Privatization of Water Corporations in the Local Governments in Israel

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Abstract

The establishment of the water corporations in Israel, which are financial companies that took the place of the Water Departments in the local governments, constitutes a turning point in the relation between the local governments and the citizens. If in the past the local government saw itself as a nonprofit organization that served the community, the reform in the water industry converted the community activity of the municipal sector into a totally capitalist business operation. In the first years of the establishment of the State of Israel, it was clear that the State had to provide water to its residents as a source of livelihood and a basis for agricultural development and the conquest of the wilderness, but today in the era of privatization the precious resource, water, has become a “product” from which economic benefit can be derived and which can even be traded. The local governments acquire water “to the city gate” and then they sell it to the city resident at a high mark-up, with the addition of VAT, when the difference goes to the Water Corporations. The neoliberal approach has reached a basic product such as water, without distinction between the socioeconomic situations of people, while placing the burden on the resident. Many Investigation Committees on the topic of the water sector have noted the improper management of the government, which does not prioritize alternative solutions such as desalination, use of treated wastewater, and re-use of water for industry and agriculture. Instead, dozens of water corporations have been established to be used as collection agents and to place the economic burden on the citizen’s back.

Keywords: privatization, water corporations, local governments, Israel studies.

1. Introduction

The awareness of the problem of the lack of water in Israel surfaces every few years. The Water Law of 1959 states that: “The sources of water in the State are the property of the public, given to the control of the State, and intended for the needs of its residents and for the development of the land” (State of Israel, 1959). In the framework of the individual’s right to water,

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the law states that: “Every person is entitled to receive water and to use it” (State of Israel, 1959). This is, of course, according to the limitations of savings and non-pollution of the water. The social protest of summer 2011 raised the issue of the high water rates charged by the local water corporations and imposed on the citizen. The local government leaders protested as well against the increase of the rates, because they were doubled and tripled for the home consumer (Azulay, 2011) (Galily & Schwartz, 2016).

The residents of the cities and towns throughout Israel displayed their dissatisfaction and called for the elimination of 54 water corporations, the ‘patent’ that was established to resolve the issue of the urban water sector. In the establishment of the water corporations, the central government put on the agenda the objective of the reduction of the gaps and ‘distributional justice’, following pressures that originated in the reports of the State Comptroller and the rulings of the Supreme Court. The main reason for the initiative to force the division of the revenues was the need to find a solution for budgetary problems (Rezin & Hazan, 2006). The water sector is a lodestone for the creation of revenues for the local governments. Making most of the revenues from the sale of water into another independent income of the local government perpetuates a problem of municipal funding, while harming the true mission of the local governments, the improvement and development of the infrastructure. This is the main reason for their refusal to manage a closed water sector and for incorporation (Ben Alia, 1998: 42). The government, on its part, forced the establishment of the water corporations as a part of the decentralization policy.

Additional issues are the reference to the resources of the environment as economic goods and not as public ones and lack of clarity regarding the division of the public burden between the local government and the central government in the handling of the resources of the environment (Arian, 2011).

Unlike the Water Law, the Water and Sewage Corporations Law, which was passed in the Knesset in the year 2001, adopted a business approach. While it determined that it is necessary to ensure “a reasonable level of service, quality, and trustworthiness at reasonable prices and without discrimination” (State of Israel, 2001), it also says in sections 3 and 4 of the law that it is necessary “to allow the recruitment of capital for investments in the economy of water and sewage” and even “to allow the partnership of private investments in the ownership and division of the profits” (State of Israel, 2001). Furthermore, the Water and Sewage Corporations Law states that “it is necessary to bring about the professional and efficient business management of the water and sewage systems in the local governments” (State of Israel, 2001).

The law authorized the local governments to establish companies for public service in the fields of water and sewage, prohibited the local governments from treating the water and sewage in their authority from February 2008, and shifted the responsibility to the corporation alone. The Ministry of the Interior even adopted a series of sanctions against the local governments that refused to establish water corporations instead of their water departments, including the refusal to approve budgets and the cessation of approvals to take out loans (Schwartz, 2009).

2. Change of the paradigm towards water as a resource

The difference between the Water Law of 1959 and the Water and Sewage Corporations Law of 2001 indicates that Israel had shifted from an approach according to which water is important for the development of society and the environment to an approach of a market economy that sees water as a business product.

In the past, agricultural work constituted an important value-based foundation of the Zionist movement (Aharoni, 1991). The agricultural sector was cultivated through government involvement in the economic market system. The reigning paradigm supported centralized planning and management, the goal of which was to cope with the basic lack of water resources in
Israel, when the water resources are owned by the State, which allocates them according to predefined quotas, while adjusting to the changing conditions (Menachem, 1999). However, at the same time, as different experts determined, a wild process of the exploitation of the water sources occurred, and in the 1970s it was argued that the water sector is found on the track to a crash (Menachem, 1999).

The Water Law of 1959 placed the ownership of all the water resources in the hands of the State and formally created a centralized system for the production and allocation of water (Menachem, 1999). The monopoly on water in Israel is found in the hands of the Mekorot Company, which was established in 1937, before the State was established, so as to provide water to the pioneering settlements. In its beginning, Mekorot engaged in the development of water plans, in the search for new sources of water, and in the planning of regional and national plants (Navon, 2007).

Levi Eshkol, the founder of Mekorot and later the Prime Minister of Israel, saw the agricultural sector to be the most important economic-social factor that should be cultivated and encouraged. He saw the agricultural profession to be an ideological objective (Goldstein, 2003: 322). However, despite the prevailing centralized socialist approach, a liberal economic approach began to penetrate, primarily after the political revolution of the year 1977, when the Likud came into power (Schwartz, 1991).

3. Theoretical background – Milton Friedman’s “Capitalism and Freedom”

*Capitalism and Freedom* is a philosophical-economic book by the economist and Nobel laureate Milton Friedman, published in 1962. Friedman presents his worldview on the role of governments in the world and the role of capitalism as a liberator. The book discusses various economic and moral issues and examines them mainly in the face of examples from the American economy in the first half of the 20th century. The book was considered Friedman’s most important book and greatly influenced the strengthening of the liberal outlook in the world.

The book has a large and varied impact on the economic conduct of governments around the world. Many of Friedmann’s suggestions in the book were implemented and were subject to extensive research. For example, in many countries his proposals for the reform and privatization of the education system, the Israel Electric Corporation, the railroads, the cancellation of direct government supervision of the exchange rate, the reduction of the protection of the freedom of association, the introduction of negative income tax and the reduction of tariffs and government supervision were implemented. On the other hand, Friedman’s other ideas, such as the abolition of government regulation of licensing professionals, the abolition of income tax on corporations, and the repeal of laws against racial discrimination in hiring have never been implemented and are considered radical to this day. Despite many critiques of Friedman’s proposals, the book is considered one of the most influential books of the 20th century. With the help of this book, Friedman succeeded in bringing to the general public his economic ideas in various fields.

At the beginning of his book, Friedman quotes President Kennedy’s famous passage: “Ask not what your country can do for you - ask what you can do for your country”. This sentence, which seems to have a patriotic consensus, is being fiercely attacked by Friedman. In his opinion, the person is not supposed to act for his country, and the country is not supposed to act on behalf of its citizens. The state is only a means in the hands of the individuals. According to Friedmann, economic freedom is a basic condition for achieving political freedom.

Friedman goes through a series of laws and attacks them as they contradict freedom. For example, the obligation to make a provision for pension. Friedman accepts only one type of restriction on a person’s liberty: the protection of the liberty of the other. In order to reduce the
impact on economic freedom, Friedman argues that monetary regulation should be limited as much as possible, so the exchange rates will be maintained (Friedman, 1962).

In 1977 Friedman visited Israel. In his visit, he met with Finance Minister Simha Ehrlich and senior Israeli officials. His visit sparked a wave of protests in the left-wing circles, fearing his influence on the economic policy makers in the government. According to Friedman, the country’s leadership after the political upheaval did not listen to his advice, and increased subsidies and public expenditure and government involvement in the economy. The arguments of Friedman’s critics are that his recommendations that the Israeli government give up some of the regulatory powers and lead foreign currency free trade, among other things, to a worsening balance of payments and a very rapid rise in inflation. Despite Friedman’s reservations about the economic policies of Israeli governments in the 1970s and 1980s, Israeli socialists tend to attribute the beginning of transition to a policy of privatization and a free market in Israel to Friedman’s visit in 1977 (Foxman Shal, 2011: 174).

The approach in the Likud leadership supported the extension of the civil rights and the reduction of government involvement in the state economy (Foxman Shal, 2011: 174). The Minister of Finance at that time, Erlich, was helped by the renowned economist Milton Friedman, who supports the neoliberal economy (Schwartz, 1991). The change of approach that came with the change of government in Israel and the rise of privatization, namely, the transfer of services, products, and assets from the public sector to the private sector, were also influenced by the rise of Thatcher to the government of Britain in 1979. This approach became a phenomenon that crossed geographic borders (Katz, 1997: 11, 31; Galily & Schwartz, 2016).

The trend of privatization in Israel also reached the government companies, the sale of which had been on the public agenda in the middle of the 1980s, reflecting the dissatisfaction with the operations of the government economy (Eckstein, Zilberfarb & Roezvitz, 1998: 11, 15). In Israel, as in the rest of the world, “the paradigm of modernization and the nation state is converted to the paradigm of globalization and post-nationalism.” (Ram, 2005). The globalization crosses borders, beyond the local context, and enables “accelerated movement of people, capital, merchandise, and messages” (Ram, 2005: 12).

In recent years, the municipal sector has adopted the process of privatization as a main element in the management of the local arena, which is expressed in the privatization of the supply of the urban services. This is primarily following the lack of the required resources; the allocation of resources is restricted by the central government and global and local processes, which influenced the development of the economic orientation in the local governments, thus compelling the local governments to search for new techniques for the development of resources. In addition to fees and charges, they increased outsourcing, namely, the transfer of work to outside suppliers and contractors, and established economic companies, associations, and association of cities (Sarig, 2008: 32-33). The meaning of these economic changes was the exchange of the welfare state for the principles of the competitive market. Consequently, the public resources transferred to the local governments were reduced, and the local governments began with economic initiatives and the formation of business collaborations, such as urban companies and cooperative associations (Sarig, 2008: 439). There were also a number of attempts to issue municipal bonds, namely, to recruit investors for the local governments (Schwartz, 2010). In essence, the corporations were established to recruit private capital, which would take the place of the governmental assistance in the financing of the water infrastructures and create the option for their sale to private investors in the future (Mazliach, 2011).
4. Absurd chain of events between the economic crisis in the Local Governments and the general water crisis in the country

From the year 2001 many local governments suffered a financial crisis. Some found it difficult to pay their debts to suppliers, others withheld wages from their employees, and for many of them the government appointed audit committees to oversee them. In the year 2006 more than one hundred local governments were in recovery programs (Ben Bassat & Dahan, 2009).

Near the time of the years of crisis in the local governments, the government was also compelled to cope with the water crisis. In the year 2001 a parliamentary investigation committee was appointed on the topic of the water sector, which determined that the water sector had reached a critical point of the depletion of the water resources – for a cumulative deficit of two billion cubic meters. The committee determined that the crisis derived from the lack of efficient and effective management and the reasons, in its opinion, were the multiplicity of the factors that deal with the topic and the failure to implement the recommendations of the experts, the government, and the severe State Comptroller Report from the year 1990. The committee argued that the Ministry of Finance had navigated the water sector in a conservative manner, which caused a significant delay in the establishment of desalination plants for sea water at the necessary scale (Magen, 2002).

In the year 2008, a state investigation committee was established on the topic of the water sector in Israel. Its fundamental assumption was that “it is necessary to address water like a product with shortage or to act with restraint in its consumption” (Bein, 2010: 14). The committee assessed two sectors. The first sector was the national water sector, including the water resources and reservoirs, the national system for the transport and supply of water, the desalination plants, and the wastewater treatment systems. The second sector was the urban water sector, including the inner-city supply systems, the sewage removal systems, and the purification plants. The local governments are dependent on the Mekorot Company, which brings the water to them. Mekorot engages in desalination, development of water plants, supply, delivery, and return. In the urban sector, the distribution of water and the collection of waste are channeled for every community separately (Bein, 2010: 294).

The water rates are set by the Water Authority, which examines the business plan of the water corporations and their meeting of standards set for the development of the infrastructures, handling of wastes and contaminations, and reduction of the water loss (Government Authority for Water and Sewage, 2011). Thus, the situation is created in which Mekorot sells the water to the local government at 2.9 shekels a cubic meter, but another rate is set for the home consumer, which is higher than this original rate and reaches 7.58 shekels a cubic meter, as noted in the report (Bein, 2010: 300). The water rates are set according to the directive of the Gronau Committee from the year 2005, which allowed the creation of a large gap between the price that Mekorot charges the local governments and the price that the local governments charges the home consumer, when in the local governments where water corporations have not yet been implement sewage fees and development levies are collected (Bein, 2010: 300).

The water corporations operate primarily in the field of home consumption, and not in every water sector in the State. The distribution of the water consumption is: agriculture – about 65%, industry – about 5%, and home consumption – about 30%. About 75% of the water consumed is potable (drinking water quality), and the rest is non-potable water: waste water, salty water, and flood water. It should be noted that two-thirds of the water is provided in essence by Mekorot (Belitz, 1999). The prices that the company is entitled to charge are set according to the decision of the Minister of Agriculture, Minister of Finance, and Minister of Infrastructures, with the approval of the Finance Committee of the Knesset (Belitz, 1999).
5. Problems in the water corporations

By law, a corporation is a “form of business association, which is established by registration, with an independent legal entity, and its goal is to produce profits for its members” (Adari, 2000). Hence, the corporation is a legal entity that is independent of and separate from the municipality, which is defined in essence according to section 7 of the Municipalities Ordinance as a corporation itself. “A municipality of the residents of a given region will be called by the name of this region and will have constant existence and the right to sue and be sued in its incorporated name” (Municipalities Ordinance, New Version, 1964). The legal basis of the activity of the municipal corporation is section 249 (30) of the Municipalities Ordinance, according to which the municipality is authorized:

To establish a company, cooperative association, or any other association for any goal that is within the authorities of the municipality and its roles, to acquire stocks or securities or any other easements of any company, cooperative association, or any other association, whose goals facilitate a role of its roles together or in cooperation with the institutions of the State, other local governments, other cooperative association, or other people (Salomon, 2008: 366).

This is, therefore, permission for the municipality to establish an economic company for the purpose of the achievement of a goal that is within the authorities of the municipality and its roles and to be the owners or a partner through stocks, securities, or any other easement, such as the local government’s assets, a monopoly over a service, and so on (Salomon, 2008: 366). However, in contrast to the Companies Law, which obligates the separation of the ownership from the control of the stocks because of concerns about ‘the problem of the representative’ – the company owners, seeking to maximize their wealth, prefer their personal interest over that of other stockholders, which can lead to taking risks and conflicts of interest (Adari, 2000: 14), section 249 (3) of the Municipalities Ordinance enables the municipality to appoint at least one half of the capital or half of the voting power in the corporation (Salomon, 2008: 366). This creates the ‘problem of the representative’, since in the corporation there are groups of interests (a group of stockholders, a group of managers, a group of creditors), who have different and sometimes even conflicting interests (Goshen, 1987: 239).

In addition, section 249 A determines that “The duty of trust that the representatives of the municipality have towards the municipality is always preferable to their obligation to the corporation”, and this is in contrast to the Companies Ordinance, which determines that “every role-holder has the duty of allegiance to the company, will act in good faith, and will act for its benefit” (Salomon, 2008: 366). Moreover, the section requires the appointment of a representation of the municipality in the urban corporation, so that the power relations will be preserved as the relations of the parties in the city council (Salomon, 2008: 366) and thus prepares for the existing conflict of interests between “being a person who is a role-holder in the municipality and being a role-holder in the urban corporation” (Salomon, 2008: 366).

The Finance Committee of the Knesset inserted another amendment into the Water and Sewage Corporations Law in March 2011:

The term of a person as a member of a council or a worker of the local government, which has control of a water and sewage corporation, will not be considered to create a conflict of interest. It is proposed to set that the term of the head of the local government in the directorate will not be considered to create a conflict of interests, and this so as to enable the head of the local government, who has control in the company, to serve as a member of the directorate.

In addition, it was proposed to cancel the limitation according to which no more than one-quarter of the directorate members will be council members in the local government and to allow the situation in which up to two-thirds of the directorate members will be council members.
of the local government (Levy, 2015). In other words, there is no business separation; there is the possibility to appoint politicians, with deviation from the idea of efficient business management. Thus, there is the continuation of the tradition of the lack of efficiency of the public sector (Zelika, 2011: 71). Following the recommendations of the Nissan Committee, which determined that role-holders in the local government can serve in the directorate of the corporations, the representatives of the local government succeeded in restoring to themselves the control over the water corporations. If they had succeeded in operating independently, then it would have been difficult for the local governments to lay their hands on the money. In essence, this was the victory of the heads of the local governments over the regulator of the corporations – the Water and Sewage Authority (Wolfson, 2011).

Sharp criticism of the water corporations was voiced from all sides of the political spectrum. The Chair of the Finance Committee, Knesset Member Shama HaCohen, argued that these inflated the mechanisms and caused the creation of superfluous jobs and the waste of money. Knesset Member Regev maintained that the corporations may cause “the water barons to purchase the corporations” (Agricultural Portal in Israel, 2011; Azulay, 2011). The Center for Local Government claimed that consumers need to pay an exorbitant price because of an inflated mechanism and 2.4 billion shekels were wasted in incorporation (Horesh, 2010). The State Comptroller criticized that most of the costs are borne by the home consumers (State Comptroller, 2009). The State Comptroller added that the State needs to find a solution for the financing of the drainage plants, for the establishment of reservoirs, for the preparation of a current masterplan, and for the improvement of the drainage infrastructures (State Comptroller, 2009). Knesset member Regev suggested restoring the supervision on the water rates to the Finance Committee. The Chair of the Finance Committee Gafni maintained that “the sharp rise in the water rates was the catalyst for the social protest” (Finance Committee, 2011), when the large part of the water cost does not derive from the cost of the production of water but from the distribution of the water by the corporations, the costs of the care for the sewage, and the component of VAT (Ben David, 2011), which was protested by the Chair of the Committee for State Supervision. The Trachtenberg Committee on the topic of the social protest recommended reducing the price of water through organizational changes in the corporations, regulation, activity in competitive markets, and the encourage of desalination and purification of wastewater (Bar Eli, 2011). The Man Nature and Law Association also demanded to eliminate the privatization of the water corporations: “water and sewage are essential services that pertain to the existence of basic fundamental rights” (Man Nature and Law Association, 2011).

6. Conclusion

The water corporations became bureaucratic organizations, which, instead of providing service for the home consumer who seeks to obtain a basic product, as noted in the Water Law, have enslaved the consumers through the monopoly that they and Mekorot have. Most of the costs fall on the urban consumers, who consume only 30% of the water in the country, a burden that is not assigned to other sectors.

Instead of addressing the problems on the level of the State, namely, finding a holistic solution to the water crisis, corporations were established that saw the crisis to be something to exploit and water to be a product for making profits and enriching themselves. In addition, the government allowed the water corporations to act in a way different from what is determined in the Companies Law and permitted the existence of a conflict of interests that derives from the combination of the relations of political powers in the local governments in the corporations. In other words, the government allowed them to act on the basis of political considerations and not only business standards.
In the end, the Golem turned on its creator. Even the heads of the local governments are not interested in the corporations as mediators between them and the citizens, who see them as responsible, despite the separation of the legal authority.

Therefore, instead of hastening projects for the desalination of seawater, the re-use of polluted water, and the storage of rainwater, as should have been done according to most of the committees, corporations were established, although it is doubtful that they are necessary.

The amount of water required can be achieved through the existing technologies (Yakovi, 1980). According to an article in Ynet (2011), “Israel does not have a water problem but rather a water management problem”.

It is necessary to reach a decision on the national level to enable the reduction in the price of water through the opening of the market to true competition, with the resolution of the conflicts of interest between all the government factors involved in the solution of the problems of the water sector, both on the municipal level and on the state level.

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