Central and Eastern Europe
Local Government and Housing Privatization

DEVELOPMENT OF A MUNICIPAL CREDIT PROGRAM TO FINANCE INFRASTRUCTURE INVESTMENTS IN POLAND

JULY 1994

Prepared for the Office of Housing and Urban Programs
Agency for International Development

Making Cities Work

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Development of a Municipal Credit Program to Finance Infrastructure Investments in Poland

July 1994

Prepared for the Regional Housing and Urban Programs
U.S. AGENCY FOR INTERNATIONAL DEVELOPMENT

Prepared by

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INTERNATIONAL CITY\COUNTY MANAGEMENT ASSOCIATION

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ABSTRACT

This report assesses the current state of local government finance and credit in Poland and, in light of the challenges faced by municipalities in obtaining long-term credit, proposes a national Municipal Credit Program (MCP) and Municipal Development Authority (MDA). The objectives of the MCP and MDA are to provide credit financing and related technical assistance, respectively, directly to municipalities in order to help them finance capital investment projects at the local level. It is only through such a program that municipalities will have the opportunity to access otherwise unavailable funds required to meet current and future infrastructure investment needs. In addition, it will provide an interim system through which Polish municipalities can establish their creditworthiness and gain the necessary skills such that they can obtain future financing through the private market.

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EXECUTIVE SUMMARY

This report presents background considerations and a proposal for a municipal credit program in Poland (**Part 1**). It includes an assessment of the financial sector (**Part 2**), local government sector (**Part 3**), and case studies of two local government programs in the country (**Part 4**). It is the result of an ICMA/USAID project on the development of a municipal credit program in Poland. The team of three consultants made several trips to Poland from May to September 1993 to evaluate the potential of financial and local government sectors to provide and sustain investment credits for infrastructure investments by local governments (gminas) and their satellite enterprises.

The analysis identifies several factors that impede the development of a market for municipal credit. In the banking sector there is an asset/credit maturity mismatch stemming from central government debt finance that restricts the supply of long-term credit funds. This crowding out will likely continue during the period of privatization and governmental restructuring. The embryonic state of financial data processing and insurance institutions adds to the uncertainty and thwarts risk management, ultimately impeding capital market activity in general.

In the local government sector there is emerging financial responsibility, but there is also apprehension about its fiscal base, revenue and expenditure balance, and its inexperience with long-term credit finance. This creates levels of uncertainty and risk that mitigate credit expansion. Both sectors lack experienced personnel who are skilled in municipal infrastructure planning, design, and fiscal evaluations, which hampers the analysis of creditworthiness and project repayment capacity.

The proposal calls for initial funding for a loan program by a foreign donor. The main elements are a transitional credit fund designed to be self-liquidating as private credit markets develop, an incentive for bank participation, and a system to mitigate risks through repayment guarantees and loan terms.

The proposal was presented to the central government in July, with further clarification presented in August 1993. It was accepted in principle. Since that time, a newly formed government has taken up consideration of the municipal credit program.

Part 1

Background and Proposal

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I. BACKGROUND OF THE MUNICIPAL CREDIT PROGRAM

The finance of public infrastructure is a major issue in all countries that have set a course to stimulate development and improve services. It presents particular challenges to those countries that are in the process of economic and governmental restructuring. In Poland, a major component of this restructuring has been the assignment of a broad range of activities and responsibilities to democratically elected local governments or municipalities, i.e., the gminas. Despite considerable capacities, the gminas and their satellite enterprises confront considerable difficulties in exercising these added responsibilities. These difficulties are in the areas of planning, finance, maintenance, and training:

Planning

1) There is a growing need for infrastructure finance to support future development as well as the backlog of infrastructure projects which are now in progress but for which sources of future funding are uncertain.

2) Infrastructure finance has traditionally been dependent on central government grants. These are neither systematic nor, given the recent reforms, dependable in terms of types of eligible projects and levels of funding.

3) A legacy of local government planning, budgetary, and financial standards and practices hampers financial management by severely obstructing planning and borrowing for infrastructure investment.

Finance

1) The early stage of development of a private securities market and the market reorientation of a noncompetitive financial sector hinders the broad-based operation of capital markets.

2) The supply of domestic savings, after central government requirements, falls far short of the long-term capital needs for local government infrastructure and private investment.

3) High rates of inflation and uncertainty are depressing banks' accumulation of the long-term savings that are necessary to allow them to actively pursue long-term lending.

Maintenance

1) Municipal responsibilities for the provision of services have increased and there is uncertainty about the adequacy of local taxes and central government transfers to finance them.

2) Public utility pricing policies and dependence on central government revenues are impeding the development of local revenue generation and self-financing, which are the hallmarks of municipal resource mobilization.

Training

1) The local government and financial sectors both lack personnel who have the analytical skills necessary for preparing credit applications, evaluating the financial viability of infrastructure loan projects, and servicing loan applications.

2) The decentralized and fragmented nature of technical assistance has neither the capacity to service all municipalities nor the coherence to ensure that practices and procedures are consistent.

Recognition of the financial and technical assistance requirements for local government partnership in the development of the nation's infrastructure has led to a series of initiatives by the Polish national government and by international organizations. In a collaborative effort, USAID EC Phare and the World Bank (IBRD) designed a program focused on the development of institutions to facilitate the provision of credits and technical assistance to Poland's burgeoning municipal sector. Polish participation in these efforts involved the Council of Ministers, the Ministry of Finance and its Office for Public Administration Reform, and the Ministry of Physical Planning and Construction. One principal outcome of these efforts was the recommended creation of a Municipal Credit Program (MCP) and a companion program of technical assistance in the form of a Municipal Development Agency (MDA).

In collaboration with IBRD and USAID, a program of assessments and evaluations leading to proposals for the design of these institutions was carried out during the Summer of 1993. On the Polish side, Project Omega (EC Phare) of the Office of Public Administration Reform took the lead in this effort. Activities related to the MCP were carried out by a team of three consultants provided by ICMA. Their work involved an assessment of gmina financial capacities, the capacity of the banking sector to provide municipal credit and, ultimately, a proposal for the establishment of an MCP. In July and September, the work of the consultants and their proposal was discussed at meetings within the Council of Minsters which, in principle, approved the proposed program. A proposal for the MDA was separately developed by consultants from the Cooperation Fund and financed by Project Omega of EC Phare.

This part of the report presents the initial considerations, conceptual framework, findings, and the proposal. The USAID-sponsored team of ICMA consultants worked closely with the director of Project Omega, Jacek Poznański, and are deeply indebted to him, as well as the above mentioned Polish government ministries and members of the financial and local government sectors, for their support and assistance. A list of contacts is appended to this report.

A. ADVANTAGES OF A MUNICIPAL CREDIT PROGRAM

The goal of an MCP is to increase the availability of loan funds to municipalities and their satellite enterprises. An MCP offers credit through a decentralized system of public administration.

In general, the advantages of providing credit for infrastructure financing, in this case through an MCP, are:

1) Credit can provide the large cash amounts required during the building phase. It frees investors from dependence on uncertain yearly budget surpluses and/or the grants-in-aid policies of a central government, which itself may have difficulties in balancing its budget. With credit, local government investors are not limited to building what they can with those funds that happen to be available after current operating expenditures are met. Credit can provide stability for both the planning and building of infrastructure.

2) Credit provides an alternative to reduced current expenditures. By allowing the cost of large projects to be spread over time, investors are not in the position of having to accumulate savings over long periods or having to make major cuts in current operations to pay for infrastructure improvements.

3) Infrastructure is long lived. Credit means that there is no need to pay today for benefits that will accrue in the future. It is a more equitable means of infrastructure finance as it allows beneficiaries, both now and in the future, to match payments with the flow of services and benefits they have received.

There are also specific advantages associated with *municipal* participation in a credit program:

1) In Poland, current central government policies are aimed to decentralize fiscal administration. Municipal credit can facilitate greater municipal participation in a broader range of the activities required to provide and administer services to the people.

2) Municipal participation can lessen strain on the central government by reducing the need for its involvement in the details of infrastructure project planning, selection, supervision, etc., and by relieving pressure on the central government budget, the balancing of which may require that many desirable spending opportunities be neglected.

3) Municipal participation in credit and financing by local infrastructure investments brings important decisions closer to those who will benefit from them. When citizens see benefits from the taxes and tariffs they pay, they are generally more willing to make the sacrifices to secure them. This can facilitate the raising of revenues necessary via user charges and/or local taxes to pay for government programs. At the same time, when citizens are confronted with the costs of the projects and services that they seek, they are more likely to both restrain their demands and more carefully consider costs when deciding on the types

and levels of services they desire. This can enhance efficiency in the division of the nation's scarce resources between public and private endeavors and within the government sector through greater citizen concern and participation.

B. GOALS SET FOR THE PROGRAM

The major objectives of this effort are the design of a program that would:

1) Improve the access of local governments and their satellite enterprises (public utilities) to investment finance while enhancing their self-reliance, autonomy, and accountability.

2) Increase the ability of local governments to plan, select, design, and complete the building of public infrastructure projects.

3) Improve local government capacity for self-financing by opening access to domestic capital markets as they develop. That is, the program should be market-oriented and designed to stimulate a market for municipal infrastructure finance where credit terms reflect borrowing costs.

4) Provide gminas, their satellite enterprises, and the banking sector with incentives for greater participation in the finance of public infrastructure.

5) Augment current levels of infrastructure finance available to local governments and their satellite enterprises without rechanneling current financial sector credit, redirecting current central government investment activities, or reducing the supply of investment capital to the private sector.

The program also has certain other characteristics, including:

1) The program should be capitalized by foreign donors in order not to divert current domestic investment funds.

2) Orientation toward the private capital market means that credit should not be subsidized. Credit terms should be set to cover the full cost of attracting investment capital and originating and servicing credit, i.e., "all in borrowing cost." This does not mean there should be no central government grant or subsidy programs for infrastructure. There are roles for such central government programs, but they are limited. Central government grants or subsidies are appropriate particularly when gminas administer programs for the central government or support activities that impact the nation. They may also be appropriate when gminas undertake activities that affect neighboring gminas.

3) The program should be limited to the basic functions of local governments, such as for water, waste disposal, primary education, and local roads. It should not include the broad

range of production (clothes, machinery, lumber, etc.), which is the domain of the private sector.

4) The levels of loan activities should reflect the desires/needs of local citizens for the projects. The loan fund should not be used to pursue other purposes or be subject to outside or special influences.

II. GMINA INFRASTRUCTURE FINANCE

A. GMINA DEMANDS FOR INVESTMENT FUNDS

In the absence of a well functioning market, it is difficult to obtain firm indications of demand. It is widely acknowledged that a great deal of the nation's infrastructure has been undermaintained and that substantial investment would be required to bring it up to standard. It is also widely acknowledged that the transformation to a market-oriented economy capable of attracting private investment in a productive capacity will require substantial new infrastructure investment.

One indication of the need for infrastructure is the current housing deficit. In the 1970s, about 6.2 residential units were built per 1,000 population. This fell to 5.0 in the 1980s and further to 3.5 in 1990-92. Current estimates indicate that 1.6 million households are without separate quarters and that approximately 30 percent of the population lives in overcrowded housing. Building to alleviate this situation as well as to accommodate normal population growth will require substantial gmina investment infrastructure—water supply, sewage, transportation, access, etc.—that supports housing. Now that housing has become a major responsibility of the gminas, their interest and responsibility in the maintenance and building of this type of infrastructure will grow.

Comparison with other countries provides another indication of the local government investment requirements. In Western European countries, local and provincial government capital expenditures typically range between 1.5 and 4 percent of gross domestic product (GDP), with the more advanced free market countries at the lower levels. In relation to aggregate national investment, Western European local governments typically account for 8-11 percent of the total investment, with the larger shares typical of the lower income and/or Eastern-most countries.

By way of contrast, in Poland, gmina capital expenditures amounted to a little less than 7 percent of gross investment, or 1.4 percent of GDP, in 1991 and just 1.3 percent of GDP in 1992. Compared with both Western and Eastern European countries, these numbers reflect both the relatively low levels of investment in the economy overall and the underfunding of local government investment. These data indicate that to match the levels typical of Western Europe (e.g., 2 percent of GDP) where infrastructure needs are not so pressing, the gminas would have to increase their spending by about 50 percent, an amount that exceeds what they paid out in wages in 1991 and that is just slightly less than the central government's total multipurpose general subsidy to gminas in 1992.

Survey data collected (by Project Omega) in 17 voïvods also indicate the extent of infrastructure demand in the gminas. These data indicate that in 1993, gmina investment expenditures were less than in 1992 and far below, i.e., less than 30 percent, of those planned for the year.

In these areas, the gminas are planning for a 500 percent increase in investment expenditures, only a minor part of which can be funded by the gminas themselves.

The large number of requests for and the 57 opinions rendered on gmina repayment capacity issued by the regional audit chambers, despite their relatively short period of operation, are further verification of gmina capital finance needs.

B. GMINA CAPITAL SPENDING

Historically, the gminas have had major responsibility for building the nation's infrastructure. In 1992, the level of capital expenditures of all gminas amounted to 15,065.9 billion PLZ,[1] representing a nominal increase over the 1991 level of about 30 percent. However, as this increase fell below the rate of inflation, the level of real capital expenditure actually decreased between 1991 and 1992.

Nonetheless, capital expenditure accounts for a major portion of gmina expenditure, i.e., just less than 23 percent of total gmina expenditure. The relative importance of capital spending in gmina budgets has been declining, primarily because of relatively large increases in operating expenditure, which totals approximately 50 percent. In large measure, these changes in the current and capital expenditure shares of gmina expenditures can be attributed to the increased spending due to gmina assumption of central government commissioned tasks, larger wage costs, and increased spending for materials and services.

There are substantial differences in the budgetary importance of capital expenditures among gminas of different sizes. In general, capital expenditures are larger relative to operating expenditure in smaller gminas, i.e., those with a population of less than 10,000. With the exception of the Union of Warsaw, the budgetary importance of capital expenditures is lower in gminas with larger populations.

There are also wide variations in the levels of capital spending, relative to population, among different sized gminas. With the exception of the Union of Warsaw districts, where per capita expenditures are quite high, higher levels of spending occur in smaller gminas.

In combination with the distribution of population across gminas of different sizes, these differences in per capita spending produce an unexpected pattern. That is, the smaller gminas account for more than half of all gmina capital spending outside of the Union of Warsaw district.

[1]The data discussed in this section are from the GUS (Central Statistical Office).

C. FINANCING GMINA INVESTMENTS

The existing grants for gmina infrastructure investment are relatively small. Central government grants for specific projects are limited to eight or nine projects, grants for housing related infrastructure are less than 8 percent, and grants from the National Fund for Environmental Protection (NFEP) are less than 1 percent of gmina investment expenditures. Grants from voïvodships are less than 1 percent of gmina investments.

There is relatively limited support of gmina investments through the central government's general subsidy. The investment part of this subsidy is a residual from complicated calculations designed to subsidize education and wage and salary expenditures and to compensate gminas with weak revenue bases. In 1993, just 3 percent of the general subsidy was directed toward gmina investments.

In large measure, the gminas have financed their capital expenditures out of their own revenues. In 1991, capital receipts or grants received from the central government for their own projects amounted to about 5 percent of gmina capital expenditure. While these grants increased substantially in 1992, they still amounted to just 10 percent, indicating that the central government plays a minor role in the financing of gmina capital expenditures.

Recent discussions concerning revision of the gmina finance law have included a proposed substantial increase of the central government's general subsidy to gminas. However, the primary purpose of the increase would be to earmark funds to pay for the anticipated delegation of education operational and expenditure responsibilities to the gminas. If the gminas are to increase their investment spending, they will have to do so out of their own funds or from sources outside the central government.

One measure of gmina ability to invest is current account savings, i.e., the difference between revenues and expenditures on current account. By this measure, gminas appear to have performed fairly well. Overall current accounts saving amounted to 12,963.3 billion PLZ in 1993. This is equivalent to about 20 percent of operating revenues, indicating that gminas were able to set aside about 1 of every 5 PLZ for purposes other than general operations. As substantial as these savings are, they declined from 32 percent of operating revenues in 1991. This decline suggests that the capacity of gminas to generate the savings needed for capital expenditure is shrinking.

Two factors allowed the gminas to increase their capital spending despite the fall in current account surplus. The first was a higher level of central government capital grants, which accounted for about three-fourths of the difference. The second was a deficit financed out of past savings of 477.3 billion PLZ. While the amount of gmina deficit spending is small relative to both the level of capital spending and operating revenues (.74 percent), it does suggest that the gminas are finding it more difficult to finance their capital expenditures. It also indicates that major increases in gmina investments will require substantial change in their access to investment funds either through larger central government transfers, increased productivity of local revenue systems, and/or greater availability of credit financing.

Two factors indicate that the ability of the gminas to generate surplus is likely to decline. The first is the assignment to them of greater responsibilities for operating expenditures in the area of education. The initial indication has been that the central government transfer of fiscal resources has not been commensurate with the added spending obligation, thus requiring a supplement from the funds gminas could use for other purposes, including investment. The second is the widespread but unsustainable windfalls that gminas have captured from the sales and leasing of residential properties.

As noted above, a survey of infrastructure spending plans in 17 voïvods indicated that gminas plan fivefold increases in expenditures. The fact that these plans presume a 650 percent increase in credit financing is testimony to recognition in the gminas that their needs are greater than their capacity to invest out of either their own funds or central government grants and that they are interested in alternative means of financing infrastructure investment.

D. DOMESTIC SUPPLY OF CREDIT TO GMINAS

The financial system in Poland is being restructured from a highly monopolized arm of the central government to a broader, more diversified set of institutions operationally more consistent with a privatized economy and a more decentralized government structure. With the restructuring of the former national banks, the 1,700 agriculture cooperative banks, and the creation of about 100 private banks, banking services are now widely available across the country. Although still small and not fully operative throughout the business week. the stock exchange provides active trading in a small number of private issues and in intermediate-term treasury bonds. However, the capacity of the system to provide long-term financing generally, and infrastructure capital to the gminas in particular, is highly constrained.

First, the profitability and security of central government treasury notes is much greater than what can be offered currently by gminas. This is due to, among other things:

1) The repayment guarantee and lower risk afforded by the central government underwriting of treasury notes.

2) The lack of experience and expertise with municipal infrastructure finance in the banking sector and in the gminas themselves.

3) Uncertainty about the viability of potentially self-financing investments in public utilities because of price regulation and the novelty of user pricing for cost recovery.

4) Ambiguity about the legality of collateral and repayment guarantees in the evolving structures of gmina finance and banking laws and in public acceptability.

Second, the prevalence, security, and profitability of short-term treasury instruments, 95 percent of which are held by banks, skew banks' portfolios against long-term lending as their large amounts crowd out other uses of bank funds and as banks generally seek to match the term structure of assets (loans) and liabilities (deposits). In the market, deposit terms closely follow those of government bonds and, therefore, currently are biased against the accumulation of long-term assets like infrastructure loans.

This bias toward short-term investments can be seen in the structure of bank loans to gminas. Of the 16 banks with gmina loan activity, half only have loans with maturities of less than a year, accounting for 25 percent of the value of gmina loans. The majority of the small amount of loan funds (about 90 percent) committed for more than a year are subsidized and preferential rate loans from the National Fund for Environmental Protection and the Bank for Environmental Protection.

This bias and the relative ease of servicing the central government is also reflected in the activity of the Polish Development Bank's APEX program, which is designed to channel funds through banks for investment in private sector productive activities. The level of activities in this program has been extremely low, with a large portion of the funds "temporarily" invested in central government securities granted on a preferential basis. The relatively low utilization rate has been attributed to the perceived difficulties of completing an application in a country that is still developing familiarity with complicated investment finance procedures.

Third, banking regulation concerning the setting aside of reserves to cover potential losses greatly disadvantages lending to municipalities or their satellite enterprises, as 4 percent of unsecured loans to municipalities or their satellite enterprises must come from bank capital whereas Treasury securities require no bank capital.

Fourth, legal limitations on credit risk concentration, coupled with a narrow capital base for many banks, greatly restricts their ability to grant loans of the large size often associated with infrastructure investment.

For these reasons, it is unlikely that the financial sector will be able to provide substantial increases in the supply of investable funds to local governments in the near future. The situation will improve as the financial system matures, the central government deficit declines, and lenders develop municipal project evaluation and servicing experience.

III. DESIGN OF A MUNICIPAL CREDIT PROGRAM

A. BASIC ELEMENTS

There are certain basic elements that should characterize a Municipal Credit Program in Poland:

- It should fit within the evolving financial system and be consistent with reforms in the financial sector. This means that the lending programs should be transitional and should assist in the establishment of market-oriented practices and processes that will link local governments with regular financial institutions. These improvements will require conscious attention to the development of skills in the areas of project planning, feasibility, cost and financial studies, and in loan appraisal and servicing. This also means that municipal lending should reflect market terms and involve regular banking institutions.

- The program should have a fixed term and a mechanism for self-liquidation. As the program will accumulate a loan portfolio, its ultimate phase is the transfer of its assets to investors who are active participants in the private financial system.

- It needs to specify and mitigate risks. Since there is little history with municipal credit, one of the reasons for a transitional program is to develop experience that clarifies the extent of risks so they can be limited and so the developing financial market can appropriately structure loan terms and guarantees.

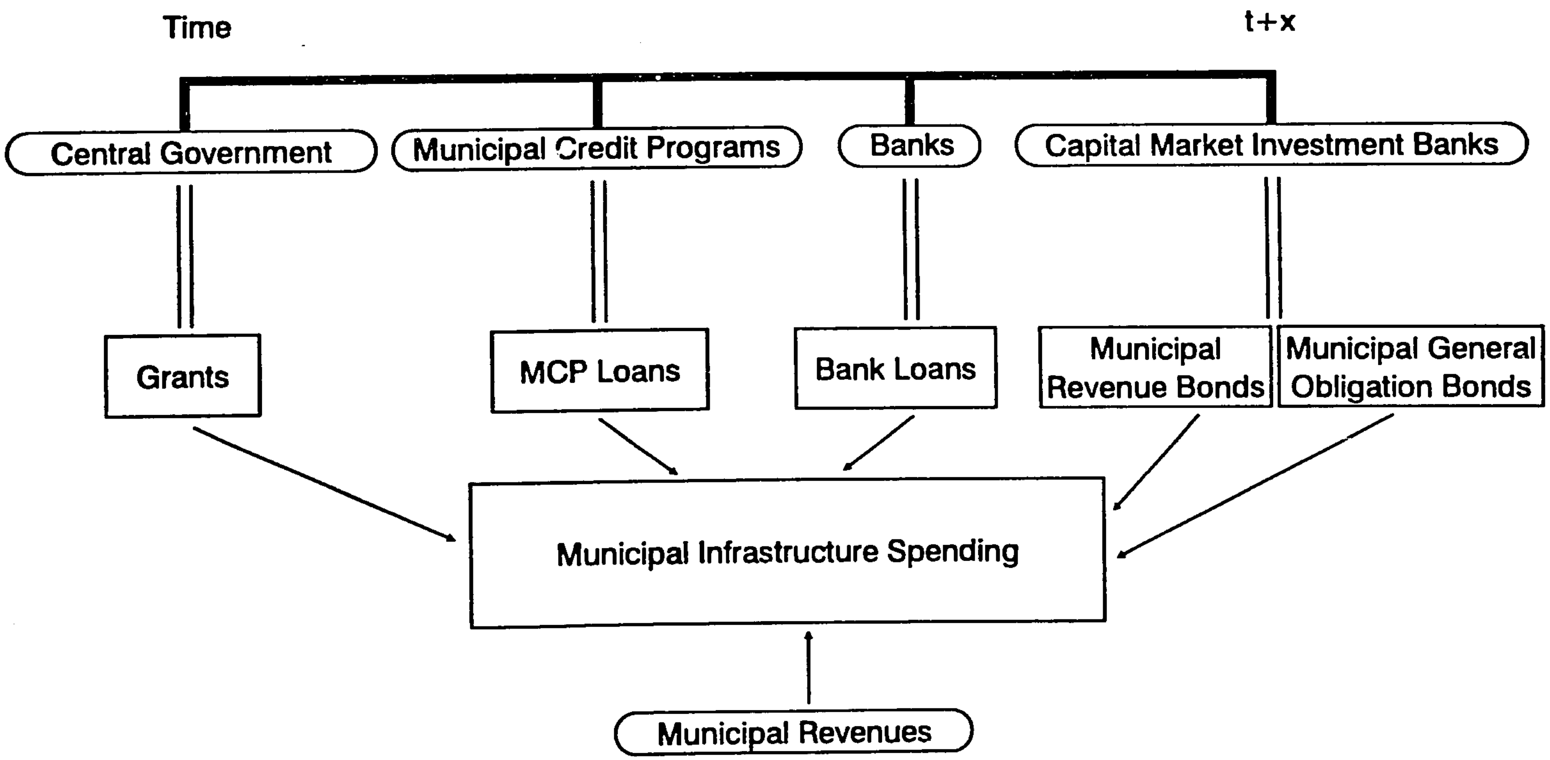
- It must secure lending repayment and insure against default. One peculiarity of infrastructure investment is that it differs from private investment in that lenders cannot generally foreclose and appropriate and dispose of municipal property. The absence of property collateral means that the lender's interest must be secured in terms of municipal revenues, i.e., public utility receipts, tax collection, and/or central government transfers.

B. STRUCTURE OF LENDING

There is an array of institutional arrangements for the provision of credit to gminas and their satellite enterprises (**Exhibit 1**). Positions to the left in the **Exhibit 1** diagram reflect greater government involvement; those to the right indicate broader integration in fully developed private financial markets. Historically, dependence on the central government places Poland at the extreme left. Most market economies are situated near the center, with their relative position determined by the composition of grants and loans because the use of bonds is far less common. The U.S., with its decentralized local governments and highly developed municipal bond market, would be farthest from dependence on central government financing.

EXHIBIT 1

TIME LINE IN THE DEVELOPMENT OF MUNICIPAL CREDIT FINANCING: EVOLUTION OF MEANS AND SOURCES OF FINANCING



Newly initiated municipal credit programs are usually designed to compensate for the lack of municipal credit provided in the financial sector. Their objective is to supplement the funds that the municipalities themselves can generate and to relieve pressure on the central government for the funding of local infrastructure projects. Their location is in the early stage of the time line of municipal credit development in the private financial sector, which is pictured on the right in **Exhibit 1**.

In Poland, there are a range of possibilities for the development of municipal credit. With certain guarantees, banks could loan their own funds when the central government reduces its short-term financial needs and as the term structure of bank deposits increases. Alternatively, a municipal development fund could be established that would channel loan funds through banks. The bank or banks would charge fees and interest to cover their costs of servicing applications and loans and their cost of capital.

There have been suggestions that a credit program be placed in one or another of existing banks. These include the newly established national banks and the municipal banks. In principle, it is not appropriate to vest monopoly power in one institution, either nationally or regionally. While doing so might accelerate the availability of credit, a monopolization would preclude the widespread participation of financial institutions necessary for the transition to an open market for municipal credit.

Channeling municipal credit through municipal savings banks would also create a conflict of interest as the municipalities and their constituents would simultaneously be the lenders and borrowers, i.e., the creditors and debtors.

A variant of this depends on a bank or banks to initiate and service loans with a credit fund providing the monies to be lent. This allows the bank to undertake lending without diverting its own funds. As the bank maintains its exposure to the loan repayment risk, the incentive is created for careful project selection and energetic collection.

Poland has had experience with a similar system for private enterprises, i.e., the APEX system. It has floundered because of a lack of experience in longer term credit evaluations, questionable profitability because of uncertainty about restructuring and the strength of the economy, and more profitable use of staff resources in the short-term credit market.

Placement of a municipal credit program with a ministry is another possibility. However, this would not be advisable for ministries that have specifically defined narrow responsibilities, e.g., housing. The danger is that the MCP would become subservient to the goals of the ministry and thereby neglect the broader concerns and interests of local government.

The fact that in Poland, as in many other countries, no ministry has a breadth of responsibility coincident to those of local governments argues for a degree of separation. In addition, the program proposed herein is transitional. Its placement within the permanent central government structure would make it susceptible to the inevitable bureaucratic tendency to retain and expand size and activity.

It has also been suggested that municipal bonds would be an expedient method of channeling investment funds to municipalities and their satellite enterprises and would be a direct move to the private market. Bond markets require a great deal of easily available information about risks and they work well where technical skills and practices and intermediary institutions specialized in bond rating and insurance have evolved. Uncertainty about property rights, repayment capacity, governmental structures, and repayment means that in Poland municipal bonds would be deeply discounted and the cost of investments accordingly disadvantaged. In addition, credit default, which occurs even when financial institutions are highly developed, would undermine investor confidence and reduce the demand for bonds and, thus, the potential supply of municipal credit. It is not in the interest of municipal governments to rely on an instrument that is widely used only where the financial sector is most developed and that is most successfully used (i.e., in the U.S.) where it is subsidized by the national government.

IV. PROPOSAL FOR A MUNICIPAL CREDIT PROGRAM

A. OBJECTIVES

It is clear that the domestic supply of funds available for local government infrastructure investment in Poland must be supplemented if the gminas and their satellite enterprises are to meet the needs of their citizens and contribute to the growth of the nation. It is also clear that large-scale expansion in municipal credit is jeopardized by inexperience with long-term credit finance and a shortage of appropriate skills.

To facilitate the development of a market for long-term credit for gminas and their satellite enterprises, we propose the creation of a Municipal Credit Program (MCP), as well as the structure and flow of the MCP.

The immediate goals of the MCP are to:

1) Establish a vehicle for the speedy channeling of investment from international donors to the gminas and their public utilities.

2) Develop criteria for consistent and sound analysis of creditworthiness and repayment capacity of both borrowers and projects.

3) Collaborate with banks that will originate loans for a fee, payable on disbursement of MCP loans to gminas and their satellite enterprises, and that will act as agents for loan servicing.

4) Approve infrastructure project loans on a cash flow basis with "all in borrowing cost" to ensure that the program covers its costs and is not a drain on central government resources.

5) Manage risks of the credit portfolio, including the monitoring of construction, completion and management of projects, and establishment of repayment guarantees.

6) Establish processes for greater interaction between local governments and a broad range of commercial creditors to enhance the human resource capacities and operational procedures for municipal credit financing in the banking and government sectors.

7) Allow for the dissolution of the program when the capacities for bank lending and, ultimately, capital markets for issuing municipal bonds develop.

Recommendations for the structure, responsibilities, and scheduling of the MCP structure follow.

B. ORGANIZATIONAL STRUCTURE

We propose that the program be initiated quickly by setting up a temporary unit for initial organization that would be subsequently transformed into a state agency. There are two alternatives for the initial structure of the MCP:

1) A program management unit (PMU) set up within the Offices for Public Administration Reform.

2) A joint stock company owned 100 percent by the state.

The advantage of a PMU is that the management structure of the MCP can be immediately established within an existing administrative structure concerned with financial operations and that has experience with international donor programs. A joint stock company would require more time to initiate, but it would have the advantage of being separated from the broader range of ministry interests and responsibilities.

The pressing need for initiation of the marketing, application, and evaluation process to develop a list of projects for financing favors the PMU option. The PMU could take responsibility for developing the administrative and organizational structure and defining procedures during the startup phase.

Once established, the MCP should evolve into a state agency that will establish its raison d'être, not as a competitor to banks and not as an arm of the central government but as: a) a conduit of funds to viable municipal projects that can support cost recovery and repayment; and b) a facilitator for the development of experience and skill in municipal project analysis, creditworthiness evaluation, and loan origination and servicing.

C. MANAGEMENT STRUCTURE

The MCP should be governed by an advisory board composed of representatives from the appropriate ministries, i.e., finance, planning, and construction, the Council of Ministries, the Joint Commission on Central Local Government Relations, and organization representatives of local governments. It should be closely related to the MDA and to the Joint Commission on Central Local Government Relations.

The MCP should be managed and operated by an experienced professional staff (10-15 persons, including five credit analysts, two project engineers, one administrative assistant, and one office manager). The support and technical activity of the MCP will change over time and will depend on its organizational form.

1. Sources of Funds

One immediate aim of the MCP is to bring new loan funds to the economy and not to divert credit away from other parts of the economy. This can be accomplished by foreign and/or international donor grants and loans. While the design is for a multiyear program, a pilot project will give the program a quick start. The World Bank has expressed interest in such a project. It has a water project in preparation that it would consider placing within the MCP. Although the pilot project has a more limited focus, services fewer clients, and involves less funding and credit than could be potentially realized, this strategy has the advantage of relatively quick funding approval and access to a list of infrastructure projects for which preparatory work has begun.

With a successful first experience, the MCP would be attractive for other infrastructure projects from the World Bank and/or other international donors. Crédit Local de France of Paris has expressed interest in cooperating with a program like the MCP. The simplicity of such a program is that it would package a variety of small loan projects within one agreement. This is likely to attract other donors, such as the European Bank for Reconstruction and Development.

It is also possible that the MCP could be the vehicle for channeling central government investment funds to local governments. This could replace all or part of the central government's allocation of investment funds directly to local governments.

By adding to the amount of loanable funds, this would increase the number of projects and borrower solicitation that the MCP could serve. It would also be possible to ensure a broader participation by allocating these funds as credit lines among local areas on a formula basis with use subject to regular loan application and approval.

Supplying credit at market terms also means that municipal repayments will continually provide funds for the repayment of the MCP debt to its funders. A means to make monies, other than those from donors, available to replenish the MCP could be to sell the cash flow from the gmina projects, perfect a security interest in it, bundle these revenue streams as the means of repayment, and sell it as a security, i.e., a revenue bond. The proceeds would replenish the MCP's loan fund.

The longer term goal is to develop a system within the Polish financial sector that will direct internally generated investment funds to municipalities. This will be facilitated first by integrating banks and borrowers into the credit process. In the longer term, the MCP will stimulate bank credit availability and/or a market for municipal bonds. Thus, the processes inaugurated by the proposed program should grow into a more self-sufficient internal mobilization of domestic Polish capital funds to municipal infrastructure investment.

2. Structure of Credit

Credit to municipalities and their enterprises can be in the form of loans or bonds. The MCP should provide infrastructure funding in the form of long-term loans only. As the institutional base of the financial system develops, nonbanking institutions (i.e., insurance, pension, and mutual funds) would expand the market for municipal debt, including bonds. As alternative sources of credit and investment finance become available, commercial competition for customers should reduce the need for a specific program for municipalities, such as the MCP.

The loans will be made on commercial terms and will reflect the actual cost of capital and MCP fund operations, i.e., "all in borrowing cost." The MCP will seek repayment guarantees from municipalities to reduce credit risks.

Another aim of the project is to acquaint municipal borrowers with participation in credit markets, project planning, loan servicing, and cost recoverable projects. Thus, the program should provide full-cost loans only, rather than commingling loan and grant monies, which would allow the preferential terms of soft loans. Soft loans do not accustom the borrowers to the rigors of credit terms in commercial markets. Preferential terms also put commercial lenders at a disadvantage and would reduce their ability to compete for municipal loans in the future. The role for grants in the program would be as a means of co-financing, which would reduce the amount of loan funds to be acquired on commercial terms by municipal borrowers.

Loan application, project selection, loan disbursement, and loan collection will be supervised by the banks or other qualified entities acting as credit/loan originators and credit/loan service monitors such as credit agents (also known as agent banks) for the MCP in exchange for service fees. Oversight, evaluation, and audit of credit agent activities will be the responsibility of the MCP. Credit agents may participate in originating and/or servicing of MCP loans. The bank agent fees for service will be performance based to give them the incentive to develop skills and expertise in gmina loan procedures. The MCP has the right to terminate agreements with credit agents providing poor services.

3. Eligibility

The MCP will make loans for projects that are essential public services so that it does not interfere with activities best left to the private sector. Loans will be approved on the basis of feasibility studies, financial analysis, and criteria stated in approved operating manuals known to all borrowers.

Applications should describe the type of investment, its priority in local planning, financial projections, the overall financial position of the borrower, repayment security, and the loans' relation to legally defined municipal debt and credit limits. In addition, borrowers will identify all sources of finance for each project application and demonstrate the relation of the project and its finance structure to broad government priorities and to the priorities of all funding sources. The MCP will be responsible for evaluating credit applications, appraising default risk, and making credit decisions.

4. Creation of a Secondary Market and Liquidation of the MCP

A major objective of the MCP is the establishment of a place for municipal credit in the capital market. Thus, it should be designed to support the development of a secondary market even though it will be years before one can actually be developed.

Participation of the MCP in the general credit market is an important step to demonstrate the creditworthiness of municipal investments. With an established MCP record of effectiveness, it will be possible to fully liquidate the loan fund, although this is unlikely to be possible for some time. Waiting for the secondary market to develop before incorporating broader participation in municipal credit would be undesirable. First, it would delay the opening of new credit sources to municipalities. Second, it would contain all the municipal credit risk within the MCP.

Over time and with greater liquidity in the banking system, broader participation in municipal credit could be induced by reducing the proportion of project finance that the MCP provides. An increasing co-financing requirement would force municipalities to seek out collaborative creditors. The likely candidates are the banks that have been acting as MCP agents. This will create a dual advantage of the bank/agent arrangement—the banks will develop the skills and experience to serve municipality infrastructure investments, and the demands for loans from banks will increase as the MCP financing proportion declines.

As broader credit markets develop and as municipalities demonstrate their creditworthiness, banks and other credit institutions will be willing to make loans directly, buy municipal bonds, and, at some point, absorb the full portfolio as the MCP liquidates itself.

The mechanism for facilitating the dissolution of the MCP when it is no longer needed as a financial intermediary will be the development of bank lending and, eventually, capital markets for issuing municipal revenue bonds. The following is a list of possible scenarios for winding-down the MCP that could happen in tandem or separately:

- The loan portfolio held by the MCP will be reduced through repayments (run off)
- The loan portfolio held by the MCP will be transferred or sold to a bank or financial services company
- The cash flows can be legally "carved-up," bundled, and sold to institutional and retail investors as securities. This would be the first "Polish Municipal Revenue Bond." The latter is contingent on the maturation of the Polish capital market in general.

D. RISK MANAGEMENT

There are six types of risks which the MCP must manage:

1) Donor fund commitment risks
2) Credit risk of the project
3) Credit risk of the borrower
4) Regulatory risks
5) Inflation rate risk
6) Foreign exchange risk

International donors impose commitment fees at the initiation of their loan programs that accrue even in the absence of the actual use of the credit funds they make available. Even though these are not large and the donors are likely to negotiate them lower, in the early stage the MCP will have no operating revenues. However, the charges need not necessarily be incurred by the central government.

It would be reasonable to consider these as central government charges to local governments for the opening and maintenance of a line of credit for the municipal sector. The central government could pass the charges through to the beneficiaries (gminas), perhaps via a reduction in general subsidies or shared taxes. Fees for opening and maintaining a line of credit are not uncommon in market economies. In addition, in several countries, local governments contribute to the institutions that support them. Such contributions often confer a stronger sense of affiliation and increase interest and participation in these programs. Because credit initiation and maintenance fees are part of the costs of making credit available, they should be included in borrowing costs.

Once the program is fully operative, "all in" loan terms will be set to cover all costs of the program. Under these contributions, the amortization of municipal loans will provide for reimbursement of all expenses due foreign donors.

The credit risk of projects is best managed by careful project design, evaluation, and selection. Strict application requirements and approval criteria will be part of the MCP endeavor to reduce risk due to inappropriate project design or selection.

The proposal also recognizes that a greater level of technical assistance than is now generally available will be required. Thus, it calls for a complementary, but separate, program of technical assistance to be established (through the MDA) to help strengthen local administrative and management opportunities and to assist in the development of municipal revenue raising capacities and private credit markets.

Credit risks of borrower default are best managed when the lender is provided with collateral, usually in the form of the loan-financed assets. As bankruptcy and confiscation of government property is not a possibility, we propose a full faith guarantee from the borrower. This requires the borrower to use its own taxing powers as well as to pledge revenue streams[2] from the specified revenues of the gmina or the municipal enterprise to repay the loan. Mechanisms to enforce the guarantee would be the automatic transfer of utility revenues in the case of enterprise loans and/or the pledge of some part of central government transfers with an automatic intercept provision, in the case of arrears or default. This establishes the creditors' right to automatic repayment out of transfers due to the municipality from general purpose subsidies or shared taxes.

Regulatory risks are those associated with the uncertainty that public utility tariffs will be set at levels sufficient for loan repayment. This risk can be secured by loan terms that require that tariff rates be set at cost recovery level and/or by the repayment pledges and full faith guarantees of the gmina.

For the remaining types of risks, there are standard procedures. To hedge against inflationary erosion of the value of loan repayments, variable interest rates can be tied to an index like WIBOR. Similarly, foreign exchange risk can be secured by tying interest rates to the spot foreign exchange rate at date of repayment.

E. STRUCTURE OF MCP PROCEDURES

The structure, interrelations, and flow of activities among the principal components of the proposed MCP are shown in **Exhibit 2**. A step-by-step explanation follows.

1) **Extension of credit facilities**: Line of credit for financing of municipal infrastructure investment through loan mechanism is concluded between donor and the MCP.

2) **Participating entities**: Banks that will serve as loan originators and as loan servicers for the program are evaluated and chosen by the MCP; they are then informed of the establishment of the credit line, and the conditions and procedures that will apply.

3) **Identification of projects**: Gminas are notified of existence of available credit facilities through loan originators and voïvodships. Gminas that are interested in borrowing money to finance specific investment projects contact the locally authorized loan originator, who will study the project with the gmina and help to prepare the initial loan application (Step 1 of Phase 1—Identification of Project).

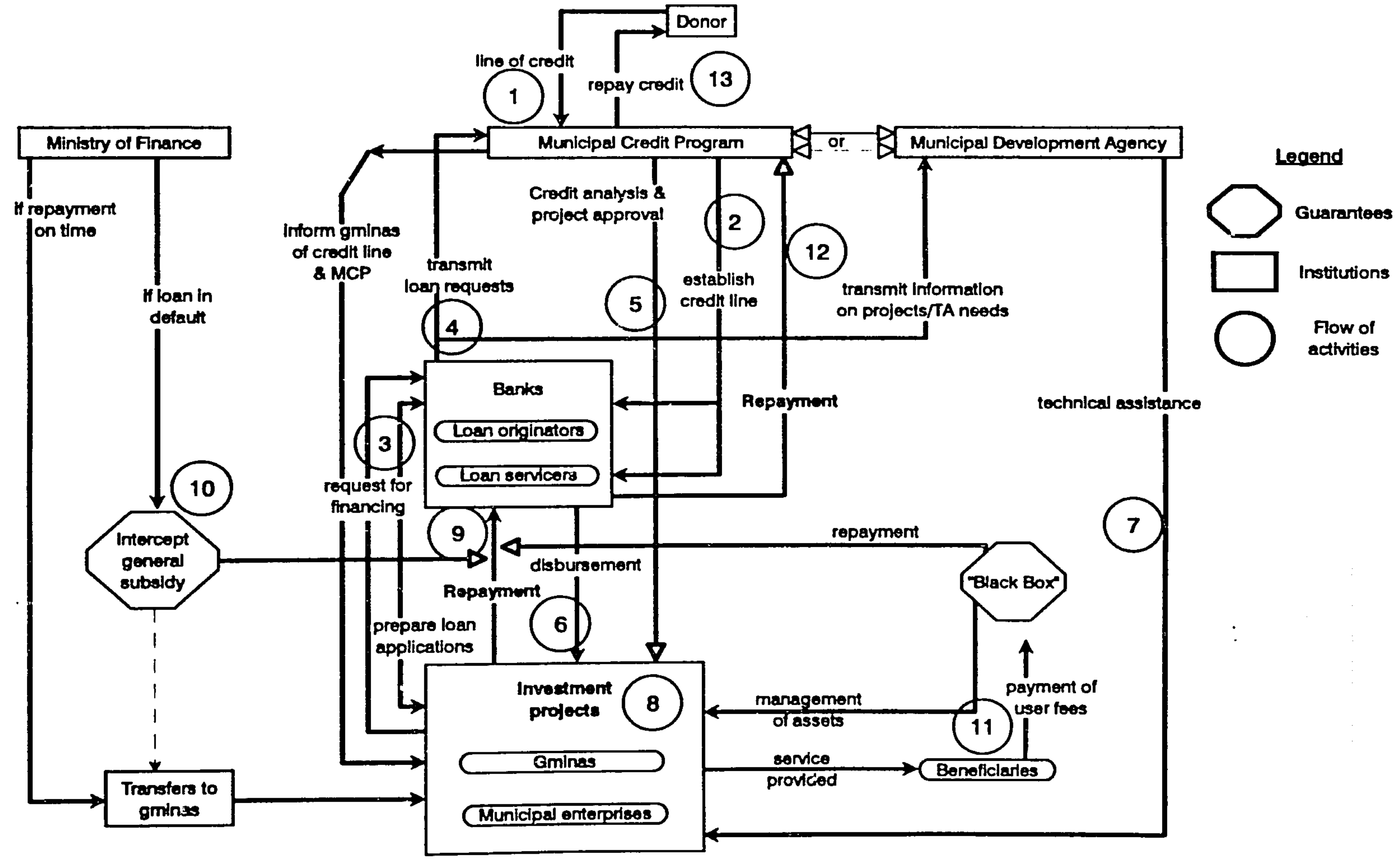
4) **Loan request**: Loan originators transmit loan requests to the MCP and information on the project and technical assistance needs to the MDA.

5) **Feasibility studies and loan agreement**: MCP analysts study project and decide whether the project proposal should be pursued. If there is initial acceptance of the project,

[2] i.e., perfecting a security interest in revenue sources (such as cash flow) that are pledged to the bank. In this manner, loan repayments do not come from the borrower, but directly from the customer.

EXHIBIT 2

STRUCTURE OF MCP PROJECT FINANCE PROCEDURES



MCP staff will carry out credit analysis and contract feasibility studies. In the event of final approval, the loan agreement is signed between the MCP and the gmina (Steps 2 and 3 of Phase 1—Pre-Investment and Feasibility Studies and Loan Approval).

6) **Loan servicing and disbursement**: Once a loan has been approved, the loan servicing and disbursement is managed by a selected loan servicer bank, under supervision of the MCP. The disbursement is contingent on successful completion of different phases of the project.

7) **Technical assistance**: During the application process and the preparation and realization phases, the MDA will provide necessary technical assistance based on needs identified by the gmina, the loan originator, and the MCP.

8) **Management of assets**: Once the project has been constructed and put into operation, the project management (municipal enterprise, public utility, and/or gmina) is responsible for operation and maintenance of the equipment, and for loan repayment.

9) **Repayment by gmina**: Repayment is effected directly by the initiator of the investment project (gmina or municipal enterprise), through its own sources of funds, such as utility tariffs or tax revenues; the latter will especially be the case for nonrevenue-generating equipment.

10) **Interception of general subsidy**: In case of default in loan payments, the general subsidy may be intercepted by the Ministry of Finance and redirected toward the MCP to honor the loan repayment schedule.

11) **Black box**: In the case of revenue-generating projects, beneficiaries are billed for service provision; these payments would be sent to a blocked account, or a "black box." The funds in the black box would be directed first to the repayment of the loan and then to the management and maintenance of the project.

12) **Repayment to MCP**: Once the loan servicer has collected payments from the gmina or municipal enterprise, these funds, minus the service fees, are transmitted to the MCP.

13) **Repayment to donor**: MCP repays credit to donor (interest and principal), and invests the interest revenues in new projects.

F. INITIAL STEPS, PLAYERS, AND DECISION IN MCP LENDING TO GMINAS

The tasks and players involved in the various phases of an MCP-financed gmina investment are illustrated in **Exhibit 3**. This is followed by **Exhibit 4**, which indicates the results associated with the tasks of the preconstruction phases of the MCP loan project.

EXHIBIT 3

PHASES OF A GMINA INVESTMENT PROJECT FINANCED BY AN MCP LOAN

	Tasks	MCP	Loan Originator (Bank)	Loan Servicer (Bank)	Gmina/ Municipal Enterprise	MDA	Consulting/ Engineering Firm	Construction Firm	Voïvodships
PHASE 0 — INFORMATION AND MARKETING OF MCP									
1	PUBLICITY & INFORMATION	✓	✓			✓			✓
PHASE 1 — PREPARATION OF LOAN AGREEMENT									
Step 1 — Identification of project									
2	PREPARATION		✓		✓	✓			
3	EVALUATION	✓							
Step 2 — Preinvestment/Prefeasibility Study									
4	PREPARATION		✓		✓	✓	✓		
5	EVALUATION	D							
Step 3 — Detailed Feasibility Study									
6	PREPARATION		✓		✓	✓	✓		
7	EVALUATION*	D							
8	LOAN AGREEMENT	D			D				
PHASE 2 — CONSTRUCTION AND REALIZATION OF PROJECT									
9	TENDER FOR OFFERS	✓			✓	✓	✓		
10	CONSTRUCTION	✓		✓	✓			✓	✓
11	LOAN DISBURSAL	✓		✓	✓				
PHASE 3 — MANAGEMENT OF ASSETS									
12	MANAGEMENT OF ASSETS			✓	✓				
13	LOAN REPAYMENTS	✓		✓					
14	POSTEVALUATION	✓			✓				

* During analysis of gmina finances, the appropriate regional audit chamber will be requested to issue an opinion on the credit-carrying capacity of the gmina.

D	DECISION
✓	PRINCIPAL RESPONSIBILITY
✓	CONTROL/FOLLOW-UP

EXHIBIT 4

GMINA INVESTMENT PROJECTS
SIMPLIFIED STEPS IN MCP LOAN FINANCE

PHASES	PLAYERS	EXPECTED RESULTS
Identification of Project	Gmina MCP Loan Originator MDA for Technical Assistance	General financial and socioeconomic justification
Preinvestment / Prefeasibility Study	Gmina Loan Originator Consulting Firm MDA for Technical Assistance	**Options / variants:** Urban aspect: site, infrastructures Commercial aspect: need for equipment Project: cost, revenues, management? Gmina: financial situation, internal savings? Optimal size of project?
DECISION 1 → **Abandon** **Continue:** **POSSIBLE eligibility of project**	MCP	
Detailed Feasibility Study	Consulting/ Engineering Firm	**Definitive program:** One or more phases? Summary technical dossier Investment financial plan Institutional / management plan
DECISION 2 → **Abandon** **LOAN APPROVAL** **LOAN AGREEMENT: MCP-GMINA**	MCP	**Signature** **LOAN AGREEMENT**
TENDER FOR OFFERS	Gmina Consulting/ Engineering Firm	**Detailed terms of reference:** Detailed estimates Tender dossier
Construction / Realization of project	Construction Firm(s)	

G. NECESSARY NEXT STEPS

The following activities are immediately necessary to establish an MCP in Poland:

1) Identify the location of the program either within the Office of Public Administration Reform or as an independent joint stock company.

2) Obtain necessary government approval for the set up of the MCP.

3) Establish a management structure.

4) Obtain technical assistance to aid in the development of the MCP organizational structure, staff requirements, responsibilities, and job descriptions.

5) Identify and hire management and staff personnel.

6) Initiate negotiations with foreign donors interested in capitalizing the MCP loan fund.

7) Simultaneously with No. 5, solicit technical assistance for the design of the MCP, the legal structure of repayment guarantees, and needs assessment and design of technical assistance for commercial banks and potential borrowers, the gminas, and their satellite enterprises.

8) Open discussion with the central government about the legal requirements to establish repayment guarantees.

9) Undertake a field study to identify projects that are creditworthy.

10) Secure technical assistance for the design of loan and repayment procedures and documentation.

11) Formulate criteria and procedures for commercial bank participation and for loan solicitation, application, and selection and for the selection of credit agents.

12) Develop formal documentation and procedures to be required for loan solicitation, approval, disbursement, monitoring, etc.

13) Design formal content and procedures for technical assistance with providers, in particular the MDA.

14) Solicit and select credit agent banks.

V. RISKS OF THE PROGRAM

There are seven main types of risks associated with the MCP program. The first relates to the restructuring of the government sector, the reassignment of activities to local governments, and the attempt to strike a balance between their management and expenditure responsibilities and their administrative and revenue capacities. The central government has demonstrated its interest in decentralizing government through a number of initiatives in 1992 and 1993 to broaden and support the structure and responsibilities of local government. The creation of the regional audit chambers and the continued reconsideration of local government finances, including discussions of substantial increases in central government revenues and aids, are indicative of serious concern with enhancement of local governments' role. Translation of current interest in technical assistance into an operative program will improve conditions and develop the administrative capacities of gminas.

The second risk is related to the capacities of gminas and their satellite enterprises to effectively manage and control their projects and finances. The success of any credit program will depend on readily available and appropriate technical assistance support to improve gmina capacity in these areas. This proposal anticipates the creation of an MDA to fulfill this need.

The third risk is attendant to progress in the development of a broadly functioning modern financial sector. Legal reforms have been put in place, but breath of practice and experience lags due to the sectors' preoccupation with financing the central government deficit, recovery of bad loans, and the privatization of industry. The proposed MCP program deals with this by: 1) targeting banks as credit agents for long-term investment finance of the gmina and their satellite enterprises; 2) providing banks with incentives (fees for services) for participation; and 3) initiating a program of technical assistance for banks and gminas to develop expertise with long-term capital projects and their financing.

The fourth type of risk is associated with the uncertainty of borrower repayment. The program attempts to mitigate these through: 1) clearly defined credit procedures and technical assistance in planning and credit analysis; 2) by establishing "all in borrowing cost" as the norm; and 3) a set of guarantees that secure repayment both by the local government borrowers and to the international donors.

The fifth type of risk is that program concern may focus too narrowly on the financial aspects of credit allocation and repayment and neglect the ultimate objectives of the program, i.e., the construction of infrastructure to enhance the delivery of services and the strengthening of gmina financial capabilities. The creation of the proposed MDA and its technical assistance responsibilities should be a counterbalance to the natural tendency in the financial sector to be narrowly focused on cost recovery. The central government has created the Joint Commission on Center Local Relations and this should also give greater representation to needs at the local level.

The sixth element of risk is that the central government will not take timely action to provide the necessary legal supports for the program. In relation to local governments, the central government has been cautious in taking steps that might aggravate its international debt and budget balance position. The program indicates both the means and rational by which local government borrowers will bear the responsibility for repayment of international credits. In reconsidering the Finance Law, the government has indicated an interest in establishing gmina revenue self-sufficiency, but it has yet to come to terms with the rigors of repayment guarantees.

The seventh risk is that of inappropriate placement of the program within the structure of the central government. Attachment of the MCP to a line ministry would lead inevitably to a predominance of ministry goals and interests and subservience of the program's activities to them. Our proposal calls for a formal connection with ministries through a board of directors and, if necessary, attachment to a ministry that reflects the varied responsibilities of the gminas and the credit program, e.g., the Council of Ministers and, within it, the Office of Public Administration Reform.

The proposed MCP, together with the MDA, incorporate mechanisms and structures that will mitigate these risks.

Part 2

Financial Sector Assessment

by

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Washington, DC

July 1994

I. FINANCIAL SECTOR OVERVIEW

This assessment of the Polish financial sector discusses the structure and conditions of the banking sector, as well as actions that will need to be taken to improve the financial capacity of banks, thus enabling the financing of long-term investment projects for both enterprises and gminas.

In recognition that the successful transformation to a market economy will be accomplished through reforms to ensure that a sound banking system will provide the necessary financial services to commercial businesses and the public sector, the government legislated the Act on Financial Restructuring of Enterprises and Banks on February 3, 1993, to simultaneously restructure state-owned enterprises and the banking sector.

Prior to 1989, the banking system in Poland was organized as a state monopoly. It comprised the National Bank of Poland (NBP) and specialized banks for foreign exchange (PKO SA);[3] foreign trade (Bank Handlowy w Warszawie SA); savings and deposits (PKO BP);[4] and agriculture (the Bank for Food Economy or BGŻ[5] and 1,700 cooperative banks). However, these specialized banks were essentially agents for the NBP. The role of the NBP was formally separated from the Ministry of Finance by the 1982 Banking Law that also introduced the possibility of establishing other banking entities. Thus, the PKO BP was formed in 1987 and the Export Development Bank[6] was created in 1988. Through this period, the NBP functioned as both a central bank and a commercial bank.

As a commercial bank, the NBP was essentially an arm of the government in the centrally planned economy. Although it did accept customer deposits, the NBP's role was really no more than that of a payment and transfer agent for the central government. Since the borrowers were all state-owned enterprises, the perception of credit risk from the bank's point of view was nonexistent. Therefore, the concept of creditworthiness and the differentiation of borrower default risk to extend loans based on rigorous credit analysis did not exist. Consequently, Polish banks have not developed much experience in rendering credit decisions.

In fact, during the period up to and beyond 1989, the banking system's ability to manage risk was further hampered by the concentration of loans to designated borrowers. Prior to 1989, each branch of the NBP was assigned responsibility to service those state-owned enterprises

[3]Bank Polska Kasa Opieki SA.

[4]Powszechna Kasa Oszczędności BP.

[5]Bank Gospodarki Żywnościowy.

[6]Bank Rozwoju Eksportu SA.

in its indigenous region. By this very policy, the NBP branches were not empowered to diversify credit risk.

On January 31, 1989, through the Act on the National Bank of Poland, the NBP was affirmed as the country's central bank, with responsibility for directing monetary policy as well as licensing and supervising the bank sector. At the same time, the NBP's commercial banking activities were spun off into nine state-owned commercial banks. The basis for the creation of each of these nine banks was principally geographic.

The establishment of private banks in Poland did not really commence until 1989,[7] even though such institutions had been authorized by the 1982 Banking Law. Between 1989 and midyear 1993, almost 100 private banks were created in Poland. Although these institutions have been licensed as banks by the NBP, their financial condition is highly varied; some are well capitalized and conservatively run, while others have made speculative loans with depositor monies.

The Polish Development Bank (PDB) was established in 1990 as a government-sponsored development bank, which serves as an APEX institution. In this capacity, the PDB acts as a conduit for monies from international financial institutions (such as its minority shareholders, Crédit National of France, and Investkredit of Austria) and international donors (World Bank, European Investment Bank, European Bank for Reconstruction and Development). These funds are on-lent to Polish banks, which in turn directly provide loans to enterprises and, eventually, local governments. The participating banks perform the initial credit analysis and ultimately bear the credit risk. Both the PDB and the participating banks are responsible for the ongoing monitoring of the loans.

Since its inception, the PDB has broadened its focus beyond its original purpose as a development bank. Today, the PDB's activities are diversified into stock brokering, corporate finance, merchant banking, and interbank overnight lending. The diversification of the PDB has made its operations profitable to date; however, the primary objective of channeling donor monies to finance projects in Poland remains far from realized. In fact, take-downs under the PDB lines of credit were reported to be minimal due to the cumbersome requirements. Borrowers complained that extensive assistance would be needed to help prepare just the application, let alone the preinvestment and prefeasibility studies.

[7] Banking Law Act of January 31, 1989.

II. BARRIERS TO GMINA INVESTMENT CREDIT

A. LOANS TO GMINAS

The current structure and operations of banking in Poland are not conducive to gmina investment financing. Due to high levels of inflation, both deposit and investment instruments are short- to medium-term, which limits funds for long-term lending to finance gmina investments.

As a result, total outstanding loans that have been extended to gminas through April 30, 1993, are predominantly short- to medium-term, as **Table 1** indicates. Of a total of 238 billion PLZ, 25 percent of the remaining capital consisted of very short-term loans or credit advances of less than 1 year. Almost 75 percent of total outstanding loans had maturities from 1 to 5 years[8] and less than 1 percent had maturities greater than 5 years; the latter were extended by only two banks: Banki Spółdzielcze Zrzeszone w Gospodarczym Banku Południowo-Zachodnim and Bank Ochrony Środiwska.

The preponderance of short-term loans results from the demand to finance short-term deficits or cash flow needs for current expenditures rather than investment in longer term capital projects. It is also a result of wariness on the part of gminas to borrow on variable rate credit terms for fear that hyper-inflationary levels of interest rates, as experienced in 1989 and 1990, will return.

B. THE DEPOSIT AND LENDING MATURITY MISMATCH

The monetary policy of the NBP dictates that the state-owned and controlled commercial banks finance the Polish Government deficit through the purchase of złoty-denominated Treasury notes (principally short-term bills with maturities up to 12 months). This policy results in the crowding out of corporate and gmina borrowers from bank loans.

As a result of the limitations on the choice of investments (3-, 6-, and 12-month government securities), banks raise deposits of similar maturities in order to minimize the interest rate risk of an unmatched asset and liability term structure. In banking, the maturity structure of deposits will generally shadow the maturity structure of Treasury bonds.

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[8] The data on this category do not distinguish loans extended for 1 to 3 years and terms greater than 3 years; however, it may be likely that many of the loans in this category have maturities of 2-3 years rather than the longer 4-5 year maturity.

TABLE 1

BANK LOANS TO GMINAS AS OF 4/30/93

Maturity	< 1 year (MM PLZ)	> 1 < 5 yrs (MM PLZ)	> 5 year (MM PLZ)
PKO B.P.	1,450	4,997	
Wielkopolski Bank Kredytowy	299	300	
Bank Zachodni	1,900		
Bydogoski Bank Komunalny	2,325		
PBK S.A.	14,112	2,361	
Bank Gdanski in Gdansk	700		
Bank Ochrony Środiwska*	11,556	158,484	36
Banki Spółdzielcze Zrzeszone w Banku Gospodarki Żywnościowej	8,499		
Banki Spółdzielcze Zrzeszone w Banku Unii Gospodarczej	.41	.365	
Bank Ślaski in Katowice	2,000	7,779	
Bank Depozytowo-Kredytowy in Lublin	1,450	1,500	
Powszechny Bank Gospodarczy in Łódź	500		
Pomorski Bank Kredytowy in Szczecin	750	678	
Banki Spółdzielcze Zrzeszone w Gospodarczym Banku Wielkopolski	701		
Banki Spółdzielcze Zrzeszone w Gospodarczym Banku Południowo-Zachodnim	1,240		1,346
Bank Przemysłowo-Handlowy	13,374		
TOTAL	60,897	176,464	1,382

*Or, the Bank for Environmental Protection, which is a universal bank with an emphasis on financing projects with environmental benefits. Loans to gminas are granted on a preferential or noncommercial basis, and the lower interest rates are subsidized by the National Fund for Environmental Protection.

Source: National Bank of Poland

The Ministry of Finance expressed its intention to introduce 2-5 year maturity, fixed-rate Treasuries in the fall of 1993. These were expected to be issued at a deep discount of face value. These new instruments should help to extend the structure of bank funding. However, there will be no competition among banks for longer term deposits in Poland until a longer term Treasury bond market develops. In addition, the high inflationary expectations held by investors will also keep the bond maturities short, constraining any extension on the yield curve.

Treasury bonds issued with maturities of less than 1 year represent 90 percent of the total bonds outstanding (average weekly rollover is 3-5 trillion PLZ), with banks buying 95 percent of this supply as presented in **Table 2** below. Longer term maturities, 1 year or greater, comprise only a small portion of total bond issuance, but the investor mix does suggest that there is some demand for longer term issues among individuals and enterprises.

TABLE 2

MATURITY OF TREASURY BONDS

	< 1 Year (%)	1 Year (%)	> 1 Year < 3 (%)
Banks	95	30	40
Individuals		40	20
Corps/SOE		30	40
Volume	90	10	

Source: Ministry of Finance

Longer term Treasury bonds are traded on the Warsaw stock exchange. However, the stock exchange does not trade daily and can issue trading stops if the price changes more than 10 percent on any given day. Like the Bourse in Paris, this mechanism is a form of "stop loss" protection for individual, retail investors. The short-term Treasury bill market is continuously quoted daily and is more suitable for institutional investors.

The reduced liquidity on the longer maturity bond market also influences banks' investment decisions to keep their funds in shorter maturity assets. Reduced liquidity results from lower net interest margins. Costs of funds are increased by competition among banks for deposit market share. The banking structure requires banks not majority-owned by the state to pay a premium rate of interest for deposits, as the latter are not guaranteed by the government. Such deposits cannot be guaranteed by a full deposit insurance system, as it does not yet exist. Finally, the lack of competition and market efficiencies result in large spreads in the interbank deposit market.

A combination of factors could help to mobilize long-term bank deposits in Poland. As the inflation rate drops, investors (bank depositors) will make the investment choice to receive a higher yield on a longer maturity than the lower rate of interest on a shorter maturity deposit. As monetary policy shifts away from encouraging the banks to buy short-term Polish Treasury bonds, the banks should be able to extend credit in the form of loans. Once this happens, banks will compete for longer term deposits and there should be growth in this type of placement. Once the banks receive longer term deposits, they can increase the term of Treasuries they purchase and receive a higher rate of interest or take credit risk by lending to enterprises and other institutions, including gminas.

In the future, another source of long-term investment funds may come from the life insurance industry. The reforms proposed under the Pensions and Social Security Act may open the Polish insurance industry as a future investor in assets with long repayment period since their liabilities are payable some time in the future. For example, a simple "death benefit" life insurance policy requires payment of the face value of the policy only when a person dies. Life insurance companies, like banks, often match their liability maturities with similar maturity investments.

C. BANK CAPITALIZATION

The "true" capitalization of the Polish banking system is difficult to determine due to the lack of information available regarding the quality of assets in general, and of loan portfolios and loss reserves established against such classified loans in particular. The weakened capital position of banks will also limit expanding banking loan portfolios. This is due to bank capital requirements imposed by the Bank for International Settlements (BIS) and to credit risk concentration limits required by the NBP.

The BIS guidelines require bank capital in the amount of 8 percent against loans to limit the leverage and risk taking of banks globally. That is to say, for every 100 million PLZ loan a bank grants, 92 million PLZ of the loan comes from deposits and 8 million PLZ from the bank's own capital. This becomes a factor in determining investment selection, as the capital risk weighting required to hold an asset will result in some assets being rated as less risky than others in terms of ultimate repayment of principal and interest. For example, Polish Government bonds carry a zero risk weighting for Polish banks, and no bank capital is required to buy these bonds, i.e., 100 percent of deposits can be used to buy government debt.

According to the NBP, unsecured loans to Polish municipalities or their public utilities would require a 50 percent risk weighting of the 8 percent capital generally required. So, if we refer to the previous numerical example of a 100 million PLZ loan, the bank is required to put up 50 percent of the 8 percent BIS capital guideline requirement for a municipal loan from its own country, or 4 percent capital (4 million PLZ of the bank's own capital and 96 million PLZ from deposit). This is in contrast to the 0 percent risk weighting for Treasury securities.

The NBP limitation on credit risk concentration to one borrower puts a constraint on the largest size loan a bank can grant. This limitation is determined as a percentage of capital: 10 percent for any one loan transaction and 15 percent of capital for total outstanding loans to one borrower. Therefore, the smaller the capital base, the smaller the legal lending limit. The Polish banking system is severely restricted in its ability to grant large loans and, in fact, the largest bank in Poland could today only extend a loan for the equivalent of 60 million USD. The industry generally suffers from low capital levels, which prevent a single institution from lending to a project greater than its legal lending limit. However, this situation does not exclude and even opens up the possibility of consortia lending among a group of banks (loan syndication).

However, in the medium term, the outlook for the Polish banking sector is optimistic as the bank and state-owned enterprises restructuring plan is implemented in the second half of 1993 and the first half of 1994. The clean balance sheets will enable Polish banks to focus on developing sound loan portfolios, as well as other bank products and services in a competitive commercial banking environment.

III. LOAN PORTFOLIOS AND FINANCIAL RESTRUCTURING

A. NONPERFORMING LOAN PORTFOLIO RISKS

Today, the loan portfolios at state-owned commercial banks remain geographically concentrated and reflect the regional health of the local economies. For many of the banks, this situation has negatively impacted the quality of their loan portfolios. Under the previous system, state-owned enterprises were principally managed as production centers where unit volume was the measure of productivity, rather than quality of the products and profitability of the enterprise. As a result, in the transformation to a market-driven economy where producers compete on quality, unit cost, and timely delivery, Polish enterprises are having difficulties in adjusting to these new requirements. Since these enterprises have lost many of their previous trading partners, new customers must be identified, a process that takes time.

The state-owned entities that are viable and/or have strategic importance in the national economy continue to be supported by the banking sector while their businesses are restructured. This means that the banks and, ultimately, the government are conceding current debt repayment for the longer term view that these enterprises will resume interest and principal payments in the future.

If Polish banks were to demand immediate and full repayment of loans from large, state-owned enterprises, there is the strong possibility that a domino-effect would ripple through the economy. If the calling of loans would force a plant or manufacturing facility to close, this could create serious economic difficulties for a particular region through layoffs of the factory workers; increased needs for social benefits for these workers; reduced revenue bases for municipalities; loss of an important customer to suppliers and utility providers; and reduction in consumer purchasing power that would hurt regional business and the local economy. In response, the government has legislated reforms, akin to bankruptcy proceedings, that will allow the banks and creditors to work together to resolve and restore these enterprises to financial health.

The February 3, 1993, Act on Financial Restructuring of Enterprises and Banks and Amendments to Some Acts enables a bank creditor and a borrower who has ceased loan repayments to commence bank conciliation proceedings and reconcile the outstanding debt through restructuring of the repayment terms. If entities are to restructure their debts under the scope of this Act, the conciliation process must begin within 3 years from the date the Act came into force.

Once a borrower elects to commence conciliation proceedings, the current loan terms are frozen and the obligation to continue repayments under the loan agreement are no longer valid. However, the conciliation must be agreed to within 4 months for an enterprise and within 6 months for a state-owned enterprise, otherwise the original loan terms are enforceable. In the case of nonpayment, liquidation proceedings would commence.

This reform act addresses the steps to restructure bad debts, but it does not resolve the problem of nonrepayment, which is in the range of 20-40 percent of loan portfolios. Even though a bank does not receive the interest income and loan principal repayment due from its borrowers, it must make current interest payments to its depositors. There are four deleterious results of this situation: 1) lower profitability; 2) reduction in equity capital; 3) modest loan portfolio growth; and 4) drain on management time.

B. LOAN LOSS RESERVE REQUIREMENTS

Although the Polish banks have reportedly been profitable, there are different means of presentation by which financial analysts are able to measure performance. Today, Polish bank accounting standards are less rigorous than international bank accounting standards. The most important difference is the requirement to set up loan loss reserves against bad loans. When a borrower is unable to repay a loan as originally agreed, the bank will not earn the interest on the loan as originally expected based on the provisions of the loan agreement. Since this usually happens after a period of time has elapsed, the banks must adjust downward the interest income accrued on this loan. This adjustment will result in a loss against current income, thereby lowering profitability.

Furthermore, if there is debt forgiveness, the bank will agree to reduce the notational amount of the loan that is to be repaid, and it will have to decrease the loan balance on its books. Since a loan is an asset and, in the case where a loan is written down, the total assets of a banking institution are reduced, there must be a corresponding reduction on the liability and equity side of the balance sheet (assets = liabilities + equity) to restore the equilibrium. This is accomplished through a charge against the loan loss reserve, a component of the bank's capital base.

In fact, there is a convergence of all these points to reduce a bank's ability to lend money. Each of the following factors negatively impacts the equity or capital of the bank:

- A narrow spread between interest earned on loans and paid on deposits will reduce profitability and also impair the bank's ability to increase its equity base.

- Loan write-downs will result from the restructuring process where there may be some debt forgiveness; the write-offs will be charged against the loan loss reserve, reducing the equity base.

- Global bank capital regulations prescribe the required capital needed to invest in loans, securities, and other assets based on the associated risk of each investment; therefore without sufficiently strong capital, the bank's ability to diversify its risk of low, medium and higher risk assets is impeded.

- The time senior management must devote to handling loan work-outs takes away from management's time for implementing strategic plans for the bank's ongoing operations.

C. BANK RESTRUCTURING

In order for the Polish banking sector to be able to grant loans to finance enterprises that will fuel economic growth, it must be well capitalized. The first step is to resolve the problem loans on its balance sheet through restructuring and loan write-downs. This process started in mid-1992. During the spring of 1993, Wielkopolski Bank Kredytowy SA, one of the nine state-owned commercial banks, was privatized through an initial public stock offering on the Warsaw Stock Exchange. The European Bank for Reconstruction and Development is a shareholder of this bank as are the Polish Treasury and private investors. Another of the nine state-owned banks, Bank Śląski, is to be privatized through a share offering in early 1994.

The next phase of the bank restructuring was planned for the fall of 1993, when the government of Poland was to receive 1.4 billion USD as part of the Bank Recapitalization fund from the International Monetary Fund (IMF). When this occurs, the banks will recognize the losses on bad debts, and new capital will be infused into the state-owned commercial banks, effectively recapitalizing the institutions. The banks will then be well positioned to put into place strategies for new types of loan products and markets to serve. Loan work-out departments will focus on resolving the bad debts. These problems will no longer detract from management time or the financial resources of the banking sector to grant new loans.

IV. ORGANIZATIONAL AND REGULATORY ISSUES

A. BANK CLEARING SYSTEMS

Once the nonperforming loan portfolio issue has been resolved, the next obstacle to growth for the Polish banking sector is the poor state of the nation's telecommunications network. Today, Polish banks do not have mainframe hookups with their branch offices. Instead, banks gather information about their customers' accounts and activity from their branches in two ways: 1) branches send hard disks to the headquarters on a periodic basis, usually monthly; or 2) KIR, the centralized clearinghouse, processes member bank transaction payments overnight.

Branch offices of banks utilize personal computers linked together by a local area network within a branch to gather information on the activity of its customer base for all banking activities: deposits, loans outstanding, loan repayments, and transfers. This information is then sent on diskettes to the headquarters to be compiled. Unfortunately, this results in a delay in information and hinders a bank's ability to make decisions regarding its overall financial position or that of a customer. Furthermore, banks need to know their liquidity position on a daily basis to either invest excess funds overnight or to borrow funds on the interbank market to fulfill their loan funding obligations. Participation in KIR, the bank clearinghouse, will alleviate some of these problems, particularly once all banks operating in Poland become members.

KIR became operational as of April 1993. It had 19 shareholders as of mid-1993, including the NBP. Shareholders are approved as members of the clearing organization based on both the size of their capital base and financial condition. An additional 14 membership applications are under consideration. KIR processes transactions (i.e., payments) between bank branches and customers transferring money to another branch or another bank at 17 regional centers across Poland. The clearing of these transactions is processed overnight and diskettes are sent to each member bank the following morning. Although banks that are members of this clearing system are able to find out what payments have been made and received from other members on an overnight basis, the customers of the banks still wait anywhere from 3 to 6 weeks to receive payment transfers. In an inflationary situation, such as Poland is experiencing, the quick receipt of payments maintains purchasing power; any delay reduces it. The development of electronic communication within the country will improve this situation.

B. DEPOSIT INSURANCE

The perception of Polish depositors is that all deposits are insured by the government. This is not valid. In Poland's two-tiered banking system, state-owned and controlled banks receive a guarantee from the Polish Government. Deposits placed in all other banks are not guaranteed or insured. There is neither a deposit insurance system in Poland like the FDIC in the USA nor a bank guarantee fund as there is in France. There are ongoing discussions at the NBP concerning this topic, which will be addressed in conjunction with the bank recapitalization fund.

C. BANKING SUPERVISION

The regulation of the banking sector is conducted by the NBP through the Inspectorate of Banking Supervision, while the insurance sector is monitored by the Ministry of Finance through the Banking and Insurance Department. There are indications that insurance supervision will be separated in the near future.

The monitoring of Polish banks, both the state-owned and the privately owned banks, is conducted on a monthly basis by the method known as off-site inspection. This method of banking supervision is combined with on-site banking examinations every 12-18 months. The off-site inspection consists of collecting financial and statistical information on bank assets and liabilities. This information is then analyzed to determine if there are changes in trends or major deviations that send up a red flag. The preferred on-site inspections include meetings with a bank's management team to understand changes in lending and business policy, reviews of loan files, and verification of adherence to credit policies. The NBP staff is now gaining the field experience to make greater use of on-site bank examinations as a supervision tool.

D. MUNICIPAL SUPERVISION

The recently established, independent regional audit chambers[9] are required to perform an audit of each municipality and their enterprises every 4 years. In the interim, if a credit institution requests an opinion on the financial condition of a municipality or a municipal enterprise from the audit office, it will receive a statement confirming the outstanding borrowing and compliance with the permitted level of indebtedness as stipulated under the Gmina Finance Act. These are not formal audit statements. They should not be mistaken for a "seal of good financial health." Rather, they just certify under a formula-driven method that the municipality has additional borrowing capacity. This is not a replacement for either a creditworthiness evaluation of the borrower or a rigorous project evaluation.

[9] Regionalna Izba Obrachunkowa or RIO.

V. CONSIDERATIONS IN STRUCTURING A MUNICIPAL CREDIT PROGRAM

Several alternatives for structuring the MCP were studied. A first option would be an existing commercial bank that would house the program. The selection of one particular bank, whether a state-owned commercial bank or one of the private banks, would be premature in that it would provide a competitive advantage over other banks at this stage in the reform of the banking system.

A second option is to house the MCP in municipal savings banks, which accept deposits and make loans to the same customer base, the municipality and its constituents. This would give rise to serious conflicts of interest. At this point in time, the municipalities across Poland are not yet in a position to make long-term investments in deposits. An MCP placed in a municipal savings bank would have the immediate disadvantage of a mismatch of the maturity of assets and liabilities. This is a dangerous and disadvantageous situation for any financial institution. Additionally, if a large municipal depositor started to experience financial difficulties, the first thing that would happen would be the withdrawal of its deposits. This might cause a liquidity problem for the municipal bank. Furthermore, this municipality would begin to experience loan repayment problems. The President of the NBP has clearly indicated that only one municipal savings bank would be granted a banking license in Poland. The third option is structuring the MCP as detailed in **Part 1** of this report.

The APEX structure, in devolving credit analysis responsibilities to the banks to whom the funds are on-lent, provides less control over credit programs, in terms of the types of projects financed and the quality of the credit analysis. Moreover, for loans to local governments, there is need for technical assistance, to the municipalities to ensure financing of viable projects, and to the banks to improve their capacity to make sound credit decisions in lending to gminas and their public utility enterprises. These elements should be factored into the structure of an MCP.

Recommendations to successfully establish an MCP in this evolving banking environment are:

- Establish consistent credit and project evaluation to ensure integrity of the program and fairness in loan disbursement.

- Centralize the loan servicing function so that all data information collected on borrowers and their repayment histories is in one location, in an identical format, on one database.

- During the preinvestment evaluation, direct the municipality and its public utility to obtain technical assistance for each stage of the application process and utilize this aid to improve its internal financial and business operations.

- Establish repayment guarantee by use of revenue intercepts.

Revenue intercepts are a means to legally perfect the security interest in certain revenue streams of the municipality or the municipal enterprise, or any other legal personality, that has pledged these specified revenue sources in order to obtain loans. This type of lending is known as secured lending, and takes borrowers' assets before granting the loan to guarantee repayment. Although this form of lending is more sophisticated, and requires legal documentation, it is one of the most successful forms of lending to less creditworthy borrowers and those that are establishing their credit track records. In Western capital markets there is an entire market known as "asset-based securities" with issuers who pledge revenue streams or receivables in order to borrow money.

Part 3

Diagnostic of Polish Local Governments

by

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SUMMARY

The diagnostic of Polish local governments presents the current financial situation of local governments and the environment in which they are evolving. Issues that will impact the structure of a municipal credit program are discussed and recommendations proposed below.

1. FINANCIAL SITUATION OF POLISH LOCAL GOVERNMENTS

■ Financial capacity

The surplus for the consolidated budgets of all gminas in 1991 was 10.5 percent of total revenues. In 1992, gminas registered a deficit of –0.74 percent of total revenues. The significance of the 1992 deficit is that it indicates that gminas are spending more than they receive in current-year revenues. Although the off-budget surplus remains sizeable, at 7 percent of total revenues, *gminas are no longer creating any additional surplus, but are eating into their margins.*

Gminas have direct control in determination of about 42 percent of their total revenues. It is in the implementation of effective procedures in the domains of property tax and rental income collection that gminas will have an impact on their financial margins and on their capacity to reimburse debt.

In 1991, gmina net operating savings represented 33 percent of operating revenue. For 1992, net operating savings attained 21 percent of operating revenue. This is a high level of "internal savings" and *indicates a capacity on the part of gminas to finance capital expenditure.* Net operating savings of gminas with up to 50,000 inhabitants is consistent with the national average, at 22 percent. *Urban gminas demonstrate less capacity for internal operating savings,* at 15 percent and lower. This reduced rate of internal savings limits larger gminas in two important respects: 1) less capacity to undertake investments, which is a serious limitation for local governments with particularly important infrastructure construction and rehabilitation needs; and 2) reduced ability to reimburse debt, as a larger percentage of the budget is needed to finance current expenditures.

■ Gmina transferred revenues

General subsidy currently represents 12 percent of gmina income. This percentage will increase, as this subsidy will be used to finance the transfer of primary education expenditures to gminas. *Shared taxes* (CIT and PIT) reach 22 percent of gmina income. Overall evolution of gmina income from the PIT and CIT will depend on several factors, including 1) efficiency of the national tax service in identifying and auditing taxpayers; 2) performance of the national economy; 3) restructuring of large state-owned enterprises; and 4) evolution of wages and other sources of personal income.

- **Gmina own revenues**

Real estate tax is the most important fiscal revenue for gminas, at 17 percent of total operating income. The basis of imposition (usable area in m^2) has several drawbacks: 1) potential revenues are limited, as the area of taxable properties is not likely to increase from one year to the next; 2) it is regressive, as it is not based on taxpayers' ability to pay; and 3) it does not account for differences in value due to location of property. *A study conducted in the city of Kraków has proposed the introduction of a value-based real estate tax.*

<u>*Perspective*</u> Taxes paid directly to the gmina (real estate tax, agricultural tax, transport tax) are calculated directly by the taxpayer. Gminas have begun to identify/locate their taxpayers and are in the process of establishing databases. *The effectiveness of computerized tax assessment and verification systems will depend on several factors*: 1) quality and appropriateness of software being developed; 2) training of staff; 3) availability of staff; 4) communication among various departments of the municipality; and 5) commitment of elected officials to improvement of gmina revenues through collection of taxes and fees.

- **Financing of investments**

Investment grants are the most important source of investment in 1993 allocated to finance infrastructure costs of new housing developments (potentially 8 percent of investment expenditure). Other sources of grants from the central government are much more limited (3-4 percent of investment expenditure). A new grant program for 1994 would allow voïvodships to finance up to 50 percent of certain gmina investments.

<u>*Perspective*</u> Most investment has been directly financed by gminas with their own funds. As a result, gminas probably do not have experience in presenting projects for loan financing. *The new system of investment grants is an opportunity to assist gminas through training in presenting projects for financing, supervising their realization, and managing the equipment upon completion.*

- **Gmina expenditures**

The level of *investment expenditure* of gminas, at more than 23 percent of total expenditures, is considerable (the equivalent proportion for Hungarian and French municipalities is less than 20 percent). The most important *sectors of expenditure* are those relating to municipal economy (27 percent—roads, bridges, solid waste, street lighting, parks, and gardens) and to education and child care (16 percent). The proportion of *education expenditures* will increase greatly in 1994, with the transfer of responsibility for primary education. As gminas cannot afford to let their budgets become hostage to education expenditures, gminas will have a strong incentive to rationalize spending and control costs in this sector.

2. ENVIRONMENT OF LOCAL GOVERNMENTS

- **Financial supervision of gminas**

The supervisory authority for gmina budget matters are the regional audit chambers, which were only established in March 1993. The regional audit chambers are currently conducting the first audits of gminas and preparing standard training for inspectors at the national level. The effectiveness and credibility of the regional audit chambers will also depend on their complete independence from political pressure, whether from the government or from gminas. Their ability to impact gmina financial practices will also depend on the extent of measures that may be taken in the case of financial or legal improprieties uncovered by audits.

- **Public utility services**

About 900 public utility enterprises were transferred to gminas, covering principally the sectors of public transport, water/sewerage treatment and distribution, council housing, sanitation, district heating, and road maintenance and repair. Many of these enterprises have been transformed or are in the process of transformation. The preferred options have been zakład budżetowe and limited liability companies. In many cases, the assets belong to the municipality and are leased by the public utility enterprise. Thus, for investment and acquisition of heavy equipment, it is the gmina that is responsible for the expenditure and the repayment of any loans used to finance such investments. However, *in order for local governments to provide these public utility services in an accountable manner, the legal and financial relationships between the actual service provider and the gmina must be clear and transparent.*

3. RECOMMENDATIONS FOR A MUNICIPAL CREDIT PROGRAM

- **Investment grants**

One of the objects of the MCP and MDA would be to assist gminas in establishing a coherent investment policy and creating local government capacity to program investments over a multi-year period. The investment grant program (50 percent financing from voïvodships) could be used as an instrument to attain this objective. For example, *for project identification, standardized forms and documentation could be required of gminas when soliciting grants. When appropriate, a request for* *technical assistance through the MDA could be required before release of subsidy funds.*

- **Definition of gmina debt limits**

  Debt reimbursement ratios should be defined as a percentage of gmina operating revenue, and the amount of debt payments taken into consideration should include potential payments from loan guarantees issued by gminas to other entities (the current draft gmina finance law has recently been amended to respond to these considerations).

- **Guarantees for loans**

  It is recommended that two forms of guarantee for loan reimbursement be incorporated in an MCP: 1) use of the general subsidy as a repayment guarantee (subject to approval of the Ministry of Finance); and 2) creation of a system ("black box" or specific bank account) to capture and direct revenues from projects financed by the MCP to repayment of the loan.

- **Accounting system**

  Due to the limitations of the current accounting system used by gminas, it is recommended that the MCP propose a modified presentation of accounts, which would have to be approved by the municipal council and would include a distinction between capital and current accounts.

- **Capacity for cost recovery**

  Revenues earned from MCP-financed projects will depend on gmina capacity to increase rates and collect public service tariffs, and on the willingness of the population of pay increased tariffs. Gmina own fiscal revenues may also serve as a source of income to cover loan payments. Demonstrated commitment of gminas to improving procedures and collection of revenues and to increasing tariffs, where necessary, should be requisites for the choice of projects financed by the MCP.

- **Public procurement**

  Successful implementation of the MCP will require open and cost-effective procurement procedures for projects that will be accepted for loan financing. Although gminas may define their own procurement procedures, it is strongly recommended that the MCP include as a requirement for acceptance of projects that gminas and their public utility enterprises conform and adhere to the procedures of public procurement legislation.

I. FINANCIAL SITUATION OF POLISH LOCAL GOVERNMENTS

General budgetary information on all Polish gminas is available through two main statistical sources: annual budget reports that are presented to the Central Statistical Office (GUS),[10] and quarterly reports submitted to the State Budget Department of the Ministry of Finance (MOF). The contents of the GUS and MOF reports are presented in detail in **Annex A.** There are some minor discrepancies between the two sets of information but, as noted by a Polish municipal finance expert who has worked with both sets of data: "It seems...that the difference between both kinds of reports are not significant enough to cause any changes in the general proportions or significant changes to the conclusions resulting from the analysis of the implementation of municipal budgets."[11] A comparison of the differences between the two sets of statistics is presented in **Annex B.**

A. BUDGET SURPLUS

The total surplus for the consolidated budgets[12] of all gminas in 1991 was 5,265 billion PLZ or 10.5 percent of total revenues (GUS data, see **Table 3** and **Exhibit 5**). However, in 1992, the consolidated result of all gminas indicated a deficit of 477.3 billion PLZ or –0.74 percent of total revenues. It should be noted that this shortfall results from a decision by MOF (pursuant to the Budgetary Law) to exclude the budgetary surplus of 1991 from the revenues of 1992.[13] If the surplus at the end of 1991 had been carried over to 1992, the end of year surplus for 1992 would have been 4,700 billion PLZ.

For all gminas, revenues per capita increased from 1.31 million PLZ in 1991 to 1.68 million PLZ in 1992 (excluding the off-budget surplus). Expenditures reached 1.69 million PLZ per capita in 1992, from 1.17 million PLZ in 1991 (refer to **Exhibit 6**). For 1992, this represents gmina budgets of less than 100 USD per capita.[14]

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[10]Główny Urząd Statysczyny.

[11]Gilowska, Zyta *Municipal Investment Policy in 1991*, Cooperation Fund, Restructuring and Privatization of Municipal Enterprises Programme, Warsaw 1993.

[12]Consolidated budgets include internal budgetary units (jednostke budżetowe) such as schools or day-care centers, but does not include external budgetary units (zakład budżetowe), under which some public utilities are organized (municipal housing enterprises, public transportation...) — see I.F. — Municipal satellite enterprises.

[13]According to MOF, this does not imply that gminas no longer dispose of surplus funds. These monies are still in gmina accounts, but they have become an "off-budget" item.

[14]At an exchange rate of 17,000 PLZ to 1 USD.

TABLE 3

GMINA BUDGET PERFORMANCE IN 1991 AND 1992

		BILLION PLZ		PLZ PER CAPITA	
		1991	1992	1991	1992
1	Revenues	50,053.2	64,401.7*	1,310,871	1,681,102*
2	Expenditures	44,788.2	64,879.0	1,172,983	1,693,561
3	Result	5,265.0	-477.3	137,888	-12,459
4	% of revenues	10.52%	-0.74%		
5	Population			38,183,160	38,309,226

*1991 budget surplus not included in 1992 revenues.

Source: GUS, Information on budget performance of municipalities in 1991-1992.

EXHIBIT 5

GMINA BUDGET PERFORMANCE IN 1991 AND 1992

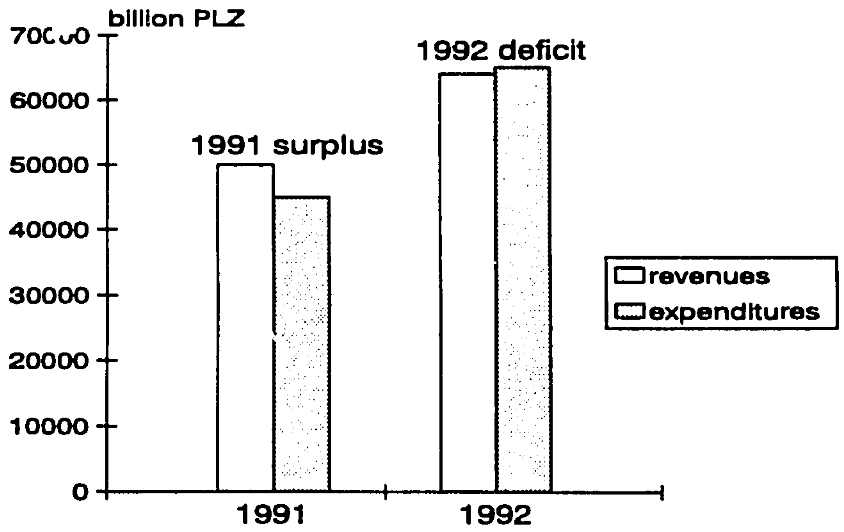
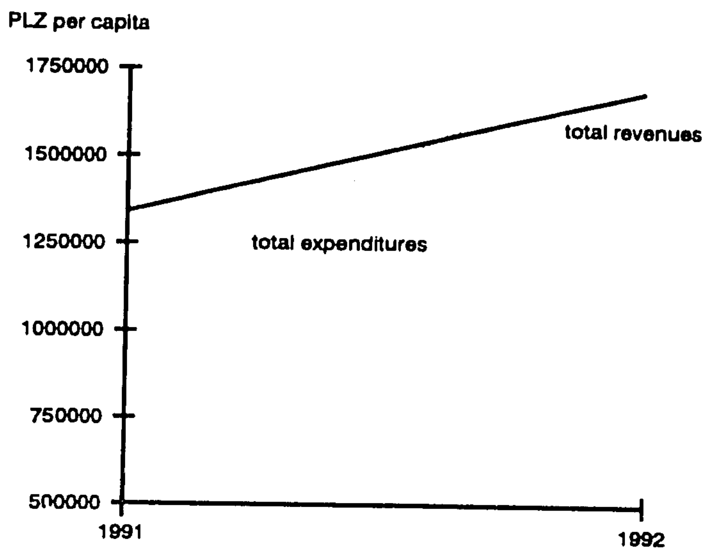


EXHIBIT 6

GMINA BUDGET PERFORMANCE IN PLZ PER CAPITA



The significance of the 1992 deficit (excluding the off-budget surplus) is that it indicates that the gminas are spending more than they receive in current-year revenues. Although the off-budget surplus remains sizeable, at 7 percent of total revenues, gminas are no longer creating any additional surplus, but are eating into their margins. Current account deficits and reduction of off-budget surplus are likely to continue in 1993 and in 1994, once education expenditures have been transferred to local governments (see below, I.E.2 — Transfer of education expenditures). *In the short term, this is not detrimental, due to the size of the off-budget surplus; in the long term, continued current account deficits will eat into gmina investment and debt-carrying capacity.*

B. STRUCTURE OF REVENUES

Total revenues of gminas in 1992 (in billion PLZ and in percent) are indicated in **Table 4** and illustrated in **Exhibit 7**, according to the presentation of municipal budget information adopted by MOF and GUS. The two most important sources of revenues are "other revenues" (23 percent) and shared taxes[15] (22 percent). The category of "other revenues" includes income from lease, rental, and sale of municipal property, interest income and

[15]Corporate income tax (CIT) and personal income tax (PIT).

collection of other taxes and fees (such as transport tax, patent tax, and market fees). About 19 percent of revenues represents transfers from the State Budget, principally to finance commissioned tasks in the areas of welfare, health care, and state administration. The fourth most important revenue source is collections from the property tax (16 percent), while the general subsidy accounts for 12 percent of overall gmina income.

TABLE 4

STRUCTURE OF GMINA REVENUES IN 1992

		1992 billion PLZ	1992 % of total
1	Property tax	10,536.6	16.36%
2	Agricultural tax	1,737.1	2.70%
3	Shared taxes	14,279.8	22.17%
	of which:		
4	Corporate income tax	1,665.5	2.59%
5	Personal income tax	12,614.3	19.59%
6	Stamp duty	3,391.5	5.27%
7	Other revenues	14,802.9	22.99%
8	Transfers from State Budget	12,092.9	18.78%
	of which:		
9	Own projects	1,625.3	2.52%
10	Commissioned tasks	10,467.6	16.25%
11	General subsidy	7,560.9	11.74%
	TOTAL	64,401.7	100.00%

Source: GUS, Information on budget performance of municipalities in 1991-1992.

When accounting for these five principal revenue categories as well as the agricultural tax and stamp duties, it becomes apparent that *gminas have direct control in the determination of about 42 percent of their total revenues.*[16] It is in the implementation of effective procedures in the domains of property tax and rental income collection that gminas will have an impact on their financial margins and on their capacity to reimburse debt. On the other hand, 58 percent of gmina revenues[17] depend on decisions taken at the national level—what percent of personal and corporate income taxes to distribute to gminas, amount of the general subsidy, and level of financing of commissioned tasks.

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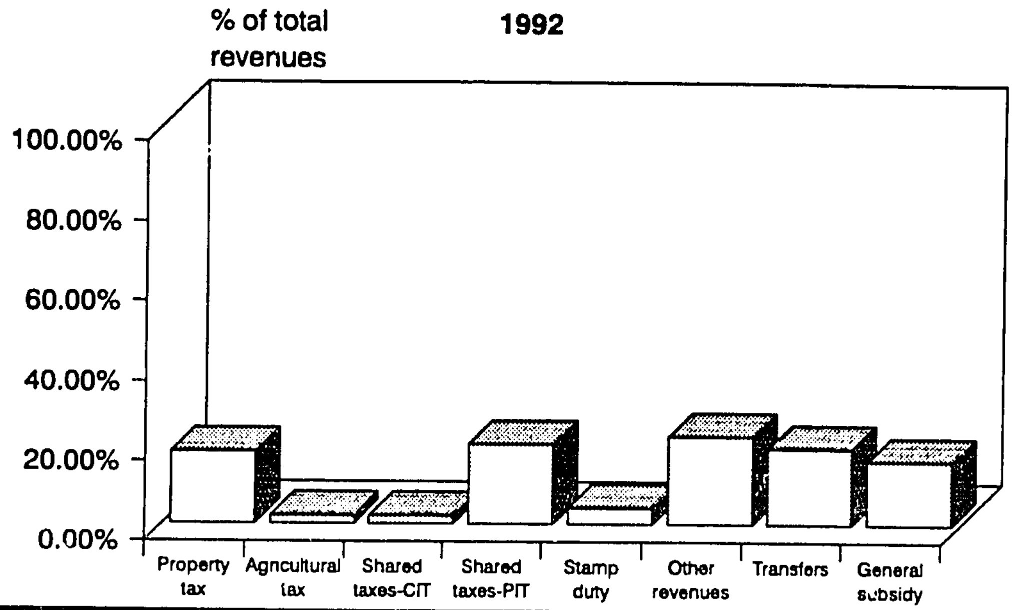
[16]Property tax, agricultural tax and "other revenues." Stamp duties are excluded, as duty rates and bases are determined at the central level.

[17]Shared taxes, transfers from the State Budget, general subsidy, and stamp duties.

EXHIBIT 7

STRUCTURE OF GMINA REVENUES: 1992



Discussions surrounding the draft law on gmina finances indicate that in 1994, the structure of gmina revenues may be modified. It would seem that there would be greater emphasis on transfers from the state, as the general subsidy will be significantly increased (possibly multiplied by a factor of 3) to finance the transfer of education expenditures. If the actual costs of education are greater than the subsidy transferred, the financial situation of gminas is likely to worsen.

C. ANALYSIS OF FINANCIAL CAPACITY

Analysis of gmina capacity to finance capital expenditures with own funds and to budget for repayment of debt necessitates a presentation of budgetary information according to current and capital accounts. Although the ordinance on classification of budgetary income and expenditures[18] does not create specific accounts for operating and capital expenditures, an attempt was made by the consultant to make this distinction, within the classifications used by MOF and GUS data.

[18] Ordinance of the Minister of Finance of April 18, 1991, on classification of budgetary income and expenditures as well as of other revenues and spending.

The gmina accounts, with a distinction between capital and current accounts, is presented in **Table 5**. The basis of this breakdown of gmina accounts is explained in **Box 1**. **Exhibit 8** further illustrates the logic of this presentation.

Box 1

Definition of Gmina Current and Capital Accounts
(Based on Presentation of GUS and MOF data)

Operating revenues retained for this classification consist of any and all revenues not specifically targeted or earmarked for investment projects. These comprise the following categories: general subsidy, shared taxes, real estate tax, agricultural tax, transportation tax, stamp duties, grants for commissioned tasks, and "other revenues." (Note: "other revenues" may include income that would be classified as capital receipts, such as sales of municipal property).

Operating expenditures by definition are those used for general management and functioning of the gmina. The categories of expenditures retained for this presentation include: wages, materials and services, transfers to budgetary units, and "other expenditures."

Net operating savings is calculated by subtracting operating expenditures from operating revenues. A positive result indicates that the gmina has the capacity to finance capital investment from operating revenues. A negative result at this level would indicate a gmina in serious financial difficulty, as the municipality would be obliged to finance operating expenditures from capital revenues.

Capital account: Based on MOF and GUS data, this account has two lines: capital expenditures and capital receipts, which for the moment include state grants for gmina own projects.

Investment financing needed is obtained by subtracting capital receipts from capital expenditures, and is an indicator of the amount needed to finance remaining investment expenditures from other sources. Essentially, these funds will come from net operating savings, eventually from loan financing.

Surplus or deficit: The final result of the budget, in this table it is calculated by subtracting "investment financing needed" from "net operating savings."

TABLE 5

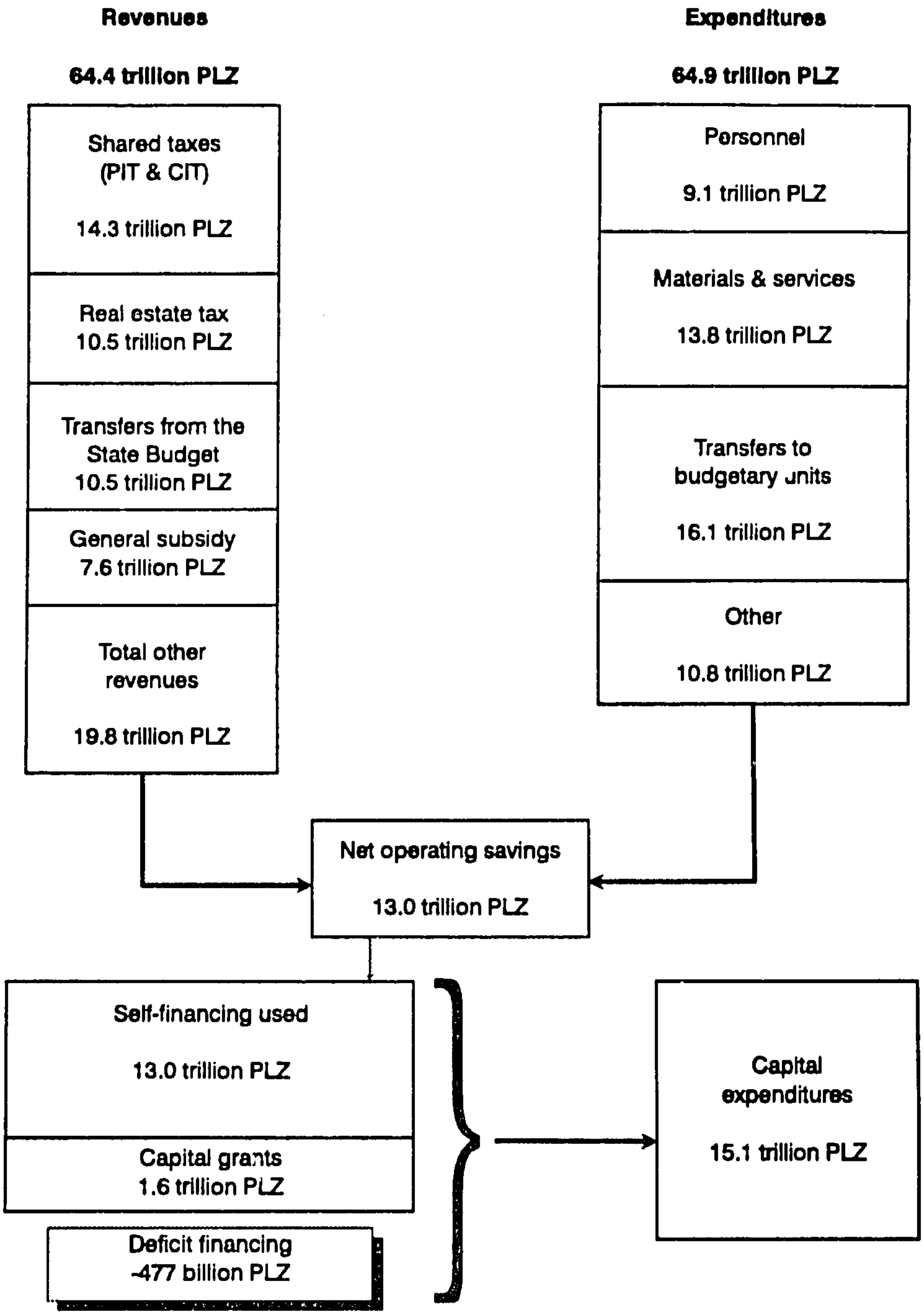
ANALYSIS OF OVERALL GMINA FINANCING CAPACITY FOR 1991 FOR 1992

	billion PLZ	1931 Actual (GUS)	1992 Actual (GUS)	Evolution 92/91 (GUS)	1991 Actual (MOF)	1992 Actual (MOF)	Evolution 92/91 (MOF)
1	**Total—Operating revenue** *of which:*	**49,460.1**	**62,776.4**		**49,244.2**	**62,659.7**	
2	General subsidy	6,771.1	7,560.9	*11.66%*	6,809.1	7,576.1	*11.26%*
3	Shared taxes	14,490.2	14,279.8	*-1.45%*	14,484.4	14,252.0	*-1.60%*
4	Real estate tax	7,658.2	10,536.6	*37.59%*	7,630.5	10,533.9	*38.05%*
5	Agricultural tax	1,860.9	1,737.1	*-6.65%*	1,935.0	1,753.7	*-9.37%*
6	Transportation tax	555.1	2,233.5	*302.36%*		2,234.5	
7	Stamp duties	2,307.1	3,391.5	*47.00%*		3,401.5	
8	Grants for commissioned tasks	5,414.7	10,467.6	*93.32%*	5,347.9	10,348.8	*93.51%*
9	Other revenues	10,402.8	12,569.4	*20.83%*	13,037.3	12,559.1	*-3.67%*
10	**Total—Operating expenditure** *of which:*	**33,210.6**	**49,813.1**	*49.99%*	**32,930.3**	**49,734.7**	*51.03%*
11	Wages	4,360.4	9,099.8	*108.69%*	4,737.7	9,116.8	*92.43%*
12	Materials & services	9,227.2	13,777.1	*49.31%*			
13	Transfers to budgetary units	13,629.5	16,097.9	*18.11%*			
14	Other expenditures	5,993.5	10,838.3	*80.83%*	28,192.6	40,617.9	*44.07%*
15	**Net operating savings (1-10)**	**16,249.5**	**12,963.3**	*-20.22%*	**16,313.9**	**12,925.0**	*-20.77%*
16	**% of operating revenues**	**32.85%**	**20.65%**		**33.13%**	**20.63%**	
	Capital Account						
17	Capital expenditures	11,577.6	15,065.9	*30.13%*	11,669.1	15,173.6	*30.03%*
18	Capital receipts (grants for own projects)	593.1	1,625.3	*174.03%*	599.7	1,572.7	*162.23%*
19	**Investment financing needed (16-17)**	**10,984.5**	**13,440.6**	*22.36%*	**11,069.4**	**13,600.9**	*22.87%*
20	**Surplus or deficit (15-18)**	**5,265.0**	**-477.3**		**5,244.5**	**-675.9**	
21	**% of total revenues**	**10.52%**	**-0.74%**		**10.52%**	**-1.05%**	

Sources: GUS, Information on budget performance of municipalities in 1991-1992 and MOF, Fourth quarter budget report for 1991 and 1992.

EXHIBIT 8

BALANCE OF GMINA BUDGET IN 1992 AND FINANCING OF INVESTMENTS

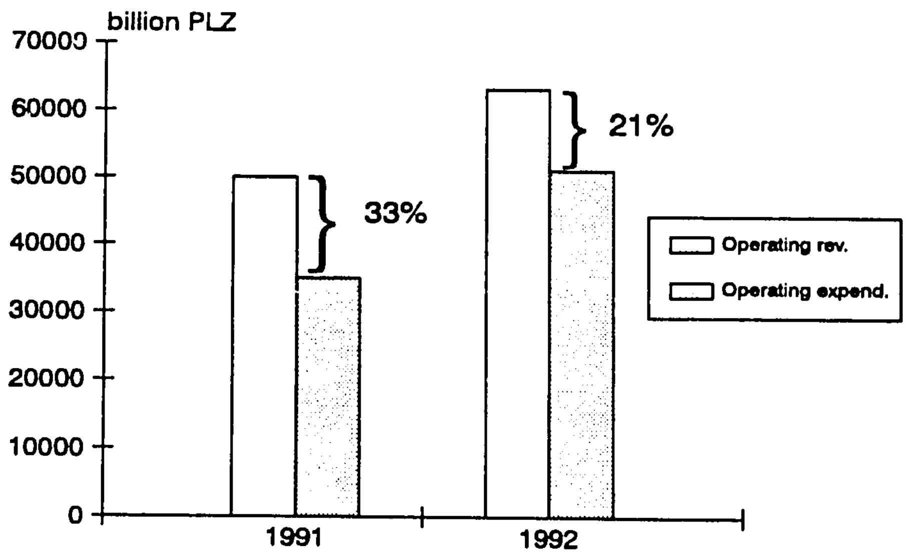


Such an approach has certain limitations, particularly when dealing with budgetary data consolidated at the national level. For **Table 5**, "other revenues" (line 9) listed under operating revenues may include income that would be classified as capital revenue according to European and American accounting conventions; these include income from sales of municipal property and gmina borrowing to finance investment expenditure. It also is possible that "other expenditures" (line 14) may include some capital investment expenditure. Although information for 1991 and 1992 are shown together, it is difficult to compare the data, as the budget surplus for 1991 was not carried over to 1992 revenues.

As also shown in **Table 5**, in 1991, the level of net operating savings of 16.2 trillion PLZ represented 33 percent of operating revenue (lines 15 and 16). For 1992, there is a net operating savings of 12.9 trillion PLZ, or 21 percent of operating revenue (see **Exhibit 9**). This is a high level of "internal savings" and indicates a capacity on the part of gminas to finance capital expenditure. However, it should be noted that the internal savings capacity has certainly deteriorated from 1991 to 1992, even if the off-budget surplus were taken into account.

EXHIBIT 9

NET OPERATING SAVINGS FOR 1991 AND 1992



Identified capital receipts to finance investment (grants from the central government and from voïvodships) represented 10 percent of identified capital expenditures in 1992 (and only 5 percent in 1991). The remainder of capital expenditures is partially financed by net operating savings. However, as there was a current-year deficit of 477 billion PLZ for 1992, gminas were obliged to use part of their off-budget surplus to cover the remaining expenditures.

The overall financing capacity by population category for 1992 (MOF data) is presented in **Table 6** and in **Exhibits 10 and 11**. Net operating savings of gminas with up to 50,000 inhabitants is consistent with the national average, at 22 percent. Urban gminas (50,000 to >800,000 inhabitants) demonstrate less capacity for internal operating savings, at 15 percent and lower. This reduced rate of internal savings limits larger gminas in two important respects:

- It lessens their capacity to undertake investments, which is a serious limitation for local governments with particularly important infrastructure construction and rehabilitation needs; and

- It reduces their ability to reimburse debt, as a larger percentage of the budget is needed to finance current expenditures.

Three categories of gminas experienced current-year deficits for 1992 (line 18 of **Table 6**); however, these deficits did not surpass 3.5 percent of total revenues. The distribution of the 1992 off-budget surplus is not available according to population category; therefore, it is impossible to estimate how much of a financial margin each category of gmina will have at their disposal in 1993 and 1994 for dipping into the surplus carried over.

Analysis of operating revenues and expenditures in PLZ per capita indicate that these overall ratios increase with the size of the gmina (refer to **Exhibit 11**). Operating revenues per capita are 40 percent greater in the largest gminas (excluding Łódź) than in the smallest. For operating expenditures, this difference is 60 percent.

The situation in the Union of Warsaw Districts is not comparable with other gmina categories, given that this specific local government received different responsibilities (particularly for infrastructure that services Warsaw on a citywide basis). A high net operating savings rate of 69 percent corresponds to the important level of investment for the Union, at 65 percent of total expenditures.

TABLE 6

ANALYSIS OF GMINA FINANCING CAPACITY IN 1992, BY POPULATION CATEGORY

		Category 1 0-10,000	Category 2 10-50,000	Category 3 50-300,000	Category 4 300-800,000	Category 5 > 800,000	Union of Warsaw D.	Total gminas
1	**Total—Operating revenue**	13,062.2	19,385.9	17,228.6	8,117.1	2,287.7	2,578.2	62,659.7
	of which:							
2	General subsidy	2,665.3	2,532.4	1,519.5	819.8	38.5	0.7	7,576.1
3	Shared taxes	2,816.1	4,352.3	3,358.0	1,855.5	401.8	1,468.4	14,252.0
4	Real estate tax	1,544.0	3,591.2	3,674.7	1,529.8	194.2	0.0	10,533.9
5	Agricultural tax	1,119.1	599.8	24.2	8.5	2.1	0.0	1,753.7
6	Transportation tax	488.8	755.9	637.6	302.4	49.7	0.0	2,234.5
7	Stamp duties	320.3	899.0	1,463.0	624.9	94.4	0.0	3,401.5
8	Grants for commissioned tasks	1,864.3	2,371.3	2,933.4	1,362.8	978.8	838.2	10,348.8
9	Other revenues	2,244.3	4,283.9	3,618.2	1,613.5	528.3	271.0	12,559.1
10	**Total—Operating expenditure**	10,194.2	15,024.2	14,625.7	7,128.7	1,971.1	790.9	49,734.7
	of which:							
11	Wages	2,437.2	2,581.6	2,336.5	1,337.9	380.6	43.0	9,116.8
12	Other expenditures	7,756.9	12,442.6	12,289.2	5,790.8	1,590.5	747.9	40,617.9
13	**Net operating savings (1-10)**	2,868.1	4,361.7	2,602.9	988.4	316.6	1,787.3	12,925.0
14	**% of operating revenue**	21.96%	22.50%	15.11%	12.18%	13.84%	69.32%	20.63%
	Capital Account							
15	Capital expenditures	3,179.1	5,150.2	3,540.8	1,441.5	369.3	1,492.6	15,173.6
16	Capital receipts (grants for own projects)	323.9	526.3	381.8	216.2	124.5	0.0	1,572.7
17	**Investment financing needed (14-15)**	2,855.2	4,624.0	3,159.1	1,225.3	244.8	1,492.6	13,600.9
18	**Surplus or deficit (13-16)**	12.9	-262.3	-556.2	-236.9	71.8	294.7	-675.9
19	**% of total revenues**	0.10%	-1.32%	-3.16%	-2.84%	2.98%	11.43%	-1.05%
	Operating account per capita							
20	*Population*	*9,890,194*	*13,181,068*	*10,059,754*	*4,333,352*	*844,858*	*1,654,531*	
21	Operating revenues (PLZ per capita)	1,320,726	1,470,735	1,712,626	1,873,165	2,707,783	1,558,293	
22	Operating expenditures (PLZ per capita)	1,030,735	1,139,833	1,453,881	1,645,070	2,333,041	478,037	

Source: MOF, Fourth quarter budget report for 1992.

EXHIBIT 10

GMINA FINANCING CAPACITY IN 1992, BY POPULATION CATEGORY (BN PLZ)

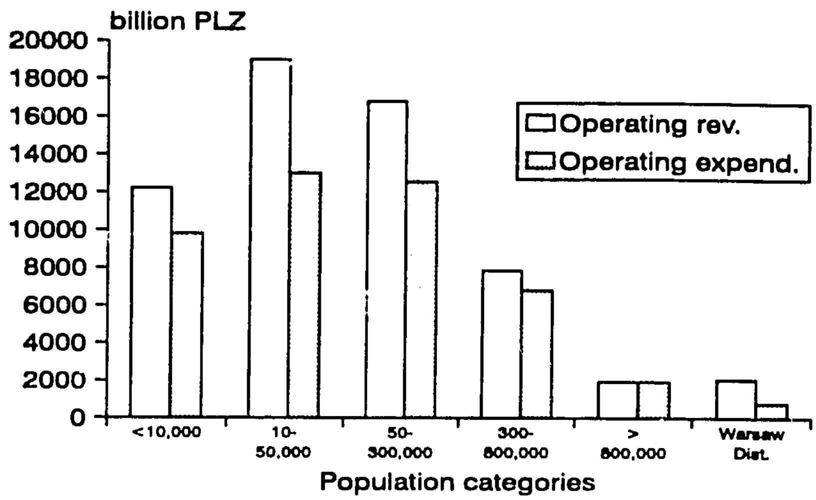
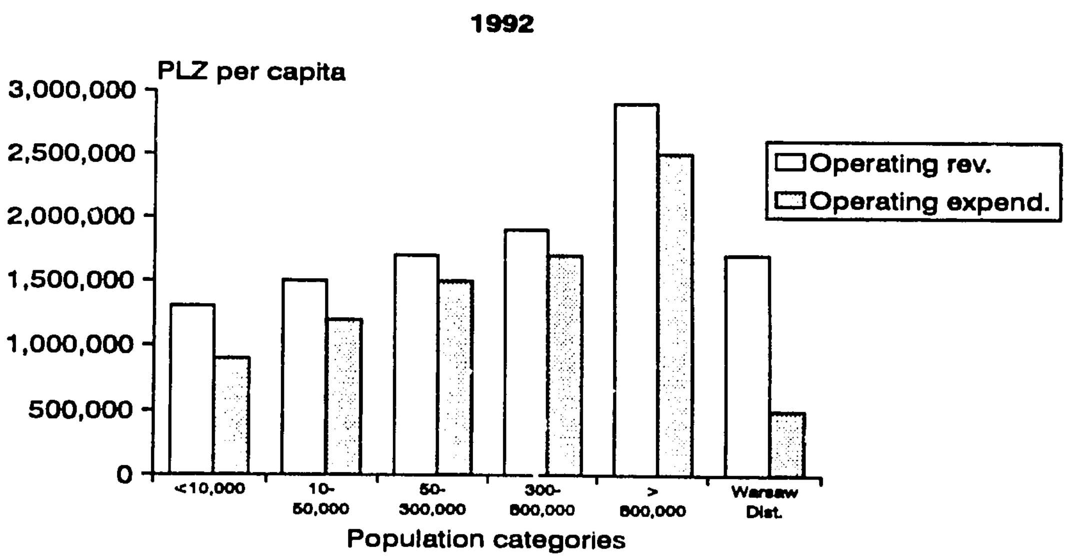


EXHIBIT 11

GMINA FINANCING CAPACITY BY POPULATION CATEGORY (PLZ PER CAPITA)



D. ANALYSIS OF GMINA REVENUES

Revenues of gminas include those transferred from the central government (both directly and indirectly, through the voïvodships) and own sources of revenues. However, many of the parameters relating to own source revenues are defined at the level of the central government.

1. Revenues Transferred from the Central Government

a. General Subsidy

(1) Current system of general subsidy. The general subsidy distributed to gminas is a form of formula-driven revenue-sharing to promote horizontal fiscal balance for financing of responsibilities transferred to local governments. The general subsidy, as defined in the law on the revenues of gminas of December 14, 1990, for fiscal year 1991 (Chapter 2, Articles 10-20), was also applied, with modifications, in fiscal years 1992 and 1993. The total amount of subsidy distributed is in principle the result of the difference between projected gmina expenditures and projected gmina revenues. These projections were calculated by the MOF on the basis of actual performance of gmina budgets in the first half of 1992 and on the forecast of state budget revenues and expenditures for 1993. The amount of the compensatory subsidy is calculated by a formula included in the law,[19] and appears to be added to the calculated need. The priority distribution of the total of general subsidy funds among the different components is indicated in **Box 2.**

Box 2

General Subsidy: Distribution for 1993
Based on Modified Gmina Finance Law of December 14, 1990

Total subsidy fund (difference between gmina projected expenditures and revenues plus result of compensatory subsidy calculation)

– Compensatory subsidy for poor gminas
– Education subsidy
– Reserve for increase of wages of school employees

= Remaining amount, to be divided as follows:

80% Basic operating expenditure subsidy/20% Investment subsidy

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[19] This formula is as follows:
$S = L \times 0.9\ (0.85\ B - A)$, where
S = compensatory subsidy,
L = inhabitants of gmina on December 31 of the base year,
A = index for gmina of revenue per inhabitant, and
B = average for all gminas of revenue per inhabitant.

Table 7 and **Exhibit 12** present the amounts distributed in 1992 and to be distributed in 1993 for each of the components of the general subsidy.

TABLE 7

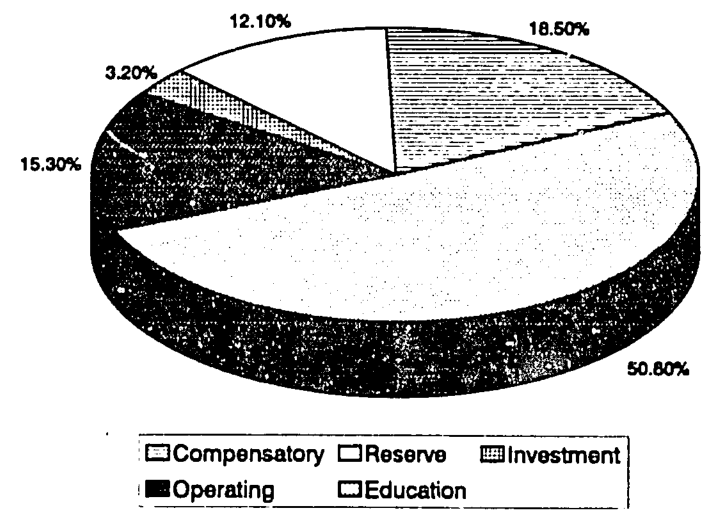
DISTRIBUTION OF TOTAL GENERAL SUBSIDY IN 1992 AND 1993, BY COMPONENT

		1992 Subsidy (billion PLZ)	1992 % of Total	1993 Subsidy (billion PLZ)	1993 % of Total
1	Total	7,571.2	*100.00%*	11,745.5	*100.00%*
	of which:				
2	Compensatory subsidy	2,698.2	*35.64%*	2,178.7	*18.55%*
3	"Education subsidy"	3,452.1	*45.60%*	5,970.0	*50.83%*
4	Basic operating expenditures (after reduction)	793.3	*10.48%*	1,794.4	*15.28%*
5	Investment expenditures	183.4	*2.42%*	378.2	*3.22%*
6	Reserve (incl. wage increase for school employees)	444.3	*5.87%*	1,424.2	*12.13%*

Source: MOF.

EXHIBIT 12

DISTRIBUTION OF GENERAL SUBSIDY IN 1993, BY COMPONENT



The compensatory subsidy is designed to ensure additional revenues for those municipalities that have a weaker fiscal base. The level of fiscal revenue is determined by the per capita revenue of the real estate tax, agricultural tax, and shared taxes (CIT and PIT), plus the amount of tax exemptions granted by gminas.[20] For a per capita total of 85 percent or less of these taxes, as compared with the national average, the compensatory subsidy can redress up to 90 percent of this difference. The compensatory component represented 18.5 percent of the general subsidy in 1993, compared with 36 percent of the general subsidy in 1992.

Based on the calculation of the compensatory subsidy formula, in 1992 1,890 gminas received a portion of the compensatory subsidy, and 1,641 gminas were compensated in 1993. The total amount awarded was 2.7 trillion PLZ in 1992 and 2.1 trillion PLZ in 1993, or 20 percent less. For 1993, the number of gminas receiving a compensation represented two-thirds of all gminas and 42 percent of the total population. However, 75 percent of gminas receiving a compensation have fewer than 10,000 inhabitants (**Table 8**). Gmina revenue wealth is consequently concentrated among one-third of all gminas and particularly among the most populous.

The funds for the "educational subsidy" component were not calculated by the MOF, but simply transferred from the Ministry of Education for the gminas that had accepted the option to have education expenditures transferred before January 1, 1994. For 1993, over 50 percent of the general subsidy was pledged to the transfer of education expenditures.

The subsidy for basic operating expenditures (15 percent of the general subsidy) includes subcomponents for municipal housing management, nonmaterial municipal services, social welfare, and other tasks. Calculating units are weighted for certain special situations (e.g., seaport, border crossing, areas of environmental protection, environmental hazard regions, poor arable land).

The subsidy for basic operating expenditures is reduced for those gminas whose per capita revenues are more than 1.5 times greater than the average.[21] For 1993, 88 gminas with 8 percent of the total population will have their subsidy reduced by 98 billion PLZ, or less than 1 percent of the total general subsidy for 1993. This is a decrease from 1992, when 116 gminas with 17 percent of the population had their subsidy reduced by 125 billion PLZ. These funds were transferred to the reserve fund of the general subsidy (**Table 9**).

[20] To ensure that gminas do not reduce taxes with the intention of increasing their portion of the compensatory subsidy.

[21] The formula to calculate the reduction is as follows:

$Z = L \times 0.25\ (A - 1.5\ B)$, where

Z = amount of subsidy decrease,

L = inhabitants of gmina on December 31 of the base year,

A = index for gmina of revenue per inhabitant, and

B = average for all gminas of revenue per inhabitant.

TABLE 8

DISTRIBUTION OF COMPENSATORY SUBSIDY IN 1992 AND 1993

		A	B	C	D	E	F	G	H
		Total # of gminas	Population	# of gminas with compensatory subsidy	*% total gminas*	Population of gminas with compensatory subsidy	*% total population*	Total amount of compensatory subsidy (billion PLZ)	*% of total compensation*
	1992								
1	Pop.: 0 – 10,000	1,647	9,912,300	1,449	*58.95%*	N/A		1,716.7	*63.62%*
2	Pop.: 10,001 – 50,000	711	13,143,704	433	*17.62%*	N/A	*0.00%*	949.8	*35.20%*
3	Pop.: 50,001 – 300,000	90	9,950,203	8	*0.33%*	N/A	*0.00%*	31.8	*1.18%*
4	Pop.: 300,001 – 800,000	9	4,328,695	0	*0.00%*	0		0.0	*0.00%*
5	Pop.: > 800,000	1	848,258	0	*0.00%*	0		0.0	*0.00%*
6	Total	2,458	38,183,160	1,890	*76.89%*	N/A		2,698.2	*100.00%*
	1993								
7	Pop.: 0 – 10,000	1,647	9,890,194	1,226	*49.88%*	7,389,874	*19.35%*	1,191.3	*44.15%*
8	Pop.: 10,001 – 50,000	711	13,181,068	391	*15.91%*	6,607,367	*17.30%*	808.1	*29.95%*
9	Pop.: 50,001 – 300,000	90	10,059,754	24	*0.98%*	2,266,734	*5.94%*	129.5	*4.80%*
10	Pop.: 300,001 – 800,000	9	4,333,352	0	*0.00%*	0	*0.00%*	0.0	*0.00%*
11	Pop.: > 800,000	1	844,858	0	*0.00%*	0	*0.00%*	0.0	*0.00%*
12	Total	2,458	38,309,226	1,641	*66.76%*	16,263,975	*42.59%*	2,128.9	*78.90%*

Source: MOF.

TABLE 9

DISTRIBUTION OF REDUCTION OF BASIC OPERATING SUBSIDY IN 1992 AND 1993

		A	B	C	D	E	F	G	H
		Total # of gminas	Population	# of gminas with reduction of basic operat. expend. subsidy	*% total gminas*	Pop. of gminas with reduction of basic operat. expend. subsidy	*% total population*	Total amount of reduction for reserve (billion PLZ)	% of total reduction
	1992								
1	Pop.: 0 – 10,000	1,647	9,912,300	34	*1.38%*	212,142	*0.56%*	5.3	*4.29%*
2	Pop.: 10,001 – 50,000	711	13,143,704	54	*2.20%*	1,173,941	*3.07%*	26.2	*21.16%*
3	Pop.: 50,001 – 300,000	90	9,950,203	24	*0.98%*	3,016,600	*7.90%*	57.1	*46.23%*
4	Pop.: 300,001 – 800,000	9	4,328,695	4	*0.16%*	2,172,582	*5.69%*	35.0	*28.32%*
5	Pop.: > 800,000	1	848,258	0	*0.00%*	0	*0.00%*	0.0	*0.00%*
6	Total	2,458	38,183,160	116	*4.72%*	6,575,265	*17.22%*	123.6	*100.00%*
	1993								
7	Pop.: 0 – 10,000	1,647	9,890,194	47	*1.91%*	290,749	*0.76%*	11.9	*9.63%*
8	Pop.: 10,001 – 50,000	711	13,181,068	31	*1.26%*	624,832	*1.64%*	27.8	*22.49%*
9	Pop.: 50,001 – 300,000	90	10,059,754	7	*0.28%*	910,827	*2.39%*	34.5	*27.94%*
10	Pop.: 300,001 – 800,000	9	4,333,352	3	*0.12%*	1,483,232	*3.88%*	24.3	*19.67%*
11	Pop.: > 800,000	1	844,858	0	*0.00%*	0	*0.00%*	0.0	*0.00%*
12	Total	2,458	38,309,226	88	*3.58%*	3,309,640	*42.59%*	98.5	*79.73%*

Source: MOF.

The "investment" component of the general subsidy represents only 3 percent of total funds and is calculated proportionately to the amount of subsidy for operating expenditures received by each gmina. It is therefore not a true "investment grant" as there is no relation between the funds distributed and specific investment projects being carried out by gminas.

(2) **Proposed modification of general subsidy (according to draft gmina finance law).** The draft law on finances of communes (draft of August 20, 1993), proposes important modifications of the system for calculation of the general subsidy for the fiscal year beginning January 1, 1994. Plans are to assign a fixed share of central government revenues to the general subsidy to account for the transfer of education expenditures. This fixed share may be set at 7.5 percent (according to Article 12 of the draft) and will increase past amounts distributed for the general subsidy.

According to conversations at the MOF, approximately 34 trillion PLZ will be necessary for the total general subsidy (before inflation): 11 trillion for the general subsidy already being distributed (including the education subsidy) and 23 trillion for education expenditures that have not yet been transferred to gminas. The share of 7.5 percent of central government revenues should cover this amount.

Under the proposed system, the first distribution of subsidies is reserved for the compensation subsidy for gminas with per capita "basic tax revenues" of 60 percent or less of these revenues as compared with the national average of per capita "basic tax revenues" of all gminas.[22] This percent is lower than the current limit of 85 percent. As a result, fewer gminas will receive the compensatory subsidy. In addition, the definition of revenues that will be included in the calculation may be expanded to include transportation tax, patent tax, stamp duties, forest tax, and other taxes on exploitation of resources (e.g., mines).

About 1 percent of the total general subsidy would be set aside as a reserve (2 percent for 1994).

A "standard amount for remuneration of primary school teachers" would be calculated according to a formula incorporating three elements:

1) standard average salary for a teacher,
2) standard number of teachers for one class (uniform ratio for all gminas),
3) average number of classes for a gmina.

This component is to serve as the "education subsidy" to finance the operating costs of primary schools, particularly payment of teachers.

[22] The detailed list of revenues to be counted as "basic tax revenues" will not be defined in the gmina finance law, but through an ordinance of the Ministry of Finance. However, the list may include: property tax, agriculture tax, and shared taxes, as well as tax on the means of transport, patents, forestry, and stamp duties.

The Minister of National Education, in agreement with the MOF, would determine the standard average teachers' salaries and the standard number of teachers for one class. The average number of classes in each gmina will be calculated by dividing the number of children in a commune by 26. It has not yet been determined whether the number of children used for the calculation will be the number residing in a particular gmina or the number attending communal schools. For towns with fewer than 5,000 residents, the number of actual children would be increased by 45 percent.

The remaining funds would be distributed based on weighted population; all gminas with a population greater than 10,000 inhabitants would have their population increased by a fixed percentage, according to four population categories.[23] The draft law appears to eliminate the reduction of part of the general subsidy for those gminas with per capita revenues greater than 1.5 times the average for all gminas. The only case for reduction of a gmina's subsidy (and payment of interest penalties) would be that of deliberate falsification of data by a gmina, when this falsification leads to higher subsidies (Article 21.1).

Box 3

General Subsidy: Distribution
Based on the Draft Gmina Finance Law of August 20, 1993

Total subsidy fund (% of State Budget revenues)

– Compensatory subsidy for poor gminas

= Subtotal A
– 1% reserve

= Subtotal B
– Education subsidy
(average teacher salary x # of teachers/class x number of classes in a gmina)

= Subtotal C

Remaining amount distributed proportionally to the weighted number of inhabitants

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[23] 10,001-50,000; 50,001-300,000; 300,000-800,000; and >800,000.

The revised formulas for determining the total general subsidy as a percentage of State Budget revenues would be a welcome modification of the current system. It would ensure local governments access to a well-defined, stable source of funds. However, including education subsidies as part of this general fund may lead to increased financial difficulties for gminas, if the 1993 experience is any indicator. *As education will form a large part of current expenditures, other tasks risk being crowded out and underfunded. Such a situation would leave gminas in a weaker position in terms of investment financing and debt-carrying capacity.*

This hypothesis presumes that the education subsidy will actually be spent on education. It is important to note that this does not constitute an earmarked fund. By incorporating these monies into the general subsidy, gminas will have the freedom and the responsibility to spend the money in the most efficient manner to provide the best service possible.[24]

b. Shared Taxes

According to the modified law on the revenues of gminas of December 14, 1990 (Article 3), gminas receive a share of income taxes collected by the state. Since 1992, these have included the corporate income tax (CIT) and the personal income tax (PIT).

These taxes are collected by the 320 fiscal offices located throughout Poland.[25] The share attributed to gminas is transferred within 20 days after the revenues have been collected by the tax office. Discussions with representatives of some local governments[26] indicate that good relations with the local fiscal offices have usually been established. Although the transfers to gmina accounts are not always exactly on time, the delays now experienced are considered to be minor.

The gmina share of the CIT is set at 5 percent; however, in 1992, this share was reduced to 2 percent for the last three quarters of that fiscal year. The draft gmina finance law of August 20, 1993, indicates that the 5 percent share is still to be discussed.

Collections of the CIT depend on the financial state of companies; large state-owned enterprises in difficulty are frequently delinquent in meeting their tax obligations. As these

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[24] After the elections, the new coalition government postponed the compulsory transfer of education expenditures until 1996; local governments still may have primary education tasks transferred on a voluntary basis and a large number of gminas, including most of the largest cities, have taken responsibility for education. These expenditures are now financed directly by the Ministry of Education rather than incorporated into the general subsidy.

For 1994, 0.9 percent of State Budget revenues has been earmarked for distribution as the general subsidy.

[25] The fiscal offices report to the Department of Organization and Tax Supervision of the Ministry of Finance.

[26] Bełchatów, Gdynia, Konstancin, and Wrocław.

companies are liquidated or closed down, the gminas where these entities are located will suffer revenue losses—particularly those gminas that are one-company or one-industry towns. Recuperating CIT revenues from new private enterprises that are being created will depend on the inspection and enforcement capacities of the fiscal offices.

There are currently about 2,000 certified fiscal inspectors at the Tax Supervision Department. These inspectors principally audit large economic entities. However, as the private sector is developing rapidly, there may be questions as to whether this sector has been sufficiently identified in the tax system. The Ministry of Finance is requesting approval for the hiring of 2,000 to 3,000 additional inspectors who will be principally responsible for the auditing of small private companies.

The gmina share of the CIT in 1992 represented 2.6 percent of total gmina revenues. The amount of CIT received in 1993 should be greater, as the legislated share of 5 percent should not be modified during the year.

The gmina share of the PIT is set at 15 percent. Currently, this tax is not distributed based on the residence of taxpayers; rather, the PIT collected within each voïvodship is distributed to gminas according to the number of actual inhabitants. This system of distribution favors rural gminas, where farmers pay little or no personal income tax. The transfer of personal income tax from urban to rural gminas in 1992 was estimated at 3 trillion PLZ, or 25 percent of the total gmina share of this tax.[27]

Current plans are to modify the distribution of the PIT in 1995 to correspond to the actual residence of taxpayers. Although urban areas will receive funds to which they are "entitled," rural gminas will experience financial difficulties when a revenue source to which they have become accustomed is withdrawn.

The PIT is an important source of revenue for gminas, at 12.6 trillion PLZ in 1992, or 19.6 percent of total gmina revenues. According to the Tax Supervision Department, there are 20 million PIT taxpayers, with half of these declaring their revenues directly in the tax offices.

Overall evolution of gmina income from the PIT and CIT will depend on several factors (excluding the form of distribution):

- Efficiency of national tax service in identifying and auditing taxpayers

- Performance of the national economy

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[27] Based on a conversation with Mrs. Zyta Gilowska.

- Restructuring of large state-owned enterprises

- Evolution of wages and other sources of personal income.

In addition, the commitment of Parliament to maintaining current proportions of shared taxes is an element of stability of these revenues for local governments. If these taxes were withdrawn or their proportions reduced, their replacement would be essential; otherwise, the financial situation of gminas would be disequilibrated.

c. Transfers for Commissioned Tasks

The Local Self-Government Act of March 8, 1990, provides for the delegation of certain tasks to gminas, which may fall "within the terms of reference of the civil service."[28] However, these tasks "shall be carried out subject to the provision of financing by the civil service."[29] The tasks delegated are in the areas of housing management, culture and arts, health care, welfare, physical culture and sport, tourism and recreation, and state administration. The funds are voted by Parliament and distributed to gminas through the voïvodship budgets. These specific tasks that have been delegated likely include, but are not limited to: management of health care tasks, welfare payments, census-taking and population registration, civil defense tasks, maintenance of war veteran's graves, and management of regional sports facilities.

The total amount appropriated in the state budget for these commissioned tasks in 1992 and 1993 is indicated in **Table 10**. About 8.5 trillion PLZ was to have been transferred to gminas for commissioned tasks in 1992, according to the state budget. The statistics from GUS indicate that 10.4 trillion PLZ were actually distributed for these tasks, or 16 percent of total gmina revenues. The total that has been appropriated for 1993 for tasks commissioned to gminas is 11 trillion PLZ. These funds are essentially earmarked for welfare expenditures (60 percent) and health care expenditures (33 percent). The third most important task is for state administration (6 percent). All other areas of commissioned tasks represent less than 1 percent of the total.

It is difficult to estimate how these revenues (and associated expenditures) will evolve. If the system of powiats is put into place, many of these tasks and the associated financing may be delegated to the powiats, particularly in the areas of welfare and health care.

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[28]Article 8.1, *Local Self-Government Act*, Rzeczpospolita No. 69, March 22, 1990, p.1.

[29]Article 8.3, *Local Self-Government Act*, op. cit.

TABLE 10

VOÏVODSHIP TRANSFERS TO GMINAS FOR COMMISSIONED TASKS: 1992 AND 1993

		million PLZ	1992	%	1993	%	Evolution 93/92
1	74	Housing management	28,100	*0.33%*	32,760	*0.30%*	*16.58%*
2	83	Culture & arts	37,296	*0.44%*	24,690	*0.22%*	*-33.80%*
3	85	Health care	2,303,767	*26.97%*	3,623,476	*32.83%*	*57.28%*
4	86	Welfare	5,476,953	*64.12%*	6,687,000	*60.59%*	*22.09%*
5	87	Physical culture & sport	0	*0.00%*	2,395	*0.02%*	
6	88	Tourism & recreation	400	*0.00%*	560	*0.01%*	*40.00%*
7	89	Other tasks	1,100	*0.01%*	4,791	*0.04%*	*335.55%*
8	91	State administration	693,500	*8.12%*	661,670	*5.99%*	*-4.59%*
9	Total		8,541,116	*100.00%*	11,037,342	*100.00%*	*29.23%*

Source: *Dziennek Ustaw Nr 50* of June 29, 1992 (pp. 816-818) and *Dziennik Ustaw Nr 14* of February 25, 1993 (pp.175-176).

d. Grants for Investment Projects

Since the creation of the Polish local self-government structure in 1990, municipal infrastructure has been essentially financed by municipal own funds. Earmarked grants from the central government for specific projects and some transfers from voïvodships were also available. Two new grant programs were introduced in 1993: a special fund of investment grants destined for regions experiencing high levels of unemployment and grants to finance infrastructure for new housing development.

(1) Earmarked grants for gmina own projects inherited from the central government. One form of grant has been distributed to finance major projects that were inherited from the central government. Only a specific, limited number of projects is involved and they are listed in the State Budget Law.[30] Although these long-term projects will require continued funding for the coming years (particularly the Warsaw subway system), it was indicated to the consultant that the Ministry of Finance does not have a multiyear planning process. Thus, the amount of funds expected to be budgeted for these projects for 1994 and 1995 have not yet been estimated. These projects are listed in **Table 11.** The amount of grant awarded for each project is determined and approved on an

[30] *Dziennik Ustaw Nr 50*, 229, Ustawa budżetowa na rok 1992, Art. 18, Warszawa, June 29, 1992, and *Dziennik Ustaw Nr 14*, 64, Ustawa budżetowa na rok 1993, Art. 28, Warszawa, February 25, 1993.

individual basis by Parliament. A total of 1.2 trillion PLZ was budgeted for 1992 and 0.8 trillion PLZ is projected for 1993.

TABLE 11

GRANTS FOR GMINA PROJECTS INHERITED FROM THE CENTRAL GOVERNMENT: 1992 AND 1993

	City	Project	1992 budgeted grant	1993 budgeted grant
			billion PLZ	
1	Warszawa	Metro line Kabaty to Huta Warszawa	900.0	500.0
2	Warszawa	"Czajka" Sewerage treatment plant	94.9	0.0
3	Chorzów	"Klimzowiec" Sewerage treatment plant	15.3	45.0
4	Sosnow	"Radocha" Sewerage treatment plant	38.0	40.0
5	Łódź	Sewerage treatment plant	111.6	100.0
6	Gdynia-Debgorz	Sewerage treatment plant	50.0	86.0
7	Poznań	Rapid Tramway	0.0	70.0
8	Sambas	Sewerage treatment plant	0.0	20.0
9	Elbląg	Sewerage treatment plant	17.5	0.0
10	Siemianowice	"Centrum" Sewerage treatment plant	45.7	0.0
11	Total		1,273.1	861.0

Source: *Dziennek Ustaw Nr 50* of June 29, 1992 (pp. 791-792) and *Dziennik Ustaw Nr 14* of February 25, 1993 (pp.153).

(2) **Grants distributed by voïvodships.** Voïvodships have commissioned some investment projects, particularly in the sectors of health, sports, and tourism. These were financed through small grants transferred to gminas. The amounts involved are quite limited, and at 100 billion PLZ in 1992, were entirely for health care investments (see **Table 12**). Only 24.7 billion PLZ were appropriated in 1993, mostly for investments in tourism and recreation and physical culture and sport. These amounts represent less than 1 percent of total gmina investment expenditure. In addition, voïvodships are authorized to distribute funds as investment grants for gminas' own projects. This is possible only if the voïvodship creates a reserve, by reducing its expenditures on other lines of its budget. Such grants are therefore at the discretion of each voïvodship.

TABLE 12

VOÏVODSHIP TRANSFERS TO GMINAS FOR COMMISSIONED INVESTMENTS: 1992 AND 1993

		million PLZ	1992	%	1993	%
1	74	Housing management	0	0.00%	0	0.00%
2	83	Culture & arts	0	0.00%	0	0.00%
3	85	Health care	100,000	100.00%	2,000	8.10%
4	86	Welfare	0	0.00%	0	0.00%
5	87	Physical culture & sport	0	0.00%	5,000	20.24%
6	88	Tourism & recreation	0	0.00%	17,700	71.66%
7	89	Other tasks	0	0.00%	0	0.00%
8	91	State administration	0	0.00%	0	0.00%
9	Total		100,000	100.00%	24,700	100.00%

Source: *Dziennek Ustaw Nr 50* of June 29, 1992 (pp. 816-818) and *Dziennik Ustaw Nr 14* of February 25, 1993 (pp.175-176).

(3) **Grants for regions with high unemployment.** In 1992, 90 billion PLZ were appropriated for grants for investments in areas threatened with high unemployment. A total of 137 billion PLZ was set aside for this grant program for 1993. These funds represent less than 1 percent of total gmina investment expenditures. For 1993, they will be distributed by a special committee within the Ministry of Labor. The projects are to be selected from applications proposed by municipalities. Generally, the grants will seek to finance projects that create the greatest number of jobs for the least investment. As of June 1993, the specific principles governing the selection of valid projects and the distribution of monies did not seem to have yet been determined. The projects that may be financed may not necessarily involve the construction of municipal infrastructure.

(4) **Grants to finance infrastructure for new housing development.** Article 28 of the State Budget Law includes funds of 1,550 billion PLZ (or 10 percent of 1992 gmina investment expenditures), which have been initially budgeted for the Ministry of Physical Planning and Construction (MPPC). These funds are allocated to finance the costs of infrastructure for new housing development.

This type of investment grant is being distributed for the first time in 1993. According to the MPPC, these funds will not actually be disbursed by the Ministry, but by the voïvodships. In the actual accounts for 1993, the accounting entries will appear under the separate voïvodship budgets and no longer in the MPPC budget.

A survey of gmina investment needs was conducted, but the Ministry did not recommend specific projects for financing. MPPC did suggest to the voïvodships general principles for the distribution of these monies, including:

- Using the investment projects to help reduce waiting lists for public housing
- Combining the projects with other funds (specifically the grant for regions with high unemployment from the Ministry of Labor) to help reduce unemployment
- Distributing grants to gminas that will use the return on profits for further investment in housing and associated infrastructure.

There were no specific principles regarding the types of projects that could be financed, the type of documentation needed to justify a request, or the need for matching funds to be proposed by gminas.

Gminas have proposed projects for financing, which are currently being examined by the voïvodships; it appears that as of the end of June 1993, no decisions have been taken on which gmina projects will be financed.

(5) **Grants distributed by the National Fund for Environmental Protection.** Although not specifically targeted to local governments, the National Fund for Environmental Protection (NFEP) does attribute both loans and grants for projects in the sectors of atmospheric, water, and soil protection. In 1992, 16 gmina projects were financed by subsidies: 4.6 billion PLZ for district heating and gas (seven projects) and 26.7 billion PLZ for construction of pipes and water intakes (nine projects). The total of 31.3 billion PLZ represents less than one-half of 1 percent of total gmina investment expenditure.

(6) **Investment grants in the draft gmina finance law.** The proposed gmina finance law (draft of August 20, 1993), which is to replace the existing law (dated December 14, 1990), does include specific provisions concerning the definition and distribution of investment grants for gmina projects. Had this draft been in place for the 1993 fiscal year, it is possible that the distribution and management of the 1,550 billion PLZ for infrastructure for new housing development would have been regulated by these provisions.

Article 23 of this draft law refers to "special purpose subsidies." These include:

1) Investments carried out by communes
2) Social welfare
3) Operation of schools above the primary level, transferred to gminas at their request

Only item 1 refers specifically to investment subsidies, which are to be granted by the voïvodships. The total amount which may be granted is not to exceed 50 percent of the estimated cost of the project, with specific limits not to be exceeded in particular years (80 percent of budgeted expenditures for the project in year 1, 120 percent in subsequent years).

At the end of each year, gminas would be required to file a report with the voïvodship on the status of projects financed by subsidy, cost estimate of the project, date of start and planned completion, and amount of gmina own financing (Art. 22, § 5). If a gmina does not earmark sufficient funds from its own budget sources, the subsidy must be refunded to the voïvodship.

(7) **Perspective.** As the monies available for gmina investment expenditures have until now been limited, most investment has been directly financed by gminas through their own funds. This lack of funds limits the amount of investment gminas may actually undertake, particularly when great demands are also being made on gminas in terms of operating expenditures. In addition and as a result of the self-financing of investment, gminas probably do not have experience in presenting projects for loan financing (e.g., feasibility studies, financial plans for the project, business plans for operation of the equipment, and repayment of the loan).

The proposed creation of a system of investment grants, to be managed at the voïvodship level, presents an opportunity to assist gminas through training in presenting projects for financing, in supervising their realization, and in managing the equipment upon completion. In the first stage of project identification, the grant program, through an implementing decree, could require standardized request forms and documentation. The monitoring of project progress by the voïvodships could help the latter detect weaknesses of local governments in project construction and implementation, and encourage gminas to request appropriate technical assistance through the Municipal Development Agency (MDA). It would also be possible to require such assistance before release of subsidy funds.

The investment subsidies that would be made available, according to the draft gmina finance law, would permit, in theory, any type of gmina investment to be financed. Given great needs in certain areas or for certain types of investments, an investment grant program may be modulated to favor the realization of specific types of projects. For example, 60 percent financing could be accorded for water/sewerage treatment plants, 55 percent for solid waste disposal and treatment, and 40 percent for other gmina investments.

The Hungarian system (see **Box 4**) has put into place a system of investment grants to favor certain types of municipal equipment. However, the system will not finance any project that falls outside a specific list of equipment. In this sense, the grant system for Poland proposed in the draft gmina finance law is considerably more flexible (see **Box 5**).

Box 4

Investment Financing—The Hungarian Example

As Poland reinforces the processes of decentralization, it is possible to compare how other countries that are also evolving from a centralized system have attempted to resolve the problem of financing local government investments. One example is the system adopted in Hungary since 1991.

The Hungarian system of investment grant financing (earmarked grants for "standard" equipment), gives local authorities the right to receive grants, if a certain number of conditions are met: type of equipment to be financed, multiyear financing plan, proof of complementary financing from local government own sources, feasibility, and other technical documents. Those projects that conform to all conditions and that are accepted are confirmed in a law voted by Parliament, indicating the type of project and the specific amount granted.

Only certain types of equipment are eligible for financing, based on nationally defined investment priorities, which correspond to needs for equipment at the local level. The rate of grant financing is from 25 percent to 90 percent of total project cost. These include: water distribution systems (30 percent grant financing), drainage of rainwater (40 percent), sewerage conduits (60 percent), solid waste treatment (50 percent), equipment for primary and secondary education (classrooms, gymnasiums—40 percent), rehabilitation of hospitals (50 percent), and purchase of medical equipment (40 percent).

The advantage of this system is that it encourages local governments to think of investments in programmatic terms, as they are obliged to provide financing schedules through the completion of the investment.

The major weakness is that local governments tend to define investment programs based on what the government will accept to subsidize, rather than based on priority needs.

One of the objects of the MCP and the MDA would be to assist gminas in establishing a coherent investment policy and creating local government capacity to program investments over a multiyear period. The investment grant program could also be used as an instrument to attain this objective.

Box 5

**Comparison of Investment Grants:
Proposed Polish Grants and Hungarian Grants**

	POLAND *draft gmina law*	HUNGARY *current system*
1. Approval of projects	Voïvodships	Parliament
2. Monitoring of projects	Voïvodships	TAKISZ*
3. Criteria for choice of project	Loosely defined, at discretion of voïvodships	Nationally defined, by investment sector
4. Requirements for local government	Provide 50% financing	Provide complementary financing, multiyear plan & technical documentation
5. Type of project financed	Any gmina investment	Specific types of projects
6. Encourage use of credit	Not directly encouraged, though not excluded	Not directly encouraged, though not excluded

*TAKISZ are deconcentrated financial and information departments, at the level of Hungarian countries (megye), and are responsible to the Ministry of Finance and the Ministry of the Interior.

2. Own Revenues

Gmina own revenues include both fiscal and nonfiscal income. In 1992, own revenues represented almost 49 percent of total operating revenues (refer to **Table 13**). This proportion is greater than 50 percent for gminas with 10,000 to 300,000 inhabitants. However, gmina capacity to impact the total amount that may be collected for own revenues is limited in the case of certain taxes.

TABLE 13

GMINA OWN REVENUES IN 1992, BY POPULATION CATEGORY

	billion PLZ	Total gminas	Category 1 0-10,000	Category 2 10-500,000	Category 3 50-300,000	Category 4 300-800,000	Category 5 > 800,000	Union of Warsaw D.	Total gminas
1	**Total—Operating revenue**	62,659.7	13,062.2	19,385.9	17,228.6	8,117.1	2,287.7	2,578.2	62,659.7
2	**Total own revenues**	30,482.7	5,716.6	10,129.8	9,417.7	4,079.0	868.7	271.0	30,482.7
	of which:								
3	**Other revenues**	10,490.4	1,980.9	3,599.2	2,938.5	1,238.1	462.7	271.0	10,490.4
4	**Total identified taxes and fees**	19,992.3	3,735.6	6,530.6	6,479.2	2,840.9	406.0	0.0	19,992.3
5	Real estate tax	10,533.9	1,544.0	3,591.2	3,674.7	1,529.8	194.2	0.0	10,533.9
6	Agricultural tax	1,753.7	1,119.1	599.8	24.2	8.5	2.1	0.0	1,753.7
7	Transportation tax	2,234.5	488.8	755.9	637.6	302.4	49.7	0.0	2,234.5
8	Patent tax	2,068.7	263.3	684.7	679.7	375.4	65.6	0.0	2,068.7
9	Stamp duties	3,401.5	320.3	899.0	1,463.0	624.9	94.4	0.0	3,401.5
10	Exemptions and reductions of taxes	1,433.0	459.0	560.0	245.0	124.0	45.0	0.0	1,433.0
	% of total operating revenues								
11	**Own revenues**	*48.65%*	*43.76%*	*52.25%*	*54.66%*	*50.25%*	*37.97%*	*10.51%*	*48.65%*
	of which:								
12	**Other revenues**	*16.74%*	*15.17%*	*18.57%*	*17.06%*	*15.25%*	*20.23%*	*10.51%*	*16.74%*
13	**Identified taxes and fees**	*31.91%*	*28.60%*	*33.69%*	*37.61%*	*35.00%*	*17.75%*	*0.00%*	*31.91%*
14	Real estate tax	*16.81%*	*11.82%*	*18.52%*	*21.33%*	*18.85%*	*8.49%*	*0.00%*	*16.81%*
15	Agricultural tax	*2.80%*	*8.57%*	*3.09%*	*0.14%*	*0.10%*	*0.09%*	*0.00%*	*2.80%*
16	Transportation tax	*3.57%*	*3.74%*	*3.90%*	*3.70%*	*3.73%*	*2.17%*	*0.00%*	*3.57%*
17	Patent tax	*3.30%*	*2.02%*	*3.53%*	*3.95%*	*4.62%*	*2.87%*	*0.00%*	*3.30%*
18	Stamp duties	*5.43%*	*2.45%*	*4.64%*	*8.49%*	*7.70%*	*4.13%*	*0.00%*	*5.43%*
	% of own source revenues								
19	Exemptions and reductions of taxes	*4.70%*	*8.03%*	*5.53%*	*2.60%*	*3.04%*	*5.18%*	*0.00%*	*4.70%*
	PLZ per capita								
1	**Operating revenues**	1,635,630	1,320,726	1,470,735	1,712,626	1,873,165	2,707,783	1,558,293	0
2	**Own revenues**	795,702	578,003	768,513	936,176	941,309	1,028,194	163,767	0
	of which:								
3	**Other revenues**	273,835	200,293	273,059	292,105	285,719	547,663	163,767	0
4	**Identified taxes and fees**	521,867	377,710	495,454	644,071	655,590	480,532	0	0
5	Real estate tax	274,971	156,119	272,450	365,289	353,024	229,861	0	0
6	Agricultural tax	45,777	113,156	45,503	2,403	1,959	2,509	0	0
7	Transportation tax	58,328	49,427	57,350	63,384	69,779	58,846	0	0
8	Patent tax	54,000	26,625	51,946	67,568	86,629	77,606	0	0
9	Stamp duties	88,791	32,383	68,205	145,427	144,200	111,711	0	0

Source: MOF, Fourth quarter budget report for 1992.

Fiscal income may be collected directly by the gmina or by the local tax office. Certain tax or fee rates are determined directly by Parliament; these include the patent tax, agricultural tax, stamp duties, and inheritance taxes. In the case of these taxes and fees, gminas have few means to modify potential income. Other taxes, such as real estate tax, tax on means of transport, and dog tax, are determined by a vote of the municipal council. However, for these three taxes, the maximum tax rate that may be imposed is limited by nationally defined tax rate ceilings.

Most taxes and fees are obligatory (except for the local fee, market fee, and administrative fee). The local government does not have the possibility to "opt out" of a tax. However, it is possible to not collect a tax by issuing a blanket exemption. This has been done by gminas for the dog tax, for example, as the revenues collected are probably not marginally greater than the cost of collection.

Nonfiscal income includes rental of municipal property, sales of municipal assets, interest income, dividends from shares in public utility enterprises, and surpluses transferred from municipal enterprises.

a. Fiscal revenues. The principal taxes and fees levied and collected directly by gminas include real estate tax, agricultural tax, and tax on the means of transport. Other fiscal revenues collected directly by the gmina include the dog tax, market fees, and "locality fee" or tourist tax. Local fiscal offices[31] levy and collect the patent tax,[32] stamp duties, and inheritance taxes.

Fiscal revenues are referred to in Article 54.1.1 of the Local Self-Government Act of March 8, 1990, and more specifically defined in the Law of December 14, 1990, on the revenues of gminas and in the Law on Local Taxes and Fees of January 12, 1991.

For all gminas, fiscal revenues[33] represented a total of 32 percent of operating revenues in 1992 (see **Table 13** and **Exhibit 13**). Gminas with 50,000 to 800,000 inhabitants obtained greater than 35 percent of their revenues from fiscal collections. Less populated gminas (<10,000 inhabitants) are more dependant on government transfers, as own fiscal revenues are less than 30 percent of total operating revenues. The city of Łódź[34] has a particularly weak fiscal base, with less than 18 percent of total operating revenues originating from taxes and fees.

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[31]Which depend on the Department of Organization and Tax Supervision of the Ministry of Finance.

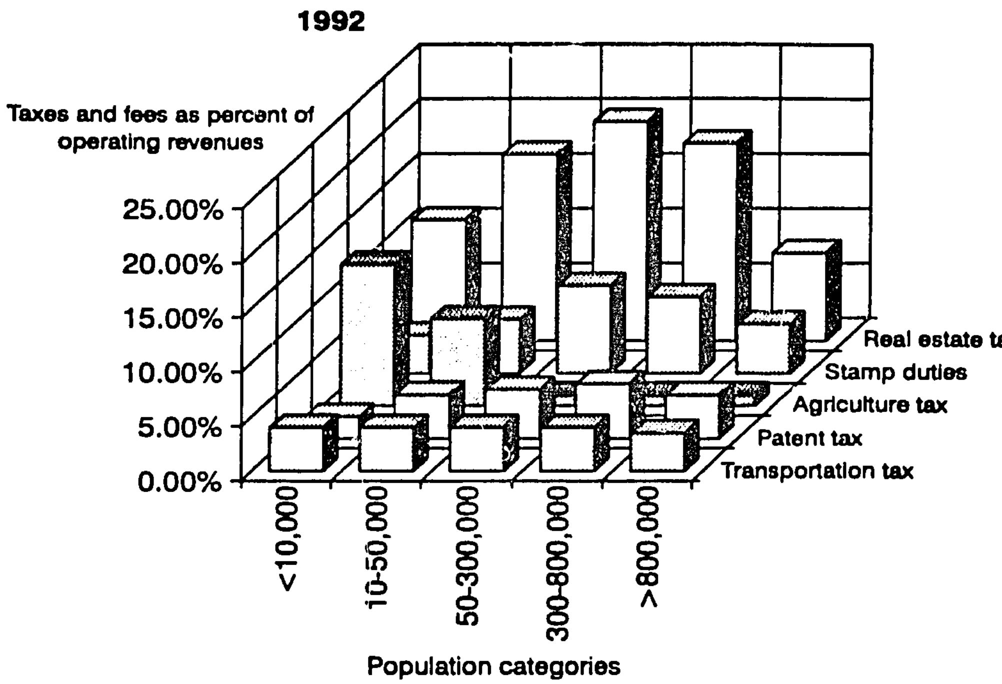
[32]Or tax charter.

[33]Those that can be identified in the quarterly reports remitted by gminas to MOF: real estate tax, agricultural tax, transportation tax, patent tax, and stamp duties.

[34]Population category 5, >800,000 inhabitants.

EXHIBIT 13

TAXES AND FEES AS PERCENT OF OPERATING REVENUE, BY POPULATION CATEGORY



Exemptions and reductions of fiscal revenues reached 1.4 trillion PLZ for all gminas, or 4.7 percent of total own-source revenues. The greatest percentage of reductions were given by gminas with fewer than 50,000 inhabitants and by the city of Łódź. This higher level of tax relief may indicate a poorer population, less able to meet all fiscal obligations.

Total taxes and fees per capita for all gminas were 521,000 PLZ in 1992, with the highest per capita level for gminas with 50-800,000 inhabitants at 640,000 PLZ (**Table 14, Exhibit 14**).

TABLE 14

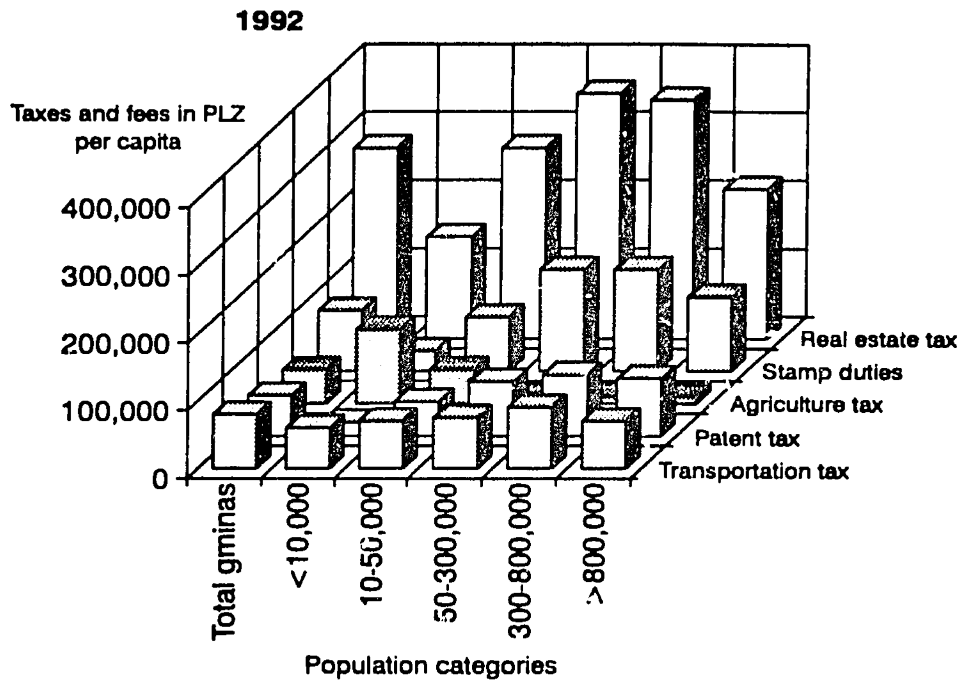
GMINA OWN REVENUES IN 1992, IN PLZ PER CAPITA

	billion PLZ	Total gminas	Category 1 0-10,000	Category 2 10-500,000	Category 3 50-300,000	Category 4 300-800,000	Category 5 > 800,000	Union of Warsaw D.
	PLZ per capita							
1	**Operating revenues**	1,635,630	1,320,726	1,470,735	1,712,626	1,873,165	2,707,783	1,558,293
2	**Own revenues**	795,702	578,003	768,513	936,176	941,309	1,028,194	163,767
	of which:							
3	**Other revenues**	273,835	200,293	273,059	292,105	285,719	547,663	163,767
4	**Identified taxes and fees**	521,867	377,710	495,454	644,071	655,590	480,532	0
5	Real estate tax	274,971	156,119	272,450	365,289	353,024	229,861	0
6	Agricultural tax	45,777	113,156	45,503	2,403	1,959	2,509	0
7	Transportation tax	58,328	49,427	57,350	63,384	69,779	58,846	0
8	Patent tax	54,000	26,625	51,946	67,568	86,629	77,606	0
9	Stamp duties	88,791	32,383	68,205	145,427	144,200	111,711	0

Source: MOF, Fourth quarter budget report for 1992.

EXHIBIT 14

TAXES AND FEES IN PLZ PER CAPITA, BY POPULATION CATEGORY



(1) **Real Estate Tax.** The most important fiscal source for all gminas is the real estate tax, at almost 17 percent of total operating revenue. This tax is particularly significant for gminas of 10,000 to 800,000 inhabitants, at greater than 18 percent of total operating revenue. The city of Łódź only receives 8 percent of total revenue from the real estate tax. The proportion of this tax in the total operating revenues of gminas with less than 10,000 inhabitants is less than 12 percent.

The tax base of the real estate tax is defined according to the usable area in m^2 of the taxable property. Such a basis of imposition has several drawbacks:

- Potential revenues are limited, as the area of taxable properties is not likely to increase

- It is regressive, as it is not based on taxpayers' ability to pay

- It does not account for differences in value due to location of property.

A study conducted in the city of Kraków, involving a monitoring of the real estate market (sales and rentals of residential and commercial properties) has proposed the introduction of a value-based real estate tax, based on current market (or capital) value of property. Simulation of the result of such a modification of the property tax base indicated that gmina revenues could be increased significantly.[35]

Gminas set the actual rate for the real estate tax. However, this rate may not exceed the maximum tax rate, which is determined by Parliament. The law on local taxes and fees[36] defines obligatory exemptions from the real estate tax. Local governments do have the option of according additional exemptions.

The maximum tax rates for the real estate tax that have been set by Parliament are extremely low. In the original bill (1991), some of the maximum rates were defined as follows:

- 400 PLZ/m^2—usable area of residential buildings

- 15,000 PLZ/m^2—usable area of buildings used in connection with conducting a business (other than agriculture or forestry)

- 5,000 PLZ/m^2—usable area of other buildings.

These ceiling rates have since been increased to account for inflation, but remain low.

A comparison of maximum property tax rates between Hungary and Poland illustrates the extent to which the ceiling rate in Poland has been set at almost insignificant levels. The owner of an apartment with 100 m^2 of usable space would pay approximately 320 USD in Hungary, at the maximum allowable rate (1992 level).[37] The owner of a comparable apartment in Poland would pay approximately 5 USD at the maximum rate.

According to the law on local taxes and fees, a distinction is made between classes of taxpayers. Legal entities and state agencies calculate their own tax bill and pay the tax directly to the gmina on a monthly basis. The tax bills of individuals and organizations

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[35] *A Framework for the Developing of the Legal and Administrative Structure for Implementing an Ad-valorem Property Tax in Poland*, J. Eckert, B. West, R. Kelly, ICMA Consortium report, May 1993.

[36] *Dziennik Ustaw*, 1991, Nr 9, Item 31 and Nr 101, Item 44; 1992, Nr 21, Item 86.

[37] Hungarian municipalities have the option to base property tax on either square meters of usable area or on adjusted market value. The comparison assumes the option based on area, at the maximum rate of 300 Hungarian forint (HUF)/m^2 (the maximum rate is valid for both business and residential properties). Hungarian municipalities also make the distinction between city center areas and outlying areas when determining tax rates.

without legal entity are assessed by the gmina, which may directly collect the tax or assign a third party to undertake the collection.

(2) **Agricultural tax.** Income from the agricultural tax is significant only for rural gminas (<10,000 inhabitants), where this source represents over 8.5 percent of total operating revenue, and 3 percent in gminas with 10-50,000 inhabitants (see **Table 6**).

The base of this tax is a number of weighted hectares. Taxable agricultural land is classified according to types of land (arable land, grassland, and pastures) and class of cropland (I to VI) and divided into one of four tax districts. The rate of tax imposition is based on an equivalent of the price of 125 kg of rye,[38] which is multiplied by weighted hectare. These average prices are determined by GUS.

Gminas have the means to modify this tax in two limited ways: 1) by requesting a modification of the applicable tax district, as long as the change does not reduce weighted hectares by more than 1.5 percent; and 2) by lowering the rate of the tax (that is, the average purchase price of 125 kg of rye).

(3) **Tax on means of transport.** The tax on the means of transport covers automobiles, trailers, motorcycles, mopeds, yachts, and motorboats. The base of the tax depends on engine capacity, payload capacity, and weight of the vehicle. Maximum tax rates are defined in the law on local taxes and fees. The Ministry of Finance determines the actual rate that will apply without exceeding the maximum. However, gminas can reduce the actual rate of imposition. The tax is paid directly to the gmina in two equal installments, on February 15 and September 15 of each year.

In 1992, the tax on means of transport represented about 3.5 percent of the total operating revenues for all gminas; this proportion is consistent for all population categories. Unless the total number of vehicles in circulation in Poland increases dramatically, this tax is likely to remain stable.

Based on conversations at MOF, there is apparently a proposition to incorporate this tax into the fuel tax. It is not clear, if this proposition were to be adopted, whether a proportion of receipts from the fuel tax would be transferred to gminas or remain at the central government level. However, this modification does not seem to be imminent.

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[38]The average purchase price is calculated separately for the first 6 months of the tax year (based on the average purchase price of rye during the fourth quarter of the preceding year) and for the second 6 months of the tax year (based on average purchase price of rye during the second quarter of the tax year). Article 7, Agricultural Tax Law, *Dziennik Ustaw*, Nr 52 (1984) and modifications from 1986, 1988 and 1989.

(4) **Patent tax.**[39] The patent tax is a lump sum monthly tax that replaces the turnover tax and the corporate income tax for certain types of businesses. Only enterprises with a limited number of employees and engaging in specific activities, including but not limited to retail trade in certain articles, catering, or health service professions, may elect to pay the patent tax. Tax rates for the patent are determined at the national level. The tax is collected by local fiscal offices and remitted to gminas. The latter do not have any latitude to modify the tax rates or to accord exemptions, though they may grant reductions and postponements of payments.

On average for all gminas, this tax represented a little over 3 percent of operating revenues in 1992, though the proportion for large urban gminas (population of 300-800,000) was greater than 4.5 percent. If economic growth improves and stimulates the creation of small businesses, particularly in the retail or service sector, there should be an increase in the revenues of the patent tax.

(5) **Stamp duties.** In 1992, stamp duties represented 5.5 percent of total gmina operating revenues. The proportion of these fees is greater for more populous cities (50-800,000 inhabitants), at 7-8 percent of total revenues. This is the result of the larger number of transactions that take place in urban areas.

A wide range of documents and activities are subject to stamp duties, including but not limited to: application forms, certificates, permits, civil law transactions, and certain judicial decisions. Central government regulations determine which activities or transactions are subject to the stamp duty, as well as the rates to be applied. The fiscal offices collect the fees and remit these funds to gminas. Therefore, the role of the gmina in receipt of these funds is completely passive and there is no leeway for gminas to affect the level of revenues accruing from stamp duties.

(6) **Other fiscal revenues.** Other fiscal revenues levied and collected or received by gminas include: market fees, tourist fees, administrative charges, and the dog tax. It is difficult to estimate the amount represented by these taxes and revenues as a percent of gmina budgets, as the information is consolidated in the "other revenues" line (see **Table 13**).

The most important of these are *marketplace fees*, which are likely to be more consequential for smaller and rural gminas. The municipal council determines the rate, which cannot exceed 476,000 PLZ/day or 28 USD/day (1993 rate). The gmina council is responsible for organizing the collection of this fee.

A potentially interesting fee for certain gminas is the *tourist fee*. This fee may be collected from visitors to localities that have a specific tourist attraction (beneficial climatic conditions,

[39] Also called the tax chart. The term "patent tax" is preferred by the consultant, as the form of the tax resembles quite closely the "patente" which is a business tax collected widely in Francophone Africa.

scenic views). In order to collect the tourist fee, gminas must apply to their voïvod, which will name gminas that conform to the necessary criteria. However, the maximum rate set is quite low, at 3,322 PLZ/day (or 0.20 USD); this may render the fee more costly to administer than potential revenues would warrant. It would be interesting for gminas that receive important influxes of tourists to levy the tourist tax, particularly if the maximum rate were considerably increased. This would permit gminas to compensate partially for stress placed on certain municipal services by tourists (solid waste, water, sewerage, use of roads, sidewalks, beaches, etc.)

(7) **Perspective on fiscal revenues.** The taxes that are paid directly to the gmina (real estate tax, agricultural tax, tax on means of transport) are calculated by taxpayers themselves and paid directly to the gmina. However, gminas have begun to try to identify and locate their taxpayers and are in the process of establishing databases. This information will serve to verify the amount being declared and paid and as a basis for audits.

The effectiveness of computerized tax assessment and verification systems will depend on several factors:

- Quality and appropriateness of software being developed
- Training of staff
- Availability of staff (not always interrupted by other urgent matters)
- Communication among various departments of the municipality (i.e., building permit office communicates information on completed structures that would be subject to the real estate tax)
- Commitment of elected officials to improvement of gmina revenues through collection of taxes and fees (in an electoral year, gmina councilors may not be willing to press the population for payment of unpopular taxes).

In the context of an MCP, gmina efforts to improve own fiscal revenue collections may be a favorable element in the choice of projects to finance; technical assistance in this domain could be associated with the project and in collaboration with the MDA.

b. **Other own revenues.** A detailed analysis of other revenues based on MOF or GUS data is not possible, as this information does not appear separately, but under the heading "other revenues." These represent a significant amount, at almost 17 percent of total operating revenues for all gminas in 1992.

The principal revenues in this category include: rental income and income from sales of municipal property. Other, less significant revenues comprise interest income and income transferred from municipal enterprises. This 17 percent of revenue also includes certain fiscal resources, such as collections from market fees, the dog tax, and the tourist tax.

(1) **Rental income and sales of municipal assets.** Properties transferred to gminas include public housing stock, commercial properties, and industrial properties. Gminas may earn income from these properties either through sales or rentals. Sound management of these properties will improve gmina revenues over the long term.

For certain properties, there may be a need to invest in their repair and rehabilitation, for which gminas do not have immediate funds. Furthermore, many municipalities are pressed for short-term cash flow to cover operating expenditures. Given the high cost of maintaining many assets that have been transferred, gminas have preferred to sell properties at lower than actual value, thus forfeiting future revenues.

Such a policy leads gminas to count on sales revenues for current income, when these funds should be more appropriately directed toward investment expenditures; in the medium term, once saleable properties have been disposed of and unless other sources of revenues are increased, gminas' financial situation may deteriorate, reducing investment and debt-carrying capacity.

Rental of municipal properties includes income from public housing, commercial properties, and other sites. For public housing units, gminas are obliged to apply rental rates defined by the central government. For other types of properties, gminas may define their rates and often award properties to occupants on the basis of tenders. Rental may be in the form of an annual contract, or as a perpetual lease (for 40-99 years, for example). Perpetual lease occurs in instances where the gmina retains ownership of the land, which is "rented out" as a perpetual lease to the owner of the building situated on the plot.

(2) **Other.** Other revenues of gminas include interest income, "voluntary taxation of gmina inhabitants,"[40] and recourse to short-term loan financing. These forms of revenues are negligible in the total of gmina income.

A limited amount of revenues accrue to gminas through transfers from municipal enterprises and units. Transfers from budgetary enterprises (zakład budżetowe) to gminas reached 107.9 billion PLZ in 1991 and 239 billion PLZ in 1992, or less than 1 percent of total operating revenues.

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[40] This is a relic of the previous system. Many investments were realized by actual physical mobilization of inhabitants. A financial participation is another form of voluntary taxation. Financial participation may still be used to finance connections to gas or water distribution systems or for improvement of telecommunications systems. Such financing has still also been observed in Hungary.

One form of resources, which is not listed separately in GUS or MOF data, is loans contracted by gminas. Due to the current lack of capital on the part of the Polish banking system and to high interest rates on loans, few gminas are willing or able to contract long-term debt for infrastructure financing purposes.

There has been short-term borrowing by gminas, usually to finance immediate cash flow needs. There may also be the possibility that these credits are used to finance infrastructure and that they are rolled over from year to year.

Loans are available to gminas from the NFEP, in the areas of atmospheric, water, and soil protection. The loans are available at very favorable interest rates (8 percent) for periods of 2-3 years. In 1992, 168 gmina projects received loans from the NFEP, for a total of 1.1 trillion PLZ (or 6 percent of gmina investment expenditure in 1992). For upgrading and modernizing district heating systems, 38 projects received a total of 221.9 billion PLZ in NFEP loans. Waste disposal projects were the object of eight loans for 65.8 billion PLZ. The greatest number of loans were in the area of modernization and construction of wastewater treatment plants: 122 projects and 818.3 billion PLZ in loans to gminas.

Current legislation on gmina finances limits loan repayments (principal and interest) to 10 percent of total gmina expenditures (operating and capital). These terms are favorable to gminas, as the latter can increase spending to increase allowed loan repayment amounts and, in effect, run a 10 percent deficit of the budget.

The draft law on gmina finances would modify the loan payment limit. *The new regulations would limit loan and bond repayments to 15 percent of gmina revenues* (Article 26). This 15 percent limit includes the amount of potential repayments resulting from loan guarantees accorded by gminas to enterprises and companies. The new limitation on guarantees is an important step, as absolute gmina freedom in this domain is a recipe for financial disaster, as the experience of some French municipalities attests.[41]

[41]For example, the town of *Plan de Cuques* (10,000 inhabitants) offered guarantees for up to 150 mn FRF (or 463 billion PLZ) for a local société d'économie mixte (SEM or joint-stock company, majority owned by the local government) in the construction sector. When the SEM declared bankruptcy, the town was unable to honor the guarantee. There is also the case of *Angoulême*, which found itself in the impossible position of repaying the debt of a local joint-stock company for which the city had guaranteed loans. These cases occurred even though there is in France a strict limit as to the total amount of guarantees which a local government may award to loans taken out by other entities.

E. GMINA EXPENDITURES

1. Existing Situation

Total gmina expenditures (operating and investment) were 64.8 trillion PLZ in 1992, compared with 44.8 trillion PLZ in 1991. This represents an increase of 45 percent in 1 year, which is consistent with the rate of inflation (see **Table 15**).

TABLE 15

GMINA EXPENDITURES IN 1991 AND 1992

		1991 Actual (billion PLZ)	1992 Actual (billion PLZ)	Evolution 92/91 (billion PLZ)	1991 Actual (%)	1992 Actual (%)
1	**Total expenditures**	**44,788.2**	**64,879.0**	**44.86%**	**100.00%**	**100.00%**
	of which:					
2	Operating	33,210.6	49,813.1	49.99%	74.15%	76.78%
3	Investment	11,577.6	15,065.9	30.13%	25.85%	23.22%

Source: GUS, Information on budget performance of municipalities in 1991-1992.

According to the classifications of GUS, investment expenditures reached almost 26 percent of total expenditures in 1991, but descended to 23.3 percent in 1992 (**Exhibit 15**). This level of investment is quite considerable; the equivalent proportion is about 15 percent for Hungarian municipalities and 15-20 percent for French local governments.

When analyzed by population category (**Exhibit 16** and **Table 16**), the greatest level of investment expenditure is achieved by gminas with populations of less than 50,000 (24-26 percent of total expenditures). More urban gminas appear to have less financial margin to engage in investment expenditures, which are less than 20 percent of total expenditures. The Union of Warsaw Districts is a case apart, due to the specific responsibilities that have been assigned to this local government.

EXHIBIT 15

GMINA EXPENDITURES IN 1991 AND 1992

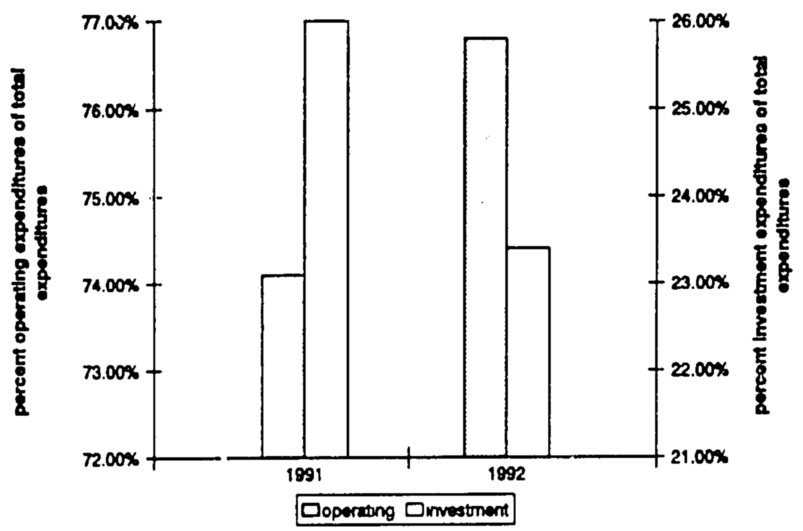


EXHIBIT 16

OPERATING AND INVESTMENT EXPENDITURES IN 1992, BY POPULATION CATEGORY

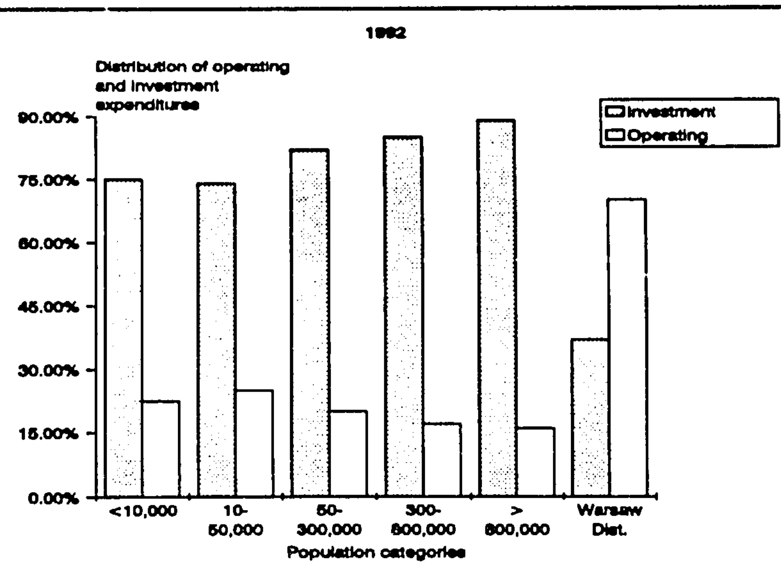


TABLE 16

GMINA EXPENDITURES IN 1992, BY POPULATION CATEGORY

		Category 1 0-10,000	Category 2 10-50,000	Category 3 50-300,000	Category 4 300-800,000	Category 5 > 800,000	Union of Warsaw D.	Total gminas
	billion PLZ							
1	Total expenditures	13,373.3	20,174.4	18,166.5	8,570.2	2,340.4	2,283.5	64,908.4
	of which:							
2	Operating expenditure	10,194.2	15,024.2	14,625.7	7,128.7	1,971.1	790.9	49,734.7
3	Capital expenditures	3,179.1	5,150.2	3,540.8	1,441.5	369.3	1,492.6	15,173.6
	% total expenditures							
4	Total expenditures	*100.00%*	*100.00%*	*100.00%*	*100.00%*	*100.00%*	*100.00%*	6.0
	of which:							
5	Operating expenditure	*76.23%*	*74.47%*	*80.51%*	*83.18%*	*84.22%*	*34.64%*	4.3
6	Capital expenditures	*23.77%*	*25.53%*	*19.49%*	*16.82%*	*15.78%*	*65.36%*	1.7

Source: MOF, Fourth quarter budget report for 1992.

Information on gmina expenditures by sector is available, but these statistics are only available in consolidated form, without distinguishing between operating and investment expenditures (see **Table 17** and **Exhibit 17**).

TABLE 17

TOTAL GMINA EXPENDITURES BY SECTOR

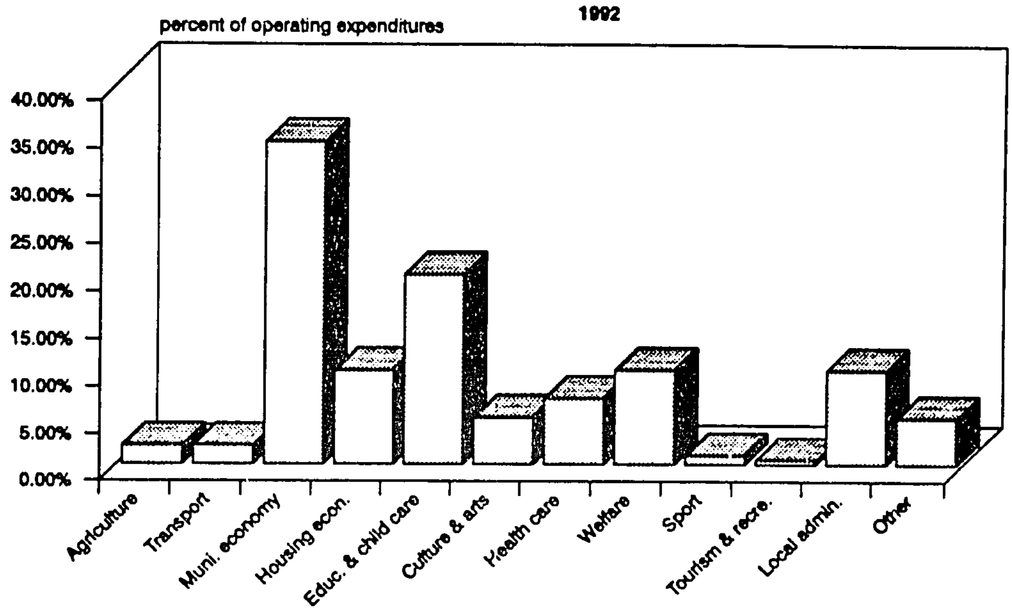
		1991 (billion PLZ)	1992 (billion PLZ)	% change 92/91	1991 struct. in %	1992 strut. in %
1	Total expenditures	44,788.2	64,879.0	44.86%	*100.00%*	*100.00%*
2	Agriculture	1,386.9	1,892.1	36.43%	*3.10%*	*2.92%*
3	Transport	1,315.9	1,594.7	21.19%	*2.94%*	*2.46%*
4	Municipal economy	12,533.1	17,700.6	41.23%	*27.98%*	*27.28%*
5	Housing economy	3,508.2	5,298.1	51.02%	*7.83%*	*8.17%*
6	Education & child care	7,173.2	12,634.0	76.13%	*16.02%*	*19.47%*
7	Culture & arts	1,739.0	2,416.6	38.96%	*3.88%*	*3.72%*
8	Health care	3,124.1	4,647.1	48.75%	*6.98%*	*7.16%*
9	Welfare	3,446.2	7,139.3	107.16%	*7.69%*	*11.00%*
10	Physical culture & sport	570.6	801.8	40.52%	*1.27%*	*1.24%*
11	Tourism & recreation	39.9	53.3	33.58%	*0.09%*	*0.08%*
12	Local administration	4,678.8	7,545.4	61.27%	*10.45%*	*11.63%*
13	Other	5,272.3	3,156.0	–40.14%	*11.77%*	*4.86%*

Source: GUS, Information on budget performance of municipalities in 1991-1992.

The most important expenditures for local governments are those relating to the *municipal economy*: roads, bridges, solid waste, street lighting, parks and gardens, and municipal cemeteries. These functions consume over 27 percent of total gmina expenditures (operating and investment). The second most important sector of gmina activities is in the area of *education and child care*: 16 percent of expenditures in 1991 and almost 20 percent in 1992. *Local administration* is the third largest sector of gmina expenditures, at over 11 percent of the total. Two other significant areas of gmina responsibility are *health care* (7% of expenditures) and *welfare* (7.5 percent in 1991, 11 percent in 1992). Overall, these five sectors represent more than 75 percent of gmina charges in 1992. The proportion of funds devoted to education expenditures will increase greatly in 1994, when local governments will receive full responsibility for primary education.

EXHIBIT 17

STRUCTURE OF GMINA REVENUES: 1992



Information on operating expenditures is available by function (**Table 18** and **Exhibits 18 and 19**). Transfers to budgetary units[42] are the most important charges at 41 percent in 1991 and 32 percent in 1992. Material and services remained stable at 27 percent of total expenditures for those 2 years, while wages increased from 13 percent to 18 percent. In 1994, the proportion of spending on wages is likely to increase, as a result of the transfer of education expenditures.

[42]Budgetary enterprises (or zakład budżetowe), auxiliary enterprises, special funds, and earmarked funds (i.e., rural social fund).

TABLE 18

GMINA OPERATING EXPENDITURES IN 1991 AND 1992

		1991 Actual (billion PLZ)	1992 Actual (billion PLZ)	Evolution 92/91 (billion PLZ)	1991 Structure (%)	1992 Structure (%)	1991 Structure (PLZ per capita)	1992 Structure (PLZ per capita)
1	**Total—Operating expenditure**	**33,210.6**	**49,813.1**	**49.99%**	**100.00%**	**100.00%**	**869,771**	**1,267,211**
	of which:							
2	Wages	4,360.4	9,099.8	108.69%	13.13%	18.27%	114,197	231,493
3	Materials & services	9,227.2	13,777.1	49.31%	27.78%	27.66%	241,656	350,480
4	Transfers to budgetary units	13,629.5	16,097.9	18.11%	41.04%	32.32%	356,951	409,520
5	Other expenditures	5,993.5	10,838.3	80.83%	18.05%	21.76%	156,967	275,719
6	Population						38,183,160	39,309,226

Source: GUS, Information on budget performance of municipalities in 1991-1992.

EXHIBIT 18

GMINA OPERATING EXPENDITURES, BY TYPE, 1991 AND 1992

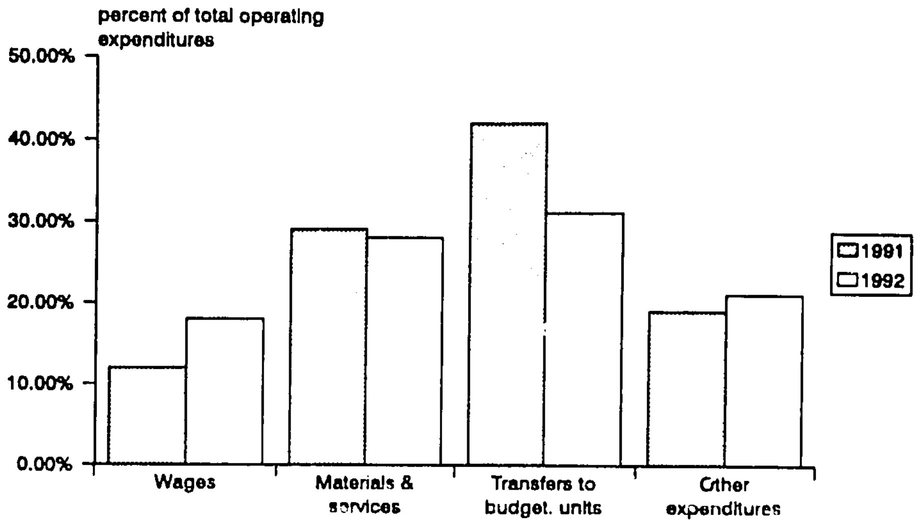
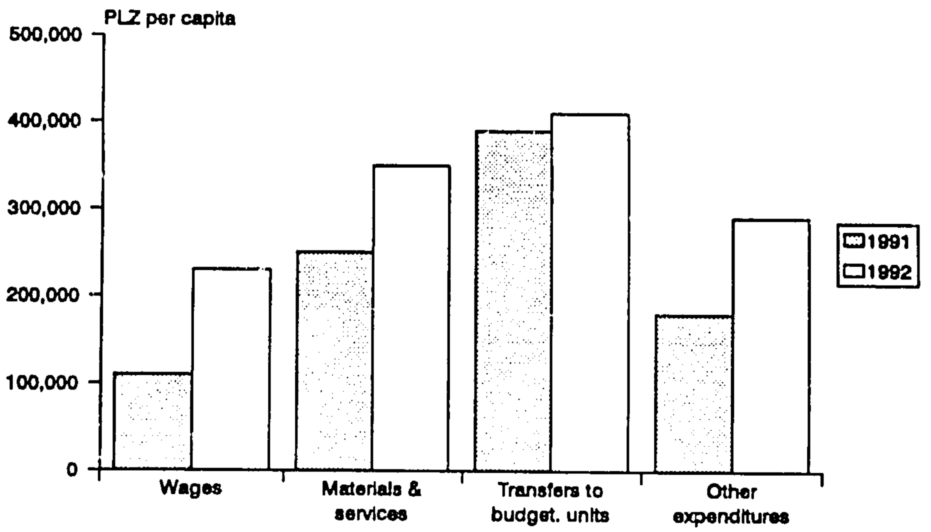


EXHIBIT 19

GMINA OPERATING EXPENDITURES, BY TYPE, PLZ PER CAPITA



2. Transfer of Primary Education Expenditures

a. Current financing of primary education expenditures. Under the current organization of primary education (June 1993), the Ministry of Education is responsible for both current and capital expenditures relating to education. Current expenditures include teachers' salaries, building and property maintenance, and supplies. Capital expenditures are defined by the Ministry of Education in the central plan of education investment. Gminas may induce education investments through the development of new urban areas, which necessitate the construction of new school facilities. These expenditures are financed by the Ministry of Education.

As of 1991, local governments were given the option of taking on responsibility for current expenditures for primary education (including teachers' salaries). In 1993, about 330 gminas opted to finance education. These funds were withdrawn from the Ministry of Education budget and distributed to gminas through a special component of the general subsidy (in 1993, 6 trillion PLZ plus 1 trillion PLZ as a reserve for increases in teachers' salaries).

Two problems have emerged in the distribution of education subsidies. The first involves the date of transfers, which does not correspond to the date of payment of teachers' salaries. The salaries must be paid at the beginning of the month, although the subsidy is received on the 15th. Therefore, local governments have to advance their own funds for payment of teachers' salaries, often through short-term loan financing, while waiting for the subsidy. This increases financial costs to gmina budgets. The second problem said to have been reported is that the amount of subsidies distributed are insufficient to cover all costs relating to primary education. Thus, gminas are required to make up the shortfall out of their own funds.

b. Financing primary education as of 1994. As of January 1, 1994, the responsibility for primary education is to be transferred entirely to gminas, at least for current expenditures—all costs related to the running of schools, including payment of teachers, and the maintenance of school buildings and all associated school facilities.

However, the kuratoria, which are deconcentrated representatives of the Minister of Education, will still have a say in certain decisions regarding the management of schools, particularly determination of curriculum. Kuratoria will continue to have an indirect say in naming school directors, although a new draft law on education proposes competitive selection of school directors.

The calculation of the education subsidies to be distributed to local governments may lead to financing problems for gminas, which will have to finance any shortfall of funds for education out of their own budget (see above, I.D.1.a.(2) — Proposed modification of general subsidy). This situation will present both risks and opportunities for gminas. As they cannot afford to let their budgets become the hostage of education expenditures, gminas will have a strong incentive to rationalize spending and control costs in this sector.[43]

F. MUNICIPAL SATELLITE ENTERPRISES

In addition to activities that are accounted for directly in gmina budgets, there are a number of gmina activities that are off-budget. GUS compiles statistics for those activities organized under the form of "nonbudgetary municipal enterprises." Four forms are identified by GUS:[44] zakład budżetowe, auxiliary enterprises,[45] special resources,[46] and earmarked funds[47] (see **Table 19**).

The most important of these are the *zakład budżetowe*, for which 1992 expenditures and revenues were greater than 31 trillion PLZ, or almost 50 percent of the total amount of direct gmina budgets. In 1992, 41 percent of zakład budżetowe's revenues consisted of transfers from gminas; these transfers represented almost 20 percent of gmina total expenditures. This proportion represents an increase in the percentage of gmina expenditures that are transferred to the zakład budżetowe budgets, up from almost 18 percent in 1991. The end of year result indicates a surplus of 122 billion PLZ (excluding surplus carried over from 1991).

Zakład budżetowe are a common form of organization for the provision of municipal public services, such as water distribution, water and sewerage treatment, urban public transportation, public housing management, and solid waste collection and treatment. There are about 900 enterprises in the domain of local public services, of which 70 percent are still organized in the form of zakład budżetowe. For this type of enterprise, the municipal council nominates the executive board and monitors spending and income. Any deficit by the enterprise is financed by the gmina budget, while any surpluses would be transferred to the gmina budget.

The other three forms of nonbudgetary enterprises do not represent significant amounts. *Auxiliary enterprises* may be units set up within gmina budgetary units, such as a workshop in a school or a prison. The budgets of these enterprises increased by 80 percent from 1991 to 1992, from 222 billion PLZ of expenditures in 1991 to 511 billion PLZ in 1992.

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[43]After the elections, the new coalition government postponed the obligatory transfer of primary education expenditures until 1996. A large number of gminas had nevertheless been preparing to take on this responsibility and accepted the voluntary transfer of education expenditures from 1994. These expenditures are now financed by a direct grant from the Ministry of Education, rather than through the general subsidy.

[44]Information on budget performance of municipalities in 1991-1992.

[45]Gospodarstwa pomonicze.

[46]Srodki specjalne.

[47]Fundusze celowe.

TABLE 19

REVENUES AND EXPENDITURES OF NONBUDGETARY ENTERPRISES

		Zakład budżetowe		Auxiliary enterprises		Special funds		Earmarked funds	
		1991	1992	1991	1992	1991	1992	1991	1992
1	Total revenues*	14,857.9	31,147.0	263.0	549.5	211.9	840.9	75.7	5.7
	of which:								
2	subsidies from gmina budgets	7,906.1	12,837.5	20.3	35.6	43.9	25.0	3.3	0.0
3	% of gmina expenditures	*17.65%*	*19.79%*	*0.05%*	*0.05%*	*0.10%*	*0.04%*	*0.01%*	*0.00%*
4	Total expenditures*	13,639.9	31,024.7	221.9	510.9	190.5	800.4	74.6	17.9
	of which:								
5	transfers to gmina budgets	107.9	239.0	19.6	23.0	8.0	8.1	1.4	0.5
6	% of gmina revenues	*0.22%*	*0.37%*	*0.04%*	*0.04%*	*0.02%*	*0.01%*	*0.00%*	*0.00%*
7	Current year surplus or deficit (1-4)	1,218.0	122.3	41.1	38.6	21.4	40.5	1.1	–12.2
8	Funds remaining (end of year)	1,920.4	1,476.1	47.4	45.8	48.2	86.8	99.8	12.5

*excluding surplus or deficit from n-1.

Source: GUS, Information on budget performance of municipalities in 1991-1992.

Special funds include principally separate accounts set up by gminas for certain types of activities. These may include school cafeterias or funds for paying accountants. Their amount increased greatly, from 200 billion PLZ in 1991 to 800 billion PLZ in 1992.

Earmarked funds are special funds set up by the Budget Law. In 1992, this sector only included a Rural Social Fund, with revenues of 5.7 billion PLZ and expenditures of 18 billion PLZ, which were apparently financed from the previous year's surplus.

II. ENVIRONMENT OF LOCAL GOVERNMENTS

The process of decentralization and a move to democratic processes at the local level in Poland implies the establishment of new norms and procedures. One of the objectives of these is to institute the legal and financial accountability of Polish local governments: accountability to the population and accountability to the central government, which is providing a major part of the financial means of local governments.

Legal and financial supervision, through voïvodships and the newly created regional audit chambers, is one institutionalized form of accountability. When it exists, the access of the public to gmina accounts is a form of accountability toward electors and toward financial institutions that may ultimately grant loans to local governments. However, this accountability may be effective only to the extent that accounts are transparent, readable, and true.

Gminas have been given a wide range of responsibilities. Some of these, such as public utility and urban services (water distribution, water and sewerage treatment, urban public transportation, solid waste collection and treatment), are managed through various forms of organization, such as municipal satellite enterprises (zakład budżetowe), limited liability companies, or joint-stock companies. Local governments are more effective in providing these services in an accountable manner when the legal and financial relationships between the actual service provider and the gmina are clear and transparent.

A. LEGAL AND FINANCIAL SUPERVISION

Legal supervision of Polish local governments entails the analysis of decisions and resolutions emanating from municipal councils and the determination of their conformity with existing laws. The financial supervision of gminas seeks to verify whether the accounts have been prepared in accordance with Polish public accounting standards, whether the information presented is true to fact, and seeks to ensure that no illegal financial transactions have been entered into.

1. Voïvodship Supervision

Chapter 10 of the Local Self-Government Act[48] provides for "Supervision over Municipal Activities." The basis of this supervision is the "criterium of conformity with the law" (Article 85.1) and, for delegated responsibilities, "purposefulness, integrity and efficiency" (Article 85.2).

[48]Rzeczspospolita No. 69, March 22, 1990, p.1.

The Act defines the supervisory authorities over gminas as the Chairman of the Council of Ministers, voïvods, and the regional audit chamber, with regard to budget matters (Article 86).

Gminas are required to submit the council's resolutions to the voïvod within 7 days after adoption. The voïvod has the possibility of rendering null and void gmina resolutions that contradict the law. Therefore, since 1990/1991, legal supervision of gminas has been established. The role of voïvods in this respect is similar to the role of French prefects vis-a-vis French local government authorities.

2. Regional Audit Chambers

The Local Self-Government Act stipulated the creation of regional audit chambers, which are defined as the supervisory authority with regard to gmina budget matters. The law of December 14, 1990, on the revenues of gminas further stipulated that the regional audit chamber is:

- To be notified by the gmina of credit and loan contracts that have been signed by the gmina (Article 22.3)

- Obliged to provide, *upon the request of the bank,* a statement of the credit repayment capacity of a gmina, when the latter applies for a loan to a bank other than the one where the gmina's account is held (Article 22.4).

It was stipulated in the Local Self-Government Act that the mode of appointing, organization, and detailed principles of operation of regional audit chambers would be defined by a separate act (Article 63.1). However, the law regarding regional audit chambers was not passed until October 7, 1992, and the chambers were not actually established until March 1993. During this period, gminas did submit their budgets to the voïvods. However, from the beginning of the process of decentralization, *there was no effective financial supervision of gminas.*

a. **Role and responsibilities.** Based on the law of October 7, 1992, on the regional audit chambers and the decree of the Prime Minister of December 9, 1992, the principal responsibilities of the regional audit chambers in regard to the financial supervision of gminas include:

- Verifying gmina budgets, on the basis of accordance with law and with factual records, and, additionally, for tasks delegated to gminas, on the basis of expediency, solidity, and efficiency (Article 5.1 and 5.2)

- Conducting a complete audit of gmina financial accounts at least once every 4 years

- Establishing the gmina budget, if the gmina fails to pass the budget by March 31 of the fiscal year.

The regional audit chamber is authorized to issue opinions on:

- The credit repayment capacity of a gmina, upon the request of the bank solicited for the credit (Article 13.1)
- The intent of gminas to issue bonds (Article 13.2)
- Drafts of gmina budgets and information concerning the state of municipal property (Article 13.3)
- Execution of gmina budgets for the first 6 months of the fiscal year (Article 13.4)
- Actual implementation and financial accounts of gmina budgets (Article 13.5)
- Contents of loan and credit contracts that have been signed by the gmina and submitted by the executive board of the municipality (Article 13.6).

Seventeen regional audit chambers were established by the decree of the Prime Minister and organized from March 1993. The Presidents of each chamber were nominated by the Prime Minister. In addition to the President, each chamber is composed of a Kolegium or committee, whose members are appointed in equal proportion by the Prime Minister and by the Self-Government Assembly in each voïvodship.[49]

No specific term of office has been set for the President of each regional audit chamber nor for the members of the Kolegium. According to the law of October 7, 1992, only the Prime Minister may dissolve the Kolegium and only in the case of "repetitive violation of law by the chamber" (Article 2.2). *In order for the work of the regional audit chambers to be effective and credible, it is important that the President and Kolegium members of each regional audit chamber be completely independent from any political pressure, whether from the government or from gminas, through the Local Self-Government Assemblies.*

b. **Practice and perspective.** Since the creation of the regional audit chambers was quite recent, the first priority was to staff the chambers with qualified inspectors and to establish audit rules and procedures. As of June 1993, the total staff of the 17 regional audit chambers was about 1,500. These employees were recruited from different organizations, including the financial and accounting offices of voïvodships, municipalities, and the Supreme Chamber of Audit.

The training of regional audit chamber staff has been undertaken by the Ministry of Finance, commencing with the President and members of the Kolegium of each chamber. First, complete audits of some gminas are currently being undertaken. These audits will serve as a

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[49]For each of the 49 voïvodships, two members are appointed by the Prime Minister and two by the Self-Government Assembly of the voïvodship.

first experience and training ground for the inspectors. It will be necessary to reinforce this acquired experience through standard training, so that all inspectors in all chambers will have the same general approach to audits. This standard training at the national level is currently being planned and should take place in autumn 1993.

Among all the regional audit chambers, 53 opinions have been issued at the request of various banks,[50] on the loan repayment capacity of gminas (including seven for the regional audit chamber of the Warsaw region). Of these opinions, only two were negative. The projects solicited for loan financing include: water and sewerage treatment facilities, acquisition of public transportation equipment, and modernization of solid waste deposit sites. The regional audit chamber for the Warsaw region expects an increase in the number of requests for the second half of 1993, as gminas begin to prepare and solicit financing for 1994 projects.

As regional audit chambers have only recently commenced their activities, it is too early to conclude as to their effectiveness, although the experience of the Warsaw chamber appears to be positive. There is some question as to the extent of measures that may be taken by regional audit chambers in the case of financial or legal improprieties that may be uncovered by audits; once a chamber has indicated the existence of such improprieties, it is up to the judicial system to initiate criminal proceedings, as may be warranted. (**Box 6** and **Exhibit 20** present the organization and activities of the regional audit chamber for the Warsaw region.)

[50] Through mid-July, 1993.

Box 6

Warsaw Regional Audit Chamber

The regional audit chamber for Warsaw is responsible for the gminas in four voïvodships: Płock, Radom, Siedlice, and Warsaw. This area includes 239 gminas. In order to fully cover the territory of the chamber, a branch office has been established in the seat of each voïvodship.

As recruitment of inspectors is difficult, the chamber is not yet fully staffed (see **Exhibit 20**). Inspectors were recruited from among employees of voïvodship offices and from the labor market.

Activities of the chamber through end of June 1993 have included:

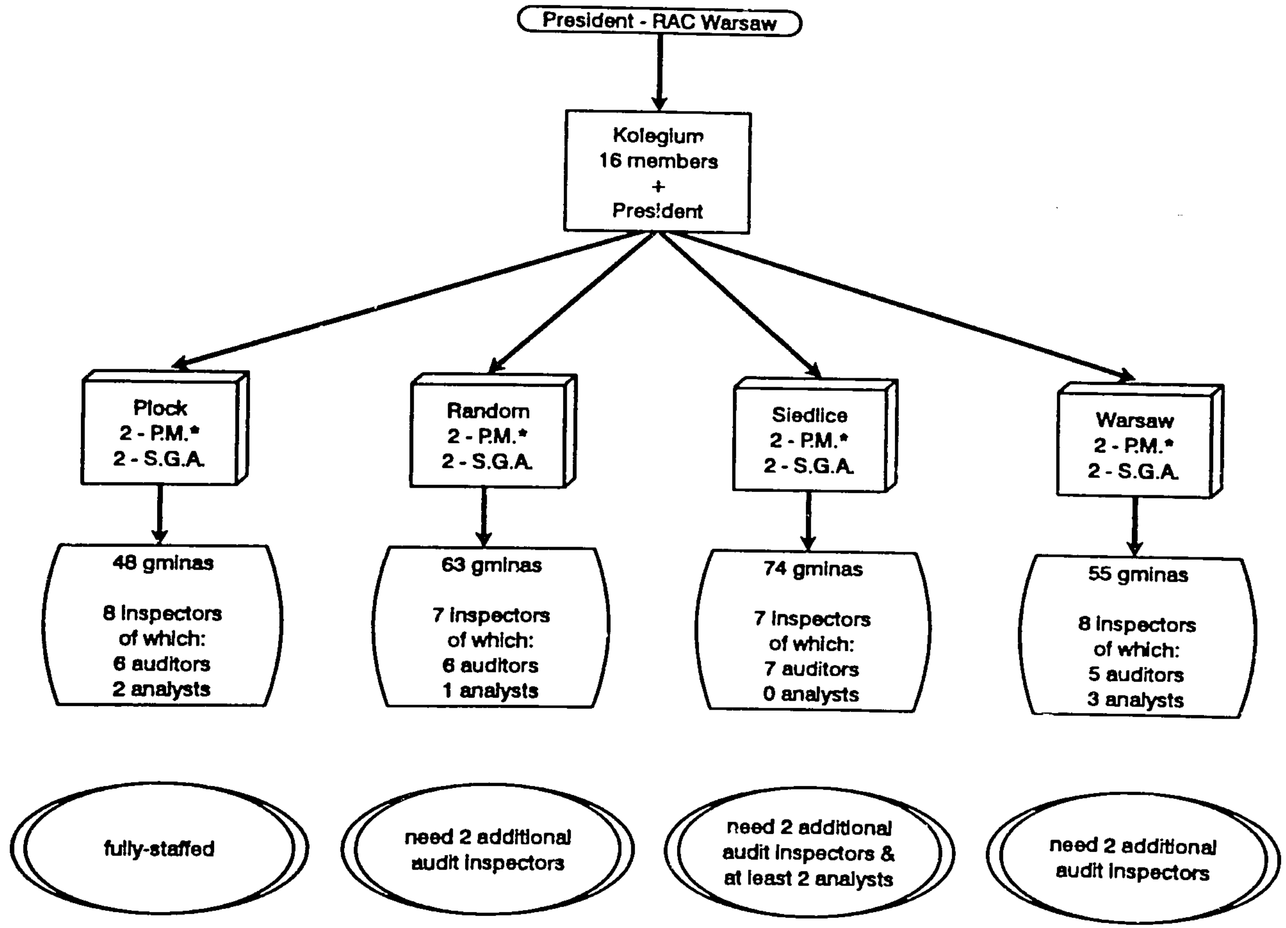
- Analysis and approval of 1993 gmina budgets
- Review of financial performance of gminas for 1992
- Seven opinions issued on requests regarding gmina loan repayment capacity
- Thorough audits of two gminas
- Attempts to identify guarantees provided by gminas to companies/state-owned enterprises

The requests for opinions on gmina debt repayment capacity emanated from four different banks, including various branches of Pekao SA bank. The projects for which gminas were requesting financing included sewerage treatment plants (six) and water management infrastructure. Positive opinions were issued in all seven requests. The basis of these opinions was an assessment of financial capacity, based on the maturity of the credit, annual repayment schedule and amounts, origination and banking fees, and an attempted forecast of potential gmina revenues.

The full audits that were carried out were discussed with one of the inspectors who has participated in one of the audits. Based on findings and conclusions, it appears that the inspection staff is competent and capable of conducting a thorough and valid audit. These experiences will serve as a basis for the national training that is to take place in autumn 1993.

EXHIBIT 20

ORGANIZATION OF REGIONAL AUDIT CHAMBER / WARSAW REGION



B. ACCOUNTING SYSTEM

The structure of gmina accounts is defined in an Ordinance of the Ministry of Finance of April 18, 1991, on classification of budgetary income and expenditures as well as of other revenues and spending. This classification applies to the State Budget and to gmina budgets. Account entries are divided into sections, subsections, and paragraphs. (The sections and paragraphs that are pertinent to gmina budgets are listed in **Annex C**.)

The current structure of accounts is based on the financial accounting of the previous system. Although a reform of these accounts is projected, appropriate legislation has not yet been drafted. However, the gmina council does have the option to define "the kind and degree of detail of information material accompanying the draft budget" (Article 53.1 of the Local Self-Government Act).

Based on this provision, and until a reform of accounts has been legislated, *the MCP could propose a modified presentation of accounts (on standardized forms), that would have to be approved by the gmina council and that would be required for loan request documentation.* One aspect of these modified accounts would be to distinguish an operating from a capital section, for both revenues and expenditures.

There is a precedent for such a modified presentation of accounts, in the information requested for the quarterly reports that gminas submit to the MOF. These reports require gminas to report total amounts received for the real estate tax and transportation tax, for example. However, according to the gmina accounting system, this information does not appear as a total, as it is classified by the nature of the taxpayer (legal person, banks, physical persons, etc.). Gminas are required to consolidate this information for the quarterly report.

C. PROVISION OF PUBLIC UTILITY SERVICES AND RESPONSIBILITY FOR INVESTMENTS

The law of May 10, 1990, on implementation regarding local governments and local government enterprises, awarded to gminas the exclusive ownership of municipal enterprises. The public utility sectors that are managed by municipal enterprises include: urban public transport; solid waste collection, disposal and treatment; water distribution; water and sewerage treatment; public housing; district heat; and hot water. Gminas also received ownership of enterprises not directly related to the provision of public services, such as construction companies, bakeries, and small industries.

Of all enterprises transferred to local governments, about 900 are municipal public utility enterprises. Gminas are obliged to determine the legal and organizational status of these entities; a delay in their transformation has been extended to May 10, 1994.

As of August 1992, 30 percent of these enterprises had not yet been transformed (see **Table 20**). Many of those that have been transformed (over 40 percent) are organized as zakład budżetowe (or budgetary enterprises). The remaining 30 percent were either liquidated or set up as joint-stock or limited liability companies. Those companies that were liquidated are most frequently set up as limited liability companies. This form is favored, as the local government may retain 100 percent ownership. For public utility enterprises that underwent a division or a merger, the majority were set up as zakład budzetowe.

Whatever the final form retained to organize municipal public utility services, it is the enterprise that is responsible for the day-to-day management, including staffing, materials and equipment, provision of the service, and collection of tariffs and fees from consumers.

The rates that are charged for the supply of these services are generally determined by the municipality. There are no rate ceilings, except for public housing rents and district heating and hot water; in these two cases, the tariffs are determined at the national level. In the case of water tariffs, there have been different interpretations as to who is responsible for rate setting. The Council of Ministers has indicated that it is the executive board of the gmina that may set water tariffs. The Highest Administrative Court, referring to a standing order of the Council of Ministers from 1985, has indicated that the gmina council is the body authorized to set prices. Water companies claim the right to set tariffs on their own.[51]

Consultant visits to gminas where these enterprises were transformed into limited liability companies[52] indicate that, in many cases, the assets belong to the municipality and are leased from the municipality by the company providing the service. Thus, for investment and acquisition of heavy equipment, it is the municipality that is responsible for the expenditure (and for repayment of any loans used to finance such investments).

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[51]Conversation with Krzysztof Nowakowski.

[52]Bełchatów—solid waste management company, district heating plant, water and sewerage company. Wrocław—heating distribution company, sanitation company, water supply company.

TABLE 20

TYPES OF TRANSFORMATION OF PUBLIC UTILITY ENTERPRISES (UP TO AUGUST 1992)

		Status quo (no change in status)	Zaklad budżetowe	Limited liability	Privatization through liquidation	Diversion/ mergers	Total
1	Public transport	13	39	4	2	0	58
2	%	22.41%	67.24%	6.90%	3.45%	0.00%	100.00%
3	Water/sewerage	23	23	4	13	0	63
4	%	36.51%	36.51%	6.35%	20.63%	0.00%	100.00%
5	Council housing	15	22	4	6	0	47
6	%	31.91%	46.81%	8.51%	12.77%	0.00%	100.00%
7	Road maintenance/repair	8	4	4	8	0	24
8	%	33.33%	16.67%	16.67%	33.33%	0.00%	100.00%
9	Parks/gardens maintenance	10	2	0	6	0	18
10	%	55.56%	11.11%	0.00%	33.33%	0.00%	100.00%
11	District heat	20	9	6	6	2	43
12	%	46.51%	20.93%	13.95%	13.95%	4.65%	100.00%
13	Sanitation	5	6	1	4	0	16
14	%	31.25%	37.50%	6.25%	25.00%	0.00%	100.00%
15	Total—Single branch	94	105	23	45	2	269
16	%	34.94%	39.03%	8.55%	16.73%	0.74%	100.00%
17	Multisector (2-5 services)	73	88	20	38	10	229
18	%	31.88%	38.43%	8.73%	16.59%	4.37%	100.00%
19	Multisector (6-7 services)	48	92	5	22	28	195
20	%	24.62%	47.18%	2.56%	11.28%	14.36%	100.00%
21	Multisector (8-10 services)	31	55	5	9	27	127
22	%	24.41%	43.31%	3.94%	7.09%	21.26%	100.00%
23	Total—Multisector	152	235	30	69	65	551
24	%	27.59%	42.65%	5.44%	12.52%	11.80%	100.00%
25	**Total**	**246**	340	53	**114**	**67**	**820**
26	**%**	**30.00%**	41.46%	6.46%	**13.90%**	**8.17%**	**100.00%**

Source: A report on the transformation of the public utility sector; ed. Tadeusz Aziewicz Gdansk Institute for Market Economics, May-August 1992.

D. REFORM OF PUBLIC ADMINISTRATION: CREATION OF POWIATS

One of the projects to reform the public administration sector is the plan to (re-)create a new level of local government, the powiat. This structure would inherit many of the tasks currently carried out by the voïvodships. The creation of these structures implies finding new sources of financing in addition to transfers from the central government; these may involve fixed shares of state fiscal revenues, or the eventual creation of revenues/taxes specific to powiats.

In the short term, the Council of Ministers is working on creating 46 "powiat-cities," which were to have come into force in January 1994. In order to rapidly define the means of transfer and the responsibilities to be extended to the powiat-cities, a Standing Committee was established on July 20, 1993. The current timetable estimates that contracts between the cities and respective voïvodships will be signed by October 30, 1993. The set of responsibilities to be transferred is defined as single block, which the powiat-cities must take or leave, without haggling over specific points.

The cities that will become city-powiats are limited to those with a population greater than 100,000, with exemptions for four large metropolitan areas (including Gdynia and Sopot in the Gdańsk region).

A specific grant to finance each task will be defined, probably by the Standing Committee, by the different ministries that currently finance these tasks and by the Ministry of Finance. Once the system of powiats is introduced countrywide in 1995, specific financing mechanisms will be defined, including the transfer of a percentage of state revenues from the personal income and corporate income taxes.

Through the implementation of powiat-cities, as a first step in the creation of powiats throughout the country, the Polish Government is demonstrating its commitment to the strengthening of decentralization. However, in order for this decentralization to be effective, stable and adequate resources need to be defined for powiats. In the short term, powiat-cities must depend on centrally defined grants that may or may not be sufficient to finance the tasks that are about to be transferred. *As it is the most populous cities that currently have weaker financial margins and reduced capacity for investment, the transfer of additional tasks (some of which may have important investment and rehabilitation requirements) may weaken their internal savings and debt-carrying capacity.*

III. ISSUES OF A MUNICIPAL CREDIT PROGRAM

A. DEFINITION OF GMINA DEBT LIMITS

Current legislation limits the total of debt payment (interest and principal) by gminas to 10 percent of total gmina expenditures. This type of ratio has several drawbacks:

- No distinction is made between operating and capital expenditures
- It theoretically permits gminas to increase expenditures in order to increase the amount of debt that may be contracted and to run a budget deficit of 10 percent
- It does not take into account gmina capacity to raise revenues necessary for debt reimbursement.

In fact, this ratio encourages gminas to weaken their effective debt repayment capacity by increasing expenditures, rather than encouraging cost controls. However, it is the capacity of gminas to collect revenues and to identify new sources of income that will ultimately determine their ability to reimburse loans.

It is strongly recommended that, if not as a change in legislation, then as a specific requirement of the MCP, debt reimbursement ratios for gminas be defined as a percentage of gmina operating revenue.[53] Thus, when creditors want to gauge the financial status of gminas, they will have a clearer idea of loan repayment capacity. The basis of this ratio:

- Is related directly to gmina current income
- Associates debt repayment to stable, renewable receipts of gminas
- Would encourage gminas to reflect on indebtedness in terms of revenue-generating capacity rather than as expenditure generating.

In fact, the draft gmina finance law, which was approved by the Council of Ministers on August 20, 1993, does modify the definition of total annual debt payment (interest and principal and potential repayment resulting from guarantees provided by the gmina). The ceiling of 15 percent will henceforth be based on gmina revenues, rather than expenditures.[54]

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[53]This is a basic ratio, which is widely used in credit analysis, such as in France and the United States.

[54]According to the Gmina Finance Law, passed on 10 December 1993, annual debt service (interest and principal) for loans and bonds contracted by gminas as well as debt guarantees given to other entities may not exceed 15 percent of the planned revenues of the gmina's budget. However, any loans/bonds which are secured with property as collateral are excluded from the debt limit calculation.

B. GUARANTEES FOR LOANS

A requirement for the establishment of a municipal credit line for Polish municipalities is the assurance that the loan will be reimbursed in a timely manner and for the total amount of funds that are owed.

One mechanism for such a guarantee is projected in the draft law on gmina finances. This law would authorize gminas to use the general subsidy as a repayment guarantee on a bank loan (Article 28 of the draft of August 20, 1993). This guarantee would be provided by the Council of Ministers, upon application from the Minister of Finance. In case of default on the part of gminas, "the Minister of Finance is entitled to retain part of the general subsidy due to a gmina on account of the reimbursement of the funds transferred from the state budget as the repayment of the bank loans..." (Article 28.4).

The Ministry of Finance is currently preparing the standardized documents for guarantee requests on the part of gminas. Although the Ministry will have the legal authority to cut off the general subsidy flow, when and if a gmina does default on a loan, the question remains whether there exists the political will to actually cut off the general subsidy flow and redirect these funds to loan repayment.

Another form of loan guarantee would be to capture the fees and tariffs paid by customers for services and to direct these funds in priority toward repayment of gmina loans. Once a project has been financed by the MCP, the revenues that are generated from the operation of the project may be directed to a "black box" or specific bank account. This account would serve to repay the loan and ensure payment of expenditures related to the operation of the equipment (salaries, supplies, maintenance, etc.).

C. CAPACITY FOR COST RECOVERY (REGULATORY RISK)

Current regulations for tarification of public services allow gminas freedom in some sectors, with restrictions in others. Currently, tariffs for district heating and hot water, and rents for public housing units are regulated by law, with specifically defined ceilings. In the case of rents, the level is determined by the amenities in the housing unit. Tariffs for other services are determined by gmina councils. These services include public transportation, water/sewerage treatment, and garbage collection and treatment.

Although gminas may theoretically determine their own rates for these public services, outside factors may limit their capacity to implement rate increases. One major factor is the capacity and, to a certain extent, the willingness of the population to pay increased tariffs. There are some sectors of the Polish population, particularly retirees and the poor, that may not be able to digest further increases. The factors that may limit rate increase absorption capacity include, but are not limited to:

- Hyperinflation of 1990-91, which has wiped out personal savings

- Increases in the prices of basic goods, through the impact of inflation

- Salaries in many sectors of the economy have not been completely adjusted for inflation, thereby reducing consumer purchasing power. These include salaries in the government and administrative sector (public offices and agencies, ministries, teachers, health care workers, employees of state-owned industries and enterprises, and retirees)

- The effect of rate increases in prices for other services, such as energy, which have been brought up to market rates.

Therefore, taxpayers and users of public goods are being financially squeezed from many sides and may not be in a position to support increases in other services. Thus, if gminas hesitate to raise rates, it may be in the knowledge that their constituents are unable to pay, and, if push comes to shove, would also be unwilling to pay increased prices for necessary services.

There is also the electoral calendar to take into consideration, as municipal elections will be held in the spring of 1994—until after the elections, municipal councils are likely to be reluctant to raise rates for public utilities.

In the short term, this situation will pose limits on the debt-carrying capacity of municipal enterprises and gminas. However, there is a possibility that the situation could be resolved within a few (4 to 5?) years. As it may take this long before projects financed by the MCP will become operational, gminas may be in a better position to raise public utility rates when the first reimbursements come due.

In the case of reimbursement of gmina loans, own fiscal revenues may also serve as a source of income to cover payments. The capacity for increases in tax revenues will depend on the evolution of three parameters:

- Local tax bases

- Tax rates

- Tax collections.

Local tax bases have been determined by the law on local taxes and fees; depending on the type of base, they will evolve with the general population and with the evolution of economic activity (stamp duties, patent tax, market fees). A reform of the real estate tax, from a taxation based on area of property to taxation based on market value of property, will ultimately be necessary to render this tax both more dynamic and just.

Maximum tax rates have been set at the national level. Capacity for collection of taxes may depend on gmina willingness to impose the maximum rate. However, there is the limitation that the current rate ceilings have been set at a relatively low level, particularly for the real estate tax (see above, I.D.2.a. — Fiscal revenues). Thus, potential gmina revenues will be limited by the low level of maximum tax rates, until higher maximum rates are authorized by law.

The collection of local taxes depends on gminas, and includes complete and thorough identification of existing tax bases and taxpayers, monitoring and evolution of tax bases, and effective procedures and sufficient means for audit and controls. Computerization is one means of following the different steps of tax identification, notification, collection, and audit. However, the effectiveness of computerization will depend on the appropriateness of software, the training and commitment of gmina staff to effect revenue collection, and communication among the various departments of gminas.

D. PUBLIC PROCUREMENT

Successful implementation of the MCP will require open and cost-effective procurement procedures for equipment that may be accepted for loan financing. Currently, gminas may define their own procurement procedures.

A draft Public Procurement Act is presently under discussion; this legislation would apply to public procurement procedures exceeding 10 million PLZ (Article 2.1, undated draft). Gminas and public utility enterprises will be obliged to comply with the law only to the extent that funding originates with the State Budget (Article 2.1.(2)). Gminas do have the option to "conduct public procurement financed by their own funds according to the provisions of this act" (Article 2.4), but they will not be required to do so.

In order to ensure that gminas have recourse to cost-efficient and appropriate technologies and services provided by competent and well-qualified suppliers, it is strongly recommended that the MCP include as a requirement for acceptance of projects that gminas conform and adhere to the procedures of the public procurement legislation.

Part 4

Case Studies of Two Gminas

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I. COMPARISON BETWEEN BEŁCHATÓW AND GDYNIA

During several missions to Poland (May to July 1993) to prepare a proposal for an MCP, the USAID/ICMA team visited a few gminas to assess current organization and financial management practices, as well as technical assistance needs. The visits were quite short (1 day in each gmina visited, or 4 to 6 hours of intense discussions) and were therefore insufficient to conduct an in-depth review of each city. Nevertheless, a few general conclusions may be drawn from the discussions with elected and administrative officials.

The two principal gminas visited, Bełchatów and Gdynia, belong to the same population category (50-300,000 inhabitants), but differ in their situation, potential economic wealth, internal savings capacity, financial margins, and capacity to finance investment and reimburse debt.

Bełchatów is essentially a residential town for the workers of an open-pit lignite mine in a neighboring commune. Therefore, the economic base is limited, reducing potential revenues from business activities. In ratios per capita, the city is poorer than the average for all Polish gminas and for its population category. Nevertheless, the current administration is quite active in seeking to improve the city's situation and has placed great emphasis on investment, which represented 36 percent of total expenditures in 1992 and is expected to reach over 40 percent of expenditures in 1993. For example, water meters were installed in residential buildings over a 3-year period (1991-1993) and distribution pipes were repaired, reducing both consumption and leakage.

The city is proceeding cautiously in computerizing financial and technical services; the mayor prefers to wait for a reform of municipal accounting structures before investing important sums in software that may become quickly outdated. However, this prudent attitude does not preclude creating simple models for the gmina's own use in budgetary management[55] and taxpayer identification databases.

Gdynia is the second largest port in Poland and, as a result, benefits from many associated economic activities (such as shipbuilding and repair, trade, warehouses). In per capita ratios, the city is wealthier than average compared with Poland and its population category. However, due to its larger population (over 250,000 inhabitants) and more urban character, greater demands are placed on the budget, and Gdynia's financial margins, in terms of internal savings and investment capacity, are weaker. Thus, the budget surplus is limited to 3 percent of total revenues, and internal savings capacity is less than 10 percent of operating revenues.

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[55] For example, the list of income from leasing of municipal assets (amounts per enterprise) is kept on a handwritten sheet of paper; however, this revenue is almost 20 percent of total operating income for Bełchatów! Nevertheless, a computer terminal does sit on the Mayor's desk, which can be interpreted positively.

The city seems to have created an effective organization, and one-third of city hall staff was replaced after the municipal elections, including all heads and assistant heads of departments. The department heads met by the consultants were competent, efficient, and dedicated. The city has been investing in computer systems and is in the process of computerizing several tasks, including population registration, electoral lists, municipal assets, local taxes, and city planning (the budget and accounting systems are already computerized).

Although the city currently has less capacity for investment projects and for debt reimbursement, in the long term, Gdynia will benefit from its higher potential wealth and effective organization. Competent financial management will ensure the capacity of the city to realize investment projects without jeopardizing current tasks, or overburdening the budget with debt.

II. CASE STUDY 1

A. COMMUNE OF BEŁCHATÓW

The information and analysis for this case study are based on a visit to the town of Bełchatów in June 1993. The USAID/ICMA team held discussions with the Mayor and the Treasurer of the commune. A number of documents were subsequently transmitted to us, which were translated into English.

The town of Bełchatów is situated about 150 kilometers to the southwest of Warsaw, in the Voïvodship of Piotrków. The population has increased by a factor of more than 7 in 20 years, from 8,000 inhabitants in 1973 to 60,000 today. This demographic explosion was spurred by the opening of an open-air lignite mine and the building of a major power plant in a neighboring town. A major part of the population is employed by the mine and power plant. The process of urban development would be similar to a "new town," with rapid development of city infrastructure and services to meet the needs of the growing population. This initial development phase has been completed.

1. Gmina Finances

a. Financial capacity. In 1992, the town of Bełchatów registered a budget surplus of 14.5 billion PLZ or over 16 percent of total revenues (**Table 21**, line 35). The gmina actually created additional surplus, as 11.1 billion PLZ of excess funds were carried over from the 1991 budget. This situation affords the municipality a comfortable financial margin for the near term.

In order to analyze the capacity of Bełchatów to finance investment expenditures, the accounts were separated into operating and capital sections.[56] The level of net operating savings[57] reached 27.8 billion PLZ or 32 percent of operating revenues (**Table 21**, line 25). This high level of internal savings is greater than the national average (by 12 points) and greater than Bełchatów's population category (50-300,000 inhabitants) average.

Capital expenditures attained 32 billion PLZ and were partially financed by identified capital receipts of 8.7 billion PLZ. The remaining expenditures were financed by part of the net operating savings.

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[56]This is the same type of analysis as was completed for gmina budgets consolidated at the national level. As the budget reports for Bełchatów and Gdynia provide more information than was available for consolidated gmina budgets, the analysis is more detailed.

[57]Net operating savings = operating revenues – operating expenditures; this is an indicator of gmina capacity to finance capital expenditures from own source revenues.

TABLE 21

BEŁCHATÓW — ANALYSIS OF FINANCIAL CAPACITY FOR 1992 AND 1993

	million PLZ	1992 Actual	1993 Planned	Evolution 93/92
1	Total—Operating revenue	86,478.7	91,194.0	*5.45%*
	of which:			
2	General subsidy	11,601.1	7,058.9	*-39.15%*
3	Shared taxes—PIT	14,722.7	18,000.0	*22.26%*
4	Shared taxes—CIT	3,136.5	6,000.0	*91.29%*
5	Real estate tax	9,051.2	12,400.0	*37.00%*
6	Transportation tax	4,030.1	5,400.0	*33.99%*
7	Stamp duties	5,303.8	6,000.0	*13.13%*
8	Tax on inheritance and gifts	230.7	250.0	*8.35%*
9	Patent tax	2,621.0	3,000.0	*14.46%*
10	Agricultural tax	113.5	152.0	*33.91%*
11	Forestry tax	6.7	5.0	*-25.67%*
12	Market fees	576.2	600.0	*4.12%*
13	Dog tax	37.1	42.0	*13.18%*
14	Grants for commissioned tasks	8,799.5	*	
15	Leasing of municipal assets	16,636.7	25,953.0	*56.00%*
16	Lease & rental of municipal property	4,662.9	5,832.6	*25.09%*
17	Interest	4,528.9		
18	Other revenues	420.0	500.5	*19.18%*
19	Total—Operating expenditure	58,659.3	65,344.0	*11.40%*
	of which:			
20	Wages	5,044.4	6,461.9	*28.10%*
21	Materials & services	12,156.7	16,918.5	*39.17%*
22	Transfers to budgetary units	25,813.3	30,661.0	*18.78%*
23	Other expenditures	15,379.9	8,937.6	*-41.89%*
24	Interest payments	265.0	2,365.0	
25	Net operating savings (1-19)	27,819.3	25,850.0	*-7.08%*
26	% of operating revenues	32.17%	28.35%	
	Capital Account			
27	Capital expenditures	33,244.8	50,850.0	*52.96%*
28	Capital receipts	8,744.8	25,000.0	*185.88%*
29	Loan installment		25,000.0	
30	Sales of municipal assets	2,766.1		
31	Privatization & sales of shares	2,513.7		
32	Grant for construction of trade center	3,465.0		*-100.00%*
33	Invest. financing needed (27-28)	24,499.9	25,850.0	*5.51%*
34	Budget surplus 1991	11,191.8		
35	Surplus or deficit (25-33+34)	14,511.2	0.0	
36	% of total revenues	16.13%	0.00%	

*not included in draft budget, due to lack of data from Voïvodship office.

Source: Bełchatow, 1993 draft budget and 1992 budget performance report.

b. **Structure of operating revenues.** Own revenues represent over 56 percent of total operating revenues, a ratio that is consistent with the structure of the population category. Taxes and fees represent 25 percent of operating revenues, a ratio that is much lower than the average for Poland and the population category (**Table 22**). Bełchatów's weaker fiscal base is illustrated by the relatively low level of real estate taxes (10 percent of operating revenues, compared with 16 percent for Poland and 21 percent for the population category—**Table 22**). This is due to the higher proportion of residential property in the municipality.

TABLE 22

COMPARISON OF 1992 REVENUES (STRUCTURE IN %)

		Bełchatów	Gdynia	Poland	Category 3 50-300,000
1	Transferred revenues *of which:*	44.24%	48.12%	51.35%	45.34%
2	Shared taxes	*20.65%*	*19.95%*	*22.75%*	*19.49%*
3	General subsidy	*13.41%*	*28.16%*	*12.09%*	*8.82%*
4	Commissioned tasks	10.18%	0.00%	16.52%	17.03%
5	Own revenues *of which:*	55.76%	51.88%	48.65%	54.66%
6	Other revenues	30.35%	16.83%	16.74%	17.06%
7	Lease municipal assets	19.24%	0.00%		
8	Lease/rental muni property	5.39%	12.72%		
9	Interest income	5.24%	1.16%		
10	Other	0.49%	2.95%		
11	Taxes and fees	25.41%	35.05%	31.91%	37.61%
12	Real estate tax	*10.47%*	*15.88%*	*16.81%*	*21.33%*
13	Agricultural tax	0.13%	0.02%	2.80%	0.14%
14	Transportation tax	4.66%	3.73%	3.57%	3.70%
15	Patent tax	3.03%	4.45%	3.30%	3.95%
16	Stamp duties	*6.13%*	*7.78%*	*5.43%*	*8.49%*
17	Other taxes	0.98%	3.18%		

Sources: MOF, Fourth quarter budget report for 1992; Bełchatów 1992 budget performance report; Gdynia 1992 budget performance report.

Other revenues are twice as important as the national average, at 30 percent of Bełchatów's income. The leasing of municipal assets to public utility and gmina-owned enterprises is the most significant revenue in this category (20 percent). The current asset management policy of the municipality is based on medium- to long-term goals. *The municipality is currently able to finance a high level of investment, as considerable revenues are generated through its leasing and rental policies. By refraining from immediate sales of assets, Bełchatów is* *generating recurring revenues, rehabilitating and renovating municipal infrastructure, and improving its long-term financial prospects.*

Within transferred revenues, which are a total of 44 percent of operating revenues, shared taxes are the most significant, at 20 percent of total current income. This level is consistent with national and population category averages.

c. **Structure of expenditures.** Total expenditures reached 91.9 billion PLZ in 1992 or 1,548,299 PLZ of expenditures per capita. This is 10 percent less than the average for Poland and 15 percent lower than for the population category (**Table 23** and **Exhibit 21**). The city places great emphasis on investments, which represented 36 percent of total expenditures in 1992 and 45 percent projected for 1993. This level is quite high, as national investment rates are in the 20-23 percent range (**Table 24** and **Exhibit 22**).

TABLE 23

COMPARISON OF 1992 BUDGETS IN PLZ PER CAPITA

		Bełchatów	Gdynia	Poland	Category 3 50-300,000
1	Operating revenue (bn PLZ)	88.5	529.3	62,659.7	17,228.6
2	Operating expenditure (bn PLZ)	58.7	506.2	49,734.7	14,625.7
3	*Operating revenues (PLZ per capita)*	*1,490,674*	*2,101,965*	*1,635,629*	*1,712,626*
4	*Operating expenditures (PLZ per capita)*	*988,222*	*2,010,230*	*1,298,243*	*1,453,881*
5	Capital revenue (bn PLZ)	8.7	102.3	1,572.7	381.8
6	Capital expenditure (bn PLZ)	33.2	115.4	15,173.6	3,540.8
7	*Capital revenues (PLZ per capita)*	*147,264*	*406,255*	*41,053*	*37,953*
8	*Capital expenditures (PLZ per capita)*	*560,077*	*458,278*	*396,082*	*351,977*
9	Total revenue (bn PLZ)	97.2	631.6	64,232.4	17,610.4
10	Total expenditure (bn PLZ)	91.9	621.6	64,908.3	18,166.5
11	*Total revenues (PLZ per capita)**	*1,637,938*	*2,508,220*	*1,676,682*	*1,750,579*
12	*Total expenditures (PLZ per capita)*	*1,548,299*	*2,468,508*	*1,694,326*	*1,805,858*
13	*Population*	59,349	251,812	38,309,226	10,059,754

*excluding 1991 budget surplus.

Sources: MOF, Fourth quarter budget report for 1992; Bełchatów, 1992 budget performance report; Gdynia, 1992 budget performance report.

EXHIBIT 21

COMPARISON OF 1992 BUDGETS IN PLZ PER CAPITA

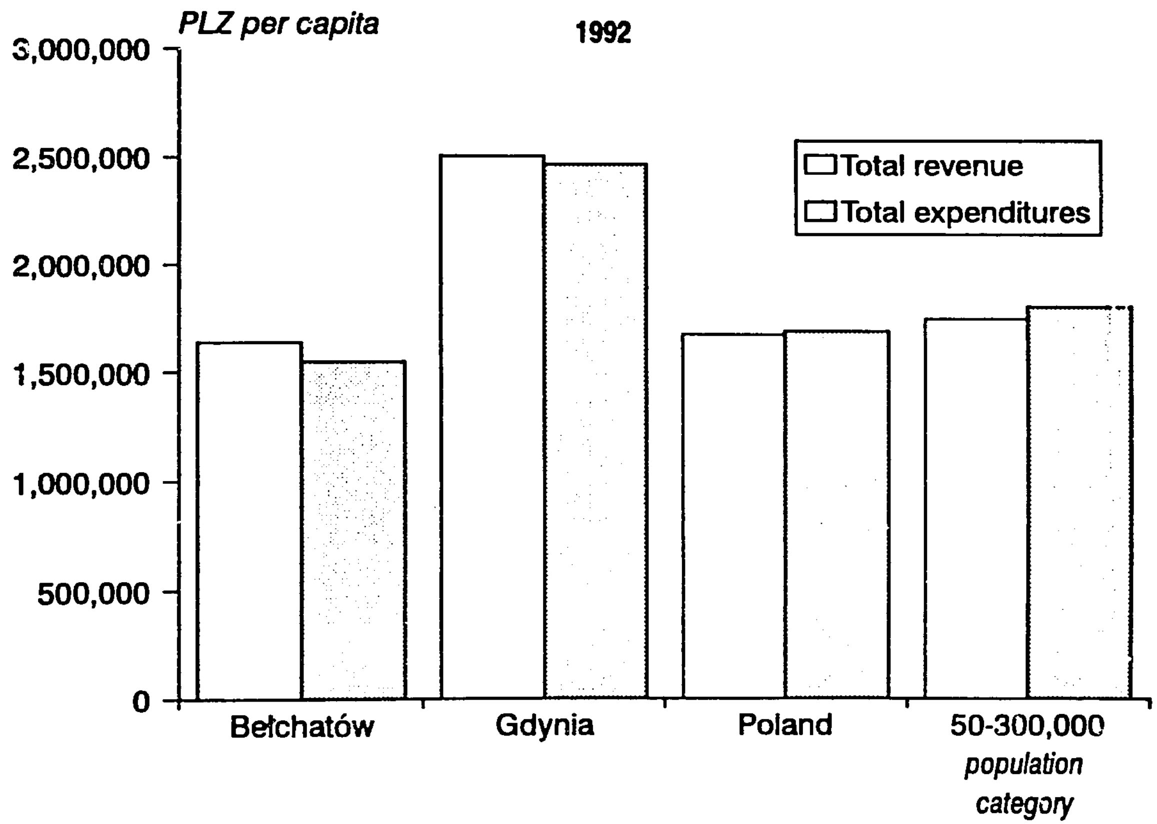


TABLE 24

COMPARISON OF 1992 EXPENDITURES (STRUCTURE IN %)

		Bełchatów	Gdynia	Poland	Category 3 50-300,000
1	Operating expenditures	63.76%	81.44%	76.78%	80.51%
2	Investment expenditures	36.24%	18.56%	23.22%	19.49%

Sources: MOF, Fourth quarter budget report for 1992; Bełchatów, 1992 budget performance report; Gdynia, 1992 budget performance report.

The gmina may not be able to maintain such a high level of investment after 1994, once primary education expenditures have been transferred. However, given the current surplus and high internal savings capacity, Bełchatów should continue to have the means to finance investment. The city would likely benefit from an MCP, given the trends toward cost- and energy-efficient projects (installation of water meters, rehabilitation of gas lines).

By sector, the most important expenditures are for municipal economy—32 percent of total expenditures in 1992 and 49 percent planned for 1993 (**Tables 25 and 26**). These expenditures include city sanitation, maintenance of municipal parks and gardens, maintenance of streets, street lighting, a major investment in the construction of heating pipes (45 billion PLZ projected in 1993), and a subsidy to the transport company (1992).

The second most important sector of expenditure is for housing economy and non-material municipal services: 27 percent in 1992 and 19 percent in 1993. The subsidy for the municipal housing enterprise and for the transport company (1993) are included in these expenditures.

The next significant sector is for welfare expenditures, at 12 percent of the total in 1992; however, the relative weight of this sector is expected to decrease greatly in 1993. Education and child care currently only represent 7 percent of expenditures, but their importance will increase in 1994, once the responsibility for primary education is transferred to gminas.

EXHIBIT 22

COMPARISON OF 1992 EXPENDITURES (STRUCTURE IN %)

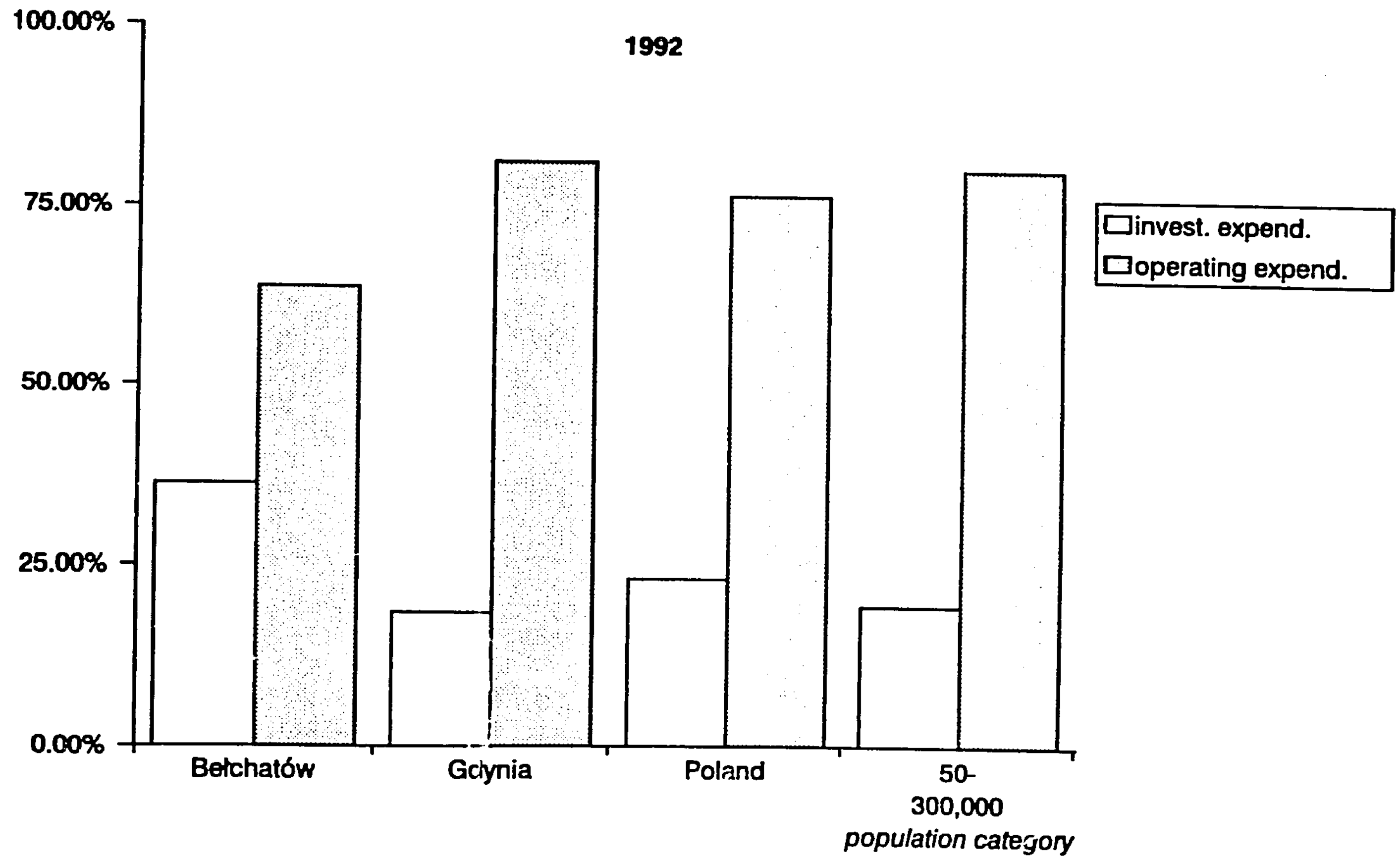


TABLE 25

BEŁCHATÓW—EXPENDITURES BY SECTOR FOR 1992 AND 1993

		A	B	C	D	E	F	G
		1992 Planned (mn PLZ)	1992 Actual (mn PLZ)	1993 Planned (mn PLZ)	% change 93/92 (planned/ actual)	1992 performance (actual/ planned)	1992 Actual struct. in %	1993 Planned struct. in %
1	Total expenditures	95,943.1	91,904.1	116,194.0	26.43%	95.79%	*100.00%*	*100.00%*
2	Municipal economy	29,368.6	29,306.6	56,930.0	94.26%	99.79%	*31.89%*	*49.00%*
3	Housing economy	24,753.7	24,655.1	22,629.0	–8.22%	99.60%	*26.83%*	*19.48%*
4	Education/child care	6,565.1	6,565.1	8,400.0	27.95%	100.00%	*7.14%*	*7.23%*
5	Culture & arts	3,740.0	3,740.0	5,300.0	41.71%	100.00%	*4.07%*	*4.56%*
6	Health care	1,357.8	1,322.0	2,050.0	55.07%	97.36%	*1.44%*	*1.76%*
7	Welfare	11,648.2	11,478.6	7,420.0	–35.36%	98.54%	*12.49%*	*6.39%*
8	Sports, tourism, recreation	300.0	274.1	300.0	9.43%	91.38%	*0.30%*	*0.26%*
9	Public order	0.0	0.0	900.0			*0.00%*	*0.77%*
10	Local administration	7,974.6	7,819.6	9,600.0	22.77%	98.06%	*8.51%*	*8.26%*
11	Other	10,235.3	6,743.1	2,665.0	–60.48%	65.88%	*7.34%*	*2.29%*

Source: Bełchatów 1993 draft budget and 1992 budget performance report.

TABLE 26

BEŁCHATÓW—EXPENDITURES BY SECTOR (BY ACTIVITY)

		1992 Operating (mn PLZ)	1992 Investment (mn PLZ)	1992 Total (mn PLZ)	1993 Operating (mn PLZ)	1993 Investment (mn PLZ)	1993 Total (mn PLZ)
		Actual			Planned		
1	Total expenditures	71,284.1	19,760.0	91,644.1	63,865.0	52,329.0	116,194.0
2	Municipal economy	11,281.6	17,425.0	29,306.6	9,730.0	47,200.0	56,930.0
3	Cleaning	1,056.2	0.0	1,056.2	1,800.0	400.0	2,200.0
4	Parks and gardens	1,030.1	0.0	1,030.1	1,430.0	0.0	1,430.0
5	Streets, squares, bridges	1,034.9	250.0	1,284.9	1,200.0	1,800.0	3,000.0
6	Street lighting	2,209.9	0.0	2,209.9	3,300.0	0.0	3,300.0
7	Maintenance of river banks, other	1,250.5	0.0	1,250.5	2,000.0	0.0	2,000.0
8	Construction of heating pipes	0.0	17,175.0	17,175.0	0.0	45,000.0	45,000.0
9	Subsidy to transportation company	4,700.0	600.0	5,300.0			
10	Housing economy/non-mat. serv.	22,320.1	2,335.0	24,655.1	17,500.0	5,129.0	22,629.0
11	Subsidies for housing company	5,000.0	0.0	5,000.0	8,400.0	0.0	8,400.0
12	Repairs private apartment bldgs	25.3	0.0	25.3	50.0	0.0	50.0
13	Voluntary fire brigade	149.1	0.0	149.1	290.0	0.0	290.0
14	Municipal land management	1,592.4	0.0	1,592.4	760.0	1,479.0	2,239.0
15	Other	15,553.3	2,335.0	17,888.3	2,100.0	3,650.0	5,750.0
16	Subsidy to transportation company	0.0	0.0	0.0	5,900.0		5,900.0
17	Education & child care	6,565.1	0.0	6,565.1	8,400.0	0.0	8,400.0
18	Kindergarten	4,605.0	0.0	4,605.0	5,452.0	0.0	5,452.0
19	"0" classes in elementary schools	1,765.1	0.0	1,765.1	2,780.0	0.0	2,780.0
20	Curriculum development	195.0	0.0	195.0	168.0	0.0	168.0
21	Culture & arts	3,740.0	0.0	3,740.0	5,300.0	0.0	5,300.0
22	Municipal cultural center			0.0	3,150.0	0.0	3,150.0
23	"Ruina" cultural center			0.0	400.0	0.0	400.0
24	Public libraries			0.0	1,750.0	0.0	1,750.0
25	Health care	1,322.0	0.0	1,322.0	2,050.0	0.0	2,050.0
26	Municipal nursery	1,277.8	0.0	1,277.8	1,980.0	0.0	1,980.0
27	Alcohol/drug abuse prevention	44.2	0.0	44.2	70.0	0.0	70.0
28	Welfare	11,218.5	0.0	11,218.5	7,420.0	0.0	7,420.0
29	Welfare center	480.4		480.4	681.0	0.0	681.0
30	Welfare benefits	8,746.3		8,746.3	4,411.0	0.0	4,411.0
31	Municipal social center	1,991.8		1,991.8	1,136.0	0.0	1,136.0
32	Assistance to homebound ill			0.0	1,192.0	0.0	1,192.0
33	Tasks delegated by voivodship			0.0			
34	Sports, tourism, recreation	274.1	0.0	274.1	300.0	0.0	300.0
35	Public order (municipal guard)	0.0	0.0	0.0	900.0	0.0	900.0
36	Local administration	7,819.6	0.0	7,819.6	9,600.0	0.0	9,600.0
37	City council & city board	627.4	0.0	627.4	750.0	0.0	750.0
38	Municipal administration	6,592.4	0.0	6,592.4	8,850.0	0.0	8,850.0
39	Tasks delegated by voïvodship	599.7	0.0	599.7			
40	Other	6,743.1	0.0	6,743.1	2,665.0	0.0	2,665.0
41	Interest: loan NFEP*	265.0	0.0	265.0	265.0		265.0
42	Interest: loan for Power Plant		0.0	0.0	2,100.0		2,100.0
43	Subs. to cooperative housing ent.	3,440.0	0.0	3,440.0			
44	Various	3,038.1	0.0	3,038.1	300.0		300.0

*National Fund for Environmental Protection.

Source: Bełchatów: Statement of reasons of draft budget, 1993.

2. Organization and Finances of Public Utility Services

a. **Municipal housing.** Municipal housing is managed by a zakład budżetowe, which employs 100 people. The enterprise is subsidized by 8 billion PLZ from the municipal budget. Revenues of the zakład are limited by rent-control laws, although the city did attempt to raise rents to a higher level than was legally permitted. The apartments owned by the municipality represent 15 percent of the housing stock (or 2,500 units out of a citywide total of 16,000 housing units).

b. **Public transportation.** Public transportation was organized as a zakład budżetowe, until its transformation into a limited liability company in July 1993. (It will eventually be integrated into the solid waste and sanitation enterprise.) The objective is to make the market more competitive and to decrease the amount of subsidies borne by the municipal budget.

c. **Solid waste and sanitation.** In 1991, the former municipal enterprise was reorganized as a limited liability company, jointly owned by the gmina (49 percent) and by the employees of the company (51 percent). The assets are leased from the municipality at a cost, in 1993, of 221.7 million PLZ. In 1993, the utility plans on investing in a recycling program, which will include education and sensitization of the population to the need for recycling and the purchase of containers to sort garbage.

Since July 1993, the solid waste company has absorbed the transport company, which was previously organized as a zakład budżetowe.

d. **District heating and hot water.** This has been transformed into a limited liability company, with the gmina as the sole shareholder. The assets used by the company are the property of the city and are leased by the district heating company. For 1993, the cost of leasing of these assets is 12.3 billion PLZ, or almost 50 percent of gmina revenues from leasing of municipal assets. The company currently has a staff of 250.

e. **Water supply and sewerage.** This company was also transformed into a limited liability company, with a single shareholder. The supervisory board has three members: two appointed by the city and one appointed by employees. The company employs 100 persons. The tariffs are set by the Municipal Council, with the same tariff for residential, commercial, and industrial customers. The 1993 rate is 3,300 PLZ/m^3, which is an increase from 1992 (1,700 PLZ/m^3 for the first half of 1992; 2,200 PLZ/m^3 for the rest of the year). The assets of the water supply and sewerage company belong to the city, and are leased by the company—the lease cost for 1993 is set at 5.6 billion PLZ.

From 1990 to 1993, Bełchatów undertook to install water meters in housing in the urban area of the gmina; these installations were financed by the municipality. According to the Mayor, water consumption has decreased since the water meters have been place. System leakage has also been reduced by the construction of new distribution pipes.

3. Commercial Companies

In addition to public utilities, the gmina is also the owner of commercial companies. The most important of these is "Multi-Max", which is wholly owned by Bełchatów. This company has two main activities: First, it is a municipal real estate management company for hotels, buildings, and commercial or industrial facilities that are sold or leased. Second, it manages health care facilities and the provision of support staff for these facilities.

III. CASE STUDY 2

A. CITY OF GDYNIA

The information and analysis for this case study are based on a visit to the city of Gdynia in June 1993. We held discussions with the following: a member of the City Board, the City Treasurer, the director of the Privatization Section, the director of the Organization Section, and an advisor to the Capital Expenditure Section.

Gdynia is a port city on the Baltic, about 340 kilometers from Warsaw, and is part of the metropolitan area of Gdańsk-Sopot-Gdynia. A small fishing village before World War I, the city developed rapidly after the war. This rapid development was due to the construction of a new port, which was built to replace and to compete with that of the free city of Dantzig (Gdańsk). Today, the port of Gdynia is Poland's second largest port, after Szczecin. The city has almost 252,000 inhabitants.

1. Gmina Finances

a. Financial capacity. In 1991, the surplus of Gdynia reached 7.2 billion PLZ; this resulted partly from a budget deficit of 32.8 billion PLZ that was carried over from 1990. The city increased the surplus to 17.3 billion PLZ in 1992, slightly improving its financial margin, to 3 percent of total revenues (**Table 27**, line 34 and 35).

The level of net operating savings of the city greatly deteriorated from 1991 to 1992, dropping from 11 percent of operating revenues (46 billion PLZ) to only 4 percent (23 billion PLZ). This level of internal savings is considerably lower than the national average, as well as the average for Gdynia's population category (50-300,000 inhabitants). Thus, this port city currently has fewer means to finance investment expenditures, and will also have less margin for reimbursing debt.

Capital expenditures reached 115.3 billion PLZ in 1992, an increase of over 150 percent in real terms from the level of 1991 (**Table 27**, line 26). This is an important effort on the part of the city to increase investment and improve infrastructure. Investment now accounts for 18 percent of total expenditure, which is lower than both the national and population category averages.

Capital expenditures were financed principally (88 percent) from capital receipts. The remaining 12 percent of financing of capital expenditures was assured by internal savings. Half of capital receipts consisted of income from sales of municipal assets.

TABLE 27

GDYNIA—ANALYSIS OF FINANCIAL CAPACITY FOR 1991 AND 1992

	million PLZ	1991 Actual	1992 Actual	Evolution 92/91
1	Total—Operating revenue	407,293.7	529,282.0	*29.95%*
	of which:			
2	General subsidy	109,379.8	149,072.0	*36.29%*
3	Shared taxes—PIT	123,675.1	94,631.0	*-23.48%*
4	Shared taxes—CIT	28,665.2	10,968.0	*-61.74%*
5	Real estate tax	47,666.4	84,047.0	*76.32%*
6	Transportation tax	4,540.9	19,762.0	*335.20%*
7	Stamp duties	29,036.7	41,190.0	*41.85%*
8	Tax on inheritance and gifts	3,493.9	7,741.0	*121.56%*
9	Patent tax	13,246.8	23,561.0	*77.86%*
10	Agricultural tax	161.3	132.0	*-18.16%*
11	Dog tax, market fees, local fees	3,544.0	9,079.0	*156.18%*
12	Lease & rental of municipal property	26,446.8	67,350.0	*154.66%*
13	Interest	5,325.7	6,134.0	*15.18%*
14	Surplus from zaklad bud.	1,687.2	8,843.0	*424.12%*
15	Dividend from state-owned enterprises	8,049.7	2,200.0	*-72.67%*
16	Other revenues	2,374.2	4,572.0	*92.57%*
17	Total—Operating expenditure	361,347.7	506,231.0	*40.10%*
	of which:			
18	Wages	62,741.5	107,277.0	*70.98%*
19	Materials & services	77,630.2	129,105.0	*66.31%*
20	Transfers to budgetary units	171,724.5	200,455.0	*16.73%*
21	Other expenditures	39,724.3	69,394.0	*74.69%*
22	Interest	4,327.2		
23	Shares in communal bank	5,200.0		
24	Net operating savings (1-19)	45,946.0	23,051.0	*-49.83%*
25	% of operating revenues	11.28%	4.36%	
	Capital Account			
26	Capital expenditures	38,071.1	115,377.0	*203.06%*
27	Capital receipts	32,291.5	102,317.0	*216.85%*
28	Loan installment			
29	Sales of municipal assets	32,291.5	52,317.0	
30	Privatization & sales of shares			
31	Grant for investments		50,000.0	
32	Invest. financing needed (27-28)	5,779.6	13,060.0	*125.97%*
33	Budget surplus/deficit carried over	(32,870.0)	7,309.0	
34	Surplus or deficit (25-33+34)	7,296.4	17,300.0	
35	% of total revenues	1.79%	2.99%	

Source: Gdynia, 1991 and 1992 budget performance report.

To a great extent, Gdynia's investment capacity depends on the ability of the city to raise revenues from the sales of assets. In the medium term, once the most interesting properties have been sold, it will be more difficult for the city to engage in investment expenditures, unless greater savings can be squeezed out of the operating budget.

Whether this is possible will depend on the financial impact of Gdynia's transformation into a "powiat-city" as of 1994. A number of responsibilities currently managed by the voïvodship (secondary, technical, and vocational education; cultural institutions; social welfare centers; health centers and hospitals) will be transferred to the city. It is not certain that the funds to be transferred from the State Budget will be sufficient to cover all related expenditures; in addition, many of the assets of these sectors will probably require important renovations and rehabilitation. Therefore, unless greater revenues can be raised from own sources (real estate tax, patent tax) and eventually from improved collections of shared taxes, Gdynia will have difficulty in improving its internal savings rate and its capacity to invest.

b. **Structure of operating revenues.** Almost 52 percent of gmina revenues are own source; this level is higher than the national average, but lower than the rate for the population category (**Table 22**). About 35 percent of own source revenues originate with taxes and fees, which are close to the average for the population category. The real estate tax represents 16 percent of operating revenues and stamp duties another 8 percent. The potential for the real estate tax is probably greater; however, many businesses are unable to meet their tax obligation (the income from the shared CIT also suffers from this problem).

Other revenues account for 17 percent of operating revenues, with the lease/rental of municipal property the most important, at 13 percent.

For transferred revenues, the most important source is the general subsidy, at 28 percent of operating revenues. This proportion is much higher than averages for all Polish gminas and for the population category and is the result of the anticipated transfer of education expenditures.

c. **Structure of expenditures.** Total expenditures reached 621.6 billion PLZ in 1992 or 2,468,508 PLZ of expenditures per capita. This is 35 percent higher than the ratio for the population category and 45 percent higher than the ratio for Poland (**Table 23** and **Exhibit 21**). Although Gdynia does have weaker savings capacity than Bełchatów, Gdynia is much wealthier. As indicated above, there is a lower level of funds dedicated to investment, although the situation is improving (**Table 24** and **Exhibit 28**). **Table 28** shows a comparison of 1992 expenditures between Bełchatów, Gydnia, and Poland.

By sector, the most important expenditures are for education and child care—37 percent of total expenditures in 1992 (**Table 29**). This is due to the fact that Gdynia has already taken on responsibility for primary education expenditures.

The second most important sector of expenditure is for municipal economy, which was 36 percent in 1992, an important increase from 17 percent in 1991.

The next significant sector is for housing economy, at 12 percent of the total in 1992. The overall structure of expenditures should be modified in 1994, once the city has taken on many of the voïvodship's responsibilities; in particular, funds dedicated to education should increase greatly, as secondary, technical, and vocational education will be transferred to the city.

TABLE 28

COMPARISON OF 1992 EXPENDITURES BY SECTOR

		Bełchatów 1992 structure in %	Gdynia 1992 structure in %	Poland 1992 structure in %
1	Municipal economy	31.89%	35.28%	27.28%
2	Housing economy	26.83%	12.14%	8.17%
3	Education & child care	7.14%	37.06%	19.47%
4	Culture & arts	4.07%	2.91%	3.72%
5	Health care	1.44%	2.60%	7.16%
6	Welfare	12.49%	2.27%	11.00%
7	Sports, tourism, recreation	0.30%	0.45%	1.32%
8	Local administration	8.51%	5.90%	11.63%
9	Other	7.34%	1.39%	10.24%

Sources: GUS, Information on budget performance of municipalities in 1991-1992; Bełchatów 1992 budget performance report; Gdynia 1992 budget performance report.

TABLE 29

GDYNIA—EXPENDITURES BY SECTOR FOR 1991 AND 1992

		A	B	C	D	E	F	G
		1991 Planned (mn PLZ)	1991 Actual (mn PLZ)	1992 Planned (mn PLZ)	1992 Actual (mn PLZ)	% change 92/91 (actual/actual)	1991 Actual struct. in %	1992 Planned struct. in %
1	Total expenditures	449,096.9	432,288.4	664,753.0	621,607.0	43.79%	100.00%	100.00%
2	Municipal economy	75,037.2	72,401.1	240,181.0	219,326.0	202.93%	16.75%	35.28%
3	Housing economy	57,168.2	52,341.5	84,290.0	75,463.0	44.17%	12.11%	12.14%
4	Education/child care	164,347.0	163,042.6	237,944.0	230,345.0	41.28%	37.72%	37.06%
5	Culture & arts	11,321.4	11,298.3	18,180.0	18,064.0	59.88%	2.61%	2.91%
6	Health care	9,606.6	10,536.6	19,097.0	16,187.0	53.63%	2.44%	2.60%
7	Welfare	16,091.9	8,882.9	14,160.0	14,114.0	58.89%	2.05%	2.27%
8	Sports, tourism, recreation	6,008.4	5,788.4	2,772.0	2,768.0	–52.18%	1.34%	0.45%
9	Local administration	20,554.2	20,480.8	36,682.0	36,650.0	78.95%	4.74%	5.90%
10	Budget deficit	32,870.1	32,870.1			–100.00%	7.60%	0.00%
11	Other	56,091.9	54,646.1	11,447.0	8,690.0	–84.10%	12.64%	1.40%

Source: Gdynia 1991 and 1992 budget performance report.

2. Organization of the Municipality

The city budget includes the finances of 44 dependant budgetary units or jednostke budżetowe. These include: 37 schools, four crèches, the City Guards, the City Office, and the Council Housing Office.

External budgetary units (zakład budżetowe) of Gdynia include: the city public transport enterprise, the investment service office, the municipal cultural center, the municipal public library, the welfare center, 44 autonomous kindergartens, and 58 "sobering-up" centers.

In 1992, transfers to all types [illegible] budgetary units (jednostke budżetowe and zakład budżetowe) represented 40 percent of operating expenditures; 1.5 percent of operating revenues consisted of surpluses of zakład budżetowe, which were transferred to the main budget (**Table 27**).

Exhibit 23 presents the organization schema of municipal services. This schema corresponds to the organization of ma[illegible] [illegible]ninas in Poland. The total staff of city hall counts only 400 people, or one person for [illegible] inhabitants.[58]

a. Municipal financial department. The Budget Department of Gdynia is headed by the City Treasurer and comprises four sections:

1)	City Hall Budget	(18 staff)	preparation of budget, accounting, payroll, inventories
2)	City Budget	(7 staff)	revenue collection (except local taxes), subsidy distribution
3)	Tax/Tax Accounts	(17 staff)	management of local taxes (identification of taxpayers, notification, tax collections, audits)
4)	Supervision/Analysis	(5 staff)	internal financial audits, supervision of schools, crèches.

b. Tax collection and management. The tax collection service is one of the sections of the Budget Department and has a staff of 17. This unit is responsible for the real estate tax, the transport tax, and market fees.

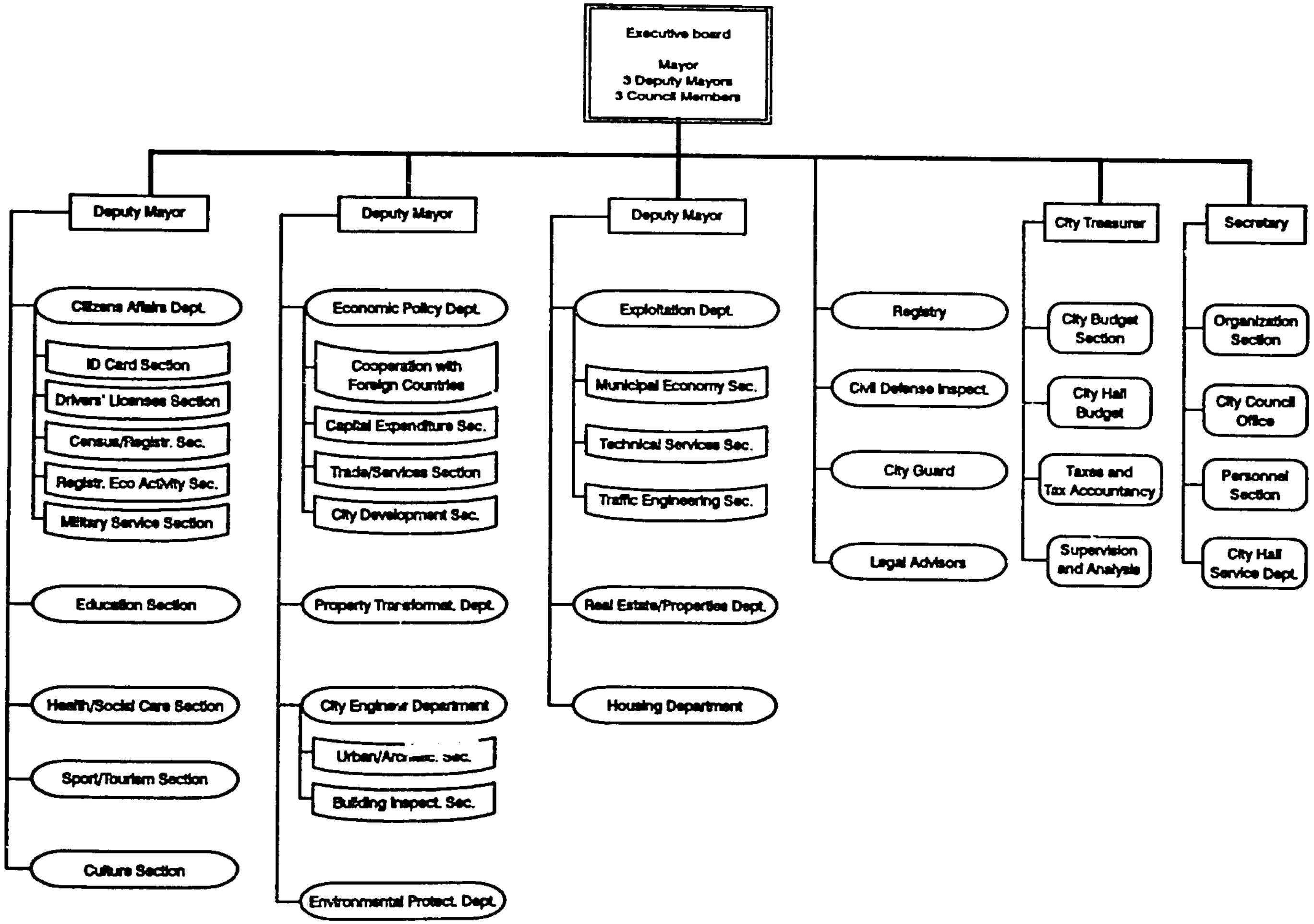
(1) Real estate tax. The tax rate voted by the city council is 20 percent less than the maximum rate permitted. The total collected for the real estate tax in 1992 was 84 billion PLZ, of which 92 percent was collected from individuals and 8 percent from businesses. The real estate tax represents 13 percent of the total revenues of Gdynia.

The cadastral registry for real estate properties is managed by the land survey and registry section. The Budget Department keeps a separate list for tax purposes. Each taxpayer is

[58] This ratio compares with a town of 22,000 near Warsaw, with a city hall staff of 70, or one person per 310 inhabitants.

EXHIBIT 23

CITY OF GDYNIA: ORGANIZATION OF MUNICIPAL SERVICES



required to file a declaration, which is entered into the computerized database of the tax office. A notification of the amount of taxes due and dates for payment is then sent to each taxpayer. The tax office conducts about 10-15 inspections/audits per month, although many of these are due to requests for tax relief, which are verified before a decision is made.

The tax department receives information from several sources to verify that all taxable properties have been identified. Existing properties have already been declared and are generally known to the tax service. Building permits and information on completion of construction are transmitted by the City Engineer, then a verification/inspection is conducted by the city tax office. The tax service is also made aware of new structures through denunciations by citizens. In addition, the local fiscal office[59] sends information to the city on potential real estate tax cheats.

In Gdynia, about 20,000 inhabitants pay real estate tax. Tax payment rates for individuals are quite high, at 97 percent. Collection rates for businesses and industries are much lower, at only 70 percent. Large state-owned enterprises are the entities that have the most difficulty in meeting their tax obligations. The city is said to have engaged in court proceedings to collect these missing revenues.

Annex E and **Annex F** are copies of the declaration to be completed by taxpayers and notification of tax obligations, respectively.

(2) **Transport tax.** The total amount of transport tax in 1992 was 19.7 billion PLZ: 18 percent of this total was paid by individuals and the remaining 82 percent by businesses. The transport tax represents 3 percent of the total revenues of the city.

Within Gdynia, 90,000 vehicles are subject to the transport tax. The tax rates, as well as tax payment dates, are published in the local press. Payments received by the municipality are compared with the registration of cars; the tax department follows up on nonpayments. The city claims that the nonpayment rate is about 10 percent; many nonpayments would be due to junked cars that are still listed as registered.

(3) **Market fees.** Market vendors are assigned a place in municipal market stalls and need a license from the municipality to ply their trade. Within organized markets, daily fees are set lower, to discourage vendors from selling in the street. The daily fee is based on surface area occupied by the vendor and is collected by the managers of the markets.

[59]Deconcentrated administration of the Department of Organization and Tax Supervision of the MOF.

The city employs five market collectors to sell tickets to street vendors; the daily fee applied is set higher than for vendors established in organized markets. Many of the street vendors are said to be from the former Soviet Union or Vietnam. The market collectors receive a commission of 10 percent of the market fees they collect, and the amount of fees they have collected are controlled by registers and printed tickets.

LIST OF ACRONYMS

BIS	Bank for International Settlements
CIT	Corporate Income Tax
EBRD	European Bank for Reconstruction and Development
FRF	French Franc
GDP	Gross Domestic Product
GUS	Główny Urząd Statysczyny or Central Statistical Office
HUF	Hungarian Forint
IBRD	International Bank for Reconstruction and Development (World Bank)
ICMA	International City/County Management Association
IMF	International Monetary Fund
MCP	Municipal Credit Program
MDA	Municipal Development Agency
MOF	Ministry of Finance
MPPC	Ministry of Physical Planning and Construction
NFEP	National Fund for Environmental Protection
NBP	National Bank of Poland
PDB	Polish Development Bank
PIT	Personal Income Tax
PLZ	Polish Złoty
PMU	Program Management Unit
RAC	Regional Audit Chamber
SEM	Société d'économie mixte
USAID	United States Agency for International Development
USD	United States Dollar

ANNEX A: SOURCES OF FINANCIAL INFORMATION

The budgets/accounts of local governments are organized according to the ordinance of the Minister of Finance of April 18, 1991 on classification of budgetary income and expenditures. Gminas provide budgetary information to the Ministry of Finance and to the GUS (Central Statistical Office), based on the classifications of this ordinance.

The Ministry of Finance receives a quarterly report (Sprawozdanic o zbiorczym wykonaniu budzetu gminy), which is due on the 25th of the month following the end of each calendar quarter. The information requested is used to determine national averages for the calculation and distribution of the general subsidy. Therefore, the information is more detailed in terms of gmina revenues. The form used includes the following items:

- Real estate tax
- Agricultural taxes and fees
- Stamp duty
- Tax on means of transportation
- Patent tax
- Gmina share of corporate income tax and personal income tax
- Earmarked grants for gmina own projects
- Earmarked grants for commissioned projects and tasks
- General subsidy
- Other revenues, which include income from lease and sale of municipal property.

In contrast, only minimal information on expenditures is reported on this form as follows:

- Total wages
- Payroll wages
- Investment expenditures
- "Other" expenditures.

Each quarter, the final result (surplus or deficit) is calculated.

For each line of revenues and expenditures, planned and actual figures are reported. In addition, the municipality must also indicate the amount of any tax exemptions that have been accorded by the municipal council. Such exemptions reduce the total revenues that could be potentially collected by the local government, as well as the per capita revenue index. In order not to increase the amount of compensatory subsidy resulting from the effect of such tax exemptions, the latter are included in the Ministry of Finance's calculations.

GUS receives half-year and annual budget reports from gminas. Five separate reports are completed:

RB 27 — Budgetary revenues
RB 28 — Budgetary expenditures
RB 30 — Revenues and expenditures of zakład budżetowe, special funds and earmarked funds
RB 31 — Revenues and expenditures of auxiliary enterprises
RB 50 — Accounting of budgetary transfers and expenditures for activities commissioned to gminas.

Gminas complete these reports according to the full budgetary classification and forward copies to the regional audit chamber.

In addition, gminas produce an annual balance sheet on the actual compared with budget income and expenditure (RB 49), as well as an annual balance sheet for budgetary units, budgetary enterprises, and auxiliary units (bilans). These reports are submitted according to the chart of accounts.

ANNEX B: COMPARISON OF GUS AND MOF STATISTICS

The sources of statistical information available from GUS and from the Ministry of Finance are gminas themselves. As indicated in Annex A, gminas send quarterly budget reports to the Ministry of Finance and an annual report (on five separate forms) to the Central Statistical Office, or GUS.

There are some differences between the numbers, but these differences are almost statistically insignificant, at less than 1 percent of total budget mass for all gminas (refer to **Table 30**). For 1991 gmina revenues, GUS data is 0.42 percent greater than MOF; this difference descends to 0.26 percent for 1992. On the expenditure side, the same difference of 0.42 percent is recorded for 1991; in 1992, MOF expenditure data is one-twentieth of 1 percent greater than GUS data.

These variations probably result from the level of detail of the reports that are sent by gminas. The annual reports for GUS require gminas to give the detail of every single budget line; the information is then compiled and aggregated by GUS.

The MOF reports only request details for specific lines, and then a global "other" line for remaining revenues or expenditures. All mathematical operations are the responsibility of gminas. However, even for specific lines, gminas are required to make some calculations. For example, in the case of the tax on means of transportation, gminas must add amounts paid by individuals and amounts paid by legal entities, which are recorded separately in gmina budgets.

As the differences recorded for these sets of data are negligible, it was not considered necessary to reconcile the information. Based on the level of detail available, one or the other set of information was used within this report; statistical sources are indicated in all tables.

TABLE 30

DIFFERENCES BETWEEN GUS AND MOF GMINA BUDGET STATISTICS

	billion PLZ	1991 Actual (GUS)	1991 Actual (MOF)	1991 Difference (GUS–MOF)	1992 Actual (GUS)	1992 Actual (MOF)	1992 Difference (GUS–MOF)
1	Total revenues	50,053.2	49,844.0	0.42%	64,401.7	64,232.4	0.26%
	of which:						
2	General subsidy	6,771.1	6,809.1	–0.56%	7,560.9	7,576.1	–0.20%
3	Shared taxes	14,490.2	14,484.4	0.04%	14,279.8	14,252.0	0.19%
4	Real estate tax	7,658.2	7,630.5	0.36%	10,536.6	10,533.9	0.03%
5	Agricultural tax	1,860.9	1,935.0	–3.98%	1,737.1	1,753.7	–0.95%
6	Transportation tax	555.1			2,233.5	2,234.5	–0.05%
7	Stamp duties	2,307.1			3,391.5	3,401.5	–0.30%
8	Grants for commissioned tasks	5,414.7	5,347.9	1.23%	10,467.6	10,348.8	1.13%
9	Grants for own projects	593.1	599.7	–1.12%	1,625.3	1,572.7	3.23%
10	Other revenues	10,402.8	13,037.3	1.72%	12,569.4	12,559.1	0.08%
11	**Total Expenditures**	**44,788.2**	**44,599.5**	**0.42%**	**64,879.0**	**64,908.4**	**–0.05%**
	of which:						
12	Wages	4,360.4	4,737.7	–8.65%	9,099.8	9,116.8	–0.19%
13	Materials & services	9,227.2			13,777.1		
14	Transfers to budgetary units	13,629.5			16,097.9		
15	Capital expenditures	11,577.6	11,669.1	–0.79%	15,065.9	15,173.6	–0.72%
16	Other expenditures	5,993.5	28,192.6	2.28%	10,838.3	40,617.9	0.23%

Sources: GUS, Information on budget performance of municipalities in 1991-1992 and MOF, Fourth quarter budget report for 1991 and 1992.

ANNEX C: ACCOUNTING ENTRIES PERTINENT TO GMINA BUDGETS

Gmina accounts are required to conform to the accounting nomenclature established by the Ordinance of the Ministry of Finance of April 18, 1991, on classification of budgetary income and expenditures as well as of other revenues and spending. This ordinance establishes the budget classifications for the State Budget and for gmina budgets.

The nomenclature is divided into sections, subsections, and paragraphs.

Principal sections and some subsections that are pertinent to local government budgets include, but are not limited to:

- 40 — Agriculture

- 45 — Forestry

- 70 — Municipal economy
  7011 — Municipal economy entities
  7221 — Sanitation and city cleaning
  7231 — Parks and gardens
  7261 — Streets, squares, bridges, and overpasses
  7262 — Street lighting

- 74 — Housing economy and nonmaterial municipal services
  7411 — Housing economy enterprises
  7415 — Repair of private multiapartment houses
  7542 — Spatial planning offices
  7551 — Surveying reports and land administration in cities

- 79 — Education and child-care
  7911 — Primary schools
  7913 — Pupil travel to schools
  7941 — Boarding houses and stipends for pupils
  8211 — Kindergartens
  8213 — Kindergartens at primary schools
  8221 — Day care and child care entities

- 83 — Culture and art
  8317 — Art centers
  8322 — Libraries
  8331 — Houses of culture
  8332 — Cultural centers
  8333 — Day rooms and clubs
  8341 — Musical, artistic, and cultural associations

- 85 — Health protection
  8517 — Preventive health units
  8535 — Combating drug abuse
  8536 — Combating alcoholism
  8552 — Disinfection, disinsection, and deratization entities
  8593 — Health protection associations

- 86 — Social welfare
  8613 — Benefits and assistance in nature
  8615 — Local social welfare entities
  8621 — Social welfare associations

- 87 — Physical culture and sport

- 88 — Tourism and recreation

- 89 — Various activities

- 90 — Income from legal and natural persons
  9013 — Revenues from agricultural tax
  9015 — Shares in taxes
  9016 — Revenues from banks
  9019 — Taxes and fees from natural persons
  9020 — Revenues on stamp duty

- 91 — State administration and self-government
  9144 — Gmina councils
  9145 — Gmina executive boards
  9146 — Gmina administration

- 94 — Finance

- 96 — Subsidies
  9619 — Subsidies to municipal economy enterprises
  9620 — Subsidies to housing economy enterprises
  9621 — Subsidies to housing cooperatives

- 97 — Various clearance
  9719 — Surplus of budget from previous year

The paragraphs that identify specific types or expenditures may be classified in the following groups:

■	11-17	Remuneration
■	21-27	Various personal spending and social payments
■	28-38	Materials and services
■	39	Fines and penalty interest
■	40-44	Payments and fees
■	45	Various spending
■	46-55	Subsidies for current spending
■	61	Clearance with domestic banks
■	65	Interest
■	66-67	Credits and domestic loans
■	69	Depreciation—deductions from fixed assets
■	71-77	Subsidies for investment spending
■	78	Shares in companies
■	80-84	Reserves
■	95-97	Transfers

Revenue paragraphs that are relevant for local governments include:

■	15-16	Income tax
■	31	Income from sale of stock and shares of the State Treasury
■	32	Income from sale of liquidated enterprises or portion of property
■	42	Revenues from services
■	43	Revenues from sale of products and property components
■	51-64	Taxes and fees
■	73	Dividends of companies
■	76	Fines and penalties
■	77	Various revenues from budget entities
■	81	Interest
■	85-88	Special subsidies received from State Budget
■	90	General subsidies from State Budget
■	95	Funds received from commune funds

ANNEX D: PERSONS INTERVIEWED (MAY 17 – AUGUST 25, 1993)

Urząd Rady Ministrów / Council of Ministers

Jan Maria Rokita	Minister and Chief of the Office of the Council of Ministers
Michał Kulesza	Deputy Minister, Government Plenipotentiary for Administration Reform
Zygmunt Karkuciński	Legal Counsel
A. Bejm	Legal Counsel

Ministerstwo Finansów / Ministry of Finance

Elżbieta Suchocka-Roguska	Director, State Budget Department
Danuta Wawrzenkiewicz	Deputy Director, State Budget Department
Mrs. Berger	General Subsidies, State Budget Department
Mrs. Korycka	General Subsidies, State Budget Department
Krzysztof Piechota	Director, Department of Organization and Tax Supervision
Dr. Krzysztof Kalicki	Director, Foreign Department
Jarosław Biernacki	Deputy Director, Banking and Financial Institutions Department
Marek Żytniewski	Deputy Director, Department of Financial Policy and Analysis
Magdalena Jagiello-Szostak	Senior Specialist, Legal Counsel Treasury Securities
Beata Balas	Deputy Director, Insurance Division, Banking and Financial Institutions

Ministerstwo Gospodarki Przestrzennej i Budownictwa / Ministry for Physical Planning and Construction

Irena Herbst	Deputy Minister, Housing
Sławomir Najnigier	Deputy Minister
Jadwiga Fedorowicz	Director, Budgetary Department
Zbigniew Rydzicki	Deputy Director, Urban and Housing Economy
Hanna Matraś	Adviser

Ministerstwo Przekszałceń Własnościowych / Ministry of Privatization

Paweł Graniewski	General Counsel, Mass Privatization Department

Narodwy Bank Polski / National Bank of Poland

Hanna Gronkiewicz-Walz	President
Jerzy Hylewski	Director, International Financial Institutions Department
Jolanta Daniewska	Director, Licensing Department
Wojciech Kwaśniak	Deputy Director, General Inspectorate of the Banking Supervision Department
Bernard Smykla	Legal Department, General Inspectorate of the Banking Supervision Department
Dr. Paweł Wyczanski	Adviser to the President, Research Department
Edmund Saunders	Adviser to the President, General Inspectorate of the Banking Supervision Department
Zenon Zebracki	Adviser to the President, General Inspectorate of the Banking Supervision Department
Piotr Bednarski	Training Coordination and Foreign Liaison

Beata Lenard	Economist
Monika Borowska	Economist

Centralny Urząd Planowania / Central Planning Office

Zbigniew Kopyra	Director, Office of Credit Qualification

Najwyższa Izba Kontroli / Supreme Chamber of Control

Czesława Rudzka-Lorentz	Adviser to the President

Regionalne Izby Obrachunkowe / Regional Accounting Chamber
w Warszawie / Warsaw

Jerzy Urbaniak	President
Stanisław Stępień	Director, Audit Department
Barbara Raczkowska-Wójak	Inspector in training

Główny Urząd Statystyczny / Central Statistical Office

Bożena Jakóbiak	Director, National Income and Wealth Department
Mr. Krawszynski	Local Government Section, National Income and Wealth Department

Krajowy Sejmik Samorządu Terytorialnego / National Assembly of Local Authorities

Piotr Buczkowski	President
Zyta Gilowska	Vice-President

World Bank (IBRD)

Vincent Gouarne	Senior Urban Specialist
Julius Varallyay	Principal Operations Officer, Poland
Christian Duvigneau	Principal Operations Officer

International Monetary Fund

Robert Sierhej	Economist

European Bank for Reconstruction and Development

Witold Radwanski	Deputy Resident Representative

Office for Public Administration Reform

Jacek Poznański	
Wojciech Mowchlewski	
Susanne Nielsen	Senior Consultant

Fundusz Współpracy / Cooperation Fund

Krzysztof Mularczyk	Programme Manager, Local Government Training Assistance
Krzysztof Nowakowski	Project Manager, Restructuring and Privatization of Municipal Enterprises Programme
Urszula Budzich	Programme Manager, Credit Line for the Import of Equipment for Agriculture and Agro-Industry
Christopher Stacy Waddy	Banking Adviser, Credit Line for the Import of Equipment for Agriculture and Agro-industry

BANKS

Bank Handlowey w Warszawie S.A.

Andrzej Kolatkowski	Managing Director, Member of the Managing Board
Thomas Brennan	Adviser, Economic Analysis Department
Irena Olszewska-Koszada	Loan Work-out Department
Małgorzata Bisz-Wyczynska	Managing Director, Credit Department

Bank Przemysłowo-Handlowy SA

Martin Miszerak	Chairman of the Supervisory Board

Powswechny Bank Kredytowy S.A. (PBK) w Warszawie

Marek Mazur	Chairman of the Supervisory Board

Bydgoski Bank Komunalny S.A.

Ryszard Slaweta	President of the Board of Management
Marek Ignasiak	Director of the Bank, Member of the Board
Urszula Ozga	Vice President, Member of the Board

Bank Gospodarstwa Krajowego (BGK) / National Economy Bank

Mariusz Stolarz	President of the Board of Management
Jerzy Kochanski	Deputy President
Wieslaw Jasinski	Director of Credit Department, Member of the Board

PEKAO Bank Polska Kasa Opieki S.A.

Zygmunt Kwiatkowski	Deputy Director, Credit and Guarantee Department
Ewa Harembska	Manager, Credit Department
Isabela Filipowicz-Wenda	Specialist, Credit Department
Agnieszka Kozlol	Department of Credit Policy
Mrs. Lucziyki	Credit Department
Mrs. Cejrzwska	Information Technology

Bank Zachodni S.A.

Grazyna Niewolik	Vice Chairman, Board of Management
Zbigniew Chuchla	Director
Marian J. Kolenski	Director

AmerBank

Marek Gadomski	President
C. Gregory Curtis	Deputy President

Polski Bank Rozwoji S.A. / Polish Development Bank

Maciej Stanczuk	Director, Credit Department
Jerzy Mirski, Ph.D.	Adviser to the Credit Department
Jerzy Chojna	Vice Director, Credit Department
Elżbieta Krop	Chief of Correspondence, Banking Section
Dariusz Krasuski	Credit Department, Credit Specialist

COOPERATIVE BANKS

Spóldzielczy Bank Ludowy w Poznaniu

Stanisław Murawski	Managing Director

Gospodarczy Bank Wielkopolski S.A. (GBW)

Urszula Gawlak	Director of Credit Department
Urszula Kraska	Senior Credit Officer

Krajowa Izba Rozliczeniowa S.A. (KIR) / Clearing House for Bank Transactions

Artur Struzynski

Warsaw Stock Exchange

Maciej Jakaczynski	Legal Department

Baker & McKenzie

Tomek Chenczke	Lawyer specializing in banking (US and Polish)

U.S. Embassy

Jim Wojtasiewicz	Deputy Secretary, Economic Affairs

Pioneer Fund First Polish Trust Fund Company

Alicja Malecka	President

Crédit Local International Conseil

François Poupée	Chef de Projet

Instytut Miasta / City Institute

Andrzej Lubiatowski	Director

Gdańsk Institute for Market Economics / Warsaw Branch

Dr. Janusz M. Dąbrowski	Director

Gdańsk Institute for Market Economics / Gdańsk Branch

Anthony Levitas	Member of the Board of Trustees, American Representative

University of Łódź

Dr. Włodzimierz Nykiel	Department of Financial Law

LOCAL GOVERNMENTS

Urząd Miasta Bełchatowa / City Board of Bełchatów

Edward Olszewski	Mayor
Mr. Baronowski	City Treasurer

Urząd Miasta Częstochowa / City Board of Częstochowa

Tadeusz Wrona, D. Sc.	Mayor

Urząd Miasta Gdyni / City Board of Gdynia

Stanisław Szwabski, Ph.D.	City Board Member
Andrzej Goldmann	City Treasurer
Maciej Matuszak	Head of Privatization Section
Barabara Pujdak	Head of Organizational Section

Tadeusz Mękal	Special Adviser, Capital Expenditure Section
Mariusz Czepczyński	Urban and Architectural Section

Urząd Miasta Konstancin / City Board of Konstancin

Józef Hlebowicz	Interim Mayor
Wioletta Biskupska	City Treasurer

Urząd Miasta Wrocław / City Board of Wrocław

Leontyna Gemza	City Treasurer

Miejskiw Przedsiebiorstwo Energetyki Cieplnej Sp.z.o.o. / Public Utility: Heating Distribution Company

Andrzej Ferdek	President of the Board of Management

Wrocławskie Przedsiebiorstwo Oczyszczania Sp. z.o.o. / Public Utility: Sanitation Department

Stanislaw Brzostek	President of the Board of Management

Miejskie Pislino Wooloscosgon i Kanalizacy / Public Utility: Water Supply Company

Janusz Zoekoszski	President of the Board of Management

ANNEX E: DECLARATION OF PROPERTY FOR REAL ESTATE TAX (SENT BY TAXPAYER TO CITY TAX SERVICE)

Item Nr.	Specification	Base of taxation	Rate of taxation	Sum of taxes in PLZ
1	Living quarters or their sections.	usage area .... sq m.	850 PLZ per 1 sq m.	
2	Buildings or their sections used for economic activity other than farming or forestry, and sections of living quarters used for economic activity other than farming or forestry.	usage area .... sq m.	30,000 PLZ per 1 sq m.	
3	Other buildings or their sections.	usage area .... sq m.	10,000 PLZ per 1 sq m.	
4	Buildings used for economic activity.	estimated value for depreciation purposes .... K PLZ	2%	
5	Lands: a) used for economic activity other than farming or forestry, excluding land adjacent to living quarters.	land area .... sq m.	1,000 PLZ per 1 sq m.	
6	b) Other	land area .... sq m.	1,000 PLZ per 1 sq m.	
X	X	Total	X	

Date.........................

....
(family name and first name of the individual responsible for the correct tax est.)

....
(head of the section)

....
(accountant's signature)

1) The base of the taxation should be rounded to the next 10,000 PLZ.
2) The amount of the taxes should be rounded to the next 1,000 PLZ.

ANNEX F: NOTIFICATION OF REAL ESTATE TAX PAYMENT DUE

ACKNOWLEDGEMENT OF RECEIPT

of the decision Nr 92/5132 regarding the estimate of real estate tax
for the year 1992

Account Nr
Acknowledgement of the receipt of the decision
ZALEWSKA KRYSTYNA

....
(date) (signature)

File Nr 92/ 5132
Register Nr
Account Nr

The Office of the Mayor
of the City of Gdansk
Independent Tax Division
Al. Marsz. J.Pilsudskiego 52/54
81-382 Gdynia
ZALEWSKA KRYSTYNA
81-454 GDYNIA
TOMASZA NOCZNICKIEGO 13

Decision of May 28, 1993, regarding the estimate of the real estate tax
for the year 1992

On the grounds of article 104 of the Code of Administrative Proceedings, the statute of January 12, 1991, regarding taxes and local fees (*Dziennik Ustaw*) [official newspaper announcing current legislation] Nr 9, line 31 and the following), and the resolution nr XL/265/9 of the Council of the City of Gdańsk of January 29, 1992, the real estate property tax was estimated as follows:

Address of the real estate: TOMASZA NOCZNICKIEGO 13
Nr of the real estate register
Owner: KRYSTYNA ZALEWSKA

1. Usable area of the living quarters	169.50 sq m x 650 PLZ/sq m = 110.000 PLZ
2. Other land	822.00 sq m x 86 PLZ/sq m = 71.000 PLZ
	Total tax 181.000 PLZ

The tax is payable in the following installments and dates:

I installment — in 14 days from the receipt of the decision	45.300 PLZ
II installment — in 14 days from the receipt of the decision	45.300 PLZ
III installment — in 14 days from the receipt of the decision	45.200 PLZ
IV installment — in 14 days from the receipt of the decision	45.200 PLZ

In case of a delay, interest will be added. Payments can be made in the cashier's office at the Office of the Mayor of the City of Gdańsk, at a post office, or at a bank to the account Nr 301820-1111-132 of the I branch of the Bank Gdanski S.A. in Gdynia with reference to the file number of the decision. The amount of real estate tax was estimated on the grounds of the statement made on May 8, 1991, using rates defined in the aforementioned tax regulations. The taxpayer is obligated to inform the local tax office concerning any changes that could affect the amount of the tax (changes in the land area, the exploitation of the land, or usage for economic activity) in 14 days from the time the changes occur. The taxpayer is entitled to file an appeal against the decision to the Council of Appeals of the Independent Council of the Gdańsk Province in Gdańsk — through the mediation of the local tax office — in 14 days from the day of the receipt of the decision. The appeal does not exempt the tax payment.

With the authorization of the Mayor
of the city of Gdańsk

Paid off....... Additional payment...... (signature and position)

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