

MANAGEMENT OF COMMUNE'S FINANCIAL RESOURCES UNDER CONDITIONS OF DEBT BONDAGE

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Abstract

Background. A commune local government is formed by inhabitants holding power through their representatives selected to the commune council and to positions of the executive body. Successful local growth is ensured by collaboration among all entities while fulfilling tasks specified by the state law and arising from inhabitants needs. In this paper an entity refers to inhabitants because this choice stems from the conviction that inhabitants co-participate in performing tasks and thus bear the consequences of management which, in the case of finance management, may lead to ill-considered expenditures and excessive indebtedness. Therefore, the research investigates inhabitant's knowledge about financial economy, specifically the scale of the commune's debt and related ramifications.

Research aim. The aim of the studies conducted is to propose a model for finance management in the commune local government, including management under conditions of debt bondage, where local potentials are used for acquiring larger financial resources from the commune local government's members.

Method. The research method used for the studies was a diagnostic survey. The survey rested on the method of questionnaire surveys and interview. The fragment of extensive empirical research carried out in all 118 communes across Warmia and Mazury Region was harnessed in the paper. Direct questionnaire surveys and interviews covered more than 5,000 persons, including councillors, officials, and principally inhabitants. 215 persons were randomly selected out of the whole base of questionnaires.

Key finding. The research subject outlined reveals a primary research problem addressed in the studies. This refers to the knowledge among the commune local government's members about the magnitude of debt in the commune, knowledge about individuals responsible for this indebtedness and, finally, implications of the debt for inhabitants.

Keywords: Commune local government, Debt management, Municipal bonds, Credits

INTRODUCTION AND BACKGROUND

The establishment of commune local governments in 1990 brought hope for restoring local democracy. It also exposed an immense gap between Poland and developed democracies worldwide. These disparities referred to almost all areas of the common good and specifically to the condition of

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local infrastructure related to meeting citizen's fundamental needs. Almost all communes launched efforts intended to reduce these disparities, and the accession of Poland to the European Union clearly accelerated the execution of infrastructure investments. However, faced with a stringent financial policy that results in rationing out subsidies and imposing the obligation of making their own contributions, many communes had to seek new opportunities for raising financial resources. Recent years saw a marked surge in indebtedness in the area of common good at the lowest management level in the state. For this reason, debt management in commune governments emerged as an issue having significant relevance, and for some local governments it became critical for driving local growth. The paper addressed the problem of local government debt. Principally, focus was placed on the causes underlying debt, the financial aftermath for local budgets as well as social costs and methods used for eliminating this debt. At the end of the paper an attempt was made to identify beneficial methods for acquiring financial resources essential for making self contribution to ventures executed in commune local governments.

Debt Management in The Commune Local government – an Attempt to Propose a Definition

In contrast to the debt held by individuals or private entities, indebtedness in the public sector is different in its character. While referring the issue to the commune local government it should be emphasized that debt occurs as a result of the decision made by the body that administers, rather than owning the assets, and thus it does not bear any responsibility for the effects produced by the decision on the debt (except for political responsibility). In this case the universal principle established within the framework of overall creditor-debtor relations and behaviours displayed by subjects of these relations (Kosek-Wojnar & Surówka, 2007, p. 117-119) fails to be applicable. Regarding finances management it is important for indebted units to implement a programme designed to eliminate the debt and management under conditions of debt bondage or debt management. It should be highlighted that rational debt management encourages maintenance of good financial standing provided that the local government unit defines the objectives and instruments for debt management, and, above all, it takes part in formulating and accomplishing the strategy for debt management. Given the mounting debt in the public sector and not always precise information about the scale of debt, interest in the issues of debt across local governments increases. Debt management under the conditions of debt bondage increasingly comes into the spotlight not only among researchers examining this problem or economists, entrepreneurs and media, but principally the citizens themselves who, in the case of the



commune local government, are its subject in fulfilling tasks on their own behalf and on their own responsibility.

The legislative act regulating public finances in Poland, including the issues of debt in local governments, is the act on public finances of 2009 (Act of 27 August 2009 on public finances). In essence, it applies to public finances, including, among others, processes concerned with collecting and allocating, including financing loan needs, incurring liabilities with public funds, managing public debt or accounting for the European Union budget. For public management, management of local government finances implies active, comprehensive and strategic influence on the processes of collecting and disbursing financial funds administered by the local authorities. Moreover, it also suggests management of any liabilities and receivables, management of financial liquidity and debt, management of financing projects and investments, including obtaining European Union funds (Guziejewska, 2012, p.133). It may be assumed that public debt means the financial liabilities of public authorities resulting from contracting loans and credits, issue of securities, or failure to discharge liabilities due by units across the public sector. While enacting a deficit budget, public authorities take responsibility for its financing, namely its payment together with interest (Owskiak, 2005, p.330). Thus, planning public expenditure, not corresponding to budget revenues, by local government units triggers the necessity of incurring liabilities (Dylewski, Filipiak, & Gorzałczyńska-Koczkodaj, 2006, p. 177). These liabilities may also arise from sureties and guarantees granted as well as damages towards entities and citizens and deposits approved and due and payable liabilities of budget units (Ziółkowska, 2005, p. 258). Pursuant to the applicable law a local government unit has to possess available funds for debt payment and payment of costs related to the liability incurred – such a situation is termed as the capability of servicing the debt and possibility of absorbing the debt by a specific local government unit. Overall, this implies that a local government unit, which plans to fulfil its tasks and fails to fully cover its expenditures by revenues, tends to have its operations determined by an imperative of finding available funds to be allocated for service of the contracted debt. When a local government makes a decision on taking on a debt, such a unit should essentially design a system for rational management of this debt in the future. Primarily, it is necessary to determine the magnitude of available funds in the approved timetable for debt payment. To do so, it is essential to calculate the difference between the magnitude of aggregate revenues and obligatory expenditures which brings the amount of available financial resources in the specific financial year, thereby providing the guarantee of effective debt settlement. Starting from budget resolution for 2014, thus following the transitory period enabling local governments to



adapt to new principles and a new method for setting debt limits, a system of individual debt ratio dependent on the planned magnitude of liabilities incurred (running into debt) and capacity of liabilities discharge was put in place. Creditworthiness is measured given the financial excess using a special formula limiting the payment of liabilities laid out in Art. 243(1) of the act on public finances (Act of 27 August 2009 on public finances). Having referred to the resources contained in the Public Information Bulletins (PIB) of commune local governments, examples of concealing actual indebtedness may be revealed. In the Polish model of finance management in commune local governments it is not usual practice to carry out studies and obtain professional reports prior to adopting resolutions by a council or decisions made by executive bodies (Kozłowski, 2012). Hence, when a local government unit applies for credit or loan, and it intends to issue securities, an opinion given by a regional accounting chamber and a prior decision made by a relevant local government body should be reliant on professional reports having not only a formal dimension, but they should refer to benefit of such a solution. Formal requirements (Kosikowski, 2001, p. 269-270) only indicate the obligation foisted on the regional accounting chamber to provide an opinion on possibilities for payment of credit or loan, or redemption of securities. The sources used for financing expenditures that are not covered by projected revenues of the local government unit may include: sale of securities issued by the local government unit, credits, loans, revenues obtained from privatization of the property of the local government unit or surpluses from previous years (Art. 217(2) of the act of 27 August 2009 on public finances). The amendment (Act of 29 June 2000 on amending the bond law and some other acts) on the bonds act (Act of 29 June 1995 on bonds) enacted in 2000 made it possible for local governments to exploit a new financial instrument; so-called revenue bonds. The asset of revenue bonds is the fact that they do not burden local government's budgets because funds for their service do not come from tax revenues. In this case a commune is not liable with all its assets from the issue of revenue bonds as they are solely secured by revenues or assets generated by the venture (Zarzecki, 2003, p.127). Revenue bonds are a measure leading to the issue of so-called self-paid bonds (revenues from these bonds create the infrastructure elements which operations generate proceeds to the local budget, thereby generating the funds needed to redeem bonds, e.g. sewage treatment plant, land-fill site, incineration plant, recycling, etc.) (Kozłowski & Czaplicka-Kozłowska, 2010, p.98).



METHOD

A commune local government is principally formed by inhabitants holding power through representatives elected by them to the legislative and executive body. Therefore, it may be assumed that collaboration among all entities constituting the local government guarantees success. However, the requirement for this collaboration is knowledge shared by all entities about the possibilities, needs and planned operations, specifically including the magnitude of financial resources being disposed by the local government. For this reason, in the research conducted the entity referred to inhabitants, thus persons constituting a local government in Warmia and Mazury Region. This selection stemmed from the conviction that inhabitants co-participate in performing tasks and then reap the rewards or suffer the consequences of poor management. With regard to finance management they face the consequences of ill-considered expenditures or excessive debt. Thus, the research investigates inhabitant's knowledge about financial economy, specifically the scale of the commune's debt and related ramifications. The research subject outlined in this way reveals a primary research problem addressed in the studies which was referred to the knowledge of the commune government's members about the scale of the commune's debt, responsible persons and consequences of this debt. In the efforts to tackle the problem so formulated, the research proceedings seek answers to, among others, the specific questions below:

1. Do inhabitants of commune governments have knowledge about the scale of the commune's debt?
2. Who, in the inhabitants' view, specifically experience the aftermath and take the responsibility for the commune's debt?
3. How do inhabitants assess the policy pursued by local authorities with regard to incurring financial liabilities?

The primary purpose of extensive studies conducted is to propose an anticipated model for finance management in the commune local government, including management under conditions of debt bondage, and a policy seeking to use the local potentials for absorbing larger financial resources. For the research conducted it was assumed that despite the consistent law specifying the debt policy, decisions about raising financial resources from credits and loans are concealed from inhabitants. Moreover, the opportunities for acquiring additional financial resources from commune bonds are not seized.

The studies, aimed to diagnose the management model put into application in commune local governments, particularly in the area of managerial qualifications, were carried out in the second half of 2014. The research method used for the studies was a diagnostic survey. The survey



rested on the method of questionnaire surveys and interview as well as a tool being a survey questionnaire. The fragment of extensive empirical research carried out in all 118 communes across Warmia and Mazury Region was harnessed in the paper. Direct questionnaire surveys and interviews covered more than 5,000 persons, including councillors, officials, and principally inhabitants (survey questionnaires are currently verified and the base is established for conducting analyses). 215 persons were randomly selected out of the whole base of questionnaires, including 69.3% of men where 34.4% had higher education and 44.6% secondary education. The majority of persons were at the age of above 45 years (33.9%), followed by 35-44 years (24.6%) and 30-34 years (17.2%). The respondents by the classification of professions and specializations basically include technicians and other mid-level personnel (32.1%), employees in services and salesmen (15.8%), office personnel (12.6%) as well as the retired (10.2%) and unemployed (6.5%).

RESULTS

While analysing the debt of the public finance sector it may be noticed that since Poland acceded to the European Union the debt soared by around 10% per year on average. For instance, the debt in 2011 of the whole public sector increased by PLN 67.4 billion as compared to 2010, and the debt of the local government sector accounted for PLN 64.3 billion (surge by PLN 10.7 billion, i.e. by 20.1%) – in 2012 the debt of the local government sector grew up to PLN 67.4 billion (Debt of local government units. Compliance with statutory debt limits and its payment, Information about the results of coordinated control of the financial economy, Łódź 2014; www.lodz.rio.gov.pl). The forecast debt for the local government sector in Warmia and Mazury Region for the end of 2014 totalled PLN 2.8 and mounted by PLN 0.2 billion relative to 2013. Whereas the debt for commune local governments (except for cities/towns on the rights of the district) amounted to PLN 1.4 billion at the end of 2013. At that point the commune of Jeziorany and Pozezdrze exceeded the 60% ceiling for the debt, and the 9 successive communes surpassed the 50% ceiling for the debt (Based on the Local Data Bank of the Central Statistical Office of Poland). The press information, published when elections to local governments take place, revealed that 3 communes in Warmia and Mazury Regions ran into debt in quasi-banks, and thus practically they became insolvent. It may be assumed that for the end of 2014 every tenth commune in Warmia and Mazury Region will maintain its debt below PLN 5 million.

Regarding the multiple choice question as to how the respondents assess transparency of financial decisions in their commune, only 198



responses were provided. The majority of responses (20.2%) referred to the statement that all information is contained in the Public Information Bulletin (PIB) and the same number of answers reported that there is no problem with obtaining such information and only information useful to local authorities is placed in the PIB. Barely 6.1% of responses referred to the statement that documents placed in the PIB are clear and the same number of answers indicated that they have complete knowledge about the financial economy in the commune, whereas 5.5% said that information is not comprehensible and many pieces of information are concealed from inhabitants (13.1%). Merely 145 persons (67.4%) answered the question (4 answers were proposed) what is the commune's debt. In the respondents' opinions the debt is definitely overly high (33.1%) and high, yet acceptable (21.4%). What is interesting (given that all communes in Warmia and Mazury Regions are indebted) is that as many as 9.7% reported that the commune is not indebted, whereas 3.4% declared that the debt is low. Only 66.5% of those surveyed provided answers to the inquiry about the assessment of the commune's policy with regard to incurring liabilities. The respondents primarily assessed that policy well (44.8%) and very well (18.9%) - the remaining respondents evaluated it poorly (36.4%). The fault for excessive debt (responses were given by 73% of those surveyed) is largely attributed to the person holding the function of the executive body (49.1%) and councillors (27.4%), then the blame is ascribed to inappropriate law (16.6%) and inhabitants themselves to the least extent (7%). Contracting credits is justified in inhabitants' views only in the event when structural investments are executed (32.9% of answers were given by 73.5% of respondents, the question contained 4 response proposals with an option to create its own answer) and when the necessity occurs to acquire own contribution required for the financial aid granted by the European Union (31.6%). Merely 13.3% agreed with the opinion that it is permissible to contract a credit for payment of previous liabilities, whereas 22.1% declared that it is acceptable to run into debt if necessary and it does not lead to exceeding the limits set. To the question of who takes the responsibility for excessive debt in the commune, the respondents provided 153 answers in total (in the question, alongside 4 response proposals, there was an option to write its own response). Principally, in the respondents' views, a person holding the function of the executive body (45.1%) and then the commune's inhabitants (40.5%) and councillors (9.1%) and officials (5.2%) will be held responsible. Furthermore, the inhabitants were also asked what is the commune's debt. Most of persons indicated an amount lower than PLN 5 million (48.1% - in total only 54 persons answered the question - 25.1%). Every third respondent admitted he has no knowledge, whereas every fifth said that the commune is in debt. 9.3% of those surveyed reported that the com-



mune's debt exceeded PLN 21 million, 42.6% maintained that the debt ranged from PLN 11 to 20 million and the remaining respondents believed that the debt stretched from PLN 6 to 10 million.

DISCUSSION AND CONCLUSIONS

Recommendations

The debt of local government units continuously grew over the recent three years, and thereby concerns about the financial liquidity and possibilities of payment of financial liabilities towards creditors mount. Analyses presented in scientific papers across numerous academic centres reveal that some local governments resort to extra financial resources in quasi-banks. Given constrained revenues from, among others, local taxes as well as implementation of family allowance and change in the tax scale and decreased proceeds from corporate income tax in the aftermath of the crisis, the amount of expected financial resources for the commune dropped. For numerous local governments the debt growth rate hit a level that limits their possibilities of debt payment. Adverse phenomena occurred in the field of finance management in the wake of the global economic crisis, increased costs for debt service and growing needs related to the necessity of raising its own contribution while using the EU funds, all these overlapped with elections to the local governments. The election campaign and frequently ruthless election struggle repeatedly resulted in concealing the financial standing across local government and taking decisions that deviated from the principles guiding effective finance management. Local government bodies (persons sitting on these bodies) assume no responsibility for the financial standing which is transferred to the new term of office. Consequences of the excessive debt in the local government are suffered by its inhabitants through payment of higher taxes, bearing costs related to enrolling children to the pre-school, or school (local governments enjoying a better financial standing financially support parents in the area of education, upbringing, sport or culture). In local governments that poorly manage their finances, including those overly indebted, primary schools and pre-schools are closed down or infrastructural investments are curbed, thereby triggering disparities among local governments in accessing for instance gas, sewage system or water supply system. Many local governments, despite adverse financial situation, decide to seek new opportunities for raising money. The debt level and its further growth pose the threat of exceeding permissible, statutory prudential thresholds. Right now, according to the data included in the *Strategy for managing the debt of the public finance sector over 2012-2018* (Ministry of Finance, Warsaw) the debt of the local government sub-sector at the end of 2014



may surpass PLN 70 billion. Hence, irrespective of invigorating regional and local activity, it is pivotal to implement new principles governing management of finances across local governments, specifically the principles underlying debt management or acquiring extra financial resources for accomplishment of tasks. It is necessary to consider, among others, implementation of the following principles defining finance management in the local government with regard to the new public management:

1. It is necessary to change the principles for planning in the long-term – the plans set up in this manner are not only an important element of raising resources coming from structural funds, but, above all, a form of communication between local government authorities and local government members (citizens establishing this public and legal relationship).
2. A significant decline in debt in external financial entities should take place (and in the future making it impossible to incur such debt) in favour of the debt rested on “local money” coming from local sources – local government bonds.
3. Adoption of the principle that the debt in the local government should rely on local financial resources principally coming from self-paid bonds where bondholders are citizens establishing this public and legal relationship.
4. The decision on the running into debt should be approved by the local government members (the whole corporation of inhabitants) – by means of a referendum or support through purchase of bonds.
5. Financial planning should be based on clear yearly and long-standing plans for revenues and expenditures in the performance configuration – this is a basic requirement for resting management on communication with citizens and approaching citizens as a subject and co-participants while fulfilling tasks, rather than an object used only in elections.

Final Remarks

Over recent years, in connection with backwardness in the development of local infrastructure as compared to other countries in Western Europe and emerging new possibilities of acquiring financial resources, scores of commune local governments make use of all opportunities for winning external aid, including from the European Union. For many local governments, specifically those having low revenues at their disposal, the only alternative is to search for external sources as their own essential contribution for obtaining the EU aid. In most cases the authorities resort to extra financial resources from commercial banks and fail to make any



attempts to acquire them from local sources, for instance from the issue of bonds aimed at the inhabitants. On the whole, this is the outcome of conducting management that is not grounded on transparency, and thus maintaining a continuous contact with the inhabitants using clear plans and reports on their accomplishment. Lack of bonds between the power centre for local authority and inhabitants rested on daily collaboration and communication engenders inhabitants' distrust to those governing, and thus impedes effective issue of bonds or self-taxation among inhabitants. The studies unequivocally reveal, which is specifically illustrated by a large percentage of persons refraining from providing answers, that inhabitants not only do not know the scale of the debt in their own communes, but they are also not capable of indicating entities which will actually suffer the consequences of excessive debt. In inhabitants' views the upshot of excessive debt will largely fall on commune heads (mayors) rather than inhabitants. Moreover, the answers referring to the scale of the debt suggest a lack of knowledge among inhabitants who first admit that the financial policy is pursued properly, and then that the debt is excessive. Contradictions occurring in the answers and lack of answers show the low awareness among inhabitants of finance management in the commune where they live, and paucity of education seeking to enhance the knowledge about management, including management of local financial resources.

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ZARZĄDZANIE ZASOBAMI FINANSOWYMI GMIN W WARUNKACH ZADŁUŻENIA

Abstrakt

Tło badań. Samorząd gminny stanowią mieszkańcy sprawujący władzę za pośrednictwem wybranych przez siebie przedstawicieli do rady gminy i na funkcję organu wykonawczego. Gwarancją sukcesu w rozwoju lokalnym jest współdziałanie wszystkich podmiotów w realizacji zadań określonych prawem państwowym i wynikających z potrzeb mieszkańców. W prezentowanym artykule podmiot odniesiono do mieszkańców a wybór ten wynikał z przekonania, że mieszkańcy współuczestniczą w realizacji zadań i ponoszą konsekwencje zarządzania, które w przypadku zarządzania finansami, mogą prowadzić do nieprzemysłanych wydatków lub nadmiernego zadłużenia. Dlatego też przedmiotem badań uczyniono wiedzę mieszkańców o gospodarce finansowej, szczególnie o wielkości zadłużenia gminy i związanych z tym konsekwencji.

Cel badań. Celem podjętych badań jest zaproponowanie modelu zarządzania finansami w samorządzie gminnym, w tym zarządzania w warunkach zadłużenia, w którym wykorzystuje się lokalny potencjał do pozyskania większych zasobów finansowych od członków samorządu gminnego.

Metodyka. Do badań zastosowano metodę sondażu diagnostycznego. Badanie opierało się na metodzie badań ankietowych i wywiadów. Wykorzystano fragment szeroko zakrojonych badań empirycznych przeprowadzonych w 118 gminach na terenie wszystkich Warmii i Mazur. Bezpośrednie badania ankietowe i wywiady objęły ponad 5000 respondentów, w tym radnych, urzędników, a przede wszystkim mieszkańców. Z całej bazy ankiet wybrano losowo 215 osób.

Kluczowe wnioski. Z tak zarysowanego przedmiotu badań wynika podstawowy problem badawczy podjęty w badaniach. Odniesiono go do wiedzy członków samorządu gminnego o wielkości zadłużenia gminy, wiedzy o osobach odpowiedzialnych za to zadłużenie i ureszcie do konsekwencji wynikających dla mieszkańców z tego zadłużenia.

Słowa kluczowe: Samorząd gminny, zarządzanie długiem, obligacje komunalne, kredyty

