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Informal Privatization and Distributive Justice in Israeli Administrative Law

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INFORMAL PRIVATIZATION AND DISTRIBUTIVE JUSTICE IN ISRAELI ADMINISTRATIVE LAW

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I. INTRODUCTION

Privatization has arguably been the most important process in Israel's economic and societal life during the past three decades. During the first 30 years of the country's existence, under the Labor Party's rule, the state established, owned, and administrated significant segments of economic activity, while others were subject to an intensified regulatory regime.[1] From the 1980s onward, however, all Israeli governments have moved toward privatization.[2] This shift was prompted both by internal developments and international trends. Since 1977, most coalition governments in Israel have been led by right-wing parties that traditionally leaned towards a market economy.[3] The inefficiency of many government industries, allied with ambitions for integration in the global economy, triggered reforms.[4] These were largely welcomed by Israeli elites that were influenced by American-oriented ideology (and to some extent, the public in general).[5]

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[1] Daphne Barak-Erez, *Applying Administrative Law to Privatization in Israel,* ISRAELI REPORTS TO THE XVI INTERNATIONAL CONGRESS ON COMPARATIVE LAW 47 2006)).

[2] Yair Aharoni, *Israel in Transition: The Changing Political Economy of Israel*, 555 ANNALS. AM. ACAD. POL. & SOC. SCI. 127, 146 (1998).

[3] Aharoni, *supra* note 2, at 142.

[4] *Id.* at 141.

[5] *Id.* at 140.

Privatization carries significant potential benefits such as the encouragement of free market competition and, consequently, the enhancement of economic efficiency and improved resource allocation.[6] It also carries, however, potential drawbacks and dangers. Privatization of state-owned industries often results in massive layoffs and may bring about unemployment and social disorder.[7] To the extent that privatization involves the delegating of governmental functions such as prison management, security tasks, or welfare services to privately owned actors, other problems arise, such as deterioration in the conditions and availability of the services and even infringements of human rights.[8] The private provider of services to the elderly may reduce the quality of the service in order to enhance profits.[9] A privately owned jail may cut costs at the expense of the prisoners' conditions and safety, and so forth.[10]

The above mentioned benefits and drawbacks of privatization are contingent on many factors, such as the quality of the privatization plan, the nature and structure of the relevant market, privatization's success in inducing efficient market competition, the quality of the regulatory regime that follows privatization, and so forth.[11] There is one consequence of privatization, however, that is *inherent* to the very process of privatization. The inducement of a free market structure to a service that was previously provided for free (or at a low, fixed, and regulated charge), such as healthcare, education, or welfare services, inevitably creates a gap between those who can pay for the service and those who cannot. The distributive implications of privatization are the focus of my analysis.

II. PRIVATIZATION: DEFINITIONS AND TECHNIQUES

Privatization can be broadly defined as a policy designed to decrease government involvement in economic life and/or to introduce market mechanisms to the provision of public goods.[12] One can distinguish in this respect between two elements of privatization that, combined, compose full privatization. The *first* element is *outsourcing.* It refers to the question of who *provides* the service or manages the relevant assets (for example, a government contract with a private supplier to provide a service previously provided by the government itself, such as healthcare or park management). Alternatively, the government can keep the management of public hospitals in its own hands, but begin charging the public market prices for the use of

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6 *See, e.g.,* A. Doron & H.J. Karger, The *Privatization of Social Services in Israel and its Effects on Israeli Society*, 2 SCAND. J. SOC. WELFARE 88, 90-92 (1993).

7 *Id.*

8 *Id.*

9 *Id.*

10 *Id.* at 91.

11 *Id.*

12 Doron & Karger, *supra* note 6, at 88.

healthcare services. This *second* component of privatization refers to the *financing mechanism* of the service and can be called *commercialization.* These two elements are often (but not always) combined in one move to full privatization (for example, the government contracts a private company to run the national parks, and the latter starts collecting entrance fees to parks previously open with no charge to the public).

It should also be noted that from the point of view of public law, the concerns entailed by each element of privatization are somewhat different. *Outsourcing* may bring about infringements of workers' rights. It may also harm the customers' interests due to deteriorating quality of service, and infringe on human rights (as in the case of prison privatization).[13] *Commercialization*, on the other hand, directly infringes *equality* in the provision of the service. That is, a service that was previously provided to everyone for free (or for a nominal equal charge) is now available only for those who can buy it at market prices. Accordingly, it is only the element of commercialization that directly raises distributive concerns.

There are various techniques for achieving the aim of privatization. Some are more formal and involve all three branches of government. For example, the government can initiate legislation to privatize certain industries, such as those in the field of communication.[14] The state can also privatize by selling governmental property, including state-owned companies.[15] Likewise, the government may introduce regulations that de-monopolize certain markets, terminate the involvement of government actors, and open up these markets to new competitive private players.[16] These moves are formal in the sense that they are carried out by legislation, with full involvement by the political system and the public, and are subject to judicial review.

There are other techniques of privatization that are much less formal. In some cases the government can simply contract out (with or without public procurement)[17] and delegate certain functions to private actors. Likewise, the government can induce market mechanisms to certain fields simply by failing to *enforce* regulation aimed at constraining private

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[13] Academic Center of Law and Business v. Minister of Finance, HCJ 2605/05, 1-2 (Israeli Supreme Court 2009).

[14] *See e.g.* Communications Law 5742-1982 (Isr.), which initially gave a monopolized license to one government-owned company to operate telephone service in Israel (Bezeq). The government later sold the company to private investors.

[15] *See* Government Companies Law 5735-1975 (Isr.). The Law was amended in 1993 through the addition of chapter H1 entitled "Privatization." The new chapter regulates, in detail, the process of privatization of governmental corporations. *See* Barak-Erez, *supra* note 1, at 50.

[16] For example, the Communication Law (*supra* note 14) was amended during the 1990s and the 2000s to enable the government to award licenses for television and cable broadcast and other modes of communications, and to create competitive market for such services.

[17] Under the Duty of Procurement Law 1992 (Isr.), most governmental contracts must be signed after competitive procurement is published.

initiative in these fields. Likewise, the government may pull out of certain fields through executive decisions, budgetary cuts, and managerial moves. Such informal moves may seriously influence the public but are often carried out with hardly any involvement of the legislature and away from public attention. As such, they raise serious concerns of democratic accountability.

Let us demonstrate the above point by the following example: suppose that certain healthcare services, such as ambulance emergency services, are provided at a certain point in time by a public corporation that is financed by the government and enjoys a monopoly entrenched by regulations. [18] This corporation provides emergency services to the whole population and charges a regulated, fixed, nominal charge for the service. Suppose now that the government seeks to privatize the service. One way to do so is by initiating legislation that would reform the whole field by allowing private companies to provide the service, and redefining the functions of the public corporation. Adopting such a strategy may prove politically costly, however. It requires legislation. It would be scrutinized both by the opposition and the media that may raise hard questions regarding the impact of such a move on the public, and more specifically on the poor.

Alternatively, however, the government may choose a much less formal course of action. It can soften restrictions on the activity of private suppliers of emergency ambulance services by using the existing regulatory regime, and by granting licenses. It can also *refrain* from *enforcing* certain regulatory restrictions and turn a blind eye to violations by these players. Such informal, unofficial practices may encourage private suppliers to enter the field. At the beginning of the process, one would expect that the prices offered by the private suppliers would be much higher than those charged by the public corporation. Therefore, at the initial stage, the private sector would attract only the very wealthy. This may gradually change, however, particularly if the government adds to the above strategy one additional (seemingly "neutral") move: budgetary cuts. Such cuts in the budget of the public corporation would bring about a deterioration in the quality of service, thereby making it much less attractive to customers. At that stage, the middle class is effectively pushed into joining the customer pool of the private market (which, as a result is expected to expand the range of its services and, to some extent, to lower prices). As a result, more private actors join the market and more customers abandon the public service, which is deteriorating due to further budgetary cuts. The end result (and final stage of the process) is a situation in which the public corporation that previously provided services to everyone now functions as part of a *welfare* network, providing low-level services only to the very poor who cannot afford to purchase the service in the market. Adopting such an informal strategy may be politically tempting from the government's point of view. The process is

[18] This was the case in Israel before 1980. A public corporation (Magen David Adom) enjoyed a monopoly in the provision of emergency ambulance services.

performed with minimal legal formalities and with little public attention or media coverage. The end result of privatization may be presented not as the result of an official premeditated plan, but as an almost coincidental consequence of some fragmented, seemingly unrelated occurrences: an economic crisis that requires (across the board) budgetary cuts, the "neutral" function of market forces, and so forth.

The above example of ambulance service signifies many processes of privatization that took place in Israel during the past four decades. While some privatization moves were carried out by taking the formal course, most processes of privatization were not. Rather, privatization was carried out by using informal techniques without legislative approval (sometimes even without any regulatory changes) and away from the public eye. Thus, public hospitals began offering special private healthcare services for market prices; public schools, officially created to offer free education to all, began offering extra classes and activities for pay (particularly in wealthy neighborhoods).[19] Other fields, previously considered as part of the public service to all citizens, were subjected to the market regime by effective mechanisms of informal privatization.[20]

III. PRIVATIZATION AND JUDICIAL REVIEW

What was the position of the Israeli judiciary regarding privatization? In general, the involvement of the courts in administrative and political decision-making in Israel is robust, and the past three decades have reflected a significant increase in the scope of judicial review.[21] During the 1980s, the Supreme Court dramatically changed its policy on *standing* to allow any person to challenge an illegal or unconstitutional governmental decision, even if the petitioner had no special personal interest in the issue at stake.[22]

The Court also dramatically changed its policies on the judiciability doctrine to allow petitions that involved sensitive political questions to be judicially decided.[23] Accordingly, the Court significantly expanded the scope of judicial review with regard to almost all aspects of governmental decision-making. As the result, the Supreme Court became a tempting arena for interest groups and organizations to pursue ideological and political causes.[24] The scope of judicial review was further increased in 1992 when the Knesset

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[19] Yoav Dotan & Barak Medina, *Legal Aspects of Privatization of the Supply of Goods and Services* 37 MISHPATIM (Law) 287 (2007) (Hebrew).

[20] *Id.*

[21] *See, e.g.*, Robert A. Burt, *Inventing Judicial Review: Israel and America*, 10 CARDOZO L. REV. 2013, 2014 (1989).

[22] HCJ 910/86 Ressler v. Minister of Defense 42(2) PD 441 [1988] (Isr.).

[23] *Id.*

[24] Yoav Dotan & Menachem Hofnung, *Interest Groups in the High Court of Justice: Measuring Success in Litigation and in Out-of-Court Settlements*, 23(1) LAW & POL'Y 1 (2001).

(the Israeli parliament) passed two new Basic Laws (including the Basic Law: Human Dignity and Liberty), to which the Supreme Court ascribes constitutional status.[25] Later, during the 1990s and 2000s, the Supreme Court widened the scope of administrative and constitutional review by lengthening the list of constitutionally protected rights and by including socio-economic rights in the list of protected rights.[26]

Given the fact that the rise in the scope of judicial review took place at roughly the same period when privatization was intensifying, one might expect that the judiciary would intensively scrutinize practices and decisions related to privatization. The reality, however, proved otherwise. The above-described transformation of major segments of society to privatization took place with very minimal involvement on the part of the courts. This judicial passivity stood in sharp contrast to the overall activist policies of the Supreme Court (and the court system in general).

One way to explain this state of affairs is to suggest that the Supreme Court refrained from intensive intervention in privatization because privatization corresponded with the liberal ideological inclinations of the Court.[27] This "attitudinal" hypothesis, however, does not seem to provide a consistent explanation for the Court's policies in the socio-economic field during recent decades.[28] Thus, for example, during the same period, the Court developed rich jurisprudence regarding the constitutional status of socio-economic rights. It acknowledged the right to minimal income, to fair housing, and to proper education as constitutional rights that the state must provide to every citizen, even though such rights have never been entrenched in any constitutional text.[29] Moreover, the ideological hypothesis seems to have suffered a serious blow, specifically with regard to privatization, after

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[25] Israel has no formal written constitution, but according to accepted constitutional convention, the Knesset holds the power to form "Basic Laws" that would serve as chapters to the future constitution when completed. After the formation of the new Basic Laws in 1992, the Supreme Court ruled that the new Basic Law constitutes *the* "bill of rights" for Israel, and that the judiciary is authorized to invalidate regular legislation that infringes on the rights entrenched by the Basic Law. CA 6821/93 Bank Ha'mizrachi v. Migdali 49(4) PD 221 [1994] (Isr.). *See also* David Kretzmer, *The New Basic Laws on Human Rights: A Mini-Revolution in Israeli Constitutional Law?, in* PUBLIC LAW IN ISRAEL 141 (Itzhak Zamir & Allen Zysblat eds., 1996).

[26] *See infra* note 29 and accompanying text (discussing the judicial expansion of protected socio-economic rights).

[27] This line of explanation was indeed adopted by various academic critics of the Court. *See, e.g.,* Eyal Gross, *The Israeli Constitution: A Tool for Distributive Justice, or A Tool Which Prevents It?, in* DISTRIBUTIVE JUSTICE IN ISRAEL 79 (M. Mautner, ed., 2000) (Hebrew); Guy Mundlak, *Social and Economic Rights in the New Constitutional Discourse: From "social rights" to the "social dimension of all rights*," 7 THE LABOR LAW YEARBOOK 65 (1999) (Hebrew).

[28] *See, e.g.,* Jeffery A. Segal & Harold J. Spaeth, THE SUPREME COURT AND THE ATTITUDINAL MODEL REVISITED (2002) (discussing the "attitudinal" hypothesis).

[29] *See* Yoav Dotan, *The Supreme Court as the Protector of Social Rights*, *in* ECONOMIC, SOCIAL AND CULTURAL RIGHTS 69 (Yoram Rabin & Yuval Shani eds., 2003) (Hebrew).

the Court's celebrated decision on the *Private Prison Case*.[30] In that case, the Israeli Supreme Court ruled that privatization of prisons is unconstitutional *per se*, regardless of the empirical conditions in private prisons.[31] It declared that the very subjection of prisoners to imprisonment in a non-governmental prison infringes the prisoners' right of human dignity.[32] Thus, in this decision the Court expressed a robust *anti*-privatization ideology, and became the first higher judicial institution ever to strike down privatization of prisons.[33]

Hence, it seems that the very limited impact that the Israeli judiciary has had on privatization processes cannot be explained on the basis of the ideological inclinations of the Supreme Court. Rather, I argue that the explanation has to do with the limitations of the legal doctrines that the Court employed, and the failure of the Court to develop non-traditional tools to deal with informal privatization. In order to demonstrate the point, we now turn to the legal doctrines that the judiciary employed with regard to privatization.

IV. PRIVATIZATION IN ADMINISTRATIVE LAW

Given the pervasiveness of privatization in many segments of society, and the informal (sometimes even covert) nature of many practices in the field, only a small portion of privatizations were brought to judicial review. But even in these cases, the courts were not equipped to understand the nature and implications of privatization and to effectively review them. In fact, most existing doctrines in public law not only failed to provide for effective constraints, but were designed in a way that *encouraged* privatization and inhibited the ability of the law to effectively review it. The first doctrine that served in this respect is *the deference principle.* When the legality and reasonableness of decisions to privatize were challenged, the Court treated the issue as a matter of *economic policy* that merits considerable deference on the part of the judiciary.[34]

Another doctrine often employed in privatization cases was the doctrine of *delegation* of statutory powers.[35] Whenever the government

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[30] HCJ 2605/05 Academic Center for Law and Business v. Minister of Finance 27 [2009] (Isr.). An English translation is available at http://elyon1.court.gov.il/files_eng/05/050/026/n39/05026050.n39.pdf. *See also* Daphne Barak-Erez, *The Private Prison Controversy and the Privatization Continuum*, 5 LAW & ETHICS OF HUM. RTS. 139 (2011); Barak Medina, *Constitutional limits to privatization: The Israeli Supreme Court decision to invalidate prison privatization*, 8 INT'L J. CONST. L. 690 (2010).

[31] *See* Academic Center for Law and Business v. Minister of Finance, HCJ 2605/05 at 127.

[32] *Id.* at 142.

[33] *See* Medina*, supra* note 30, at 2.

[34] *See* Dotan & Medina, *supra* note 20 at 305-306.

[35] *See* Sir William Wade & Christopher Forsyth, ADMINISTRATIVE LAW 347-58 (7th ed. 1994).

contracted private actors to provide services or to manage public assets, the court treated the action as delegation.[36] Under the framework of delegation, the main question is whether the governmental agency delegated to the private party the very statutory (discretionary) power (which is unlawful under the *ultra-vires* doctrine),[37] or whether the delegated functions were merely "executive" (non-discretionary and "ancillary") in nature.

Indeed, the courts took notice of the fact that in privatization, the delegatee of the governmental power is a private entity wholly outside the framework of the state. They ruled that such cases of delegation raise special concerns, since private actors might abuse the delegated power in order to enhance their profits, undermining the purposes of the delegation and the original intention of the legislature. Accordingly, they advocated caution before delegation, and required special assurances to avoid conflicts of interest.[38] However, the whole legal framework of delegation seems wholly unfit to deal with the privatization phenomenon. It was designed to regulate the delegation of power from one public agency to another (or, most commonly, from one official to another within the same administrative agency). It completely ignores the major distributive impact of privatization, and is thus unfit to effectively deal with the conditions and consequences of privatization.

A third doctrine of administrative law that was applied to privatization is the doctrine of *semi-public* actors. Under this doctrine, developed by the Supreme Court during the 1980s, the requirements of public law, such as the principle of equality and the rules against bias, apply not only to state agencies but also to various other actors that provide services to the public. This doctrine enables the Court to apply principles of public law to entities such as utility companies, healthcare providers, universities, and even sport clubs.[39]

At the outset, this doctrine seems perfect for dealing with privatization, since it implies that even when the government privatizes certain services by assigning private actors to provide them, the provision of the service still remains regulated by public law since the "private" contractor is classified as a "semi-public" entity and must abide by the principles of public law. A closer look at this doctrine, however, reveals the fact that it is ill-equipped to deal with the distributive consequences of privatization. This is because the principles of public law prohibit discrimination on the basis of *political* grounds such as race, gender, ethnicity, etc. There is nothing in the doctrine of equality, however, that bans discrimination on *socio-economic* grounds. Thus, for example, under this

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[36] *Id.* at 352-358.

[37] *Id.* at 347.

[38] HCJ 39/82 Henfling v. Mayor of Ashdod 36(2) PD 541 [1982] (Isr.); CA 4855/02 Borovitz v. State of Israel [2005] (Isr.).

[39] HCJ 731/86 Micro Daf v. Israel Electric Corp. Ltd. 41(2) PD [1987] (Isr.); CA 3414/94 On v. Diamond Exchange 49(3) PD 196 [1995] (Isr.).

doctrine, utility companies and healthcare providers are not allowed to deny service on the basis of ethnicity and/or to discriminate against potential customers on the basis of race or gender. They are, however, allowed to discriminate between customers on the basis of their ability to pay for the service. Thus, while creating the allure of "equality," the doctrine completely fails to cope with the distributive consequences of privatization.

Doctrines referring to fundamental human rights also played a role with regard to privatization. In 1992, the Knesset passed two new Basic Laws that included a list of entrenched rights which formed the constitutional framework for future legislation. Among the rights embedded in the new Basic Laws were the right to own property and the right to pursue free trade.[40] The fact that such "libertarian" rights were bestowed with constitutional status was certainly conducive to processes of privatization, at least in the sense that it could *fortify* the already *existing* deferential tendencies of the Court towards policies and practices of privatization.[41]

More interesting in this respect is the doctrine of *socio-economic* rights developed by the Court during the same period.[42] The Court ruled that despite the fact that rights such as education, healthcare, housing, or minimal income were not mentioned in the constitutional text of the new Basic Laws, these rights are included in the fundamental right to human dignity.[43] On the face of the matter, the development of an activist doctrine of fundamental rights in the socio-economic field might serve as a constraint against the distributive consequences of privatization. In reality, however, the *reverse* proved to be true. This is because the idea of fundamental socio-legal rights does not require *full distributive equality* with regard to relevant social goods (such as healthcare, housing, or education). It only provides for some *minimal* (constitutional) *level* of service that the state must supply to every member of society. The problem is, of course, that when one deals with the distributive outcomes of privatization, the doctrine does not constrain the process but rather approves its very essence and outcomes. This is because the starting point of privatization is complete equality in the provision of the service, and its end result is the creation of a free market that serves most people, with some minimal assurance of (an inferior) public level of services to the poor.[44] Thus, the socio-legal rights doctrine is conducive to the outcomes of privatization because it only takes care of the minimal (welfare) level, while completely neglecting the overall impact of the process.

The above discussion leads to another paradigm that was conspicuous in the Court's rulings on privatization. When the Court encountered arguments against the distributive impact of privatization, it was

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[40] *See supra* note 25 and accompanying text (discussing the Basic Laws).

[41] *Id.*

[42] *See supra* note 29 and accompanying text (discussing court decisions regarding the constitutional status of socio-economic rights).

[43] *Id.*

[44] *See supra* text on pgs. 5-6 (explaining the end result of privatization).

always willing to accept the infringement of socio-economic equality if the government ensured some "basic," "minimal" level of public service.[45] Thus, for example, when a public action organization attacked a decision to privatize a municipal park (that was previously open to all for no charge), the Court dismissed the petition while stating that there remain other (albeit less modern and equipped) parks open to the general public in the relevant municipality.[46]

V. ALTERNATIVE APPROACHES TO PRIVATIZATION

The failure of the traditional doctrines of public law to cope with privatization (and, particularly, with informal privatization) raises the question of whether existing doctrines of public law can serve this purpose at all, or whether we need to create completely new doctrines in this respect. I argue that, in fact, existing doctrines of administrative law may well provide proper constraints on processes of privatization. But before I present the argument, some clarifications are needed with regard to the proper *role* of the judiciary in privatization.

What then is the proper role of the courts with regard to privatization? At the outset it seems clear that the primary decision *whether* to privatize certain fields of economic or social activity should not be taken by the judiciary. Decisions on privatization are major social decisions that should be made by the political branches. The judiciary has neither the professional expertise nor the democratic mandate to make such decisions.

On the other hand, the decision as to *how* the government should decide on privatization, i.e. what should be the proper *process* for privatization, should be in the domain of the judiciary. In other words, if the democratic community in country X decides to privatize its national healthcare system, it is not for the judiciary to decide whether such a decision is right or wrong. The judiciary, however, is awarded the role of making sure that the relevant democratic community so decided. This means that when major decisions on privatization are made behind closed doors, by unelected, mid-level bureaucrats, without any specific legislative mandate and with no public participation, it is the role of the judiciary to intervene in order to verify that the proper democratic process was carried out.

VI. CONCLUSION

How can we achieve this goal? I suggest we use the old and simple concept of *legality.* That is, I suggest that whenever the government proposes

[45] HCJ 8676/00 Adam Teva Vedin (Man, Nature and Law) v. Municipality of Ra'anana 59(2) PD 210 [2004] (Isr.).

[46] *Id.* at 228. *See also, e.g.,* HCJ 205/94 Nof v. Ministry of Defense 50(5) PD 449 [1997] (Isr.).

to privatize major public services, it would be required to present a clear legislative mandate and to meet due process requirements. After all, under the *ultra-vires* doctrine, the judiciary requires a clear statutory mandate (and due process) whenever the government decides to *nationalize* private property (i.e., whenever society decides to bring something that was previously private into the public domain). Why shouldn't we make the same demands whenever the government does the reverse? Indeed, traditional doctrines of public law such as legality and due process were developed on the basis of the liberal ideas of the eighteenth century. The massive distributive implications of privatization in the past four decades suggest that we should renew these same doctrines in order to answer the contemporary problems of informal, covert privatization.