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Determinants of choice in the form of conducting municipal economy by local government units

Abstract

Objectives: This paper aims to address a problem that includes the managing of the municipal economy by local government units (LGUs). The research issue raised regarded, in particular, the rules and organisational-legal norms for managing a municipal economy. Its expression is the posed hypothesis according to which what matters significantly for LGUs in the choice of form for conducting a municipal economy is both the character of the task as well as whether this form is recognised as a subject of the public finances sector, and, what follows, whether its indebtedness is subject to statutory restrictions and influences the financial situation of LGUs.

Research Design & Methods: To verify a hypothesis formulated in such a way, firstly theoretical and legal aspects of managing a municipal economy by LGUs have been put forward. Next a comparative analysis for forms of managing a municipal economy by LGUs was conducted, i.e. a local self-government budgetary establishment and a municipal company, and the most significant characteristics of the discussed forms, as well as their effects being a result of their choice by LGUs, were indicated. Comparative and descriptive analysis has been used in this paper; it included analysis of financial data regarding the management of a municipal economy by LGUs, but in strict correlation with institutional and legal conditions for the realisation of public tasks and their conditioning.

Findings: As a result of the research conducted, it has been concluded that changes taking place in the scope of forms of managing a municipal economy point towards more and more common tasks realised by LGUs both in the field of public utility as well as outside of the public utility zone in the form of commercial law companies.

Contribution: Basic kinds of risks associated with the realisation of tasks by the budgetary establishment and municipal company have also been defined. Moreover, research results show that possibilities for such a wide operation result first and foremost from imprecise legal regulations, which are at the same time the only source of risk associated with the operation of such companies.

Keywords: municipal economy, economic activity of LGUs, local self-government budgetary establishments, municipal company, risk.

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Introduction

The basic goal in the functioning of local government units (LGUs) is the performance of public tasks directed at meeting the needs of the local community. Bodies constituting local government units have the right to choose the organisational and legal form of these tasks, but at the same time are responsible for the performance of public tasks carried out in private forms.

The legislator does not formulate restrictions as to the category of organisational units, but only defines the scope of conducting business activity by LGUs and organisational units. Local government units may create, for the purpose of carrying out tasks, both units with no legal personality as well as units with legal personality. The first of those involves organisational units such as a budget entity and a local self-government budgetary establishment. The legal bases for their functioning have been defined in the Act of 27 August 2009 on public finances (the Public Finances Act). The second group of organisational units are entities with legal personality, a category which includes joint-stock companies, limited liability companies that can be created by local government units on the basis of the provisions of the Act of 20 December 1996 on municipal management (the Municipal Management Act), as well as foundations, public independent healthcare institutions, local government cultural institutions and other local government legal entities. Organisational and legal forms can be distinguished among units included in the aforementioned groups, in which local government units can conduct municipal management – these are local self-government budgetary establishments and commercial law companies. Moreover, LGUs may also entrust tasks from the field of municipal economy to be performed by natural persons, legal persons and entities without legal status, and perform these tasks in the form of municipal relationships and agreements.

Bearing in mind the above premises, the authors have undertaken a research problem formulated in the form of the following questions:

What are the essence and reasons for the creation of individual organisational units by local government units?

What are the legal regulations and rules of managing a municipal economy by LGUs?

What factors determine the choice of the form of management in a municipal economy by local government units?

What are the consequences of choosing individual forms of task implementation?

Based on a problem formulated on this basis, a scientific hypothesis has been made according to which what is important for the choice by LGUs of the form of managing a municipal economy is both the character of the task as well as the fact of whether it is an entity of the public finances sector, and, what follows, if its indebtedness is subject to statutory restrictions and influences the LGU's financial situation. Derivatives of the research problems and research hypotheses are the main objectives of this study, which include: analysis of the legal basis for the creation and functioning of organisational units, with particular emphasis on legal regulations included in the Municipal Management Act; and analysis of the premises and consequences of the selection of individual forms of performance of tasks within the municipal economy.

The structure of this study reflects the adopted research objectives. Firstly, organisational and legal forms for managing a municipal economy have been characterised considering the issue of managing business activity by an LGU in a public utility area. Furthermore, changes in the scope of managing a municipal economy by an LGU in the form of a local self-government budgetary establishment and commercial law companies have been analysed, inter alia based on a revenue and expenses analysis in budget divisions in the years 2010–2016, and the most significant characteristics

of the discussed forms have also been shown. The last part of this article, on the basis of previous considerations, includes an analysis of factors determining the choice of form of managing a municipal economy and results of that choice of form for the realisation of tasks. This study ends with a summary setting out the most important conclusions from the research.

Organisational and legal forms of municipal economy management by local government units

The source literature includes many views on the form of performing public tasks by municipal authorities. This results from, *inter alia*, the shape of legal regulations in this field. Statutory acts indicate that LGUs, in order to perform their tasks, may create organisational units; however, the acts do not specify which units this specifically regards. Such terminological heterogeneity causes many problems in practice. The answer came to a certain extent in a judgment of the Supreme Administrative Court in 2009 (II OSK 664/09, LEX No. 552881), in the light of which the concept of an organisational unit means an entity with a specific organisational structure. An organisational unit is such an entity that was created by a local government unit, in which the local government unit has shares, or which uses the government's financial means. Therefore the concept of an organisational unit includes both organisational units (municipal, county and provincial) as well as local government legal entities. The concept of a local government legal person should be understood as a municipal, county or provincial organisational unit with the legal status of an entity. It is an entity separated organisation-wise, having separate property and personal components, performing tasks specified in relevant legal regulations.

In the case of organisational units without legal personality (budget entities, local self-government budgetary establishments) there is consensus among authors as to the essence and principles of the functioning thereof. Most authors emphasise

the fundamental differences between a budget entity and a budgetary establishment. S. Owsiak (2017, p. 603) defines a budget entity as an entity typical for the economy by means of public funds the essential feature of which is that it covers its expenses directly from the state budget (an LGU budget), and income is transferred directly to the account of the appropriate budget (i.e. it settles payments with the budget using the gross budgeting method). This view predominates in the source literature (Dolata, 2016, p. 115; Wróblewska, 2014, p. 178). Similarly, in the case of local government budget divisions there is homogeneity of views of different authors. It may be concluded that a common element of all definitions is a result of the disposition of Art. 14 of the Public Finances Act pursuant to which local self-government budgetary establishments are created in such fields of public life where it is possible to introduce an entire or partial payment for services, and therefore a budget division, in contrast to an authority may cover the costs of functioning (expenses) from obtained income. In addition to the forms discussed, local government units can create what are known as local government organisational units with legal personality (Dolata, 2016, p. 130). They are referred to as municipal, county and provincial public utilities, and mainly carry out tasks in the field of culture (e.g. orchestras, museums, community centres, etc) and in the field of health care (independent public health care facilities).

However, most controversy in the source literature is related to the issue of communal management of LGUs. Markets for communal services differ from commercial markets. The basic difference stems from the fact that they are usually operated by one entity providing a given service, which means that it operates in the conditions of a monopoly market. It seems, however, that given the technology for producing and delivering goods and services, the local reach and structure of the market and the fact that one entity is able to meet the needs that occur therein by generating lower costs than a few competing suppliers, this market has characteristics of a natural monopoly

(Grzymała, 2010; Mosca, 2008). However, opinions are divided with regard to causes and the mechanism of creation in the sphere of the communal economy of structures corresponding to the natural monopoly model, (DiLorenzo, 1996 (as cited in Satoła, 2017, p. 33)).

The provisions of the on Municipal Management Act are crucial from the point of view of an LGU's municipal economy. As per the cited act, a municipal economy is based upon the LGU performing its own tasks, in order to meet the collective needs of a self-governing authority, and may be managed in particular in the forms of a local self-government budgetary establishment or a commercial law company. There is a stance in the doctrine according to which the concept of municipal economy covers every sphere of self-government activity in the area of *minium* and *empire* (Kulesza, 2012, pp. 7–8, 10–11). However, one may encounter other approaches that give municipal economy a narrower meaning, as an activity of LGUs that is not a ruling activity the purpose and effect of which is the material implementation of public tasks, and thus the production of goods, the provision of services, or the obtaining of financial resources for that purpose (Skoczny, 1991, p. 3).

The first of these views connects the concept of municipal economy with the entire sphere of the self-government's activity, and does not leave any activities that are only of organisational character or special protection of communal property. It seems, however, that the statutory understanding of municipal economy explicitly points not towards every LGU activity, but instead to the provision of public services. The content of the Municipal Management Act directly regulates, on the one hand, the subjective aspect of its management (including transformation of the subjective forms of running this economy), and, on the other hand, the subject of this act was designated by Art. 4 of the Municipal Management Act, covering the provision of municipal services (and the rules for the payment for them) (Bandarzewski, 2016, p. 42). The second significant doubt concerns the scope of local government tasks covered by

municipal management. It is clear from Art. 1, sec. 1 of the Municipal Management Act that the municipal economy includes only own tasks. Although the concept of own tasks directly concerns only municipalities, as in relation to counties and self-government provinces the legislator refers to such tasks as “tasks of supra-municipal nature” and “tasks of provincial nature”. There is no doubt that municipal economy also covers municipal tasks of supra-municipal character and, respectively, tasks of a province self-government of provincial character (these are own tasks of these tiers of local government) and does not include commissioned tasks (tasks from the field of government administration). The tasks of municipal economy can be divided into:

- a) tasks of public utility character, covering own tasks of LGUs;
- b) tasks exceeding the scope of public utilities, which, according to the definition of the municipal economy concept, should also include only own tasks of LGUs.

In addition, the legislator, when describing performance of tasks in the field of public utilities, also refers explicitly to the concept of economic activity. Hence another question arises: can local government manage its own business activity as part of both above-mentioned categories of tasks? The concept of economic activity is defined in the Act of 2 July 2004 on freedom of economic activity (the Act on Freedom of Economic Activity). According to Art. 2 of the above-mentioned act, business activity should be understood as profitable production, construction, trade and service activities, as well as exploration for and identification and extraction of minerals from deposits, and professional activities, performed in an organised and continuous manner. The key element of the definition of business activity is profit, so therefore directing activity at gaining income (profit, revenue). However, the concept of profit does not appear in the definition of municipal economy, and the criteria for performing tasks in the field of public utilities indirectly eliminate this criterion.

In neither doctrine nor judicial decisions is there uniformity of views as to the permissibility of conducting business activity by LGUs, and with the permitting of conducting business, as to the characteristics of such activity. K. Kohutek (2005, LEX/el.) indicates that the performance of tasks in the sphere of public utilities cannot be treated as running a business, while conducting activities outside that sphere should be treated as economic activity.

The aim of the performance of tasks of a public utility nature is ongoing and uninterrupted satisfaction of the collective needs of the population through the provision of publicly available services. These tasks should include, in particular, municipal services and, in accordance with Art. 2 and Art. 9, par. 1 of the Municipal Management Act, they may be performed by local self-government budgetary establishments, commercial law companies (limited liability companies) and joint-stock companies (JSC). The legal basis of activity for the first of the aforementioned forms are the provisions of the Public Finance Act, which in Art. 14 sets out a detailed catalogue of LGU tasks that can be performed in this organisational and legal form. The cited article mentioned LGU's own tasks, *inter alia* in the scope of: housing management and business premises management; local road infrastructure and traffic organisation; supply of water, electricity, heat and gas; ensuring sanitation; maintaining cleanliness, order and sanitary facilities; local public transport; marketplaces and market halls; communal greenery and trees; physical culture and sport; social assistance, professional and social reintegration, as well as vocational and social rehabilitation of disabled people; maintaining various species of exotic and domestic animals; and maintaining cemeteries. Analogically, the activity of commercial law companies in the sphere of public utilities may concern the same areas.

The detailed list of tasks presented by the legislator is a closed catalogue. Unauthorised activity would include the creation of a local government budget division in order to run a school or kindergarten. What is more, as a rule, local

self-government budgetary establishments must be created solely for tasks for which it is possible to self-finance business operation. A local self-government budget division, performing chargeable tasks, covers its operating costs with its own revenues. It results from the content of court judgments that budgetary establishments are not business entities within the meaning of Art. 4 par. 1 of the Act on Freedom of Economic Activity, because this unit is distinguished as a form of budgetary law, and not a form of conducting business activity (Sołtyk, 2017, p. 79).

The Public Finance Act also allows for the possibility of transferring subsidies for budgetary establishments from the LGU budget. These may be subject-related subsidies as well as subject- and purpose-based subsidies. In the latter case it is possible to transfer both target subsidies for current tasks financed with EU funds and other funds from non-returnable foreign sources, as well as targeted subsidies for financing or co-financing investment implementation costs. The last type of subsidy for local self-government budgetary establishments is a one-time subsidy for the first equipment in working capital, which can be granted only to a newly created plant.

It must be explicitly emphasised that subsidies for a budgetary establishment are legally limited. There is a restriction according to which subsidies cannot exceed 50% of a given plant's operating costs. Only the above-mentioned two types of targeted subsidies are exempted. This means that the fees charged for services provided must account for at least 50% of the given plant's total revenues.

Another important element from the point of view of budgetary establishments' principles of operation is the method of accounting for budgetary establishments with the LGU budget. Pursuant to the Public Finance Act a plant's settlements with the budget are made via the net budgeting method. This means that the surplus of the company's financial resources is paid into the budget, and any shortage of financial resources is covered by means of a money transfer from the LGU's budget in the form of subsidies. The

detailed manner of establishing a surplus in working capital in a local self-government budgetary establishment is defined by the Regulation of the Minister of Finance of 7 December 2010 on the manner of conducting financial management of budget entities and local self-government budgetary establishments (the 2010 Regulation of the Minister of Finance).

Although within the current legal status the catalogue of tasks which can be performed by local self-government budgetary establishments is extensive, in recent years there has been a visible reduction in the scope of tasks performed by LGUs using this form. Particularly significant changes took place in 2010 with the entry into force of the currently binding Public Finance Act. By 31 December 2010, in accordance with the provisions of that Act and the provisions introducing this law, municipalities were required to liquidate or transform those budgetary establishments the activities of which went beyond the scope defined in Art. 14 of the Public Finance Act. The financial results related to mandatory changes in the scope of operation of budgetary establishments are presented in Table 1.

Financial data for local self-government budgetary establishments shows that as a result of changes to the Public Finance Act plant revenues and costs in 2011 decreased by more than 36% compared to 2010. The highest revenues and costs were related to the activity of municipal budgetary establishments and plants operating in cities with poviats rights: in 2010 they accounted for 46% and 50% of the revenues of all local self-government budgetary establishments (the situation was similar in 2011). These changes were, *inter alia*, a result of the transformation in 2010 of 90 budgetary establishments into limited liability companies (*sp. z o.o.*) and 16 budgetary establishments into budget entities. In addition, 25 new budgetary establishments were created and 4 were closed. Irrespective of that, 159 new limited liability companies and up to 30 new joint-stock companies were created or launched.

In 2010 the number of capital companies in the municipal economy exceeded the total number of budget units and budgetary establishments. At the end of 2010 LGUs held 2,431 companies (2,058 limited liability companies and 373 joint-stock companies), 782 local self-government budgetary establishments and 1,305 budget entities (Ministry of Treasury, 2011). In subsequent years the scale of changes in organisational and legal forms was smaller. For example, in 2013 33 budgetary establishments were transformed into limited liability companies, in the following year seven, and in 2015 nine. At the end of 2015 LGUs held 2,597 companies, including holding shares in 2,324 limited liability companies and in 273 joint-stock companies. This means that in the years 2010–2015 the number of municipal companies increased by nearly 7%. The number of budgetary establishments in 2015 was 779, remaining at a level close to that in 2010 (Ministry of Treasury, 2016). However, revenues of local self-government budgetary establishments in 2010–2016 decreased by nearly 50% (with the largest falls in municipalities and cities with poviats rights, down by 33% and 60% respectively). The largest scale of changes, as noted earlier, concerned the years 2010 and 2011.

Thus it is possible to point out two fundamental reasons for the transformation of budgetary establishments and the growing number of commercial law companies. One worth mentioning are changes in legal regulations that even required LGUs to limit the scope of the performance of tasks by budgetary establishments. The second reason was related to the benefits associated with the creation of commercial law companies by LGUs (including freedom of their creation and the financial consequences for local governments). They are equal in relation to private entities, participants in economic life, and their organisational structure favours a more effective and rational use of municipal property. Given the typically commercial nature of capital companies, profit dividends are a potential source of LGU revenues. These types of companies give LGUs much broader options for operations. It should be emphasised here

Table 1. Revenues and costs of local self-government budgetary establishments in 2010–2016 (in PLN thousand)

Specification	2010	2011	2012	2013	2014	2015	2016
IN TOTAL							
Revenue	8 750 765	5 582 645	5 355 589	4 962 610	4 709 468	4 696 733	4 588 813
including subsidies from the budget	2 135 530	772 442	601 108	538 781	532 370	549 734	538 718
Costs	8 774 132	5 963 797	5 406 006	4 962 650	4 648 580	4 643 282	4 519 004
Corporate tax		28 457	26 776	26 334	24 893	25 442	26 215
Deposits to the budget	41 546	22 106	23 712	27 424	23 450	24 003	33 048
MUNICIPALITIES							
Revenue	4 051 743	2 871 694	3 017 283	2 818 714	2 734 822	2 764 905	2 713 078
including subsidies from the budget	774 627	349 570	319 109	302 969	293,314	307 128	300 676
Costs	4 046 801	3 128 628	3 062 955	2 838 283	2 696 399	2 745 736	2 677 844
Corporate tax		14 628	13 627	13 854	13 640	13 876	14 731
Deposits to the budget	20 361	14 614	10 968	15 853	14 114	16 962	20 390
COUNTIES							
Revenue	152 671	28 438	27 329	32 656	42 553	53 225	56 590
including subsidies from the budget	100 566	7 009	6 947	8 438	11 245	10 938	12 495
Costs	151 493	27 764	28 165	33 799	42 302	49 927	56 186
Corporate tax		39	6	26	43	19	62
Deposits to the budget	1 405	0	0	0	80	6	341
CITIES WITH POWIAT RIGHTS							
Revenue	4 409 476	2 651 502	2 282 921	2 042 589	1 873 832	1 820 627	1 758 982
including subsidies from the budget	1 225 878	412 258	271 808	223 660	224 321	229 248	222 350
Costs	4 432 648	2 775 523	2 285 287	2 025 896	1 852 979	1 791 041	1 727 043
Corporate tax		13 723	13 115	11 691	10 741	11 059	10 956
Deposits to the budget	19 257	7 472	12 375	7 828	7 821	6 427	11 222

Table 1 – continued

Specification	2010	2011	2012	2013	2014	2015	2016
PROVINCES							
Revenue	136 875	31 011	28 056	29 456	30 081	30 084	29 830
including subsidies from the budget	34 460	3 605	3 244	3 465	3 231	2 336	2 384
Costs	143 191	31 882	29 598	29 041	30 131	29 782	29 033
Corporate tax		67	27	2	1	219	239
Deposits to the budget	523	20	369	513	114	0	79

Source: own study based on reports about the implementation of budgets of local government units for the years 2010–2016, Ministry of Finance 2017.

that although the obligatory goal of the municipal economy is to meet the collective needs of the self-government's community in the scope of the own tasks thereof, it is not limited to the sphere of public utility tasks, which increases the possibilities of establishing commercial law companies. The Municipal Management Act in the case of tasks outside this sphere limits only the forms of performance thereof and stipulates that the tasks of local government units which go beyond the scope of public utilities can only be performed using the form of commercial law companies (both personal and capital). In addition, the activity of LGUs outside of the public sphere is allowed only in the case of municipalities (including cities with poviats rights) and self-government

municipalities. The legal basis and principles of establishing companies or joining companies by LGUs are presented in Table 2.

Although running the operations of LGUs outside of the public utility domain is not a rule, the catalogue of cases in which especially a municipality can undertake such activity is relatively wide. This is due to, in particular, the provision that allows municipalities to participate in companies "important for the development of the municipality" (Art. 10 sec. 3 of the Municipal Management Act). W. Gonet (2010, p. 83) notes that it is much easier for a municipality to show that establishing or joining a company is important to its development than it results from the unmet needs of the community and existing unemployment.

Table 2. Legal basis and principles of creating and joining companies by LGUs outside of the public utility domain

Municipality (incl. city with poviats rights)	Province
Legal basis	
Article 9 of the Act of 8 March 1990 on the municipal government (the Act on Municipal Government): a municipality and other municipal legal person may conduct business activity beyond tasks of a public utility nature in the form of commercial law companies.	Article 13, par. 2 of the Act of 5 June 1998 on voivodeship self-government (the Act on Voivodship Self-government): outside of the public utility area a voivodship may establish limited liability companies and joint-stock companies and join them.
Rules for creating and joining companies	
Art. 10 of the Act on Municipal Management	Article 13, par. 2 of the Act on Voivodship Self-government
1) If the following conditions are met cumulatively: <ol style="list-style-type: none"> a) there exist unmet needs of the local government's community on the local market; b) unemployment in the municipality has a negative impact on the standard of living of the local self-government's community, and the application of other measures and legal measures did not lead to economic activation, and in particular a significant revival of the local market or permanent reduction of unemployment. 	– if the operations of companies consist in the performance of promotional, educational, publishing activities as well as telecommunications activities serving development of the province
2) If disposal of an element of municipal property that may constitute a non-cash contribution of the municipality to the company, or its disposal in another manner, will cause a material loss to the municipality.	
3) When the municipality owns shares or stocks of companies engaged in banking activities, insurance and consulting, promotional, educational and publishing activities for the benefit of the local government, as well as other companies important for the development of the municipality.	

Source: own study based on: the Act of 8 March 1990 on local governments; the Act of 5 June 1998 on voivodeship self-government; and the Act of 20 December 1996 on municipal management.

Therefore, since the municipality can always take up activities outside the public sphere, if it considers that that is important for its development, the relatively restrictive Art. 10, para. 1 loses its importance in practice.

Controversy surrounding the functioning of municipal companies outside of the public utility domain is due to, inter alia, the fact that the rules governing their creation by LGUs and activities result from many different legal acts, including from the provisions of the Act on Municipal Self-government, the act on Voivodeship Self-government, the Municipal Management Act and the Act of 15 September 2000 on the Commercial Companies Code (the Commercial Companies

Code). This diversity and multiplicity of legal acts has results in three areas. In addition to the aforementioned problems in the functioning of companies (both in the organisational financial sphere and with regard to corporate governance), another effect of the dispersion of legal regulations is significant differences in relation to rules for managing the municipal economy by an LGU in the form of a local self-government budgetary establishment. As a result of those differences completely different areas make these forms attractive from the LGU's perspective. The most important features of local self-government budgetary establishments and municipal companies are presented in Table 3.

Table 3. Characteristics of budgetary establishments and municipal companies

Budgetary establishments	Municipal companies
Legal personality	
No	Yes
Areas of potential operation	
As entities of the public finance sector they may perform: <ul style="list-style-type: none"> – tasks in the field of public utility; – LGU's own tasks specified in the Act. 	As entities outside the public sector they may perform: <ul style="list-style-type: none"> – tasks in the field of public utility; – tasks outside the sphere of public utility.
Access to public funds	
Relatively easy	Relatively easy
Sources of funding	
<ul style="list-style-type: none"> – income from fees for services rendered; – subsidies from the LGU budget (simplicity of subsidising); – no ability to use returnable sources of financing. 	<ul style="list-style-type: none"> – income from fees for services rendered; – no possibility to transfer subsidies from the LGU budget; – increasing the share capital; – capital subsidies for current expenses; – supplementary payments to cover operating losses; – retained earnings; – creditworthiness, enabling the taking of loans for investment purposes and the raising of funds from EU sources.
Principles for spending	
<ul style="list-style-type: none"> – administrative expenses; – legal regime for violation of public finance discipline; – covering operating costs with own revenues. 	<ul style="list-style-type: none"> – quasi-market conditions of operation – the company operates on market principles, being a monopolist in the scope of services provided; – discipline of public finances limited only within the framework of disposing of public funds; – covering operating costs with own revenues.
Connection with the LGU budget	
<ul style="list-style-type: none"> – financial result (net budgeting method). 	<ul style="list-style-type: none"> – not calculating the company's debt with regard to the LGU debt limit.

Table 3 – continued

Budgetary establishments	Municipal companies
Accounting principles	
<ul style="list-style-type: none"> – cash approach; – limited depreciation, reducing (apparently) the prices of services provided. 	<ul style="list-style-type: none"> – result from the Act of 29 September 1994 on Accounting (OJ of 2016, item 1047, as amended), accrual basis; – calculating full depreciation on assets owned, which gives the opportunity to finance the development of a company from own depreciation fund; – ability to capture all costs of a given activity and include them in prices for municipal services, which results from full financial reporting.
Principles of financial management	
<ul style="list-style-type: none"> – the financial plan of the self-government budgetary establishment is the basis for conducting financial management; – the principles of financial management result from the current budget classification; – implementation of the plan is part of the LGU budget report (Rb-30S – report on the implementation of financial plans of local self-government budgetary establishments) – Regulation of the Minister of Finance of 16 January 2014 on budget reporting (as amended, Journal of Laws of 2016); – the Rb-30S report is the basis for making management decisions with regard to the LGU budget. 	<ul style="list-style-type: none"> – the basis for conducting financial management is the material and financial plan, approved by the relevant local government body; – diversified legal regulations shaping the principles of financial management (including the Accounting Act, the Commercial Companies Code, the Act of 4 March 1994 on social benefits fund (the Social Benefits Funds Act), the Act dated 29 January 2004, the public procurement law (as amended, Journal of Laws of 2017, item 1579).
Rules for receiving orders from LGUs	
<ul style="list-style-type: none"> – receiving orders without tender procedures or procedures resulting from the Public Procurement Act. 	<ul style="list-style-type: none"> – entrusting tasks to be carried out without a procedure resulting from the provisions of the Public Procurement Act (what are known as in-house orders); control over the performance of entrusted tasks resulting from the LGU's complete control over the company.
Principles of management	
<ul style="list-style-type: none"> – ease of management by the LGU. 	<ul style="list-style-type: none"> – obligatory establishment of the company's bodies; option of making the remuneration of the management board and supervisory board dependent on the results achieved; distributed supervision exercised by the authority constituting the LGU, the executive body and the supervisory board.

Source: own study.

The third effect of differentiation of legal regulations in the area of municipal companies is their certain specification, which includes, inter alia, the following elements: the executive body performs the function of gathering partners (in the company with the municipality's 100% share); a supervisory board is mandatory; the supervisory board is appointed and dismissed by the company's management board; councillors cannot be members

of the supervisory board; the mayor may be a member of the supervisory board; no internal committee of the council can directly control a company in which the municipality participates (the audit committee may control the company's activities involving the municipality only indirectly, by controlling the mayor's supervision of the company).

Premises and consequences of the choice of organisational and legal form of municipal management of LGUs

When searching for forms and methods of effective management of a municipal economy, LGU authorities must address a few fundamental matters, in particular:

- whether tasks should be performed in exchange for payment;
- what the charge for performing a task should be;
- whether the entity performing tasks should be included in the public finance sector or it should operate outside that sector;
- whether the entity that is to carry out tasks will operate on the basis of a market/quasi-market mechanism or decisions on its spending will be taken in an administrative manner;
- what the degree of independence (legal, organisational and financial) of an entity that performs public tasks will be.

In the context of the dilemmas mentioned above, addressing the question of what premises local government authorities should be guided by when choosing organisational and legal form, it should be agreed that, in addition to the nature of tasks, the complexity of financial management should also be considered (including public funds) (Sawicka, 2010, p. 33). Previous considerations indicate that before making a management decision as to the organisational form in which an LGU will perform its tasks in the field of municipal management, i.e. through the local government budget or a municipal company, it is reasonable for the LGU's authorities to draw up an appropriate economic balance. Such an analysis should include, inter alia, a statement in the form of a performance account (in terms of forecasts of revenues and assumed costs, including planned investments). This will make possible the answering of the questions of to what degree is income from a particular business able to cover the expenses of functioning and the creation of which organisational form for performance of a particular public task is reasonable from the economic point of view? An

analysis of the choice for the form used for task performance should not, however, be limited to only the economic balance, taking into account the goals of tasks to be performed, including, first and foremost, the ongoing and constant meeting of the collective needs of society on the path of providing the commonly available services. In this context the basis for this choice should be the settlement of such issues as the creation of the conditions for these entities in terms of: determining the amount of payment for services provided by the entity; the forms in which they will be supplied from the budget, including subsidies (particularly subjective); and whether they will use any funding which will need to be repaid to the source thereof. It is for these reasons that attention should be paid to the fact that the choice of organisational and legal form in which the municipal management of LGUs will be conducted entails various types of risks. The full catalogue thereof would significantly go beyond the lean framework of this article, therefore only those of such which are, in our opinion, of fundamental importance are presented below.

As is clear from the table above, tasks entrusted by the legal order in effect to municipal companies are encumbered with numerous types of risks. Some of them also occur in a situation when tasks in the scope of an LGU's public usability are implemented in the form of a budgetary establishment. Here are a few examples:

From an LGU's point of view financial risk related to the liability of LGUs for company debts is particularly important. It is enough to point out that if an enterprise operates in the form of a limited liability company, the municipality is only liable up to the amount of the company's share capital. However, in the case of tax liabilities, the municipality will be liable for the full amount. However, when the municipality is the owner of all shares in a municipal joint-stock company, it is always fully responsible for all the obligations thereof, similar to the tax liability of a limited liability company. Another example of risk that is particularly prevalent in municipal companies is

Table 4. Selected types of risks determining the choice between budgetary establishments and municipal companies

Budgetary establishments	Municipal companies
Risk related to performance of public tasks	
<ul style="list-style-type: none"> – Relatively small – may occur as a result of limited options for continuity of financing tasks (the budget is an annual plan); – the goal is to satisfy the community’s collective needs; – the principle of timely execution of tasks resulting from Art. 17 of the Public Finance Act; – lack of incentives to effectively spend funds, which may affect the quality of services provided. 	<ul style="list-style-type: none"> – larger; – the goal is not only to meet collective needs but also to maximise profits based on the Commercial Companies Code, which in principle determines economic balancing; subordination of implementation of profit maximisation tasks may affect the quality of services provided.
Financial risk and accompanying risks: loss of liquidity, loss of credibility and bankruptcy	
<ul style="list-style-type: none"> – limited, due to the discipline of public finances; – regime of openness and transparency; – principles of purposeful and cost-effective spending are based on Art. 17 of the Public Finance Act. 	<ul style="list-style-type: none"> – relatively large; – lack of transparency – obscuring the image of LGUs – resulting, on the one hand, in the possibility of ‘shifting’ the debt of LGUs to companies, and, on the other, in the liability of LGUs for the debts of the company; – greater freedom in running a business that could lead to violation of statutory restrictions; – failure to comply with the principle of economy, e.g. through multiple recapitalisation of the company; – incorrect management of municipal property; – possibility of losing liquidity and credibility, possibility of bankruptcy (e.g. resulting from high costs of maintaining management boards and supervisory boards, as well as external services).
Risk of corruption	
<ul style="list-style-type: none"> – relatively small, due to the inclusion in Art. 34 of the Public Finance Act of the principle of publishing information regarding tasks or services performed or provided by the undertaking and the amount of public funds for their performance/provision. 	<ul style="list-style-type: none"> – occurs especially in the case of companies operating outside the public sphere; – the position of a monopolist generally promotes corruption and the occurrence of pathological phenomena; – lack of transparency in terms of revenues achieved, by involving public funds in conducting commercial business activities (contact between public and private interests).
Personnel risk	
<ul style="list-style-type: none"> – limited chances of recruiting highly qualified staff, due to the remuneration system. 	<ul style="list-style-type: none"> – significant chances of recruiting highly qualified staff due to the remuneration system applied; – greater opportunities to give public affairs to efficient managers, although this will depend on the procedure used to employ them; shortcomings in this area may result in the employing of inept and incompetent people who do not have the expertise and experience.

Source: own study.

the risk of corruption. That may occur in the case of companies operating outside the public utility sphere and results from the fact that the municipality has a stronger position in legal transactions than private entities, which in turn creates a risk of

distorting rules of competition and the risk of corruption related to financing commercial activities from public funds (Chyb, 2015, pp. 8–9).

In addition, a report published by the Supreme Chamber of Control indicates many irregularities

in the functioning of municipal companies. In particular, attention was drawn to the fact that these entities carried out activities that were not permitted under applicable law, not respecting the restrictions for activities outside the public sphere. Irregularities involved, *inter alia*, companies running hotel and catering businesses, management of commissioned real estate, and even property development and funeral services. It should be emphasised that the percentage of such companies in the large number of audited enterprises was very high and amounted to as much as 29% (the study covered 229 companies) (SCC, 2014, pp. 17–21).

The SCC also draws attention to irregularities occurring in many municipal companies as a result of lack of efficiency of ownership supervision and the lack of proper control by LGUs. The report emphasises such weaknesses as, *inter alia*: lack of qualification procedures enabling the selection of the best candidate; appointment of the same persons to several supervisory boards; and application of discretionary criteria (SCC 2014, p. 29).

Another area of the functioning of local government companies in which irregularities are indicated is the management of municipal assets. In seven audited offices, the SCC identified irregularities in the management of LGUs' assets for companies in the amount of PLN 96.5 million). This amount constituted 1% of all means transferred by these LGUs to municipal shareholders. The companies improperly managed assets with a total value of PLN 11.3 million. In addition, in 236 companies (out of 244 analysed) no audits were performed in the years 2009–2013 regarding the method of using assets contributed (SCC, 2014, pp. 8, 27).

Summary

The LGU sector in Poland is the most important public services provider and investor. However, due to the legal regulations in effect with regard to the indebtedness of LGUs, options for performing tasks (especially investment) are decreasing due to

restricted funds necessary for the financing thereof. Therefore more and more often LGUs establish companies the aim of which is to perform specific public tasks. Commercial law companies are not included in the public finance sector, so they are not covered by the regime of disclosure and transparency of finances resulting from the Public Finance Act, but they are included in the public sector when municipal or state-owned property dominates that sector. The indebtedness of these companies is not subject to statutory restrictions; however, it can significantly affect (even indirectly) the financial situation of LGUs.

Analysis of the scope and forms of municipal management of LGUs indicates that, when having the opportunity to choose to perform tasks in the field of public utilities in the form of a local self-government budgetary establishment and a municipal company, they more often decide to perform such in the form of commercial law companies. This is evidenced not only by the decrease in revenues and costs of budgetary establishments in 2010–2016 but also by the decreasing number of organisational units operating in this form. LGUs decide to perform in the form of municipal companies not only tasks in the field of public utilities but increasingly also tasks from outside the sphere of public utilities.

The conducted analysis shows, however, that the performance of tasks in the form of a local self-government budgetary establishment brings about a much smaller risk from the LGU's point of view than the functioning of municipal companies, which is accompanied by numerous irregularities. They exert or can have significant effects on the property of municipalities and the conditions of competition on local markets. These irregularities result mainly from ambiguous legal provisions. Regulations concerning the principles of creating, joining or functioning of local government companies are scattered in many legal acts, which does not facilitate proper performance of municipal management in this form. The functioning of local government companies is regulated by, *inter alia*, provisions of the Commercial Companies Code,

the Municipal Government Act, the Act of 5 June 1998 on powiat self-government, the Voivodship Self-Government Act, Municipal Management Act, Act of 30 August 1996 on commercialisation and certain rights of employees, the Act on Freedom of Economic Activity, the Public Finance Act, and the Act of 21 August 1997 on real estate management. In addition, the act which is key from the point of view of municipal economy management, i.e. the Municipal Management Act, should regulate this matter comprehensively, defining the principles of municipalities creating and joining companies, as well as the rules of their operation. Regulations being included in so many legal acts, and, in many cases, the lack of their precision, causes the occurrence of numerous types of risk, both regarding the implementation of tasks and the risk of corruption, but first of all financial risk.

It should be noted, however, that, on the other hand, the SCC (2014, p. 9) points to the fact that the performance of public tasks by companies with the participation of LGUs has allowed for effective undertaking of many infrastructural investments. However, even in this area the effectiveness of performing public tasks was reduced by irregularities both in the activities of companies and the local authorities supervising them.

It seems, therefore, that for spending of public funds that is effective and consistent with the principles of economy and savings it is necessary to clarify legal regulations for conducting municipal management by LGUs outside the sphere of public utilities. Particularly imprecise are the provisions regarding LGUs creating and joining companies, tasks that can be performed and the effective governance of companies by LGUs. The need to change provisions of law does not raise doubts. Thanks to amendments in law LGUs will change their approach to engaging in the municipal economy in private-law forms, and commercial companies will become an effective form for performance of public tasks, which will also reduce risk associated with their activities.

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