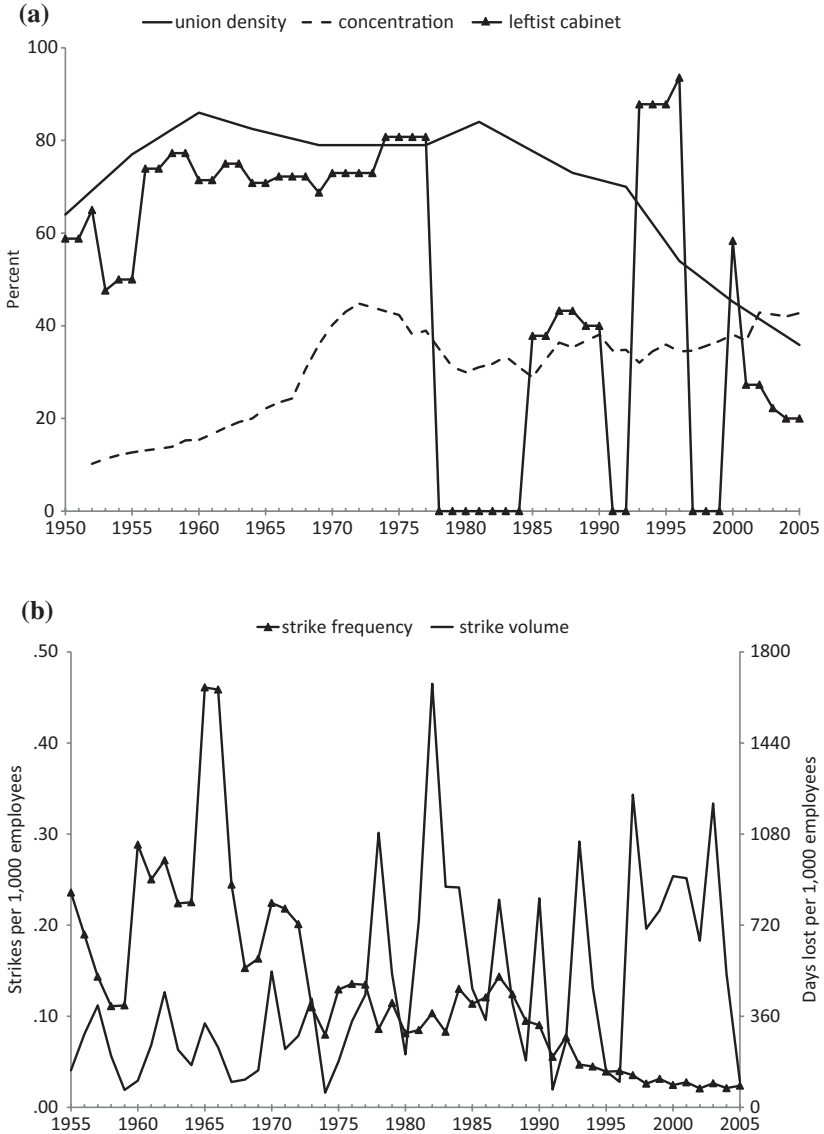
Prior to more complicated statistical analyses, in Fig. 13.3 I plot the raw data for several indicators for state policy and class organization. A visual inspection of the time-series data provides a useful intuitive test: do the

measures in question appear to move together over time? If the indicators for state policy, strength of class organization, and labor's share appear to move together over time, this would provide some nominal evidence of a linkage among them.

Over the last fifty years, there has been considerable variation in Israeli labor's share. Few observations can be made about the long-term trends in it. The steep decline in labor's share between the late 1960s and mid-1970s occurred during the dramatic rise in military spending (from 7% of GDP in 1965 to 18% of GDP in 1974, Fig. 13.3c) and the significant increase in capital concentration (Fig. 13.3a). The increase in labor's share during between 1975 and 1986 coincided with the strong position of the labor movement (Fig. 13.3a), which was manifested also by an increase in public sector employment and public sector wages. Labor's share rose when the more powerful unions in the public sector—the strong professional unions and national workers' committees—struck for better wages and benefits (Fig. 13.3b).

Most importantly, the period of “profit squeeze” was followed by two decades when labor's share declined. The sharp decline occurred during the privatization of state-owned firms. Public and *Histadrut*-owned establishments were at their peak in the mid-1980s when the two sectors produced 52% of manufacturing product (Fig. 13.3d) and employed 37% of employed persons (data not shown). As a result of the privatization of state corporations and the *Histadrut*'s sale of its industries, by 2005, twenty years later, the two sectors had produced only 17% of manufacturing product and employed only 8% of employed persons.

Besides high rates of unemployment during the 1990s that reflect labor's weakening bargaining power vis-à-vis employers, the rise in capital concentration, and market-oriented state policies, also relevant here is the continuous disorganization of the Israeli labor movement in both the political and economic spheres, which may also explain why the very few strikes in the 1990s were significantly longer, sometimes lasting months. Although civilian spending as a percentage of GDP increased, this occurred mainly during the second electoral shift in Israel in 1992 when an alignment of parties led by Yitzhak Rabin's Labor party was able to regain control of the *Knesset*. Civilian spending has stagnated since the mid-1990s concurrently with the expansion of outsourcing services, as part of the ongoing partial privatization of public services, a process that also contributed to the continuous disorganization of the Israeli labor unions (Paz-Fuchs, this volume).



**Fig. 13.3** State policy and class organization in Israel (Source See part 4 on data and variables)

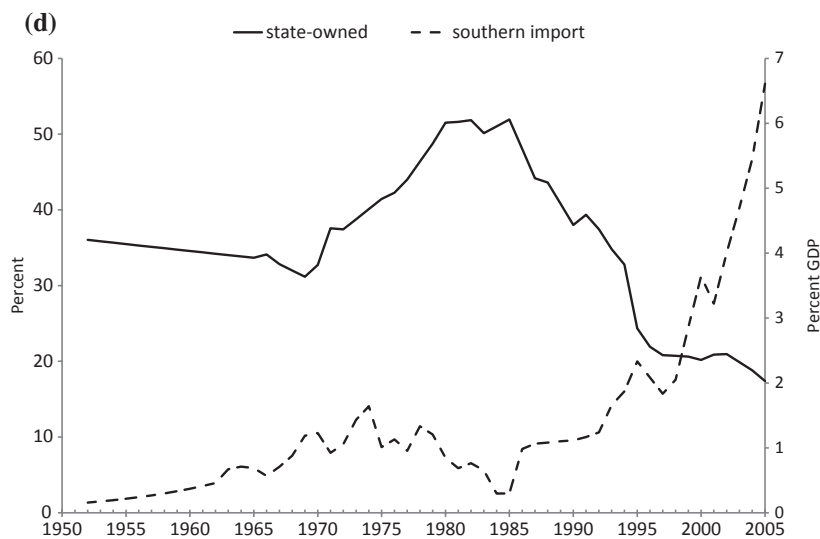


Fig. 13.3 (continued)

The overlapping trends of labor's share and the explanatory variables are largely consistent with the study's hypotheses. In all cases, these could be merely spurious correlations, so it is necessary to analyze the dynamics of labor's share within industries and to perform state-level time-series analysis to establish the explanation for changes in labor's share.

### *Within-Industries Comparison*

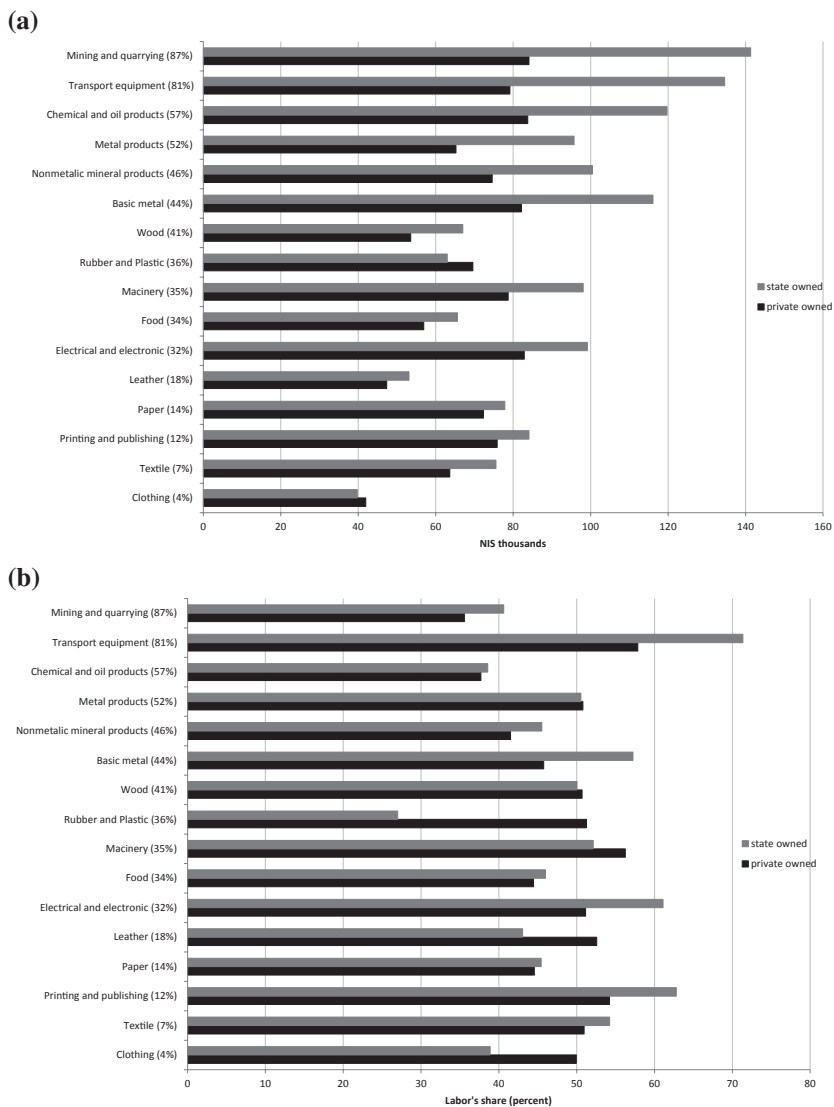
Evidence of the linkage between state-owned production and labor's share is provided by a within-industries comparison. Figure 13.4a shows that within industries, workers' compensation in state-owned establishments was higher than in privately owned establishments. In the chemical industry, for example, where 57% of the production was accounted for by the *Histadrut* (through firms such as Tambour and Makhteshim) and Israel Chemicals—a state-owned enterprise established in 1968—annual average compensation per employee in state-owned establishments was 1.4 times higher than in privately owned establishments. Also in the basic metals industry, where 52% of the production was accounted for by the *Histadrut* through Koor—one of the largest industrial conglomerates in Israel—annual average compensation per employee in state-owned establishments was 1.4 times higher than in privately owned establishments. Consequently, labor's share in most state-owned was higher than in privately owned enterprises, although not as high as real compensation (Fig. 13.4b).

Figure 13.4c presents the distributional changes in the chemical industry. Following its privatization and transfer to the ownership of the Eisenberg family between 1992 and 1995, Israel Chemicals became a multinational concern (the Eisenberg family sold their controlling stake to the Ofer family in 1999). Kur industries were also transferred into private hands during the late 1980s and early 1990s. Ever since, real wages have lagged behind productivity growth, and labor's share in the chemical industry has declined.

### *Time-Series Models*

The theoretical arguments suggest that labor's share is a function of the business cycle and structural changes in the strength of class organization and forms of state policy. Specifically, the expectation from theory





**Fig. 13.4** Within-industries comparison of labor's share (*Source* CBS industry and craft surveys). *Note* The numbers in percentiles on the Y axis of (a) and (b) refer to the percentage of the production within each industry that was accounted for by state-owned establishments

(c)

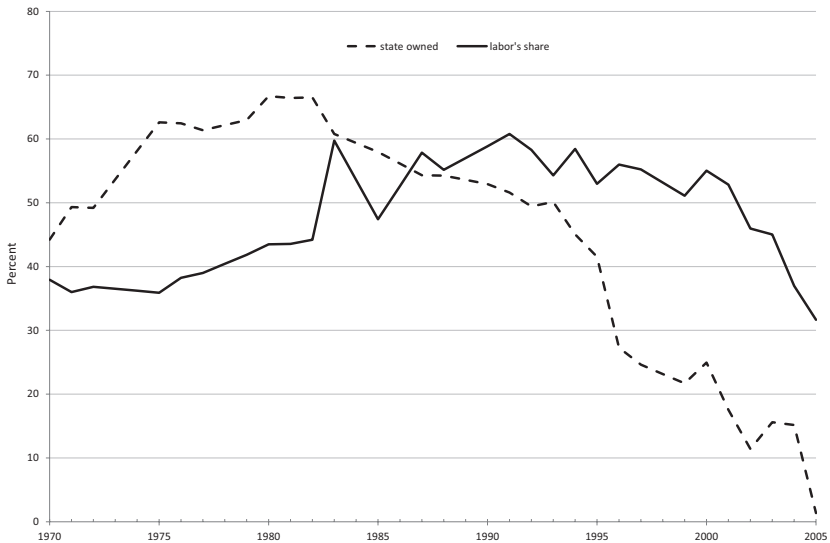


Fig. 13.4 (continued)

is that macroeconomic variables, manufacturing concentration, military spending, and import penetration should have negative effects on labor's share, while union density, strike activity, leftist cabinet, civilian spending, and state-owned production should have positive effects. The initial models in Table 13.1 present the net effects of these variables on labor's share from estimating multivariate time-series equations with all variables in first difference form (Model 1) or all variables in level form (Model 2). Due to the nonstationary data, in Table 13.2, I estimate models with all variables in first difference form and several variables with lag structure in order to capture part of the long-term effects revealed in the level form.

To ease some of the difficulties in analyzing time-series data of only fifty years, I estimate alternative specifications of the regression models and test whether the coefficients significantly changed with the inclusion (or exclusion) of the control variables (columns 1 to 6). To address the question of the variables' relative impact on labor's share, I present in column 7 the semi-standardized coefficients, expressed in labor's share percentage points. In column 8, I estimate the same model with change

in *workers' share* (excluding the top 1% earners' income) as the dependent variable. Results are substantially the same, most likely because the correlation between changes in labor's share and workers' share is .909. To specify the mechanisms through which the variables affect labor's share, I decompose change in labor's share into three additive components (measured by percentage change scores): employment growth (column 9), average compensation growth (column 10), and product growth (column 11). Everything else remaining constant, a rise in employment and in compensation rates (i.e., the numerator) increases labor's share, while an increase in product growth (i.e., the denominator) decreases labor's share.

The results concerning the effect of indicators for state policy on labor's share are consistent with the theoretical model. Net of economic growth, the distributional outcomes of government development policies favor labor, as expected. High levels of state-owned production and low levels of competing imports from developing countries advance earnings and

**Table 13.1** Initial models of the determinants of labor's share ( $N=50$ )

	<i>Change in labor's share</i>	<i>Level of labor's share</i>
<i>Labor's share</i>	<i>Model 1</i>	<i>Model 2</i>
<i>Macroeconomic</i>		
Ln GDP per worker	-15.170**	-13.055**
Unemployment	-0.206	-0.081
Inflation	-0.015**	-0.018**
<i>Class organization</i>		
Union Density	-0.042	-0.229**
Ln Strike Volume	1.580**	1.112
Leftist Cabinet	0.021	0.002
Manufacturing concentration	0.058	-0.098**
<i>State policy</i>		
Civilian Spending	1.565**	-0.428
Military Spending	-0.296	-0.270*
State-Owned	0.269	0.251**
Import Penetration	-0.609	-1.138*
Labor's share <sub>(t-1)</sub>		0.573**
Constant	0.162	45.958**
Adj R <sup>2</sup>	0.277	0.829
DW	2.01	1.97

*Note* OLS estimates, standard errors omitted to save space. \* $P < .10$ , \*\* $P < .05$ , one-tailed test. Serial correlation is corrected with AR(1). Model 1 all variables in first difference. Model 2 variables in level rather than first difference form (except for economic growth). Indicators for state policy are lagged by one year

**Table 13.2** Determinants of labor's share and its components, all variables first-differenced ( $N=50$ )

<i>Change in Labor's Share</i>												
	<i>Model 1</i>	<i>Model 2</i>	<i>Model 3</i>	<i>Model 4</i>	<i>Model 5</i>	<i>Model 6</i>	<i>Model 7</i>	<i>Workers' Share</i>	<i>Employment Growth</i>	<i>Model 9</i>	<i>Model 10</i>	<i>Model 11</i>
<i>Macro-economic</i>												
Ln GDP per worker	-15.175**		-12.321*	-10.278*		-11.807*	-0.454*	-13.853*	3.376		98.617**	105.540**
Unemployment	-0.157		-0.077	-0.094		-0.027	-0.034	-0.098	-1.510**		-1.133**	-1.563**
Inflation	-0.013**		-0.011**	-0.013**		-0.015**	-0.784**	-0.014**	0.004		-0.016**	0.003
<i>Class</i>												
<i>organization</i>												
Union		-0.160	-0.009	-0.015		-0.237*	-0.383*	-0.137	0.411**		0.285	0.445**
Density $t_2$												
Ln Strike		1.726**	1.590**			2.055**	0.692**	1.738**	0.077		3.058**	0.070
Volume												
Strike				20.009**								
Frequency												
Leftist		0.028*	0.016	0.009		-0.009	-0.120	-0.016	-0.005		-0.011	-0.004
Cabinet $t_2$												
Concentration		-0.445**	-0.310**	-0.326**		0.092	0.151	0.235	0.144		0.356*	0.176
$t_2$												
<i>State policy</i>												
Civilian Spending					1.042**	1.199**	0.576**	0.976*	0.966**		3.086**	0.934**

(continued)

**Table 13.2** (continued)

<i>Change in Labor's Share</i>											
	<i>Model 1</i>	<i>Model 2</i>	<i>Model 3</i>	<i>Model 4</i>	<i>Model 5</i>	<i>Model 6</i>	<i>Model 7</i>	<i>Workers' Share</i>	<i>Employment Growth</i>	<i>Compensation Growth</i>	<i>Product Growth</i>
Military Spending <sub>t-1</sub>					-0.527*	-0.400*	-0.362*	-0.521*	-0.168	-0.965**	-0.187
State-Owned					0.086	0.361**	0.566**	0.365**	-0.692*	-0.325	-0.693**
<sup>t-3</sup> Import Penetration					-3.391**	-3.393**	-0.648**	-2.993*	-1.809*	-8.723**	-1.918*
Constant	0.239	-0.022	0.343	0.374	-0.026	0.185		0.137	3.245**	3.979**	3.436**
Adj R <sup>2</sup>	0.165	0.151	0.232	0.271	0.164	0.502		0.327	0.743	0.800	0.937
DW	1.95	1.99	1.99	2.02	2.03	2.06		2.07	2.03	2.00	2.04

*Note* OLS estimates, standard errors omitted to save space. \*  $P < .10$ , \*\*  $P < .05$ , one-tailed test. Serial correlation is corrected with AR(1). Growth is a rate of change, calculated in percentage change scores,  $100 \cdot [y_t - y_{t-1}] / y_{t-1}$ . \* Unstandardized regression coefficient multiplied by the sample standard deviation of the independent variable  $X$ . Represents the change in  $Y$  associated with an increase of one standard deviation in  $X$ , in original units of  $Y$ .

benefits more rapidly than productivity, therefore, increase labor's share. Hence, when state policies open up, through privatization and trade liberalization, new fields for capital accumulation in domains hitherto regarded as off-limits to the calculus of profitability, labor's share tends to decline. The distributional consequences for income of state fiscal policies in Israel are, as expected, divided. The more the government spends on armaments by investing in profitable military production, the better off capital is than labor. By contrast, civilian spending on direct social services increases labor's share due to an increase in employment, wages, and benefits.

The results concerning the variables related to class organization are consistent with the theoretical model, except for unionization. The coefficient of union density is not statistically significant in most models and even has a negative effect on changes in labor's share when indicators for state policy are included in the model. The finding that increasing unionization does not benefit Israeli workers' share accords with Wright's (2000) argument that strong unions in corporatist settings may not advance labor income relative to capitalists' profits, but rather allow significant gains in productivity and rates of profit due to high levels of cooperation between workers and capitalists and an enhanced capacity for solving macroeconomic problems. Indeed, although the dominant Israeli unions have a positive effect on employment growth (column 9), they also impose wage restraint while providing significant gains in productivity (column 11).

As expected, both strike volume and strike frequency have a large and positive effect on changes in labor's share. This implies that the more frequent and the more intensive the actual exercise of workers' strength via strike activity, the higher labor's share of national income, mainly due to an increase in workers' compensation. Leftist cabinet is positively associated with labor's share due to its positive relations with employment and compensation growth (data not shown). Yet there is no effect of labor-affiliated government on labor's share when macroeconomic variables are added to the model. This finding suggests that a labor-affiliated government's pro-labor policies advance labor's share indirectly by maintaining low levels of unemployment and inflation. Lastly, manufacturing concentration that indicates corporate capitalists' relative bargaining power is, as expected, negatively related to labor's share. Taking into account indicators for state policy, however, diminishes the effect of manufacturing concentration on labor's share. This may imply that the stronger the organizational base of economic elites, the more likely they are to put pressure on the government to adopt interventional policies that create a better business climate.

In sum, the results generally confirm the theoretical model. Net of macroeconomic variables, high levels of manufacturing concentration, government military spending, and competing imports all decrease labor's share over time. By contrast, escalation in strike militancy, expansion of the public sector, and maintenance of state-owned establishments all increase labor's share. The presence of a labor-affiliated government has a positive impact on labor's share, channeled through a favorable macroeconomic environment, but only when the labor movement was a dominant actor and relatively unified.

## CONCLUSION

The key conclusion of this chapter is that in the Israeli setting, state policies had a strong impact on the dynamics of labor's share. In particular, the Israeli case provides some important evidence regarding the link between free-market policies and the decline in labor's share, which can be generalized to other countries as well. I find that state policies, such as privatization, trade liberalization, and cuts in civilian spending have all benefited capital accumulation and led to a decline in labor's share and a rise in capitalists' profits.

The finding that the shift from social protection to economic liberalism, manifested by free-market policies and workers' disorganization and disintegration, is congruent with the interests of the capitalist class indirectly testifies to one of the possible causes of neoliberalism. David Harvey (2005) argues that the neoliberal revolution is actually an attempt by the capitalist class to restore their share of income. Although the current research design cannot demonstrate that inequality outcomes of state policies are a result of classes' direct or indirect power, the analyses reveal that the net outcomes of free market policies are more congruent with the interests of the capitalist class.

## NOTES

1. For a comprehensive discussion of the term privatization and how and why it reflects economic liberalism, see Mandelkern and Paz-Fuchs, this volume.
2. National income, as defined in government statistics, is the value added when workers turn, for example, \$10,000 worth of raw materials into \$15,000 worth of new products or services. The \$5,000 in added value is split between capitalists' profits and labor's compensation.

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## The Impact of Privatization on the Non-profit Sector and on Civil Society in Israel

*Varda Shiffer*

The renewed interest in the non-profit sector during the 1980s and 1990s was largely associated with the crisis of the welfare state, and the social and political changes that occurred in Europe as well as in Israel from the late 1970s onwards (OECD 2003, 11–12; Gidron 2007). The research during that period generated two, almost distinct, bodies of literature concerning non-profit and voluntary organizations. One focused on the idea of “Civil Society” and its place and role in the changing societies (Putnam et al. 1993; Putnam 2000; Habermas 1989; Dahrendorf 1992, 1997; Ben-Eliezer 1999, 2001), with non-profit or voluntary associations as a main “ingredient” of civil society. The other body of literature described and defined the new type of non-profit organizations, and attempted to understand their role in the reformed public services that emerged during the years following the transformation of the welfare state (Salamon 1987; Anheier 2007; Gidron et al. 2003; Gidron 2007). The restructuring of government bureaucracies and the ensuing privatization and outsourcing of public service delivery led

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to the formation of new types of welfare regimes in which non-profit organizations took upon themselves a significant share of the provision of privatized services in general, and social services (welfare, education, and health) in particular. The changes that occurred thereby in the structure and mode of operation of the non-profit organizations became a major theme of much of the research (Smith and Lipsky 1993; Clarke and Newman 1997).

This article examines the effects of the changes in the welfare regime in Israel from the late 1970s on the development of civil society in Israel. It follows the new roles and responsibilities which non-profit organizations undertook as a result of the “privatization revolution”, and evaluates the influence it had on the non-profit sector and through it on Israeli civil society. In doing so, it draws on two clusters of literature—the public policy-organizational literature, and the political-philosophical, or “civil society”, literature. The public policy literature offers the categories and insights necessary to understand the interrelations between government and non-profit organizations; whereas the civil society literature suggests the criteria for the evaluation of the extent to which the relatively large non-profit sector in Israel contributes to the creation of a flourishing civil society. Research of the early 2000s (Borzaga and Santuari 2003; Hasenfeld and Gidron 2005), referring to the effects of privatization on non-profit organizations, raised questions as to the possible negative effects of the new service delivery role on the more traditional roles of non-profit organizations, such as advocacy. It suggested that non-profit organizations adopted multiple strategies and became “hybrid” in terms of their mode of operation. They thus succeeded, according to these researchers, in preserving their independence, criticizing government, and acting as social change agents, while, at the same time, providing privatized services.

My findings indicate that in Israel, privatization processes, rather than encouraging the development of hybrid organizations, curtailed the ability of non-profit organizations to act effectively as social change or civil society organizations. The unique history of the non-profit organizations in Israel and their relations with government proved to have a powerful, ongoing influence on the development of the non-profit sector and its capacity to become a driving force toward a flourishing civil society. One distinct indicator of that influence can be seen in the nature of the tenders that govern the privatization process. These tenders attempt to bureaucratize the non-profit organizations rather than harness

their unique abilities to generate trust and solidarity. Privatization and outsourcing processes solidified, instead, an already existing tendency of the social sector in Israel to be strongly dependent on the state for its very survival.

## A CONCEPTUAL FRAMEWORK

The analysis of privatization and its influence on the non-profit sector and on civil society will be informed by two distinct theoretical bodies of literature: first, the non-profit sector and New Public Management (NPM) literature, which links different research themes, and highlights the particular role of non-profit organizations in NPM reforms. Second, civil society literature, which analyses the potential and actual role of civil society in general, and non-profit organizations in particular, in Western liberal democracies.

### *The Non-profit Sector and New Public Management*

NPM was the attempt by the new regimes of the 1980s<sup>1</sup> to find a solution to a most pressing dilemma, namely—the need to improve services and adapt them to a growing and more heterogeneous population, on the one hand, while being forced to economize and adapt to budget cuts, on the other hand (Jorgensen and Kickert 1995; Drucker 1995). The ideas behind NPM originated in what was perceived as successful business practice. Quality management, improving services to the “clients”, dividing big bureaucracies into smaller “management centers”, and downsizing state bureaucracies—were some of the measures applied by the governments of the US, UK, New Zealand, and Australia (Gore 1993; Kemp 1993), to “square the circle” i.e., provide better and more services for less money. The notion that nongovernmental organizations of various kinds could become partners with government for a more efficient delivery of services was ripening together with the spread of NPM to more countries. In 1993 Kooiman wrote, “No single actor, public or private, has all the knowledge and information required to solve complex, dynamic and diversified problems; no actor has sufficient overview to make the application of needed instruments effective; no actor has sufficient action potential to dominate unilaterally in a particular governing model” (Kooiman 1993, 4). Smith and Lipsky noted in 1993 that we were already in the era of the “contract regime”—governments use

contracts with non-profit organizations to attain objectives in the realm of social services. Whenever government officials are required to solve a new social problem they would look for a private organization with which to sign a contract (Smith and Lipsky 1993, 43). Anthony Giddens provided the reasons why collaborating (or contracting) with non-profit organizations should be the preferred option. He expressed concern over the weakening of solidarity and the decline of active civic participation (under the new neoliberal regimes), and thus proposed that “State and civil society should act in partnership, each to facilitate, but also to act as a control upon the other” (Giddens 1998, 78–79). Giddens was optimistic about the new entrepreneurial energies demonstrated by civil society organizations, especially in poor communities, where they should be harnessed to the greater benefit of society. Though the terms “privatization” or “outsourcing” were not yet widely used, “harnessing” or “partnering” with “civil society” through the use of contracts were tantamount to the same. To this day, contracts are still the main expression of cooperation between government and service providing organizations.

The wish to restore values that were being eroded within neoliberal regimes by engaging non-profit organizations was also expressed by Cohen and Rogers (1995), who proposed the devolution of certain characteristically state responsibilities to “associative arenas of civil societies”, i.e., opportunities outside of state institutions for deliberation, for generating a “thinner” type of solidarity and for creating trust. Furthermore, their “associative democracy” idea recommended “explicit harnessing of the distinctive capacity of associations to gather local information, monitor compliance and promote cooperation among private actors by reducing costs and building the trust on which it typically depends” (Cohen and Rogers 1995, 250). NPM ideas and policies saw non-profit organizations not just as service delivery partners, but also as agents for restoring solidarity and a sense of community. It is evident from the literature that NPM and the privatization revolution had a profound influence on the mode of operation, the focus and the structure of the non-profit organizations, as they were actively drawn into this process.

### *Non-profit Organizations of a “New Type”*

The non-profit sector as a distinguished area of research developed in parallel to these changes in the structure of civil service bureaucracies in many countries. Lester Salamon observed that newly emerging associations

following the crisis of the 1970s had special attributes—they were creative, innovative, and entrepreneurial, thus justifying specific and focused research into their evolving role in changing societies (Salamon 1987). In 1991 he headed the Johns Hopkins University Comparative Nonprofit Sector Project (CNP), which set out to propose a standardized definition of non-profit organizations, and to create an international database that would enable comparable and reliable research of the characteristics and activities of non-profit organizations in countries across the globe. Non-profit organizations, according to the CNP, were defined as entities that were:

<i>Organizations</i>	institutionalized to some extent (i.e., formally registered);
<i>Private</i>	institutionally separate from government;
<i>Non-Profit Distributing</i>	prohibited from returning profits to their owners or directors;
<i>Self-Governing</i>	able to control their own activities and cease operations on their own authority;
<i>Voluntary</i>	non-compulsory and involving some meaningful degree of voluntary participation (CNP-website).

The project soon generated literature that categorized and described the non-profit sector and its activities in over 30 countries (Salamon et al. 1999; Gidron et al. 2003).<sup>2</sup> It showed that non-profit organizations had common features across nations, and that their structure and mode of operation distinguished them from both the public and the business sectors to the extent that they could be seen as a “sector” within the state’s economy.

### *Civil Society—The Hope of the Late Twentieth Century*

The ideas brought forward by the NPM researchers correspond directly with the more optimistic civil society literature led by Habermas, Dahrendorf, Putnam, and others.

The concept of “civil society” is broader in its composition and modes of operation than the “non-profit sector” and the formal organizations it comprises. Habermas suggests that civil society peaked during the nineteenth century, against the background of complete economic liberalization: “... only during this phase was civil society as a private sphere emancipated from the directives of public authority to such an



extent that at that time the political public sphere could attain its full development in the bourgeois constitutional state” (Habermas 1989, 78–79). He placed civil society in a historical context and reminded us that the level of its independence may change in accordance with historical, social, and political circumstances. The developments of the twentieth century, continued Habermas, were characterized by the state’s penetration into society, and by the widening of public authority over sectors that were previously active in the private sphere. A new sphere was created as a result of the blurring of borders between the state and society (Habermas 1989, 142, 150).

One of the features of the literature on civil society from the 1970s onwards was its normative quality; political philosophers and researchers were looking for ways to turn civil society into an influential factor in shaping the new and emerging, post-welfare, democracies. Ralf Dahrendorf believed in the potential contribution of civil society to the design of the new democracy, and in its ability to create a balance between economic competition and democratic values. Dahrendorf defines civil society as: “...that texture of our lives with others which does not need governments to sustain it because it is created by grass-root initiatives” (Dahrendorf 1997, 77–78).

Focusing on the relations between the state and civil society, John Kean defines civil society as “An aggregate of institutions whose members are engaged primarily in a complex of non-state activities ... and who in this way preserve and transform their identity by exercising all sorts of pressures or controls upon state institutions” (Kean 1988, 14).

Civil society thus refers to the mode of interaction among individuals, where the media through which they express their common values are the associations, or non-profit organizations. Associations help galvanize the formation of opinion and wishes of active individuals; they are the necessary infrastructure of a flourishing civil society (Kean 1988; Cohen and Arato 1992; Putnam et al. 1993; Dahrendorf 1997; Putnam 2000).

In particular, Kean (1988, 11–12) thinks that civil society widens civil participation and creates a variety of possible coalitions; it, therefore, increases citizens’ choice and equality. The multiplicity of organizations within civil society envisaged by Kean continuously monitors and supervises government activities, thus serving to check and limit governmental power. Putnam, in his seminal book *Making Democracy Work, Civic Tradition in Modern Italy*, reintroduces the concepts of “trust” and “social capital” as central properties of a well-functioning civil society (Putnam et al. 1993, 90).

Non-profit organizations can thus contribute to the development of a well-functioning civil society if, as researchers suggest, their activities meet certain criteria:

- Non-profit organizations should act independently from government.
- While they should not necessarily be in conflict with government, they ought to be able to criticize state actions and restrain the use of state power.
- Non-profit organizations should act on behalf of individuals and communities, in particular those that are underrepresented.
- The activity of non-profit organizations generates trust and creates social capital.

We use some of these criteria when evaluating the characteristics and functioning of the non-profit sector in Israel.

It is evident that the two streams of literature acknowledge the special characteristics of non-profit organizations and their ability to add value to society. Nevertheless, there is a salient tension between the idea of NPM designers to harness non-profit associations and engage them in the new social policies, and the role of non-profit associations as guardians of democracy and of a decent society, as seen by the civil society authors. In the early 2000s, the idea of *Hybrid Organizational Forms* began to appear, as a way to resolve this apparent tension.

In 2002 Debra Minkoff coined the term Hybrid Organizational Forms to describe American human rights organizations during the 1960s that added advocacy to the provision of services, thereby combining two different strategies (Minkoff 2002). The concept proved very useful in describing how the non-profit organizations of the 1990s and 2000s, operating in a very different environment, adapted to new requirements and new settings. Minkoff demonstrated the direct and almost immediate effect that changes in the political environment had on organizational formation. As part of a wider research initiated by the OECD (OECD 2003), Borzaga and Santuari examined the “New Trends in the Non-Profit Sector in Europe” (Borzaga and Santuari 2003), and found that, in general, the “new” non-profit sector developed in accordance with the type of welfare system that had previously prevailed in the country.<sup>3</sup> Prior to the 1970s, non-profit organizations in well-developed welfare states (such as Denmark, Sweden, and to an

extent the UK) were almost entirely confined to advocacy activities. In countries in which the welfare system was largely based on cash benefits, and less on state controlled service provision (such as Germany, Austria, and the Netherland), the non-profit sector engaged extensively in the provision of services, and was also active in advocacy; and in countries, which had a less developed welfare system (such as Italy and Portugal) services were provided by informal organizations and family, and advocacy was also very limited (*ibid.*, 37). Despite these structural differences, Borzaga and Santuari found that the new non-profit organizations at the turn of the twenty-first century shared common features, present in all the countries they examined. The new non-profit organizations:

1. Provide services that meet needs not recognized by the authorities, thus they need to be both productive—organizing their activities to generate income, and entrepreneurial. They are more autonomous vis-à-vis the government and use a variety of resources to reduce their dependency on government.
2. Tend to be innovative in the type of services, the target populations (mostly marginalized), and in the way they organize the provision of services.
3. Pay attention to creating new jobs, especially for people who are hard to place.
4. Are usually locally based, and develop strong links with a defined community.
5. Emphasize a social goal and democratic control and management, rather than the question of distribution of profits (*ibid.*, 40–41).

The new non-profit organizations in Europe are thus hybrid in the sense that they use several strategies that require multiple capacities and an innovative organizational formation. Hasenfeld and Gidron (2005) embrace Minkoff's idea of hybrid organizations to propose a broadening of our understanding of civil society. They suggest that civil society includes organizations, usually service providing, that "legitimate and reinforce state regimes and policies through their programs and activities". They "obtain from the state a significant portion of their resources" (*ibid.*, 101). They found that these organizations are dynamic, go through cycles of activities and formations: "It is precisely the fluidity in the movement of organizations across the complex landscape of civil society and the periodic changes in the polity that generates

many hybrid forms” (ibid., 102). However, “third sector organizations formed or controlled by the state do not contribute to a viable public sphere” (ibid., 103).<sup>4</sup>

In the following sections, I examine the case of the Israeli non-profit sector’s reaction to the privatization process, and the way in which the reformation and adaptation of the non-profit organizations have affected civil society in Israel. In evaluating the mode of operation of organizations in the face of the privatization process, and their contribution to civil society in Israel, I refer to the following criteria that most researchers—whether focusing on civil society or on non-profit organizations—seem to agree upon:

- A. Have the organizations preserved independence from government?
- B. Have they retained their innovative and entrepreneurial attributes?
- C. In what way do they contribute to generating trust, and a sense of community?
- D. To what extent do they represent marginalized populations?

#### ISRAELI NON-PROFIT ORGANIZATIONS AND THE STATE—PRESENT AND PAST

Israel has a large non-profit sector relative to the size of its population, when compared to other countries participating in the CNP (Gidron et al. 2003). Data relating to the exact numbers of registered non-profit organizations since the enactment of The Law of Associations 1980<sup>5</sup> have not been comprehensive,<sup>6</sup> as many of the organizations appearing on the Associations Registrar list, though registered legally, are no longer active. Estimates of the number of active organizations range between half to two-thirds of the registered organizations at any given time (Limor 2004). Nevertheless, data compiled from a number of sources (Guidestar Israel 2014; Gidron et al. 2003; ICTR 2005; Weinhaber 2008) indicate a steady increase in the number of new non-profit associations, from 10,000 in 1980–85 to 50,000 in 2013. During 2012–13 there was a slight decrease in the number of newly registered associations.

In 2013, 50% of the regular income of the entire non-profit sector in Israel came from government transfers. This is among the highest percentages compared with 12 countries surveyed by the UN Non-Profit Handbook where the average government contribution was 32%

(Salamon et al. 2012). Another 33% of Israeli non-profit income was derived from selling services (the average among 12 countries is 43%), of which a significant portion was to government agencies (CBS 2016a). Borzaga and Santuari note that the new non-profit associations maintain their independence by diversifying their sources of income, and avoid relying on a single dominant source of funding; but this does not seem to be the case in Israel. The Israeli non-profit sector plays a significant role in the Israeli economy. It contributes ~14% to the GDP (second to Canada; Salamon et al. 2012, 3), and in 2015 it employed 14.2% of the economically active population (CBS 2016b), placing it first among member countries assessed in the CNP (Johns Hopkins University CNP). It is worth noting that the average salaries paid by non-profit organizations to social professionals, such as social workers and teachers, are lower than the average salaries paid by state agencies or even by private businesses (Gronau 2012). This last fact is significant in the context of the privatization process, as its purpose is to widen and diversify services, while reducing costs.

Prior to the mid-1970s, Israel could be described as a well-developed welfare state falling within the first category of Borzaga and Santuari—but the development of its non-profit sector, and in particular its apparent integration in the Israeli economy, is strongly related to its unique legacy.

### *A Dubious Legacy*

Before the establishment of the State of Israel in 1948, the Zionist movement developed a very elaborate political and social system of organizations. Despite having placed itself in direct opposition to the ethos of the traditional diaspora Jewish community (Silver and Rosenhek 1999; Limor 2004), there were significant similarities between the self-help associations of the diaspora communities, and the institutions developed by the Zionist movement that served as the infrastructure of an embryonic state, or rather a welfare state in the making. Both were top-down structures and involved a system of fund-raising closer to the idea of taxation than to a culture of philanthropic giving. Due to a division of power within the Zionist institutions that reflected the relative power of the various Zionist political parties, the Labor movement was dominant among those institutions. These institutions included organizations, such as the Federation of Workers (Histadrut), networks of schools, welfare services, health services, sports clubs, and recreational services. Some of those organizations were officially registered as associations under the

Ottoman Law on Associations, which remained the framework for the establishment and governing of associations until 1980.

With the establishment of the state, some Zionist Movement institutions were absorbed into the state's welfare structures, but most remained as quasi-nongovernmental organizations, operating under the control of the ruling party (or less frequently under the control of other parties), and representing faithfully the collectivist ethos of the State. In effect, large segments of the non-profit sector were, for all intents and purposes, nationalized. As late as the mid-1980s, a large number of associations, most still registered under the Ottoman Law, were established either by political parties, the Federation of Workers (pre-1948), or by Israeli government departments (post-1948), carrying out a variety of public services. Government or party representatives acted as board members of these organizations, often constituting the majority of the membership on the board of directors (Attorney General 1988). During the 1970s and 1980s, the practice of establishing or "quasi-nationalizing" non-profit organizations by government departments became widespread.<sup>7</sup> Government departments used non-profit organizations to bypass bureaucratic limitations, such as the restriction on the number of civil service employees, and rigid budget allocations (Paz-Fuchs, this volume). Privatization, as carried out within the framework of NPM, was not necessary. The government funded the organizations attached to it via "supporting funds",<sup>8</sup> designed to support organizations that enhanced the objectives of the government in power. This state of affairs began to change when, in 1988, the Israeli Attorney General issued guidelines concerning "Associations alongside Government Ministries - Procedures for Cooperation between Government Ministries and Non-Profit Associations" (Attorney General 1988). While attempting to regularize a rather problematic situation, the Attorney General noted that, sometimes, "there is a need to establish non-profit associations, or to act via existing associations, to carry out government's duties or other activities that the government is not obliged to do, but has an interest in doing" (*ibid.*, 2).

By 1988, over ten years after the election of a conservative government, a unique situation, whereby the public services were outsourced, but the organizations that delivered them had been nationalized or "semi-nationalized", lingered on. It would seem that the historical legacy prevailed over political and ideological changes and kept the lion's share of the non-profit sector as an executive arm of government.

*1990s—The “Privatization Revolution” Begins*

In 1984, Israel underwent a major economic crisis, which was followed by a recovery or “stabilization” program introducing measures that align with NPM policies. These measures included downsizing the civil service, cutting government spending, and in general—moving more rapidly and explicitly into a neoliberal welfare regime. The popular assumption in Israel was that privatization on a significant scale started with the “stabilization” program and that the non-profit sector grew considerably as a result of these measures and the ensuing transformation of the welfare system (Gidron et al. 2003; Schafferman 2010). However, the steady pattern of growth of the non-profit sector since 1980 underwent no significant change in the years immediately following the economic crisis (1984 and onward). The two peak years in terms of the registration of new associations were 1983 (prior to the outburst of the crisis), with a record of 2645 newly registered associations, and 1998 with 2075 new registrations. From 2001 the number of newly registered associations slightly (and gradually) declined.

The lack of correlation between the significant changes in the civil service and cuts in public funding on the one hand, and the development of the non-profit sector on the other hand, should come as no surprise. At the time of the crisis, the government still had its own, quasi-nationalized organizations, as a readily available tool for the provision of essential services (and possibly for relocating many government employees who were made redundant). The government could increase the “supporting funds” to its own associations without too many bureaucratic obstacles.

The introduction of the Mandatory Tenders Act 1992, together with the gradual implementation of the Attorney General’s recommendation concerning associations which operate alongside government, eventually set the non-profit organizations free from the state insofar as their structure and “ownership” were concerned. In terms of their cooptation to political ends, however, the Israeli non-profit organizations were subject to yet another setback. In 1998, an official who oversaw the “supporting funds” process at the Ministry of Justice wrote an article entitled “State Support of Public Bodies—the Flourishing of the Supporting funds” (De Hartog 1998). In it, he demonstrated how government departments tailored the criteria for allocating supporting funds to suit particular associations, and how the requirement for equal distribution

of public funds was disregarded in favor of political benefits. During that period, the Israeli State Comptroller published reports pointing primarily to the lack of adequate supervision by the government over public funds allocated to non-profit associations, and to the preferential manner in which funds were allocated to certain sectors (State Comptroller 1997). Both De Hartog and the State Comptroller's reports emphasized the role of government departments in creating a severely flawed system of allocating public funds, and in encouraging the establishment of non-profit associations (including, at times, fictitious associations: De Hartog 1999) specifically for political purposes. The large number of associations established and registered during 1998 could be explained by the booming of the direct, "supporting funds" system that encouraged politicians to establish associations to enhance their political agenda. The first important sign that things began to change was an apparent shift, beginning in 2002, of the main method by which funds were allocated to associations—from "supporting funds", the use of which decreased significantly, to an increase in the use of contracts (following tenders). The latest available data, from 2014, indicates that the government allocated only 2 billion NIS via "supporting funds", to 3000 organizations (Ministry of Finance—General Accountant 2016) (over half of this sum was allocated by the Ministry of Education), while 72.1 billion NIS were allocated through purchase (of both goods and services) contracts (Frankenburg 2016).

The era of government's full control over most of the non-profit sector has formally ended, but the long legacy of interwoven relations continues to influence the new method, namely—tenders and contracts—whereby the government cooperated with the non-profit sector.

### *Government Tenders for the Provision of Social Services*

Tenders invite organizations to offer their services to government agencies, in accordance with needs, as defined by government departments. The participation in government tenders indicates a freedom of choice on the part of the non-profit organizations: they can compete for providing services within the framework of the tender or decide to operate independently. Theoretically, they could do both and add advocacy to their arsenal of activities, if they wished to become hybrid organizations, as suggested in the literature. Tenders are a tool for the formation of government-non-profit partnerships that



would help harness the organizations' special features and abilities for the improvement of services (and possibly the reduction of their cost). I argue that the nature of the tenders has a decisive influence on the ability of the non-profit organizations to retain their special attributes of innovation, entrepreneurship, and the generation of trust. In Israel, government tenders encourage competition between for-profit and non-profit organizations, emphasize managerial abilities on a large scale, and generally play down the importance of attributes such as specific, professional expertise or innovative abilities.

Over the past decade, government agencies have constantly redesigned and reformed the tender process to ensure that suppliers abide by a growing number of legal standards (for instance—employment regulations, criminal record specifications, safety regulations, etc.), while the government's bureaucratic workload and regulatory obligations would remain at a manageable level. The examination of four recent tenders (Ministry of Finance—Government Procurement Authority 2016)—two issued by the Ministry of Education and two by the Ministry of Social Services<sup>9</sup> reveals the elaborate ways in which government departments try to deal with this dilemma, and the potential impact on the non-profit sector as well as on the quality of the services. The Ministry of Education includes among its threshold requirements from suppliers three consecutive years of activity (down from the previous eight or five years), services supplied to large numbers of schools or of pupils, and a budget of 6–12 million NIS per year. The tender with the higher budgetary requirement limits the number of partners who can apply jointly to two. The Ministry of Social Services in its tender on “Production and operation of recreational projects for people with cognitive–developmental disability” clearly specified its interest in finding one sole contractor to deliver the service nationwide. These criteria prevent new and smaller organizations from competing in these tenders. A recent research (Madhala-Brik and Gal 2016) on the outsourcing of welfare services in Israel indicates that these requirements are typical of social service tenders. It notes that, in 2015, 80% of welfare services had been outsourced, and that two-thirds of the suppliers were for-profit organizations, while the expenditure for welfare services was divided roughly equally between non-profit and for-profit organizations. This would indicate that, as in the case of the Ministry of Education, welfare services' tenders attract sizeable non-profit organizations with the ability to serve large numbers of beneficiaries. The Ministry for Welfare Services,

as seen in these recent tenders, prefers large and experienced suppliers; and, indeed, according to Madhala-Brik and Gal, 96% of outsourcing expenses went to veteran organizations (for-profit and non-profit), and 4% of supplying organizations received 70% of the funds (ibid., 13–15). The obvious centralization of the welfare services market pushes non-profit organizations to adopt for-profit modes of operation: to grow, or merge with others, and to improve managerial abilities.

When describing the required activities, all four tenders (covering 125–200 pages each) specified in great detail not only the type of activities, the time framework and even the length of intermissions, but also the exact qualifications expected from each staff member and the range of their salaries. In the case of the tender for innovative activities in science and technology (Ministry of Education), the tender denoted that the innovative ideas would come from the Ministry's steering committee, and the contractor's job was to implement the activities in accordance with the specifications. The tenders did not attempt to encourage providers to innovate or offer better solutions to social problems; instead, they imposed strict managerial standards, a phenomenon not unique to Israel. Summing-up the findings of six researches on the influence of privatization on the characteristics and mode of operation of non-profit organizations, Katan says that the differences between non-profit and for-profit service providers had been blurred—both need to survive financially and neither is able to generate a social value (such as an increase in trust or solidarity). Furthermore, some of the unique features of the non-profit organizations suffered erosion—including their entrepreneurial activity in developing new services, their advocacy activity on behalf of unrepresented populations, their work with volunteers and their internal democratic processes (Katan 2008; Werzberger and Katan 2005). A 2010 policy paper warned that arrangements designed to regularize the privatization and marketization processes of service delivery were jeopardizing the potential benefits of non-profit organizations' contribution to society, especially their innovative and entrepreneurial abilities (Limor 2010). Moreover, the tender method encourages the concentration of service delivery in the hands of large, national organizations—be it non-profit or for-profit organizations (Katan 2008; Werzberger and Katan 2005). It can be concluded with a high degree of certainty that a number of recurring features of government outsourcing and privatizing tenders, such as the equal approach to for-profit and non-profit suppliers, requiring extensive prior experience, and the capacity to serve large numbers

in a wide geographic area are not conducive to harnessing the special social attributes of non-profit organizations. The (perhaps) unintended impact of these tenders was to erode some of these special attributes and possibly impair the ability of a large section of the non-profit sector in Israel to act as civil society associations. Under such circumstances, is the option of adopting multiple strategies, of becoming “hybrid” organizations, possible?

### THE IDEA OF HYBRID ORGANIZATIONS

Hybrid Organizations emerged as a possible solution to the civil society deficit caused by the engagement of the non-profit organizations with the process of privatization and outsourcing of social services (Hazenfeld and Gidron 2005). Borzaga and Santuari found that the new type of non-profit organizations in Europe were indeed hybrid, but the services they provided were not recognized by the authorities, thus the organizations were not bound by contracts with government. In other words, the hybrid organizations observed by Borzaga and Santuari did not replace the state, but tended to develop special services needed, but not provided by the state. This contrasts with what Katan describes as a “massive” privatization of welfare services (Katan 2008, 11; Benish, this volume) in Israel. There are needs, often related to marginalized populations, which are not recognized by the state. The organizations that took upon themselves to address these needs, and have been doing so outside the tender regime, were indeed acting as hybrid organizations. In a small country like Israel, these remarkable organizations, though small in number, are well known and have an impact. To name but a few: Yad Sarah, which provides equipment and services for sick, disabled and elderly people to support them and their families in their homes, operates across the country and is managed by over 6000 volunteers. Only a very small number of paid employees serve as national and regional directors. About 50% of the population has had some contact with the organization, and its trust-generating activities (including training and employing people with special needs to repair equipment) have a wide spillover effect. Maslan (The Center for Support for Victims of Sexual Violence), No2Violence, and others, provide a variety of services, advocate for and represent victims, and are simultaneously supported by the Ministry of Welfare. Government support is allocated through the “supporting funds” mechanism, and not

via a service delivery contract. These organizations work with volunteers, give a voice to marginalized people, and provide specialized services. Hazenfeld and Gidron were justified in proposing to broaden the term civil society beyond the category of “civic organizations” (single strategy, namely: advocacy, social change organizations). Nevertheless, our findings show that, in Israel, this can only be achieved when avoiding contracting with government and, at this time, only few organizations can function in this manner. Furthermore, we were not able to observe the fluidity, namely the moving in and out of contracts, and changing of strategies, as noted positively by Hazenfeld and Gidron. As Madhala-Brik and Gal noted, government ministries tend to contract with veteran organizations. Comparative data of the JHU Center for Civil Society Studies show that, in most of the countries surveyed (14), service delivery dominates the non-profit sector’s activities, and constitutes on average 73% of its activities (JHU 2004). In Israel, service delivery constitutes 89% of the sector’s activities, only second to Japan with 95% (Salamon et al. 2012). “Expressive Activities”, defined as sports and recreation, arts and culture, interest representation, and advocacy, comprise only 10% of activities of the non-profit sector in Israel, compared with an average of 22% in the countries surveyed (*ibid.*). The studies related to social service tenders, combined with the aggregate data generated from international surveys, suggest that hybrid organizations, namely—service providing and at the same time increasing trust, building social capital, checking and limiting state power—cannot be easily realized under the tender regime, which governs the Israeli privatization process. Israeli non-profit organizations were unable to sustain these two strategies. Whenever they chose to provide services under a contract with government, they had to invest primarily in developing managerial abilities rather than in the more civic-related strategies.

#### THE “NEW NON-PROFIT SECTOR” AND CIVIL SOCIETY IN ISRAEL—CONCLUDING REMARKS

Civil society as envisioned by Dahrendorf, Putnam, and others was not inherent to Israel’s culture and legacy but, in 1980, the year in which the new Law of Associations was enacted, the New Israel Fund (NIF)—a Jewish American-Israeli partnership was also established. Its stated objective was to encourage the development of civil society in Israel, to support the establishment of grassroots civic associations for social change, and

to provide them with finances and technical support. Silver and Rosenhek describe this event as an “important development encouraging the emergence of a more vocal and defiant third sector” (1999, 35).

Indeed, the years following the establishment of NIF saw a surge in the registration of new civic/advocacy and social change organizations with the registrar of associations: from 13 civic organizations registered in 1981—to an accumulated number of 1354<sup>10</sup> in 1998. This could be viewed as a remarkable development of civil society in Israel. However, in 1998, civic associations still constituted 4.1% of registered associations, and their share among non-profit organizations never peaked beyond 6%; a rather low percentage in comparison with countries participating in the CNP (Gidron et al. 2003, 214; Salamon et al. 2012, 5).

The traditional “civil society” literature sees the capacity of non-profit organizations to generate trust as the core component of a flourishing civil society. The literature links the generation of trust to attributes such as voluntarism, representation—in particular that of marginalized populations—and to the organizations’ ability to mediate successfully the needs and wishes of disempowered populations vis-a-vis policymakers who would, in turn, design better adapted policies (Kean 1988; Putnam et al. 1993). Putnam et al. (1993, 170–171) referred to this phenomenon as the “virtuous cycle”, which requires an a priori positive disposition toward non-profit organizations.

The non-profit sector in Israel has been struggling for decades to overcome a deeply entrenched lack of trust by the public.<sup>11</sup> This disposition was undoubtedly related to the rather unique episodes in Israel’s recent history of misuse of non-profit organizations for political or personal ends, and reinforced by the State Comptroller’s reports (Goldberg 2003; Arian et al. 2008). Israeli non-profit organizations struggled assiduously to regain legitimacy and the public’s trust.<sup>12</sup>

We see that, as in other countries, Israeli non-profit organizations can be innovative, creative, while also addressing the needs of marginalized populations. During the past 10–15 years, many of them were able to convince (through advocacy, raising demand, etc.) state agencies to assume responsibility for the delivery of those innovative services. In many cases, this was a significant success of the non-profit organizations but, as demonstrated, it came at a price. Contracts with the government in the 1990s, as in the early 2000s, influenced the pattern of activities of non-profit organizations by creating an environment that is unfriendly

toward civic-oriented activities. Even when the contract involved the delivery of services that were innovated by the contracting non-profit organization itself, it caused an erosion of the trust-generating aspects of that organization's activity (Shiffer 2003).

Despite some general similarities between Israel's social-economic development since the 1970s and that of many European countries, the new, post-1980s, Israeli non-profit sector has unique and significant attributes. Relative to the size of its population, Israel has a large non-profit sector, but in comparison with OECD countries, its non-profit organizations are more dependent on government funding, service delivery is more dominant among Israeli non-profit organizations, and the sector as a whole is deeply integrated in the country's economy.

The apparent ease with which this cooptation process took place could be explained by the unique history of the non-profit organizations in Israel. There was, and to a large extent still is, a strong legacy of non-profit organizations acting as the extended arm of the authorities. During most of the second half of the twentieth century, non-profit organizations were nationalized, or semi-nationalized, and in fact controlled by government departments. The nature of the outsourcing and privatization tenders is, in a way, an expression of the lingering effect of the legacy. The process of becoming truly independent is still ongoing, with mixed messages and some resistance on the part of the government.

The solution suggested in the literature, and to an extent found among European non-profit organizations, to the tension between contracting with government and retaining their ability to contribute to a vibrant civil society, was to become hybrid in terms of the strategies used. In the Israeli case, we demonstrated that this could be possible only if the service delivery segment was not subordinate to a contract with government, and indeed, there are a few, very successful, such hybrid organizations in Israel.

Our research demonstrates that the privatization process encouraged the formation of large non-profit organizations that invested in their managerial abilities to compete successfully with for-profit organizations for government tenders, while neglecting their previously praised features of innovation and entrepreneurship. The privatization process blurred the distinctions between for-profit and non-profit organizations that deliver services, thereby rendering the large Israeli third sector unable to contribute significantly to the development of a flourishing civil society.

## NOTES

1. Among them—France in 1974; Netherland in 1974; UK in 1979; West Germany in 1982.
2. Israel participates in the CNP and data collection generally follows these definitions, Initially through the Center for Third Sector Research at Ben-Gurion University, and currently through GuideStar Israel.
3. They described three types of welfare systems: (A) A well-developed, universal welfare state engaging both in public services provision and in cash benefits (Sweden); (B) A developed and universal welfare state, although largely based on cash benefits, with a limited commitment on the part of the government to the direct provision of social services; and (C) A less developed welfare state, especially until the early 1980s, largely based on cash benefits, with a limited public provision of social and community care services confined to a few sectors (education and health) (Borzaga and Santuari 2003, 37).
4. The examples of such state controlled organization, given by Hasenfeld and Gidron are organizations under Soviet and Nazi regimes; extreme cases indeed.
5. Limor in his 2004 report on the development of the “Third Sector” in Israel, describes the difficulties in finding and verifying data on numbers of organizations, type of organizations, and areas of their activities. Nevertheless, he quotes the Minister of Justice Rosen who during a discussion in the Knesset in December 1954, said that when the British left Palestine there were ~5000 registered organizations. Since the establishment of the State, notice was given of the registration, or the existence of 2600 organizations. (Limor 2004, reference No. 20, 6).
6. Taking an organization off the registrar’s list involved a lengthy legal process, which the various registrars over the years tended to use quite rarely. From 1997, the Registrar of Associations transferred information to the Israeli Center for Third Sector Research operating within Ben-Gurion University in the Negev (ICTR). The ICTR built a database using the widely accepted Johns Hopkin’s criteria. In 2008 the authorities stopped transferring data to ICTR. Partial and nonaggregate data can be found, as of 2010, in Guidestar Israel.
7. The Ministry of Housing, the Ministry of Welfare, and the Ministry of Education, each had over 700 organizations linked to them. The author was an employee of the State Comptroller’s Office in Israel from 1979 to 1995, and conducted research on the supervision by government departments of the associations that provided services for them.
8. The Law of Mandatory Tenders was legislated only in 1992 (see below).

9. Ministry of Education: (1) Tender No. 38/12.2016, 1.12.16; *Operating educational projects to strengthen and enhance science and technology in the southern and northern regions, and to implement innovative activities in science and technology.* (2) Tender No. 2/1.2017, 9.1.17; *Purchasing pedagogical training and coaching services for elementary schools—pedagogic leaders.* Ministry of Welfare Services: (1) Tender No. 250/2016, updated 26/1/2017: *Operating summer and holiday activities for children and young people with disabilities.* (2) Tender No. 251/2016, 15/12/2016; *Production and operation of recreational projects for people with cognitive—developmental disability—in the entire country.*  
Ministry of Finance Website: <http://www.mr.gov.il/OfficesTenders/Pages/SearchOfficeTenders.aspx>.
10. Database of the Israel Center for Third Sector Research (currently not active) at the Ben-Gurion University in the Negev.
11. At the time newspapers often reported about corruption in non-profit organizations—<http://www.haaretz.co.il/misc/1.1182476>; and the director of the Ethics Center in Jerusalem addressed the issue of loss of trust—<http://mishkenot.org.il/wp-content/uploads/2015/03/%D7%93%D7%A0%D7%99%D7%90%D7%9C.pdf>.
12. Between 2001 and 2006, two committees were established to examine the relations between the government and the non-profit sector: The first was *The Review Committee of Government Policy Toward the Third Sector in Israel*. This was an independent public committee initiated by the Israeli Center for Third Sector Research, at Ben-Gurion University in the Negev; report published in 2003 (ICTR 2003). The second was the committee for the “Reexamination of State Support to Public Institutions”, initiated by the Ministerial Committee for State Control Affairs in 2004, and published in 2006 (Prime Minister’s Office 2006).

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# From Nationalized Ownership and Provision to Privatization in Israel: The Politics of Institutional Change

*Ronen Mandelkern*

Privatization in Israel is a wide-ranging and continuing process, which constitutes a major institutional transformation. This chapter is dedicated to revealing the political conditions and factors that have facilitated Israeli privatization and the processes through which the various dimensions of privatization have been taking place. Toward that end, I rely on two branches of literature which are concerned with explaining institutional change: historical institutionalism and discursive institutionalism (Fioretos et al. 2016; Schmidt 2008). Accordingly, the analysis focuses on how crises, ideas, and gradual change processes have together contributed to the consolidation of privatization as a central policy practice in contemporary Israel.

The chapter begins by briefly describing the main dimensions of privatization in Israel and suggests that privatization policy in Israel should

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be considered as a major institutional transformation. The other sections analyze the political dynamics which have pushed forward this institutional transformation in the face of various potential and actual obstacles. The chapter concludes by briefly discussing the political possibilities for, and hurdles of, future privatization policy in Israel.

### PRIVATIZATION IN ISRAEL: AN INSTITUTIONAL TRANSFORMATION

Institutional theory defines institutional change as a structural transformation which reflects the redefinition of the “rules of the game” political actors face, the replacement of one set of norms with another, and, with respect to policy issues, the adoption of new policies that diverge from past policy legacies (Hall and Taylor 1996; Streeck and Thelen 2005b). Privatization in Israel reflects such an institutional transformation. The watershed period, which aligns with Israel’s wider political-economic transformation, is the mid-1980s. Prior to that point, the basic logic of Israeli policy was “nationalization” rather than privatization. As detailed in the following paragraphs, the logic of national ownership and provision was evident in both the economic sphere and in the sphere of government services.

In the economic sphere, nationalization was most clearly manifested by the increased role played by the Israeli government, during the 1950s and 1960s, as the owner of major economic enterprises such as Israel Chemicals, an industrial concern (formed in 1968), and El-Al, the national airline (formed in 1948). At the same time, the Workers’ Company (*Hevrat HaOvdim*), the national-like holding company owned by the *Histadrut* (the labor federation), continued to own major industrial and financial concerns it had established during the pre-state period, like *Koor*, *Solel Boneh*, and *Bank HaPoalim* (all formed in the pre-state years). Furthermore, nationalization of private corporations, such as Paz, a major oil company (1959), and the Israel Electricity Company (1954), was hardly uncommon during these years (Eckstein et al. 1998, 127). As Tevet’s chapter details (this volume), before the 1980s the government had also positioned itself as the main owner and operator of public utilities, partly by nationalizing the delivery of water (1959), electricity production (1954) and the founding of postal and telephony services. Services like rail transport and road construction were managed and conducted by government ministries.

Similarly, the government had also been continuously expanding its role during the pre-1980s period insofar as public and social services were concerned. The government had increased its direct control over already nationalized-like services, like education (which was previously organized according to political streams) and the Employment Services (1959) (which were previously managed by the Histadrut). The government was also the main force behind expansion of welfare services, which, during the pre-state period, were conducted by various non-state bodies. While non-state bodies operated certain public and social services during this period, this mainly reflected the continuation of pre-state organizations and arrangements, such as the central role played by the Histadrut in managing healthcare services and pension funds (see also Filc, Harel Ben Shahar, and Lurie in this volume).

Against this background, the topics covered in this volume demonstrate that privatization in Israel reflects a striking transformation not merely because the state sold government corporations and contracted out services, but also because its basic logic of action was completely changed (Maman and Rosenhek 2012). Instead of establishing new government corporations or even nationalizing privately-owned firms and privately-operated utilities, the government began, in the mid-1980s, to sell nationally-owned corporations and allocate more and more operational functions to non-state bodies.<sup>1</sup> Instead of taking greater *direct* responsibility for existing and new social and public services, the state's default policy was to outsource services that it saw itself as responsible for providing. At the same time, the Histadrut ceased to own or manage significant economic enterprises, pension funds or public services.

The most striking demonstration of the fact that a structural and normative change of the rules of the game has been taking place is the ongoing expansion of the privatization logic into spheres and domains in which, previously, privatization would be considered impossible. During the last decade, we have witnessed an ongoing effort to sell not only economic enterprises like Israel Chemicals but also companies from the defense sector, such as the Israeli Military Industry. At the same time, government contracting-out broke the boundaries of administrative and even social services and expanded into core governmental actions such as the operation of checkpoints and attempts to erect a privately-operated jail (see also Galnoor, this volume). The delegation of the responsibility to form Israel's socioeconomic vision for the next two decades (to the Rand

Corporation) and the contracting-out of monitoring and supervision of public services suggest that contracting of “in-house” services is no longer limited to technical and professional matters such as cleaning and computing (see also Marciano and Kariv-Teitelbaum, this volume).

### EXPLAINING INSTITUTIONAL TRANSFORMATION

Given the inherent tendency of institutions toward path dependency and continuity, institutional theory has given much attention to explaining institutional transformation. Earlier attempts emphasized the role of crises as catalysts of transformation: Crises undermine the efficiency of prevailing institutions, shake the belief in their inevitability, and weaken the power of those who support them. Destabilizing prevailing institutions provides the opportunity for their replacement with a new set of institutions, a mechanism of change that has been defined, following evolutionary biology, as “punctuated equilibrium” (Krasner 1984; Baumgartner and Jones 2010).

More recent attempts to explain institutional transformation have suggested that despite their inherent tendency toward stability and continuity, political institutions may also change gradually (Hacker 2004; Streeck and Thelen 2005a). Agents who seek change can apply various “tactics” to achieve gradual institutional change, most prominent among which are *institutional conversion*—the usage of prevailing institutions for the sake of new goals; *institutional layering*—the addition of new and different institutions on top of prevailing ones (while leaving the latter intact); and *institutional drift*—freezing prevailing institutions and blocking their expansion and adaptation to new needs and demands. The common feature of all of these tactics is that they strive toward institutional transformation while avoiding direct confrontation with prevailing institutions and their supporters.

At the same time, other scholars argue that both abrupt and gradual institutional transformations necessarily require ideational guidance (Blyth 2002; Schmidt 2008, 2012). The replacement of one set of political institutions with a new one requires agents who have an ideational and ideological vision (for an example of such an application, see Shpaizman, this volume). Building new institutions demands normative and theoretical guidelines regarding the faults of prevailing institutions and their inevitable replacement.

Indeed, and as the following sections demonstrate, privatization in Israel has been generated by both crises-induced abrupt changes and long-term and incremental processes, which have been guided by proactive neoliberal visionaries. Section “[Crises as Political-Economic Opportunities to Privatize](#)” discusses the role played by the economic crises within the state and the Histadrut, which were accompanied by a legitimacy crisis in the Israeli public sector, in the turn toward privatization. But these crises can hardly account for a process that has been proceeding continuously for over 30 years. Rather, and as detailed in Sect. “[Gradual Changes: Privatization as a Day-to-Day Practice](#)”, the privatization of government enterprises and utilities and the contracting-out of government services mostly occurred incrementally, without directly dismantling pre-1980s institutions. Section “[Ideas and the Overall Coherence of Privatization in Israel](#)” suggests that both abrupt and gradual institutional transformations were guided by neoliberal ideology which defined a new role for the state: namely, expanding and nurturing a competitive private sector and implementing market values within the public sector. But before looking at the political processes and conditions through which privatization policy in Israel has evolved, Sect. “[Pushing for Privatization: The Israeli Ministry of Finance](#)” presents the main political actor that has stood behind privatization.

### PUSHING FOR PRIVATIZATION: THE ISRAELI MINISTRY OF FINANCE

Remarkably, privatization policies in Israel have almost never been a top political priority for any of the main political parties. Political conflict in Israel mainly concerns national, security, and religion issues, and economic liberalization has rarely been a prominent goal of politicians from either the left or the right (Netanyahu’s strong neoliberal convictions reflect a prominent exception) (Shamir and Arian 1999). Nevertheless, privatization policies have been carried out by both rightwing and leftwing governments. As revealed by various chapters in this volume, the main political actors who have promoted this policy have been the officials of the Ministry of Finance (MoF), primarily within the Budgets Division.

As the Israeli political system’s focus has been on noneconomic issues, the MoF, and its Budgets Division have been left to “take charge” of promoting economic reforms in Israel since the 1980s (Mandelkern



2015; Maron and Shalev 2017). Guided by a neoliberal approach, this Ministry, in addition to promoting the various dimensions of privatization, has pushed for welfare reforms, budgetary cuts, lower taxes, and the weakening of organized work (Asiskovitch 2010; Doron 2009; Ratson 2008; Zohar and Frenkel 2011). Behind the processes that described below, we repeatedly find that the MoF was the main driver toward privatization in virtually every possible area and through every available channel.

Furthermore, legislative changes have empowered the MoF since the mid-1980s. These have included the Arrangements Laws and the Budget Fundamentals Law (Mandelkern 2015). The Budget Fundamentals Law enhanced the control of the MoF over the budgetary processes vis-a-vis “spending” ministries and other budgeted bodies, like local municipalities and higher education institutes (Cohen 2015). The basic principle of the Arrangements Law, which is primarily designed by the MoF, is the attachment of policy reforms to the yearly approval of the government’s budget. In the Israeli multiparty political system, in which governments are necessarily coalitional, this attachment guarantees the support of all coalition partners in a reform and minimizes potential opposition. Furthermore, in contrast to reforms which are legislated through regular procedures and are processed in a specialized parliament committee, the reforms included in the Arrangements Law are processed relatively quickly in the Finance Committee of the Knesset.

Both legislative acts have shifted the balance of power within governmental decision-making processes to the advantage of the MoF, and especially its Budget Division. These two acts complement each other: the Budget Fundamentals Law sets the rules of the game and augments the influence of the MoF throughout the policy process; the Arrangements Laws allow this Ministry to promote its ad hoc priorities and policies. As the following sections demonstrate, the pivotal position of the MoF regarding economic issues has allowed it to continuously promote privatization during both crises and regular times.

### CRISES AS POLITICAL-ECONOMIC OPPORTUNITIES TO PRIVATIZE

The watershed moment, marking the shift from nationalization to privatization, was the mid-1980s—particularly the adoption of the 1985 Emergency Economic Stabilization Plan (“the Stabilization Plan”). This plan, designed and promoted by economists from the MoF, the Bank of

Israel, and academia, was implemented as a means to stop inflationary escalation and improve Israel's balance of payments (Bruno 1993; Mandelkern and Shalev 2010). To achieve these aims, the government and the central bank adopted highly restraining monetary and fiscal policies, both of which had direct bearing on the privatization of government and Histadrut enterprises and contracting-out of government services.

The economic crisis, and the adoption of fiscal restraint in response, meant that the expansion of government services could not continue, at least not in the same form as in the past, and set the political conditions required for contracting-out government services. An important expansion of the Israeli welfare state, the 1986 institutionalization of the right of elderly dependent people to receive nursing assistance, clearly demonstrates this change (see also Benish, this volume). The legislation of this reform included the explicit requirement that these services, while financed by the government, must be provided only by nongovernmental bodies and not by government employees (Ajzenstadt and Rosenhek 2000).

Fiscal restraint immediately weakened the bargaining position of the main potential opponents to government contracting: namely, government employees. Budgetary cuts were supposed to be achieved by reducing the number of government employees and the long-term costs associated with the employment of each worker (Bruno 1985). While the goal of reducing the number of government employees was hardly achieved, it put the workers in a continuously defensive position and forced them to focus on preserving their current employment conditions.

To make matters worse, from the workers' perspective, the Histadrut was dramatically weakened, politically and economically, during the mid-to late 1980s (Grinberg and Shafir 2000; Harpaz 2007).<sup>2</sup> The Histadrut and its Workers Company suffered from detrimental financial conditions, not least due to the very high-interest rates the Bank of Israel had set, as part of its anti-inflationary monetary policy (Grinberg and Shafir 2000). Like the Kibbutzim during these years, the Histadrut and its holding company were continuously recycling debt and high-interest rates, leading to a dramatic increase of debt service.

Fiscal and monetary restraint also triggered the privatization of government and Histadrut services. For the government, the selling of state enterprises and firms, even, or perhaps particularly, the profitable ones, was a source of additional, instant revenues. For the Histadrut, the selling of its industries was essentially the only possible way of improving

its economic situation and was also demanded by the government as a condition for receipt of financial help (Shafir and Peled 2002, 247).

Fiscal and monetary restraint is difficult to implement in normal times, but the culmination of economic crisis legitimized this kind of macroeconomic action and weakened any potential opposition. Crucially, even though economic conditions improved quite quickly after the implementation of the Stabilization Plan, by then these policies had already had their effect and, in any case, were not reversed. The macroeconomic crisis that culminated in the mid-1980s had set the stage for the drastic fiscal and economic restraint, which in its turn had triggered the transformation from nationalization to privatization.

Though less encompassing than the macroeconomic crisis of the 1980s, additional crises have also paved the road to privatization in the specific policy domains within which they have taken place. One prominent example is the nationalization-as-means-of-privatization of the Histadrut's pension funds in 2003, in which the government took control of the Histadrut's collective pension funds due to their "actuary crisis," forbade the recruitment of new members and decreased their subsidy through government bonds (Ratson 2008). This has been a crucial step in the longer-term process of fully privatizing pension funds in Israel (Lurie, this volume). Another example is the budgetary crisis of 2003, in which the government experienced difficulties in selling its bonds and financing its debt. Following that, the government adopted emergency budgetary cuts and utilized the Arrangements Law to implement various reforms that were "waiting in the pipeline." Perhaps the most prominent among these reforms was the "Wisconsin Plan" welfare reform, which made the conditions for receiving welfare benefits more stringent in order to encourage beneficiaries to find jobs and reduce governmental social expenditures (see also Benish, this volume). In contrast to the recommendations of past committees that dealt with this topic, the reform was executed solely through contracting-out to private firms (Benish 2014; Mandelkern and Sherman 2015; Maron and Helman 2015).

The political significance of all of these crises is that they created a political atmosphere which legitimized change and delegitimized opponents of change. Crises reflect a systemic dysfunction, and may easily be referred to as proof that change has to take place in order to solve systemic problems. The crises that were mentioned enhanced the possibilities for political maneuver of the MoF and limited the possibilities of those who opposed it. This has been particularly true when the program

of change—namely privatization—has been ripe and ready, and merely waiting for the “window of opportunity” to be adopted and implemented (Kingdon 1995). A vivid illustration of this dynamic is the government-run housing facilities for people with intellectual disabilities. Despite being a continuous target for privatization, a fact exemplified by the adoption of numerous governmental decisions during the 1990s and 2000s concerning the contracting-out of some or all of these facilities, most of these facilities were never privatized due to the objections of their workers and, especially, of the residents’ parents (Mandelkern and Koreh 2017). The only exceptions are two such facilities, which, following ad hoc crises in 1988 and 1992, were swiftly transferred to private contractors (Mandelkern and Sherman 2015). In each of these cases, the specific circumstances were less important than the fact that the management of these facilities had failed and therefore could be relatively easily removed and replaced.

#### GRADUAL CHANGES: PRIVATIZATION AS A DAY-TO-DAY PRACTICE

While crises have played a crucial role in pushing forward privatization processes in Israel, privatization has mainly been promoted through gradual but continuous changes. This applies to the various dimensions of privatization in Israel: the piecemeal privatization of government-owned corporations and companies, the privatization of pensions, the growing share of private funding in education and health services, and the contracting-out of public and social services (see also chapters by Filc, Harel Ben Shazar, Lurie, and Tevet, this volume).

As mentioned above, the basic idea behind the concept of “gradual institutional changes” is that attempts to directly dismantle existing institutions are likely to be overly demanding tasks, especially during normal times. Consequently, institutional change can—though not necessarily—be achieved if the institutions targeted are not “attacked” directly. This has been the political logic that has characterized a great deal of privatization efforts in Israel.

The first channel through which change can be achieved without directly harming prevailing institutions is defined as “drift”—when official policies and arrangements remain as they were and political agents with veto power intentionally prevent the adaptation of these institutions to changing circumstances. A prominent example in the current context is the continuous application of budgetary freezes in relation to existing

government services, while the population of recipients has continued to expand. Such budgetary freezes undermine the service effectiveness and hamper their public legitimacy. This well-known practice has been applied by the MoF in the context of employment and welfare services (Koreh 2001; Mandelkern 2012).

Drift is followed by channels of gradual change like “layering” and “conversion.” “Layering” pertains to a process through which prevailing institutions remain intact while next to them, or on top of them, a new and different system is gradually established. In services like education and health, which provide for a very wide target population, unsatisfactory budgets encourage middle-class recipients to look for private replacements (see Filc and Harel Ben Shahr, this volume). Consequently, these services are now characterized by different combinations of public and private systems, in which the share of the private component constantly increases.

In welfare and employment services, where recipients cannot afford to pay for fully-privatized solutions, frozen budgets mean that demand surpasses supply and this supports the efforts of the MoF to introduce and expand contracting-out practices (Mandelkern and Koreh 2017). The privatization of housing for people with intellectual disabilities took place through layering: While most government facilities were not privatized, the expansion of this service took place primarily through contracting-out. Consequently, the share of service recipients within government-owned facilities decreased from some 70% during the 1980s to 20% today (Mandelkern 2012). Similarly, when the government implemented the “Wisconsin Plan” welfare reform, new and private employment centers operated alongside the existing governmental Employment Service bureaus (Mandelkern and Sherman 2015).

The privatization of government corporations also took place gradually since the 1980s. Generally, this process began with the more easily justified privatizations of corporations and firms that were strictly business enterprises, like *HaHevra LeIsrael*, and only then did the privatization of corporations, like the Military Industry (which is still ongoing), take place. The privatization of the postal service reflects another mix of gradual change processes: The government postal service gradually changed its organizational structure, from a ministerial division to an independent governmental authority and from there to a government corporation which is to gradually issue shares. At the same time, the monopoly of the government-owned postal service was gradually and

intentionally eroded. As Tevet's chapter in this volume demonstrates, similar combinations of gradual change channels have been adopted in the privatization of other public utilities.

The crucial point is that, while constituting a major institutional reform, privatization in Israel has mainly taken place gradually, over at least 30 years. Consequently, for many years it went under the radar of public and academic attention (Galnoor, this volume). When public and scholarly attention finally shifted toward it, privatization was already a well-established, perhaps even a final, fact.

### IDEAS AND THE OVERALL COHERENCE OF PRIVATIZATION IN ISRAEL

Crises and gradual change mechanisms like drift and layering allow us to understand how change takes place but not necessarily why change is in one direction and not another. To answer that last question, an important additional factor that has to be taken into account when studying the politics of privatization in Israel is the role of the ideas which have guided the MoF and its political allies. This section highlights the causal and normative beliefs which have guided privatization policies in Israel over the last three decades.

During the 1980s, neoclassical economics and New Public Management theories had significant intellectual and political impact, particularly in Anglo-Saxon countries and in Israel as well (Backhouse 2005; Hood 1995). Neoclassical economics theories offered guidelines regarding the appropriate relations between the public sector and the private sector and the desired size of the public sector within the economy. New Public Management theories addressed the appropriate management of the public sector itself. Together, they complemented each other and were able to offer a coherent and encompassing perspective for the various dimensions of privatization.

According to neoclassical economics, economic prosperity rests on the activity of the private sector and the size of the public sector generally comes at the expense of the private sector (e.g., Aschauer 1989). It follows that the privatization of public utilities and services is expected to encourage private sector activity and therefore is desirable. According to New Public Management theories, the traditional public sector suffers from chronic inefficiencies and unresponsiveness to the needs and demands of its constituencies (Hood 1995). These problems are rooted

in the fact that the public sector, in contrast to the private sector, is not incentivized by the profit motive. In order to revitalize itself, the public sector has to rely on private bodies to execute its tasks and to adopt common private sector practices, like performance-based incentives.

The “importation” and “translation” of these ideas into the Israeli discourse is best exemplified by the publication of two reports, commissioned by the government, during the late-1980s. The First Boston Bank report, published in 1988, defined a “master plan for privatization” of government corporations and strongly reflected the neoclassical economics preference for reducing the size of public sector (Eckstein et al. 1998, 165; Marciano, this volume). The Kovarsky Report, published in 1989, set the framework for government contracting and reflected some of the ideas of the New Public Management approach to reforming the public sector (Kovarsky et al. 1989). Both reports were commissioned and endorsed by the grand-coalition governments of the time.

Privatization of both services and corporations was considered the most effective—even the exclusive—solution for the problems within the public sector, such as stagnation, rigidity, and inefficiency. These difficulties are related, at least in part, to prevailing employment arrangements within the public sector, which in many cases pose substantial hurdles to smaller and bigger attempts to reform services and corporations. Such hurdles gave the MoF’s privatization efforts legitimacy and at least partial support from those who were not necessarily dedicated supporters of privatization, like professional officials in various government ministries.

In some cases, privatization went hand in hand with more professionally-oriented reforms that were based on new policy ideas and perceptions. For example, the professional trend of de-institutionalization and community integration of people with intellectual disabilities (Aminadav and Nissim 2009), supported the privatization of housing facilities for this population and more generally reflected an attitude of suspicion toward the state. Relatively small nongovernmental organizations were considered to be better suited to provide community-based services (Mandelkern and Sherman 2015, 291).<sup>3</sup> Similarly, the adoption of the Wisconsin Plan welfare reform included the adoption of an “activation” approach toward welfare beneficiaries. This approach was considered as incompatible with the more “passive” approach of the governmental employment bureaus, and justified resorting to private firms that had international experience in operating activation-based employment centers (Maron and Helman 2015).

## OPPOSING PRIVATIZATION

This section discusses how potential opposition to privatization—most notably by public sector workers and service recipients, who had the most to lose from privatization (Pierson 1996)—was affected by privatization and how it responded to it. To begin with, implementing privatization through gradual change mechanisms substantially helped to “divide and conquer” potential opposition, in two main senses. First, cooperation between different losers from privatization was relatively hard to achieve since different services and corporations were privatized at different times. Second, and no less important, privatization of a certain service or corporation had different consequences for different potential losers. Most prominent in this context is the division between different “generations” of workers: the compensation of veteran workers after privatization was similar to their compensation before it, while the compensation of new workers was substantially eroded (see Paz-Fuchs, this volume). Similarly, “freezing” of services through drift created a divide between actual beneficiaries, who already received the service and therefore were more inclined to demand that it would remain public, and new potential beneficiaries, who were more interested in getting the service and were less concerned if it was operated by a government agency or private contractors.

This internal division between different “losers” meant that actual opposition to privatization was much more effective in services and corporations that had relatively strong power in the first place. Most prominent in this context are the actual difficulties faced in privatizing public utilities like electricity and the seaports (e.g., Tevet 2012). The pivotal economic function of these utilities greatly empowered their unions and allowed them to counter privatization, in most cases quite effectively. For example, the government’s attempt to build a new private seaport (reflecting an attempt at institutional “layering”) ended in the incorporation of this seaport into the nearby government-owned port (Israel—State Comptroller 2014, 266).

In addition, the opposition to privatization enjoyed greater success when decision-making regarding privatization was moved from the bureaucratic arena into the political arena and/or the judicial arena (Mandelkern and Koreh 2017). In the strictly bureaucratic context, the pivotal position of the MoF gave it a clear advantage and allowed it to influence substantially the actions of other governmental units



(Asiskovitch 2010). The MoF did not have such leverage in the political and judicial arenas, and it is there that opponents have managed to interrupt privatization processes.

Two prominent cases of privatization that were reversed demonstrate the limited capacity of the MoF outside the bureaucratic arena. The first is the “Wisconsin Plan” welfare reform, already mentioned: The Israeli parliament blocked the continuation and expansion of this reform. A wide coalition of politicians, who represented different social groups negatively affected by this reform, managed to politicize the issue of a privatized welfare reform, to discuss it as a regular bill and not as a part of the Arrangements Law, and consequently to vote against its continuation (Maron and Helman 2015; Mandelkern and Koreh 2017).

The second case is the attempt to build a privately-operated prison, which was deemed unconstitutional by the Supreme Court (Medina 2010; Galnoor, this volume). This Supreme Court ruling was initiated by an appeal of coalition of social advocacy organizations and canceled the governmental tender to select a private prison operator. Nevertheless, the Supreme Court is generally reluctant to intervene in issues of privatization and so far has avoided similar interventions in less extreme cases of privatization.

In sum, opposition to privatization policies in Israel has generally been weak and ineffective. This is directly related to the combination of the crisis-triggered mechanism of change, on the one hand, and gradual mechanisms of change, on the other. The first mechanism has given credence and legitimacy to proponents of changes vis-à-vis their opponents, and the second mechanism has made cooperation between different opponents more difficult. The main exceptions to this rule have been the most powerful trade unions, with their pivotal position in the economy and/or the government, which allowed them to hamper change efforts, and, more rarely, different advocacy organizations, that managed to politicize privatization policy and/or to undermine its legality in the courts.

### WHAT NOW?

After more than three decades of privatization, mostly carried out gradually and without much public scrutiny, privatization policy in Israel has become a more contested issue. A prominent manifestation of this change are the criticisms of privatization policy that arose during the 2011 Social Protest (Yonah and Spivak 2012). But while the costs and disadvantages of privatization are more widely acknowledged, both

within and outside the government, it seems that privatization is still the main paradigm according to which the government conducts its operations and copes with public sector weaknesses.

The opposition to privatization has had some noteworthy political successes in recent years: The cancelation of the private prison and the Wisconsin Plan welfare reform, which were mentioned; the retreat from the ongoing efforts to privatize government facilities for people with intellectual disabilities; and the recent decision to directly employ workers in various governmental services who up to now have been employed by private contractors (Siegel-Itzkovich 2017). Does this signal a shift in the power relations between supporters and opponents of privatization? At the moment these cases seem to reflect specific and ad hoc achievements of privatization opponents rather than a real change in the general trend. Furthermore, while these achievements might signal a pause to continued privatization, and to set limits, they do not cancel or roll back the wide-ranging privatization that have already occurred. Thus, attempts at further privatization might be blocked in the foreseeable future, but substantial nationalizations of services, utilities, and corporations are quite unlikely.

The first reason for the unlikelihood of substantial change in the near future is the fact that the continuation of the privatization policy is primarily a derivative of the government's economic and budgetary policies, both of which remain under the control of the MoF. It is hard to imagine any significant policy change happening without the agreement of the MoF, which demands, as a precondition for reconsidering the privatization policy, a substantial reform in the employment conditions within the government sector. In short, the MoF aspires to cancel tenure within the government and it is very unlikely that it would agree to any policy change that would significantly increase the number of government employees before such a reform takes place. At the same time, the government workers' unions and the Histadrut are not likely, to say the least, to agree to any such reform that would directly undermine the privileges of the workers who they represent.

It is also unlikely that significant impetus for change will come from politicians. So far, the privatization policy has been steadily implemented under both left- and right-leaning coalitions, and generally this policy has not received significant political or media attention. While the 2011 Social Protests have somewhat changed that, and have also led to increased coverage of these issues in the economic media, at the

moment there is no political party or faction which has raised this banner. It is noteworthy that advocacy efforts, that have been led by non-governmental organizations, resulted in a bill that aimed to restrict and regulate more closely the privatization of government services.<sup>4</sup> The bill, which was initiated by Knesset members from both the coalition and the opposition, was rejected by the government in 2016.

The second reason why significant changes are unlikely, or at least would be very difficult to achieve, is the fact that the private ownership of previously public corporations, and the privately-financed and/or contracted out provision of services, has become the prevailing institutional logic. In other words, additional privatization of new and existing services and corporations no longer reflects a process of institutional change, but rather one of institutional continuity. Galnoor rightly suggests at the beginning of this volume, that “the burden of proof falls on those who wish to shift the boundaries between the public and the private.” But as the boundaries have already shifted, the political burden of shifting them back becomes heavier and more difficult to achieve. In short, it would demand the efforts which are required to implement institutional transformation.

## NOTES

1. Privatization efforts began during the 1970s but remained relatively minor before 1980 (Katz 1997, 166–167).
2. Clearly, the Histadrut’s weakness not only enabled privatizations to take place but was also exacerbated by them.
3. A similar growing preference for community-based services had a similar influence in services for children and teens at risk (Maron 2014).
4. The Hazan Center for Social Justice in the Van Leer Jerusalem Institute, which initiated the publication of this volume, played a central role in these advocacy efforts.

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## Conclusions

*Ronen Mandelkern and Amir Paz-Fuchs*

While centered on the common theme of privatization in Israel, the chapters of this volume cover a very wide range of subjects and topics. The first challenge of concluding such a diverse volume is to point out the common themes and issues that arise from contributions that focus on very different issues and domains, like education and public utilities or the pension system and civil society. In addition, our concluding remarks pertain to the more general lessons that we may learn regarding the significance and consequences of privatization in general as well as with regard to contemporary developments in Israel's economy, society, and politics.

Our conclusions are divided into five parts. In the first part, we revisit the difficulties of defining the exact boundaries of the concept of privatization, especially vis-à-vis the related, and sometimes confused with, concept of liberalization. We then suggest, in the second part, that more

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than an amalgam of policies and practices, the wide-ranging implementation of privatization policies in Israel reflects the adoption of a policy paradigm, namely a set of ideas that have been guiding policymakers in Israel in recent decades. On the one hand, the implementation of this policy paradigm reflected an attempt “to fix” the problems of the past, with its centralized public control of services and utilities. At the same time, the implementation of privatization in Israel was carried out almost unquestioningly and its consequences were never examined seriously. Nevertheless, as all the chapters in this volume show, privatization in Israel has had substantial consequences.

The other sections discuss the socioeconomic and institutional consequences of privatization. In the third section, we survey how privatization affected the allocation of public goods and services, what its impact was on social and economic inequalities, and how it contributed to the transformation of other social and political institutions, like labor relations and the welfare state. We also explore in this section the unintended consequences of privatization in Israel, like the replacement of old systemic rigidities and inefficiencies with new ones. In the fourth section, we turn to the more contested normative consequences of privatization, and discuss how privatization interacted with, and affected, democratic and national values. We conclude by referring to the meaning and significance of privatization, as part of the wider neoliberal paradigm, for the division of responsibility between states and their citizens.

### PRIVATIZATION: THE PROBLEM OF DEFINITION

Privatization means different things to different people. In the introduction to this book, we set out our stall by suggesting that, for the purposes of this book, “privatization” would refer not only to the selling off of government companies to a business entity but also to contracting-out of public services (also known as outsourcing), to ‘privatization by omission’, which occurs when the government refrains from expanding or improving its services and allows the market to fill the gap, and to ‘fiscal privatization’, i.e. the financing of public services through user charges.

However, it was not our intention to limit the analysis and discussion to those interpretations and, indeed, some chapters looked beyond them to include the role of neoliberalism, or to note the promotion of liberalization, New Public Management, ‘consumer choice’,

or decentralization within government agencies or to local authorities. Why, and to what extent, is this matter of importance? Any analysis of any policy—including the motivation for its advancement, as well as its rationale and consequences—requires an understanding of its boundaries and parameters. For present purposes, for example, one would need to identify whether neoliberalism is an ideational cause of privatization or, alternatively, whether privatization is a subset of neoliberalism (the latter being an amalgamation of a wider set of policies). Other questions involve whether privatization is a subset of New Public Management policies, or perhaps enables them, and to what extent consumer choice and user charges are related to privatization or independent of them.

This is not the place to offer a conclusive answer to these questions, but a reflection on the book's chapters offer some interesting preliminary insights. Ilana Shpaizman, for example, is explicit in her support for an ideational approach when addressing the roots and causes of privatization policy. She suggests that “one of the main policy tools ideas that the direct absorption policy was based upon was that the market could handle the integration process better than the government”, a statement that is very closely aligned to one of the ‘myths’ identified by Galnoor in his chapter. Mandelkern, for his part, adds an institutional aspect to the analysis, by identifying Ministry of Finance officials as driven by a neoliberal ideology and operating as the ‘main driver toward privatization in every possible area and through every available channel’. Tevet is more agnostic on this matter, suggesting that it is difficult to distinguish between ideological motivations, political reasons and pragmatic concerns for the establishment and privatization of government companies.

One convenient, and readily accessible, escape route is to suggest that, as privatization covers almost all of the social and economic institutions of the modern state, there can be no ‘grand theory’ that applies equally to every instance. To an extent, that is surely the case. And yet, while it is important to make note of nuances within each sector, such as services or provision of goods, one can identify the ebbs and flows of certain policies. An overview of the trends suggests a similar state of mind among decision makers in the latter part of the twentieth century in Israel (and elsewhere; Peters 2012), whether implemented through selling off of companies, public–private partnerships, contracting-out or the increased use of tenders. Conversely, and as we note below, over the past decade we may find a recalibration of the trend, whether through increased

regulation of privatized services, or even through the reversal of past decisions through nationalization, incorporating workers as employed directly by government agencies and local councils (as opposed to contracting-out), restricting user charges, and so forth. It seems, then, that ideas matter, and that when they change so do concrete policies. If this account is (at least partially) accepted, it would imply that changing (or reversing) the course of privatization would require winning the battle of ideas. A scenario that, given current estimates, seems quite remote (Brown 2015; Crouch 2011).

Perhaps one way to advance a more nuanced, and less dogmatic, approach to privatization is to disentangle it from the overarching attractiveness of liberalization. While liberalization is concerned with the creation of markets or, where they exist, enhancing their competitive nature, privatization is a parallel policy, which may or may not overlap with liberalization. The temptation to conflate the two is understandable, as privatization is often justified by reference to the desire to increase competition. In addition, the two policies are often implemented simultaneously, perhaps because both are driven by the same (neoliberal) ideology. But this is yet another temptation that should be resisted. As Galnoor and Tevet note in this volume, the transfer of ownership of a natural monopoly from the state to a business entity will result not in increased competition but rather in a private (rather than a public) monopoly. In addition, arguably, liberalization may happen without privatization. Thus, the telecommunications sector was liberalized (by allowing private companies to offer mobile phone services) a decade before it was privatized (by selling off the government-owned company, Bezeq). Once this distinction is in place, we will be able to engage in a more productive conversation as to the merits of both liberalization and privatization. Moreover, such a distinction would make the inquiry into the causal links between the two policies all the more relevant: are they driven by the same (ideological, pragmatic, political) source? Does liberalization lead to privatization? Or vice versa? Or is such a relation sector-specific? The health and education sectors in Israel have witnessed a parallel growth in privatization and liberalization initiatives (see Filc and Harel Ben Shahr, respectively). In other sectors, from industries to social services, privatization (including outsourcing) was not accompanied by liberalization (as seen in the chapters by Galnoor, Tevet, and Benish).

## PRIVATIZATION AS A POLICY PARADIGM

The most straightforward insight this book conveys is the fact that privatization is essentially everywhere in Israel: in universal social services like education and health as well as in selective welfare services for needy populations; in public services that the government provides to citizens as well as in services the government itself “consumes”, like policy advice and supervision; in domains related to national goals and values, like immigrant absorption and land and planning policies, as well as in public utilities that serve the public at large. How can we make sense of this diversity? One might suggest to ask *cui bono*? But this would only reveal the diversity of beneficiaries (as well as losers) in the different domains in which privatization has been implemented; for example, it might be argued that privatization of health and education services has benefited the Israeli middle class but that same class had probably lost out as a result of the privatization of public utilities, which has seemed to benefit mainly the narrow layer of the top rich.

Our own interpretation of the seemingly unlimited spread of privatization in Israel emphasizes not the interests of those who have benefited from it but rather the beliefs of those who promoted it. More specifically, we suggest that privatization policy in Israel has been primarily driven by a policy paradigm, i.e. “a framework of ideas and standards that specifies not only the goals of policy and the kind of instruments that can be used to attain them, but also the very nature of the problems they are meant to be addressing” and which is “influential precisely because so much of it is taken for granted and unamenable to scrutiny as a whole” (Hall 1993, 279).

Privatization in Israel has been guided by a paradigm that refers to the local public sector as inherently broken and which its repair could only be attained through the utilization of market and/or business-like instruments and standards. As Galnoor emphasizes in his chapter, the questions of whether privatization did indeed solve the problems of the Israeli public sector and whether it produced new problems to be dealt with were hardly raised by most policymakers. Guided by a paradigm, Israeli policymakers did not feel the need to prove, to themselves or to the public, whether privatization was the right path to pursue in each and every public domain. Even when doubts were supposedly raised, policymakers immediately resorted to their deep convictions, like in the case of a former director general of the Ministry of Social Services, who,

in a newspaper interview that followed public opposition to privatization of housing facilities for people with intellectual disabilities, emphasized the importance of competition between service providers and stated that the government should focus on budgeting and standards setting (while services should be contracted-out) (Arlosoroff 2011).

As an overarching ideational framework, the privatization paradigm was adapted to different contexts and policy domains. In the introduction (and at the beginning of section “[Privatization: The Problem of Definition](#)” of this chapter), we distinguished between four main types or meanings of privatization: the privatization of ownership; contracting-out of public services, privatization by omission, and fiscal privatization. Accordingly, different public domains have experienced different mixes of privatizations: contracting-out took place in all social services but privatization by omission and fiscal privatization mainly occurred in the health and education services, which are also designated to the more affluent middle class (who can spend money on the private purchase of these services). In public utilities, privatization of ownership has been pursued, while in-governmental tasks, like policy advice and service supervision, were contracted-out. In other words, the privatization paradigm is comprehensive but also flexible (cf. Schmidt and Thatcher 2013).

The power of the privatization paradigm manifests itself also in its almost continuous expansion into new domains. Currently, the most prominent example is probably the expansion of privatization into what seem to be strictly governmental functions and tasks. Whereas the contracting-out of government services was initially justified by the idea of allowing the government to focus on its “core” functions, Kariv-Teitelbaum and Marciano demonstrate that contracting-out has extended to the inherently governmental duties of policy design and the regulation and supervision of governmental services. Similarly, Benish’s analysis of Israeli welfare reform is also insightful; although this reform was canceled, the willingness to implement it reflects well the expansion of the limits of privatization in social services, from the provision of services to determining eligibility for social security benefits.

The 2008 financial crisis gave weight to the general criticism of neoliberal policies, within which privatization was a central component. In Israel, criticism of neoliberalism was pronounced during the 2011 social protests, which also expressed specific opposition to privatization policy (Yonah and Spivak 2012). Following that, the reports of the governmental committee that was formed in response to the protests included

the recommendation to “re-examine” the privatization of government services (not corporations or utilities). In parallel, as Mandelkern mentions, attempts were made to limit the privatization of government services or, at least, to limit its effects through regulation. Indeed, political and judicial limits were placed: politicians sympathetic to marginalized communities and to trade unions prevented the continuation of the welfare-to-work reform that was operated by private contractors, and the Supreme Court blocked the establishment of a private (contracted-out) operation of a new jail.

It might be tempting to interpret these developments as cracks in the prevailing paradigm. We doubt that, however, not least because of what has followed. The attempt to restrain privatization through legal mechanisms—which was moderate in and of itself—was obstructed by the government. The Ministry of Finance—the driving force behind the Israeli welfare reform and privatization in general—kept attempting to renew it, and the official within the treasury who enthusiastically supervised the welfare reform when it began to operate in 2005 was recently assigned to the most powerful position within this ministry (i.e., Head of the Budgets Division).

Furthermore, while the government did set up a committee to examine the contracting-out of public services, this committee has mainly focused its final report on improving the management and supervision of contracted-out services. Reverting to Hall’s conceptualization, this essentially reflects a classic example of learning “within the paradigm”: the criticisms of privatization policies did not result in an examination of its fundamentals, that might have generated its replacement, but rather only yielded attempts to improve the specific tools and instruments through which it is implemented.

Suggesting that Israeli policymakers were guided by a paradigm, as they relentlessly pursued privatization policy, should be read as an assessment and not necessarily as a criticism. In fact, such an assessment might allow us to better understand why privatization policy continued to spread despite its problematic consequences, to which each of the chapters have pointed out and to which we shall refer in the following sections. As hinted by Hall (1993) and more recently by Blyth (2013), prevailing paradigms are hard to change even when compromising evidence is gathered since, by definition, paradigms limit our perspective and drive us to focus on certain questions and problems and to “ignore” or underplay others. It might even be said that the problematic consequences,

which are raised here and by other critical observers, also reflect paradigmatic limitations. Keeping in mind that the chances of fruitful communication between those believing in the privatization paradigm and their critics might be low, we move on to assess the consequences of privatization.

## THE CONSEQUENCES OF PRIVATIZATION

### *Efficiency and Competition*

The first question commonly raised regarding privatization—in Israel and elsewhere—is “Does it work?” In essence, this question is interrogating whether the services improved and whether the allocation of public goods has become more efficient. Regarding most domains in which privatization took place, answering these questions responsibly is quite impossible, and not just because of the fundamental issues we raised in the previous section. The reason is more mundane, and mainly concerns basic methodological limitations. On the one hand, no systematic data has been collected over the years, leaving us in the shadows even with regard to the exact amount of services the government was and is purchasing, not to mention any systematic evaluation of the quality of services. At the same time, since privatization has been an ongoing and evolving process, it is very difficult to make valid comparisons, especially at present. For example, and as mentioned by Benish, most social services are already contracted-out and comparisons with the very few that remain in public hands generated inconclusive results. The bottom line is that while privatization was intended to improve efficiency in the provision and allocation of public services and goods, evidence that supports (or refutes) such a conclusion is almost completely lacking.

Notwithstanding these caveats, several chapters in this volume suggest that an essential precondition for such improved efficiency—namely competition among the providers of public services and goods—is limited or absent in privatized domains. Promoters of the privatization paradigms commonly associate its advantages with the operation of market and/or market-like mechanisms of competition which leads to cheaper and/or better services and goods (e.g., Savas 2002). Nevertheless, as several chapters in this work show, competition in privatized domains in Israel has been very weak between pension funds, providers of social services and providers of public utilities (see chapters by Lurie, Benish, and Tevet).

In the areas of pensions and public utilities, lack of competition is a result of the fact that initial privatization policies gave preference to few market actors, which since then have managed to maintain their market position (see also Mandelkern and Shalev, forthcoming). In social services, uncompetitiveness has more to do with the risks that competition may generate in long-term services for dependent people. So far, lack of competition was not regarded as an unavoidable result of privatization (in general or in certain domains).

But even where competition was successfully achieved, its implications were not always efficient. For example, competition between the sick funds on the number of their members—according to which they are budgeted by the government—is intended to encourage them to improve their services. However, as Filc explains, competition also encouraged sick funds to utilize “creaming” practices—recruiting younger and more “profitable” members. More recently, after transferring from one sick fund to another became easier, sick funds adopted aggressive marketing practices, including attempts to ‘steal’ doctors from each other in the hope that they would ‘bring with them’ their regular patients (Linder-Ganz 2017). In other words, competition has a logic of itself, and does not necessarily serve the benevolent causes of those who initiated it.

### *Socioeconomic Inequalities*

While the effects of privatization on competition and efficiency are at best inconclusive, its impact on socioeconomic inequalities is rather clear. Kristal’s chapter surveys the general connection between privatization policy, rising inequality and the diminishment of labor’s share in the national income. This connection is especially prominent when looking at the comparative data on workers’ compensation in privatized and non-privatized corporations. Kristal’s findings should be read in connection with the chapters that look into the concrete transformations in labor-related laws and regulations. First, Paz-Fuchs shows how the contracting-out of government services resulted in the creation of a two-tiered labor force in Israel. The extensive use of agency workers, initially through the contracting-out of personnel and later through the contracting-out of services, has led to a significant deregulation of employment in sectors that range from cleaning to security, from teaching to social work, from IT to tourism. The result is that two (groups of)



workers may be performing identical roles but one enjoys generous pay, promotion opportunities, fringe benefits and union protection while the other has none of the above. In addition, the economic disparities are not arbitrary. Rather, there is a noticeable over-representation of women, Palestinian citizens of Israel, newly arrived immigrants and Mizrahi Jews in the latter cohort. Similarly, Lurie explains in her chapter that the privatization of the pension system not only shifted financial risks from the state to the insured workers but also enhanced inequality within it. For example, not only can unorganized workers in precarious jobs afford to save less (as their salaries are lower), their pension schemes are normally inferior to those of organized workers who have better negotiation capacity vis-à-vis insurance companies.

Privatization exacerbated social and economic inequality not just among workers but also among service recipients. Filc and Harel Ben Shahar explain how privatization in education and health (respectively) not only allowed wealthier Israelis to purchase for themselves better services through the introduction of market rationales to these sectors. This market rationale was also manifested in the income stream, as wealthier cohorts managed to gain access to more donations and generate more income, thus offering a new coat of paint to the age-old adage—services for the poor are poor services. In the field of pensions, while it is obviously the case that those who have more income will have better chances of enjoying more savings, Lurie shows that poorer workers are more likely to have no savings at all. Privatized pension funds, which are subject to weak regulation, are not required to offer pension schemes to poorly paid workers. Shpaizman shows that, even in the domain of Jewish immigration, the logic of privatization led the government to adopt preferential policies toward wealthier immigrants. And according to Tevet, the privatization of public utilities brought with it an increase of disconnections of users who failed to pay their water and electrical bills; we can safely assume that such disconnections disproportionately affect less affluent households.

### *Institutional Transformations*

Privatization policy had also contributed to substantial changes in central social, economic and political institutions, such as the welfare state, labor relations, and local civil society. As Mandelkern suggests, privatization in itself should be regarded as an institutional transformation.

One prominent manifestation of this transformation is evident when looking at the Israeli public administration, which has been dramatically reorganized as it nowadays relies upon an ever-increasing number of private contractors. A number of contributors to this volume (Galnoor, Filc, Harel Ben Shahaar, Teitelbaum-Kariv, and Marciano) noted that privatization policies have led to a blurring of the boundaries between the private and public sector.

But beyond these direct implications, privatization policy had also had indirect implications and consequences. First, privatization policy in Israel has had a significant impact on labor relations in Israel. As several contributors in this volume have noted (e.g. Kristal, Lurie, and Paz-Fuchs), undermining the power of unions in general, and the *Histadrut* in particular, was a clear motivation for some privatization proponents, and it was one that was achieved in dramatic fashion. The years of privatization saw a dramatic decline in union membership and coverage, thus realigning the structure of power in Israeli society for the future. Privatization and outsourcing had an impact not only on matters of quantity but also on quality. As Galnoor and Paz-Fuchs note, the Israeli civil service lost its professional authority, and has been relegated, to a large degree, to an administrator of tenders. In the meantime, expertise has developed outside the civil service, where contractors in fields such as social services, engineering, technology and environmental studies have positioned themselves as irreplaceable by accumulating knowledge and institutional memory that was once the preserve of the civil service.

Privatization policy also generated changes in the institutional structure of the Israeli welfare state. The most evident implication pertains to the enhanced role of non-state bodies in the Israeli welfare state. Non-state actors are the backbone of the welfare services under the jurisdiction of the Ministry of Social Services and the Ministry of Immigrant Absorption, while in education and health service provision the reliance on non-state bodies is ever growing. The Israeli welfare state, in other words, has become increasingly dependent on private bodies, and the question is whether and how this affects the professional capacity of state bodies and their ability to design and update social services and to supervise them. In terms of welfare state finance, privatization by omission in health and education services has been undermining the universal and egalitarian ethos of the Israeli welfare state. In practice, the Israeli welfare state has probably never been egalitarian or universal (e.g. Rosenhek 1999), and in many senses universalism actually increased during the

1990s (Asiskovitch 2017). However, it seems that privatization by omission opens the floor to economic and class-based inequalities, while past inequalities were principally based on nationality and ethnicity differences (which were correlated with class differences).

As Shiffer discusses in her chapter, another social institution that was impacted by privatization policy is domestic civil society. Israeli civil society has been a relatively weak and marginalized institution for many decades. Privatization had the effect, at first blush, of contributing to the expansion and growth of civil society organizations, which began playing a growing role in the Israeli welfare state. Yet this did not mean the development of a vibrant civil society that challenges the state; rather, it institutionalized the position of Israeli civil society as a sector dependent on the funding of the state and which has to adapt itself to the demands of the state rather than challenge it.

### *Unintended (and Unwanted) Consequences*

Promoters of privatization policy in Israel probably did not wish to enhance socioeconomic inequalities and/or to support all the institutional changes that were discussed above; at the same time, these effects cannot be regarded as overly unexpected or surprising. In this sense, they are qualitatively different from the consequences of privatization, which by and large counter the original intentions of privatization policy. These consequences included the generation of new “rigidities” in the supply of privatized goods and services, limitations to competition, and new incentives for the government to distance itself from contracted-out public services. Such unintended consequences mainly concern the contracting-out of public services.

The first unwanted consequence of government contracting concerns the emergence of new rigidities in service provision. One of the main motivations for the contracting-out of public services was the rooting out of the rigid, and therefore dysfunctional, operation of government units, which has been mainly attributed to the combination of tenured workforce and red tape. Assuming these are indeed problems (and not a reflection of desired workers’ rights and due management processes), contracting-out was supposed to solve both of them. Yet, as Benish mentions, in parallel with the shift toward privatization policy, new legislation formalized the tendering and contracting processes and the relations between the government and its contractors in general. Consequently, it

became more difficult for government officials to manage contracted-out public services and to update them throughout the contract period, thereby creating a new type of rigidity. Moreover, while proponents of the tender mechanism accept that competition is not apparent during the life of the contract with the supplier, even this limited version of competitiveness is not realized in practice. Research has shown that 3900 contractors were exempted from the competitive tender process, and were simply handed contracts with government agencies worth a total of 31.6 billion NIS (Dattel 2016). Moreover, of these, 50 large companies secured contracts while circumventing the need to compete for jobs worth 19 billion NIS. Some ministries are particularly averse to the hassle associated with the competitive process. The Ministry of Defense, for example, engaged in a tender process for only 19% of its contracts. The Ministry of Health leads the way in budgetary terms, with over 8 billion NIS worth of contracts granted without a tender process.

A second and related unwanted consequence of the privatization of public services, for which we only have limited evidence and which requires further investigation, is enhanced concentration among service providers. As noted in areas as far afield as utilities (Tevet) and social services (Benish), privatization in Israel did not necessarily encourage competition and has even led to over-concentration of the sector. Here we argue that, in fact, there are good reasons to assume that privatization of public services will actually limit and diminish competition among service providers, due to the dynamics of the contracting mechanism itself (and not because of the features of the contracting-out services and their markets). Contracting-out has significant costs, for both government bodies and potential contractors. The main costs for government bodies are information costs, i.e. the need to gather reliable information regarding present and potential contractors. One channel through which such costs may be reduced is to work with contractors with whom government officials have experience. The main cost for potential contractors is the preparation of the tender, which seems to increase over time as government specifications become more detailed and sophisticated. This gives an advantage to larger contractors who have more experience in government contracting (and not necessarily in the provision of the privatized service) and who can more easily dedicate resources toward tender preparation. In practice, we know that in both education and welfare, for example, there are a few large contractors that receive much of the budget (Dattel 2014; Gal and Madhala-Brik 2016).

The third unwanted consequence of government contracting is the growing incentive for the government to distance itself from services that were contracted-out. We should firstly mention that, in contrast to other types of privatization, contracting-out of public services was never meant to diminish the control of the government over public services but rather to maintain or even to enhance it. But developments in labor law, discussed by Paz-Fuchs, undermine this basic justification of government contracting, as they “penalize” the government if it appears to be too closely affiliated with the contracted-out service (in terms of directing and/or supervising the contractor’s workers). This seems to encourage the government to avoid the direct supervision of contracted-out services and, as noted by Kariv-Teitelbaum, to also contract regulatory and supervision tasks.

### THE NORMATIVE IMPLICATIONS OF PRIVATIZATION

In the previous section, we discussed several concrete consequences of privatization policy in Israel. In this section, we look at the abstract, or theoretical, implications privatization may have on normative concepts that are more open to interpretation. Specifically, we discuss here how privatization affects the state and its capacity to carry out its responsibilities, how it affects the nation state and its commitment to protect national values (however defined), and the implications of privatization for the quality of democracy.

#### *Privatization and the Nation State*

Privatization does not necessarily mean “market universalism”. Rather, privatization may be implemented while the essential national goals are being protected. Of course, national goals may vary. They could, potentially, include tolerance, individualism, a particular culture (which a migrant from any background may assimilate into) or, as in the case of Israel, a particular religion that is assumed to have an inextricable bond to the nation.

Israel, for its part, has never shied away from identifying itself as a “Jewish state”, of course. The general recognition of the principle of self-determination, buttressed, in the Jewish case, by historic

traumas and the place of Jews as a noticeable minority who are, at times, subject to antisemitism, serve as justification for many, not only in Israel, of the existence of Israel as a Jewish state. But what implications does this identification of a nation's core values have for non-Jewish—in particular, Palestinian—citizens of Israel? The Israeli Supreme Court has stated repeatedly that Israel's national identity as a Jewish identity is paramount at the country's gates, as expressed in the Law of Return (1950), which guarantees any Jew (or son, daughter or grandchild of a Jew) the right to emigrate to Israel and settle there, as a citizen. However, the Court continues, this is where the preference regarding members of one religion over others must end. Using the metaphor of the Israeli state as a house, President Barak states: "Indeed, a special permission is given to enter this house to the Jewish people (see the Law of Return 1950). But once an individual is legally in the house, he enjoys equal rights to all other residents of the household".

However, despite the clear statements of the Supreme Court, Israeli policy has been engaged in a delicate dance to extend and entrench preference for Jews over non-Jews in areas that go beyond immigration policy. Two such areas stand out prominently: land and labor. Both arenas have been central for Israel, from the pre-State (Yishuv) era to the present day. As Sternhell (1999, 15) explains: "the significance of Zionism was the conquest of land and the creation of an independent state through work and settlement".

However, these two manifestations of national values—land and labor—have had different historical trajectories. Land is the easier case, as it seems to offer a consistent approach: from early on, Jewish control of the land was seen as "quite literally [a question] of life and death for Zionism and the Jewish National Home" (Avraham Granot, cited in Kretzmer 2002, 45). Since then, little has changed: land is seen not only as a pragmatic, zero-sum game (land in Jewish hands is a self-haven; land owned by Palestinians is an existential threat) but also one that has serious emotional value. However, a blatant preference to members of one ethnic group over members of another ethnic group, even in relation to allocation of public land, was deemed illegal by the Israeli courts. To circumvent this obstacle, public land and planning rights were privatized or, more precisely—as Yacobi and

Tzfatia explain—were “selectively privatized”. After expropriating land from Palestinians, the land was transferred to the Jewish National Fund, and from there it was used to establish villages in the north (Galilee) and south (Negev) of Israel, benefiting only Jews with aim of “Conquering” or even “Redeeming” the land (*Kibbush Hashmama, Geulat Ha’Karka*). As Yacobi and Tzfatia argue persuasively, the ethno-nationalist values were not hindered but rather buttressed by privatization policies.

To their account, one may add the problematic relationship between the Israeli government and the Settlement Division, a subset within the World Zionist Organization. As such, it is intentionally placed outside of the public sector, thus distancing the government somewhat from measures that are (at least) questionable by international law standards (see also Harel and Sharon forthcoming; Rolef 2016). The Israeli government has increasingly employed the Settlement Division to carry out its agenda to build Jewish villages in the north (Galilee) and south (Negev) of Israel, but more importantly beyond the Green Line in the Occupied Territories. While this strategy has been in place since its foundation, in 1971, the Settlement Division has gained a prominent role in recent years, both in budgetary terms—by over tenfold—and in legal recognition. Following criticism that the government may be acting illegally even under Israeli domestic (as opposed to international) law, the Israeli Parliament amended the law that now codifies the right of the government to assign to the Settlement Division “national tasks in the settlement sphere, in accordance with the government’s policy”—essentially the enactment of the existing status quo.

The matter of labor is somewhat more complicated. Historically, the concept of “Hebrew Labor” (*Avoda Ivrit*) was, according to David Ben-Gurion, “the key idea of the Jewish revival” (cited in Shafir and Peled 2002, 61) and the realization of Zionism as a national goal was regarded as undetachable from the “renaissance [of] the Hebrew worker”. Sternhell puts this even more forcefully: “the main preoccupation of Jewish workers was ‘the conquest of labor’, in other words, the dispossession of Arab workers in order to take their place” (Sternhell 1999, 16). Jewish work no longer holds such a prominent place in Israeli society. Americanization, materialism, and capitalism in general have diluted the cache of ‘building a nation’ in the physical sense, in sectors such as agriculture and construction, and Israeli Jews are usually the managers

in the fields rather than the manual workers. The most prominent place where the phrase “Hebrew Labor” still holds sway is in the disgusting campaigns to boycott Palestinian shops and to persuade businesses not to hire Palestinian workers. It should be emphasized that such practices (discrimination in employment) are illegal in Israel in the public and in private sector; however, privatization is relevant here as well, as it is only in the public sector that affirmative action (or positive discrimination) is mandated. Thus, as Paz-Fuchs notes, reducing the size of the public sector (not least through government contracting-out) would result in fewer places that should take positive measures for the inclusion of minority groups, including (but not exclusively) Palestinian citizens of Israel.

Since the turn of the century, then, ‘national values’ insofar as employment relations are concerned have been transformed. But this does not mean that the nation state does not play a significant role in guiding the market, while employing policies of (selective) liberalization and privatization. Thus, when security concerns became prominent, Israel licensed contractors to introduce migrant workers into the economy. The numbers of migrant workers were growing at a rapid pace—from 10,000 in 1990 to over 300,000 in 2000. The contractors would pay the government a permit fee (thus enriching the public purse) and would ensure that all necessary excises and tolls would be paid. The result, therefore, was the “contractualization” of Israel’s labor market, entrusting private corporations and manpower agencies not only with the supply of work but also with the supervision of the welfare of workers (Kemp and Rajman 2007). By replacing Palestinian (both citizens of Israel and residents of the West Bank and Gaza) workers in the secondary markets—mainly construction, agriculture, and old age care—migrant workers relieved the historical and contemporary anxiety regarding Palestinian labor and, even, Palestinian presence in the public sphere.

### *Privatization and Democracy*

As privatization is often associated with economic concerns, arguments for and against privatization are often confined to that realm: does privatization offer ‘value for money’? Does it offer better services at lower prices? Does it enhance efficiency or competition? Or does it exacerbate (economic) inequality and poverty? But as Galnoor persuasively argues, privatization is not solely about economics. It is centrally about



the boundaries between the public and the private, also referred to as the boundaries between the state and the market. In that respect, privatization should concern political scientists and political theorists, as it can have profound effects on how we understand democracy, and how democracy plays out in practice.

Interestingly, in a manner that parallels the economic realm, one finds arguments on both sides of the democratic debate. Indeed, one of several prominent chains of semi-private schools in Israel is the Democratic Schools, which is attractive to progressive and liberal parents who not only wish to embrace a ‘democratic pedagogy’ for their children but are also reluctant to subject them to (what they see as) the nationalist and religious curriculum that is paramount in Israeli public schools. In schools of this chain (and other similar ones, including ‘Bilingual’, i.e. intentionally integrated Arab-Israeli schools) it is arguably the case that democracy is enhanced on two levels: first, as a matter of substance, by reinforcing democratic values in the curriculum; and, second, as an institutional matter, by allowing parents to engage in the deliberative, ongoing process that concerns the fundamental questions that lie between the citizen and the state, within the context of their children’s education.

But alongside these, more favorable, examples, there are others that are more worrisome, as they endanger, rather than enhance, democratic ideals. First, and perhaps most formally, we find the tensions and, at times, even the rupture, of the “chain of accountability”, which is a cornerstone of bureaucratic conduct in any democratic regime. The expansion of privatization into explicitly state domains—like policy design, regulation, and supervision—hinders the underlying principle of accountability. Moreover, the problem of accountability exists even in the context of government contracting in “traditional” service areas, since it involves bodies that answer not just to the public but also to shareholders and boards. However, when state functions are contracted-out there is the risk that responsibility for the policymaking process would become blurred, as policymakers seek to deflect blame toward private contractors for their policy choices and suggest there is a quick fix to any problems in the form of simply replacing the contractor.

A second obstacle to democratic processes is somewhat related to the first, as it involves the means and mechanisms for accountability. Tevet’s chapter raises concerns regarding the quality of democracy and government in Israel by focusing on the “immense economic power ... concentrated in the hands of a relatively small group of owners who control

most of the public companies, and who thus wield considerable political influence” (Tevet, this volume; see also Hamdani 2009, 10–14). Government decisions regarding the reserves of natural gas—licensing, taxation, and so forth—serve for Tevet as a case in point. Here, the government enthusiastically sought to bind itself, as well as successive governments, to terms and conditions that were extremely favorable to the major gas companies, and was only blocked from doing so by the Supreme Court.

Another mechanism that supports accountability and democratic deliberation is a value in its own right—that of transparency. The public, after all, can hardly hold its representatives accountable and reach meaningful decisions if it is not informed. And here we find, particularly where social services are concerned, that privatization and outsourcing have led to diminished transparency. There is an element of irony here, as these schemes were advocated for, *inter alia*, under the pretense that transparency would be advanced. Ministry of Finance officers argued that, whereas previously policies were decided in dark rooms within the bureaucracy, now the contracts and tenders associated with the process would bring them to light. However, reality had a different story to tell. Thus, when NGOs approached the businesses operating welfare-to-work schemes and requested to survey the guidelines that govern their sanctions policies, they were told that such policies are commercially sensitive and cannot be revealed. A Freedom of Information request led to the guidelines being shared but only in an extremely redacted format. Needless to say, previously, when these programs were controlled by the public sector, the guidelines were in the public domain and thus completely transparent.

A third, more subtle and complex, challenge to democracy comes in the form of the impact of privatization, and the neoliberal agenda more generally, on equality and solidarity. These two values are obviously not identical, but not only are they related, they support a similar goal in this context. The link between the two is bi-directional: societies that exhibit smaller social and economic disparities tend to be more solidaristic; and more solidarist societies tend to express more support for redistributive and universal policies, which enhance and sustain social and economic equality (e.g. Beramendi and Rueda 2014). In contrast, as a society becomes less equal, its members and constituent groups begin to view the battle over public goods (education, health, land) as a zero-sum game, and seek to secure holdings that would benefit themselves and those similar

to them. The fact that this process is buttressed by privatization policies should not be surprising.

As part of the neoliberal paradigm, privatization schemes aim to create a competitive environment in areas where none existed and to galvanize it where it did. And in a competitive environment, there must be winners and losers (otherwise, what is the point of the competition?). Where the resource that is subject to competition is a classic market good (e.g. television or cars), the character of the competition is unlikely to correspond to particular identities within the polity (e.g. white/black, center/periphery). However, as the chapters in this volume suggest, when competition permeates the fields of, for example, migration (Shpaizman), health (File), education (Harel Ben Shahar), pensions (Lurie) or land (Yacobi and Tzfadia), a clientelistic atmosphere becomes prominent. The middle class are pitted against the working class; the elderly against the younger generations; the center against the periphery; the indigent population against the newly arrived migrants; and migrants from one country against those from a different country. The seams of solidarity are constantly tested, and social and economic gaps expand. To what extent is this, and the corresponding difficulty in finding a common narrative, a danger to democracy? The answer to this question depends on one's understanding of democracy, what it entails and what the requirements are for its continued existence. And yet it is arguably acceptable that a thriving democracy benefits from the people's ability to come together. Thus, a 'republican' ideal of democracy presupposes the idea that there is a 'res publica' (public thing) to which we aspire. And supporters of 'deliberative democracy' plausibly suggest that ongoing deliberations are not (only) an end in themselves but should also lead to better results for everyone involved, and to the implicit understanding that the rules of the polity are reinforced in and by the process. While one may convincingly argue that a democracy does not require these facets to exist, the case may be made that a democracy that lacks these attributes is a thinner, poorer version of the ideal.

### CONCLUSIONS: PRIVATIZATION AND STATE RESPONSIBILITY

Privatization does not necessarily undermine the power of the state. In many senses, privatization allows the state to function more autonomously, for example, vis-à-vis labor unions. Accordingly, in many instances privatization is considered by its adherents as a means for

enhancing state responsibility for the provision of public goods and services. This is mainly true in the case of contracting-out, which many Israeli policymakers would outright reject its definition as a form of privatization, since the state retains its responsibility for outsourced services for which it continues to pay, while the value of every shekel or dollar spent is maximized. In other words, and like neoliberalism more generally, privatization does not necessarily imply the withdrawal of the state in the face of the market (Ban 2016; Brown 2015). The market and the state are not necessarily exclusive entities, and in many cases of privatization the two actually support each other.

But state power does not necessarily align with state responsibility. In the current context, and following T.H. Marshall's lead (1950), state responsibility refers to the state's role in minimizing risk (of ill health, disability, unemployment, old age, etc.) and advancing equality (through education, communication, transportation, etc.). The neoliberal dominance has shifted this responsibility from the state to the individual, through a process referred to by scholars as 'responsibilization' (Brown 2015). Brown describes responsibilization as involving "the moral burdening of the entity (individual) at the end of the pipeline". It "tasks the worker, student, consumer or indigent person with discerning and undertaking the correct strategies of self-investment and entrepreneurship for thriving and surviving; it is in this regard a manifestation of human capitalization". The American 1996 welfare reform, or welfare-to-work, legislation, does not have 'welfare' in its title at all. Instead, it is the *Personal Responsibility and Work Reconciliation Act* (emphasis added). The Israeli welfare reform, which was already discussed, reflected an extreme adoption of this logic.

In many countries, "responsibilization" policies have been promoted by center-right think-tanks and by conservative politicians. In Israel, one finds that neoliberalism in general, and privatization in particular, has been advanced by both right- and left-wing governments and, within the civil service, by the Ministry of Finance, which has developed a reputation for promoting a neoliberal agenda (Maron and Shalev 2017). One may ask, therefore, whether the traditional loyalty to the idea of small government has been abandoned? How do these policies align with the most cherished of 'liberal' rights, that is—the right to be left alone? This is, yet again, a testament to the force of the neoliberal revolution: when neoliberalism has faced off with liberalism, it has come out ahead. To bring us full circle, then, the state has not withdrawn from power under

the aegis of privatization and neoliberalism. In important respects, it yields far more power. It is its dedication, or responsibility, to addressing risks and advancing equality of opportunity that has been significant redrawn, or withdrawn.

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