

Municipal Companies and City Associations – Political Economics in the Local Government in Israel

Daniel Galily

*South-West University “Neofit Rilski”, Blagoevgrad, BULGARIA
Faculty of Philosophy, Department of Philosophical and Political Sciences*

David Schwartz

*Bar-Ilan University, Ramat Gan, ISRAEL
Department of Political Science*

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Abstract

This study aims to present the Municipal Companies and City Associations – Political Economics in the Local Government. The perception of the local governments has already changed, and they do not see their mission only as the supply of municipal services according to law. The competitive environment in which they operate brings about an orientation of the improvement of the quality of life in the community, the extension and variety of the sources of employment, the development of infrastructures, and the improvement of the image. Does the resident know about the existence of companies and organizations in his residential area? Local initiatives in the form of municipal companies and city associations – Explanation and interpretation. The main points in the article are: Urban Development; Reciprocal Relations with the Private Sector; Project Finance; Taxation; Management Techniques; Diversification of Areas of Action of the Local Governments. Conclusion: The municipal company is not a new invention. However, the transformation of the municipal company into a significant and important factor in the Israeli economy is a relatively new phenomenon. It is intended to bridge between the local government, the organization that determines and executes municipal policy, and the private sector, with the resources, the instruments, and the business orientation, so as to ensure the success of public economic projects on a significant scale.

Keywords: Israel, local government, urban development, private sector, project finance, taxation, management techniques.

1. Introduction

Municipal companies have existed since the establishment of the state (and some even beforehand) as one of the executive instruments of the local authorities. In the past decade, this sector has broadened significantly. This expansion comes in parallel to the demand of the governments for increased efficiency and the reduction of the involvement and financing of the local governments in both social and economic areas (for instance, housing and industry, institutions for the elderly, etc.).

Today, in the local government approximately 360 municipal companies are registered (about 50% are active), when 80% of them are companies for urban economic development and the rest operate in different areas, as defined in the designated local authority. The local governments exhibit considerable interest in the instrument of the urban companies, in light of the accelerated urban development and the need for a rapid, initiated, creative, flexible, and simple response from the accepted system in the traditional public-municipal framework, in combination with the guidelines, the rules, and the perceptions accepted in the framework of public mechanisms. The perception of the local governments has already changed, and they do not see their mission only as the supply of municipal services according to law. The competitive environment in which they operate brings about an orientation of the improvement of the quality of life in the community, the extension and variety of the sources of employment, the development of infrastructures, and the improvement of the image.

All these are vital to attract “strong” and entrepreneurial populations, to establish focuses of advanced industry, and so on. On the part of the residents, there is a phenomenon of the increase in the expectations for the level of services, in parallel to the increase in the standard of life.

The main issues that come up for the discussion are urban development, reciprocal relations with the private sector, project finance, taxation, management techniques, and diversification of areas of action.

2. Urban development

This topic has become the leading field and the pretext for the establishment of municipal corporations in the past decade, following the accelerated urban growth that the country has experienced since the first third of the 1990s, as a result of the mass immigration. The urban growth created a competitive arena for the local governments in all that pertains to the development of residential neighborhoods and the attraction of “strong” populations, and especially in all that pertains to the initiation and establishment of regions of employment. The accelerated planning of employment regions, especially in the center of the country, reflects in many cases the desire to broaden the “municipal tax base”. In the continuation of these processes, the motivation of the local governments, especially the established ones, has increased to raise the added value from the momentum of urban development in them, through the management of infrastructure works.

Another area of action is the improvement of municipal real estate assets. In recent years, the real estate industry has surpluses of supply as a result of the cessation of the demographic growth and in continuation of the prolonged financial crisis in the world and in the economy, which is reflected, first and foremost, in the area of real estate. Consequently, the competition to attract populations intensified, especially populations considered ‘strong’ groups, as did competition over initiatives to establish advanced hi-tech centers.

The municipal company is therefore a paramount instrument for the achievement of strategic objectives of the local government in the competitive arena.

3. Reciprocal relations with the private sector

The importance of public entrepreneurship, which originates in the strategy of the local authority, which is more aware today than ever of the need to act to realize its public objectives, is not doubted. The active approach on the part of the local governments is without a doubt positive.

The municipal company was intended to enable the realization of the objectives of “public entrepreneurship”. Conversely, a fundamental issue that pertains to the interface and the reciprocal relations between the local government and factors in the private commercial sector arises. To a certain extent, it is possible to find a parallel with the sector of the government companies, which in recent years has been marked by a policy of privatization. The local government must adopt, in principle a policy for the prevention of overlap and duplication with private organizations and the finding of areas of action in which there is added value to the public initiative. Hence, it is possible to derive the methods for the sharing of the capital and the private initiative and the finding of the timing for the transfer of public activity to private hands. In any event, the municipal company is supposed to fill a key role in cases that require cooperation with business factors (which is beyond the publication of tenders or the sale of assets). Of course, it is necessary to focus on cases in which public initiative is required. In the past decade, many examples have accumulated of cooperation of this type (for instance, the establishment of municipal buildings in the framework of real estate transactions with private factors, or a more extreme example of the sale of more than 50% of the MATAM shares by the Economic Company of the Haifa Municipality). There is room to draw appropriate conclusions.

4. Project finance

Another topic that is associated with the previous topic and has gained impressive momentum in recent years is the field of the financing of the development. Both the government of Israel and the local government developed a number of methods of project finance that were prevalent in the Western world and even in developed countries. The intention is methods such as BOT (Build-Operate-Transfer), in the framework of which it is possible to recruit sources from the private sector for the financing of projects of infrastructures in the method of the long-term franchise. Examples include the Cross Israel Highway and the Carmel Tunnel. In many cases, the projects are on behalf of the local government or a joint administration of the government and a municipal organization, for instance the Light Rail in Jerusalem (an international tender of the State of Israel and the Municipality of Jerusalem), the sewage treatment plants (Netanya, Nahariya, Ashdod, Kiryat Gat, Beer Sheva, and so on), and waste sites. Recently, we have seen the recruitment of funds through designated bonds for financing projects. This topic may definitely contribute to the reinforcement of the ability of the municipal corporation to act.

5. Taxation

As the financial activity related to the municipal corporations is more divergent, problems of taxation may arise (value added tax [VAT], appreciation tax, etc.). In a number of cases, the tax authorities were required to determine rules on this topic. This topic has implications on what was previously said.

6. Management techniques

Management techniques change once in a while, and in recent years there is increasing awareness of “measurement tools” such as “profit centers” or “achievements ruler”, as a means for the evaluation of the performance of the administrative units. In this context, two alternative approaches are prevalent. The first approach maintains that it is possible in the framework of the municipality to deploy divisional “profit centers” and to hold a measurement system that will ensure effective management in the framework of a given budget. The second approach holds, in contrast, that the framework of a municipal corporation managed according to the rules of the balance sheet and the profit and loss statements is the only one that can ensure motivation and

financial management of the service. Today the prevalent approach is the second approach, as previously mentioned.

Innovative examples of the privatization of areas of action through municipal corporations include: performance of infrastructures, building of public institutions, “evacuation-construction” (urban renewal, parking, gardening and parks, water and sewage sector, leisure culture, and so on).

7. Diversification of areas of action of the local governments

As aforementioned, there is a continuous trend of pressure to diversify the “classic” areas of action of the local governments and especially in cases of established populations. For example, areas include not only education, garbage removal, and student transportation but also leisure culture, establishment and operation of computerized information databases, parking facilities, and urban projects and their initiation. These topics would seem to suit the framework of the municipal company

Advantages of the Municipal Company versus a Unit in the Local Government (Dor, 2006)

- **Ability to promote projects.** The municipal company has an orientation of the promotion of projects on a shorter schedule. It is suited to the implementation of new ideas and entrepreneurship according to the economic approach. It is less immersed in “ongoing management” and constraints of the mechanism.
- **Flexibility in implementation and performance.** Flexibility is expressed in the recruitment and reward of manpower, connection with suppliers, allocation of designated budgets for the project, and creation of flexible professional tools.
- **Efficiency in operation.** Reduction of the permanent municipal mechanism and establishment of a mechanism whose size changes according to the needs of the projects. Most of the municipal companies operate in a skeletal format. Most of the work is performed by subcontractors, and the overhead and fixed costs are low relative to the volume of turnover.
- **Transparency in reporting.** The activity is conducted in the form of a “closed economy”. This enables transparency, follow up, and control after the use made of the resources and the outcomes of the activity. Hence, it is possible to know how much everything cost, to know whether the public monies were invested wisely, and to know the return obtained. In contrast, in the management of the activity in the traditional municipal framework, the data “becomes mixed”, and it is hard to separate the financial data and to attribute them to certain activity. It is easier to conceal deficit activity or inefficient activity within the municipality's budget book. The transparency in the municipal company enables us to learn from the performance of today, to draw conclusions, and to improve for the activity in the future. It leads to efficiency, to the improvement of functioning and performance. Since the municipal company submits a summative annual financial report, it is possible to identify deficit/loss activity, when had the activity been performed in another organizational framework, it would be harder to know its true outcomes.
- **Extension and diversification of the sources of financing.** The municipal extension can create financial momentum and extend and diversify the financing sources for the performance of different municipal projects, from public and private organizations, entrepreneurs, and investors.
- **Collaborations with the private market.** It is more comfortable to collaborate with private factors through the municipal company than through the

local government. The local company better finds the “shared language” with private organizations.

- **Collaborations with other local governments.** Municipal companies that are joint for a number of local governments create economy of scale and opportunities that do not exist for the single local government. There are municipal companies that offer service also to other local governments, as well as companies shared by a number of adjacent local governments. The same is true for collaborations with other public organizations, such as universities, the Jewish National Fund, the Jewish Agency, and so on.
- **Cultivation of professionalism.** Cultivation of professional ability in the branches of services and infrastructure, which is parallel to the abilities that exist in the leading companies in the private market. These abilities are directed towards the development of the city.
- **Advantages in taxation.** When the Tax Authority recognizes the activity of the company as a licensed dealer, it is possible to deduct the VAT from the costs, while the local government cannot obtain this status.

Disadvantages of the Municipal Company (Dor, 2006)

- **Excessive flexibility.** The municipal company can serve as an opening for the performance of projects, for the transfer of payments, and for the employment of suppliers not according to the rules of engagement accepted in the local governments, thus bypassing the existing mechanisms of supervision and control.
- **Transparency of the financial reports.** Sometimes the financial reports of the municipal company are not published along with the financial reports of the local government and do not include sufficient clarifications and illuminations. Thus, it is difficult to understand from the financial reports of the municipal company essential data, including data pertaining to the financial commitments between the municipal company and the local government, data about the conditions of the employment of the manpower, the terms of engagement with suppliers, the costs of the performance of projects under the company’s responsibility, and so on. In cases where the financial reports of the local governments do not address the activity of the municipal companies, the comprehensive viewpoint that will faithfully reflect the financial data of the entire municipal system is lacking.
- **Conflicts of interest.** In the environment of the municipal companies, opportunities for the deviation from the rules is created by different role-holders in the companies and local governments in the areas of planning, transactions, employment conditions, tenders, and so on.
- **Inactive companies.** In some of the cases, the phenomenon of inactive companies (about half of the registered companies) sometimes indicates inefficient functioning, failures in management, and unrealistic planning. This phenomenon makes it difficult for the Ministry of the Interior to supervise, since until today the ministry has not received reports on the status of the activity in every company.
- **Proper administration.** When the municipal company is fully controlled by the municipality (100% ownership), then sometimes there is ambiguity in the authorities, definitions, formulation of agreements, documentation of decisions, and so on. There is a feeling that in any event this is “one entity” and therefore there is no need for the same formal actions. This situation can detrimentally influence the rules of proper administration.

Rules of the game

1. General. In recent years, lessons have accumulated that indicate the need for the examination and crystallization of the new rules of the game in the sector of the municipal

companies, according to the new challenges and the competitive environment. Generally, the active approach of the municipal companies is perceived as legitimate and desired by the government. However, in parallel there is alertness to the need for control to ensure the preservation of the frameworks and so as not to abuse this instrument. For this purpose, it is necessary to continue in the “dialogue” with the main government.

The association of the administrations of municipal companies in the local government often clashes with representatives of the government in all that pertains to the integration in projects and government tenders, such as urban renewal (“evacuation and construction”), the privatization of the public transportation, the construction of the public institutions, the development of the state lands, etc.

2. Rationale. The municipal companies generally are companies owned by one or more local governments or by a partnership between the local government and another factor, whether state, public, or private. Since the municipal company is a limited liability company, it is not different in legal and business terms from any limited company and it acts as a business organization in all respects. As such, it has a significant number of advantages over the existing bureaucratic system. The company acts on a business basis, as a closed economy, with economic measures of success. The activity is task-oriented, with clear objectives.

The municipal company constitutes an important resource for urban development and initiatives in the local government. The transfer of certain activities from the local government to the municipal company includes operational advantages and financial advantages. The intention by business-financial entrepreneurship in the local government is to create and to promote economic projects for the benefit of the residents of the local government through municipal resources or public and/private resources found in the boundaries of the local government and whose promotion will ensure positive public and financial return.

The advantages of the municipal company over the local authority are primarily in the encouragement of economic initiative in different areas, such as building, housing, transportation, sport, recreation, and so on. This “encouragement” means that the municipal company is found in essence at the meeting point between the market needs and the policy shapers (the city leaders) and the capital owners (the entrepreneurs). The municipal company is found in essence at the intersection between the business domain, where the behavior is dictated by considerations of efficiency and profit, and the government-public domain, where the guiding considerations are proper administration and upholding of the public interest.

The municipal company can identify, create, and encourage economic initiatives in areas where the private sector fears to invest, for reasons of high business risk or fear or bureaucratic delays (namely, “market failure”).

3. The Activity. Most of the municipal companies are based on a limited organization with minimal and efficient manpower that buys services (outsourcing). This method has been proved financially and is efficient and effective in business and public terms and enables the disconnection from the organization that provides the service immediate after the completion of the project execution. In all that pertains to the privatization of services through a private organization, it is necessary to improve the ways of communication and built an appropriate control system.

8. Conclusion

The municipal company is not a new invention. However, the transformation of the municipal company into a significant and important factor in the Israeli economy is a relatively new phenomenon. It is intended to bridge between the local government, the organization that

determines and executes municipal policy, and the private sector, with the resources, the instruments, and the business orientation, so as to ensure the success of public economic projects on a significant scale.

The municipal companies have become in recent years, without a doubt, a dominant factor in the economic development of the local governments. However, today as well, with the rise in the status and centrality of the municipal companies, there is still a need to increase the awareness of them both in the local governments themselves and among the decision makers in the local government. It is necessary to encourage activity and contribution on the part of the municipal companies for the promotion and development of infrastructures, and social, cultural, and financial activities in the framework of the local governments. In parallel, it is necessary to promote and improve the work methods and devices, especially those intended to harness the private sector for the promotion of important projects for the municipal interest. In this framework, there is room for cooperation and the transfer of experience and lessons in the municipal system through days of review, in-service training courses, and an ongoing system of studies, held at the initiative of the association of managers of municipal companies in the local government.

Association of Cities. Associations of cities are the most common model for the framework of government over the municipalities, through which the local authorities in Israel tried to promote a shared interest. The establishment of associations of cities was made possible and arranged in the 1950s, with the legislation of the City Associations Act (1955). This law expressed the recognition, as noted in the explanatory words of the law, that “there are services that to be performed efficiently and thriftily obligate shared management of a number of local governments found in a certain region by a central executive organization ... the need for this type of cooperation was found in important areas of the local government, such as the supply of water, sewage, and drainage, high school education, hospitalization, development of roads and other services, etc.”

The City Associations Act defines this framework as “an association of nearby local governments even if they do not border with one another”. The establishment of the association can derive from the desire of the local governments to associate in a city association or from the initiative of the (Minister of) Interior. In the original law, the establishment of a city association according to the proposal of the Ministry of the Interior was conditioned upon the agreement of the local governments proposed to associate and as long as another local government, which is related to the matter, did not object to the initiated program. In other words, in the eyes of the legislature, the establishment of an association of cities was an agreed-upon association, whether at the initiative of the local governments themselves or at the initiative of the Ministry of the Interior. In the year 2004, there was a sharp turn on the topic. In the Economic Policy Law for the 2004 Fiscal Year (Legislation Amendments, 2004) the law was amended so that “the establishment of the city association by the Minister does not require the consent of the local governments pertaining to the issue”. The Minister of the Interior is entitled today, after the consultation with the Minister of Finance, to establish an association of cities against the opinion of the local governments pertaining to the issue, even if the rules of procedure enable them to voice their arguments before an investigation committee.

The original legislation was characterized by a certain degree of ambiguity regarding the status of the association of cities relative to the constituent local authorities. The association is an independent governing authority that can include the authorities of the local government, in the boundaries of its mission, other than the authority to impose taxes. Section 9 of the law expresses this status by way of negation: “The association of cities should not be granted anything but the authorities and clerks that were granted or are permitted to be granted according to all legislation of the local government in its field, as long as the association of cities is not granted the authority to impose the municipal tax.”. In addition, it has the authority, according to article 14 of

the law (amended), to legislate bylaws for the performance of the role of the association or the use of its authorities. Although there are some who interpreted the status of the association of cities as a federative authority, its true status is that of a confederative authority. The local governments that are members in the organization have delegated their authorities to fill its role but they have not relinquished them to the association. Article 10 determines that, “The order that establishes the association does not remove from the local governments in the field of the association the authorities and roles they hold and does not exempt them from the obligation upon them, unless this is determined explicitly by order.”

This status enabled, in the continuation, the re-assumption of the roles from the association or the non-extension of authorities and roles for the association. An amendment following the legislation of the Economic Policy Law for the 2004 Fiscal Year changed this situation by recognizing the unique authorities of the association of cities. “It was determined that the association of cities will have the authorities and roles of each one of the local governments in its field in matters related to its authorities. This authority of the association of cities will be unique, and each one of the local governments in its field will be released from its obligations regarding each one of these matters and will not have any authority in the topic.” If we are interpreting this amendment correctly, then the meaning is not only the granting of unique authorities to the association of cities but also the expropriation of authorities from the local government.

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