

Navigation to the Market

Regulation and Competition
in Local Utilities
in Central and Eastern Europe

Edited by

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Foreword

The chapters in this book were prepared under the “Local Government Policy Partnership” Program. This is a joint project of two donor organizations: the British Government’s Department for International Development (DFID), and the Local Government and Public Service Initiative (LGI) of the Open Society Institute, Budapest, which launched this regional program. The “Local Government Policy Partnership” (LGPP) projects intend to contribute to policy development and innovations in Central and Eastern European countries.

LGPP hopes to develop expertise and to support professional cooperation among local government specialists throughout Central and Eastern Europe. Parallel to this, experiences from this region should be made available in Central and Eastern Europe, and in Central Asia. The core partner countries are the Czech Republic, Hungary, Poland and Slovakia. However, other countries have been invited to participate in these regional projects, which would help direct information exchange and comparison of policy efforts. Planned LGPP publications include policy studies and proposals discussed with government officials and experts in the countries involved.

Targeted beneficiaries of LGPP projects are national government ministries, local government associations, research and training institutions, and individual local authorities throughout the CEE region. LGI intends to publish three studies each year. In 2001–2002, (the first year of LGPP operations), the following policy areas were selected:

- a) Education financing and management;
- b) Regulation and competition of local utility services, and
- c) Public perception of local governments.

This book, however, should not be seen as a typical product of the LGPP program. This work offers no specific policy recommendations. Instead, it concentrates on changes in public attitudes towards local governments, and on differences in approaches towards various components of the respective municipal systems. As local governments become increasingly important in citizens’ everyday lives, political institutions and public actors who can demonstrate greater sensitivity towards public opinion are vital for the success of future reforms. The hidden message of this work is that without regular and systematic analysis of public opinion, viable local government policies will become even more difficult to design and implement in the future.

Ken Davey & Gábor Péteri

August, 2001

Regulation and Competition in the Local Utility Sector in Central and Eastern Europe

Tamás M. Horváth, Gábor Péteri

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Regulation and Competition in the Local Utility Sector in Central and Eastern Europe

Tamás M. Horváth, Gábor Péteri

1. INTRODUCTION

Local public utility and communal services are the focus of this report. They are regarded as basic services in the studied six countries of Central and Eastern Europe (CEE). Water services, regular solid waste collection and disposal, district heating, public cleaning, management of social housing, public transportation, and so on, are all a part of the everyday lives of ordinary citizens. However, there are great differences in the manner in which these services are provided, and there is still much confusion in approaches, objectives and policies as to how these activities should be managed and financed.

In this publication, we deal with local public utilities and communal services, which are specific branches of the utility sector. During the changes of the past decade, public utilities have also been under transformation worldwide. The public utility sector still has its own problems in this period of rapid technological change with the increasing dependence of the economy on energy, along with the development of global networks. The role of the private sector has to be identified within the framework of public functions of the welfare state.

The future of urban services (local public utilities, communal services) in the CEE countries raise even more specific problems than the transformation of the utility sector. These changes are implemented in a decentralized political and administrative environment, which further complicates existing problems. Economic and management decisions are always influenced by local politics, which does not help the economically rational design of service provision.

Political considerations and traditions led to fragmented and—from an economic point of view—small size service providers. Political goals of accountability and public control of local governments are in conflict with the economies of scale arguments. New political and administrative mechanisms have to be developed, in order to achieve efficient service provision.

Conditions of local decision-making further complicates the transformation of these services. At local governments the roles of owner, budget designer and social service provider are mixed. These three functions have to be balanced in each local decision. Operational rules of municipalities are influenced by other factors, for example the specific conditions for managing conflicts of interest, lack of professional capacity, and so on.

However, it is precisely these nuances and complexities of this topic that makes it all the more challenging and interesting. We hope that the target audience of this book will be broad. This information on Central Eastern European countries might be useful for policy analysts, who are interested in various aspects of local public utility services. Discussion of the linkages between various regulatory mechanisms and on service management issues will help the policy makers as well. Regulatory policies and specific rules of service delivery are rather diverse in the CEE region, so this book will support the information exchange amongst experts. Beside national government officials it will also be informative for local practitioners.

The subject of the research is the role of public influence in the transformation of local infrastructure. It is a topic with many conflicts, because as state functions decrease, they need to be replaced by private actions and new types of policymaking should be developed. Our approach in this study is that changes in the utility and communal sectors are prerequisites of transformation in the public sector as a whole. For improving public utilities, consequent and persistent government policy is needed. The specific objectives of these studies are:

- i) to make an inventory on the present status of local public utility service management;
- ii) to identify those areas of local public utilities which are required to develop efficient and high quality service provision in the emerging market environment, in the current stage of decentralization. This critical assessment leads to stage (iii);
- iii) policy proposals, which will lead to the real transformation of this sector.

Despite the present strong incentives and pressure, conditions have not, as yet, been guaranteed in the researched countries. There are many controversial circumstances preventing development from turning into the direction of modern welfare economies. Drawbacks are different by sectors and by countries.

We are aware of the fact, that a description of these local utility and communal services will not lead to general conclusions on all the studied sectors. Special characteristics of these activities do not allow a comprehensive analysis. That is why we often make a reference to special features of technology or to specific country. But, we believe that we were able to identify a more or less complete list of issues in local public utility service provision.

During the past decade, the emphasis in public debate on utility services has been slightly modified in the CEE countries. At the first stage, and after the political changes, the primary goal was to

improve the service efficiency; to utilize the benefits of the decentralized system and private institutions for achieving a better performance of services.

There is no comprehensive and reliable information on the efficiency gains of the transformation of public utility and communal services in the CEE countries. So we cannot evaluate the impact of these changes, but evidence from other countries, which have already been through this transformation, show a significant reduction of costs. For example, an OECD study on solid waste management has proved that a private collection of communal waste results in 15–40% percent lower costs than a public collection.¹

Despite these facts, the political and public debate on local public utilities has been slightly modified during the past few years. Without having specific information on efficiency gains and improvement of service performance, equity and affordability came into the focus point of discussions. These arguments do not seem to appreciate the impact of privatization on the level of public utility services, but they raise different issues.

This second stage of service transformation (regulation, competition, contracting) was the focus of our research. We believe that advantages of the private sector can be realized in a properly designed public service environment. We do not want simply to neglect or to support private provision of utility services, but our goal is to discuss those components of regulation, which would protect the public interest, but do not destroy the market. This approach will hopefully support the public debate on these issues.

This fits into the theory of public sector management, focusing on communal and utility services. Management of economic and political transition in CEE countries gives the framework for the topics to be examined in this book. This particular viewpoint can be generalized, and it will be useful for a better understanding of more complex problems of the whole region in its transformation period.

Our aim is to draw conclusions on the relationship between the public and private sector by investigating specific issues in this area. This method will be more relevant than following some recent comments on the ranking of countries, or describing the present process as a race for joining various frameworks of international integration. However, in addition to the analyses, a normative character is also preferred in this study. We focus mainly on policy formulation at both government levels. Nevertheless, the authors recognize the limitations, but the aim is that a professional debate will be launched.

This comparative paper is based on country reports from six Central and Eastern European countries: the Czech Republic, Hungary, Latvia, Poland, Romania and Slovakia. There are differences in the selected countries according to their model of development, involvement in the EU integration process, historical heritage, and so on. However their common feature is

their strong motivation to reform and transform their systems. We think this sample represents more or less other countries of the former 'Eastern block', at least in its European region. The authors are united in the opinion that conflicting situations commonly arise from similar challenges or problems.

Authors from the six countries—following an agreed outline—produced detailed comprehensive reports on local public utility and communal services. The approach and style of each paper is different, because the available information, the form of existing institutions, and the present problems varied regionally. This summary chapter is primarily based on the information collected by the national teams, but it was supplemented with other facts, collected from personal interviews in these countries and from the available literature. It has been discussed at a regional workshop with the authors and other experts.

This summary chapter is heavily based on the information collected by the country teams, so we are very grateful for their excellent work. The editors have visited the studied countries, and with the assistance of the country teams were able to collect information from practitioners. We are also grateful to Eva Voszka for commenting the earlier version of this summary chapter. Meetings with national and local government officials, service company managers, representatives of professional associations helped a lot to understand the reality. Any possible misinterpretation of the collected information is our responsibility.

2. THEORETICAL FRAMEWORK

In classical theory market failures arise from the production of public goods and other operating mechanisms of society. There are several limitations like natural monopolies, externalities and information asymmetry on the market². There are different linkages among these phenomena, for instance, the production of public goods generally involves externalities³ for example services which provide additional benefits for specific users, which then has an impact on income distribution, which is either accepted by the public bodies or has some favorable macroeconomic effects (on unemployment, inflation, et cetera).

What is the basic characteristic feature of public utility and communal services from the point of view of market failures? Most of them are public goods, because government actions are needed in the production and distribution; natural monopolies dominate the network based services; and to a lesser extent externalities and information asymmetry exists.

According to public sector economics⁴ social or public-good consumption benefits are available in a non-competitive manner. Market failure occurs in the provision of public goods, because individual consumers will act as free riders. For efficient provision of public goods, a political process of allocation is needed.

“A public good is a good or service that provides benefits which cannot be limited to those who directly pay for it”.⁵ The government is involved in the production of public goods. In a pure case consumption is realized collectively by all people, notwithstanding payments.⁶ Two basic characteristics of pure public goods are specified, such as non-excludability in consumption and joint use of goods and services. According to the well-known typology⁷ apart from specific public and private goods, common pool and toll goods are also distinguished.

‘Pure’ public goods are relatively rare, typically public characteristics are mixed with private features. These mixed goods are characterized by different scale of joint consumption. Only in extreme cases is individual consumption excluded absolutely, so the level of excludability makes the real difference between public and private services.

According to Savas (1987) the separation of service provision and production is a further dimension, differentiating public and private functions. From this aspect linkages to the public bodies are crucial and they are more important than ideal-typical forms of private and public goods. This concept argues that public provision does not mean necessarily governmental production of goods and services. Governments are more service managers, facilitators using the private sector for producing public services⁸

The other most relevant market failure in natural monopoly services is the neglected competition. Natural monopolistic character of public utilities is a more significant feature of these services, than the scale of government involvement in production of services and goods. According to Stiglitz, we talk about natural monopoly, “when a firm has attained its monopoly position as a result of increasing returns to scale”.⁹

In all cases of market failures, government actions are needed. The content and focus of public activities depend on the nature of market failures. Natural monopolies and public (or mixed) goods and services in urban areas more precisely consist of the following:

- i) Urban public utility services as natural monopolies:
 - healthy drinking water supply;
 - sewage;
 - district heating;
 - electricity;
 - urban gas supply.
- ii) Urban public utility services as specifically public goods:
 - public lighting;
 - rain-water drainage;
 - public cleaning;
 - urban (non-toll) roads.

- iii) Urban communal services as mixed (not-specifically public) goods:
- public park and green;
 - public cemeteries;
 - solid waste removal and disposal;
 - individual liquid waste removal and disposal;
 - (social) housing maintenance;
 - public chimney cleaning and supervision of heating facilities;
 - public transport.

It should be noted in point i), that in urban areas a healthy drinking water supply, sewage, rainwater drainage and district heating are typically provided as natural monopolies under local or regional management. Electricity and urban gas are slightly different, because the provision of these services are supplied mainly at the national level, and less by municipalities and other regional governments.

The characteristics and scale of public services and especially natural monopolies are changing. The recent trends in regulatory systems and ownership structures have developed a new environment for classical natural monopolies. Large networks are owned and operated by big national or international companies. In parallel to these changes, regulations force third party access to networks, which might limit the monopolistic character of the network based service provision.

Public functions are very different in each sector mentioned above. For instance, electricity has not been fully privately owned. Gas utilities have been privatized in some of the studied countries. In their case, the regulatory functions have been changed intensively. Models of public involvement do not depend only on sectors, but they are also influenced by historical development. Former publicly owned utilities can be transferred to the private sector quickly in the privatization process, but government regulatory functions are changing slowly.

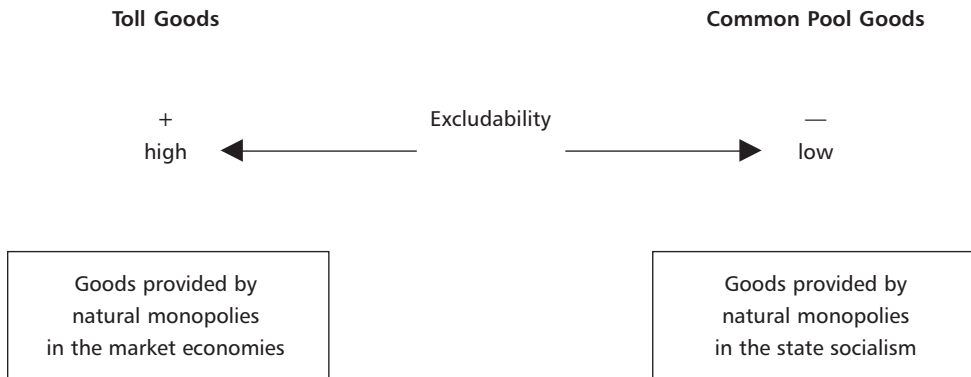
The public character of services depends on three basic conditions. First of all ownership matters, but also the style and form of regulations have a strong impact on service provision. Secondly, private or public character of service production is very much influenced by several elements of the regulatory system: licensing, access to networks, price setting authority etc.). Finally, the method of financing greatly matters (i.e. whether services are financed through national and local taxes or user charges).

As these factors can be changed during the transformation of service provision, the characteristics of goods provided by natural monopolies changes gradually. As far as basic feature of goods provided by utility networks is concerned, the borderline between public and private is also

modifiable. In the modernization process of natural monopolies, the main tendency is to split marketable, competitive activities from publicly owned and managed assets. For this purpose, exclusion from access to goods and services (networks) should be guaranteed. This general tendency is also expected in the provision of urban services. Under state socialism in its classical period, public services were mostly common pool goods. Consumption was not limited by the symbolic price. In the period of so called 'market socialism' some changes did begin, however, clear excludability has been implemented for the years of transition, after a reorganization of service provision. Changes can be illustrated with characteristics of goods and services provided by utility works (Figure 1.1).

Figure 1.1

**Direction of the Change of Services Provided by Natural Monopolies
in Transitive Economies**

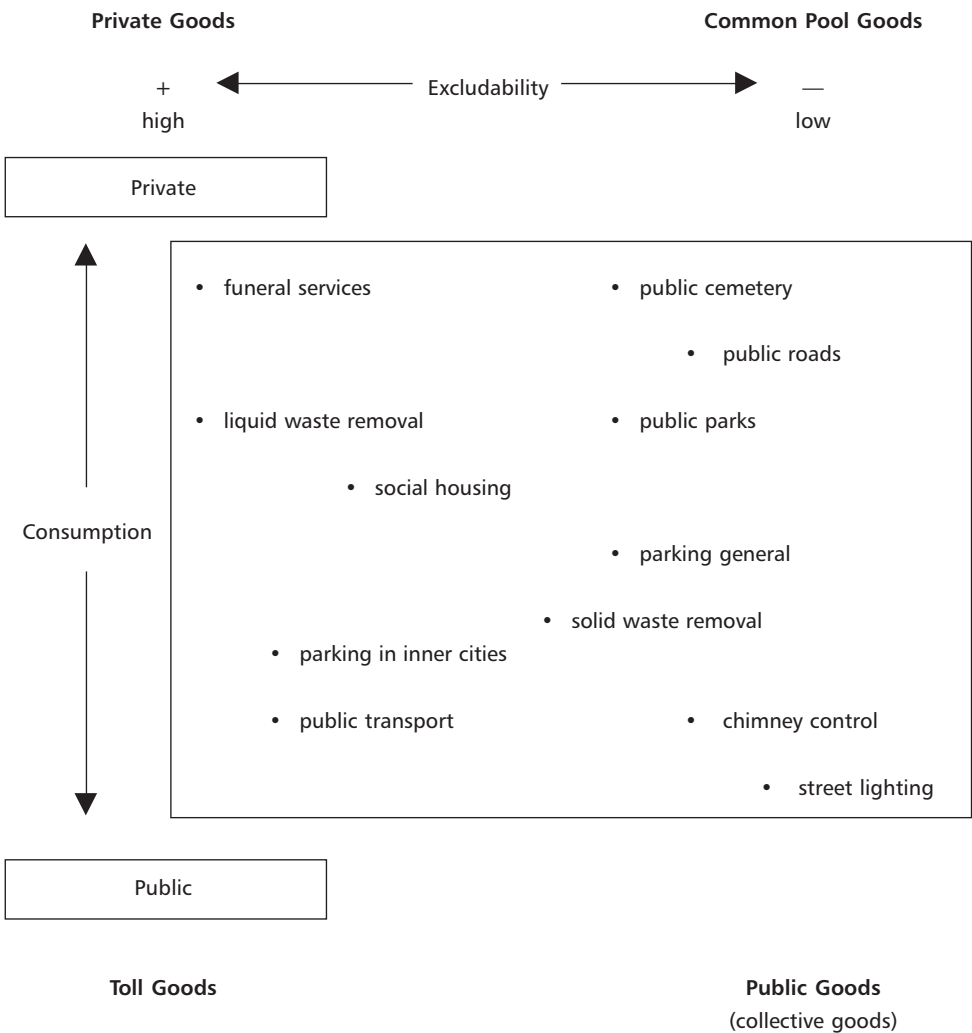


In point ii) above, it should be noted that in the case of specifically public goods, the market failure does not link to the position of natural monopolies. Specific public goods are relatively restricted at this level, because public goods can be provided by more aggregate (national or federal) level of government. Defence, police and prisons are typically managed by central government and administration. In relation to these type of services, it can be highlighted that public characters are more important in the practice than ideal-typical forms.

In point iii) above, it can be noted that as far as mixed goods are concerned, two main different factors may work against market failures. Firstly, the existence of the public client (the municipality) limits competition because of the missing cost saving interest. The second factor is the necessary joint provision, for ensuring the economies of scale rationale and restricting the competition (e.g. in waste collection, public transportation).

Local public goods and services are typically mixed. The extent and content of public provision is different by sectors. Additionally, the public character is changing historically. In a more developed stage of market economy in these countries, communal goods and services can be characterized according to Figure 1.2. The figure shows that stage, when some of the services have been privatized as a whole or partially. We used Savas’s typology as a basis,¹⁰ however it has to be changed according to the characteristics of service provision in the region.

Figure 1.2
The Nature of Communal Goods and Service



In a denationalized environment, in spite of possible privatization, particular government functions must remain such as pricing, involvement of the government in service development, consumer protection, et cetera, because under free market circumstances these tasks are not fulfilled. Roles of the general public are different by sectors, stage of development and country specifications. However, there is a common tendency, which is similar in developed Western economies and transforming countries, that has changed the character of mixed goods: that is the increasing role of exclusion and private consumption.

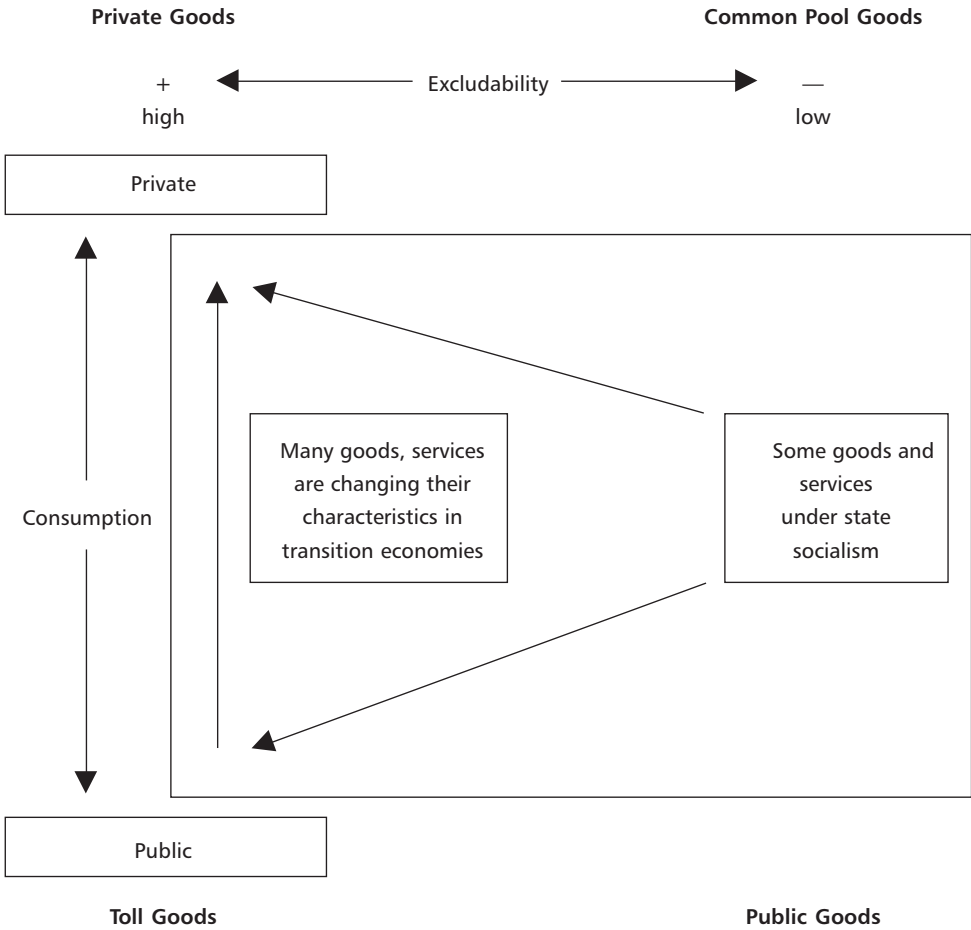
Motivation and social frameworks of these changes are very different. From a welfare state to the post-welfare, the development of economics is motivated by the intention to stop the overspending of the state budget. In transition economies, the main task is to transform the former centralized service assignment systems. From this respect, private roles in public provision could be more politicized, incentives for efficient services are less highlighted, partly because of the higher costs of reconstruction. In many respects, practitioners have to face similar challenges as does the modernization process of a few countries of the third world. Nevertheless, a common tendency of widely accepted direction to the expected development can be sketched. A lot of goods that used to be public goods or common pool goods become toll goods or private goods, such as social dwellings, public transport, clean water, et cetera. Formerly toll goods become 'pure' private goods in some cases, especially funeral services, health services of baths, et cetera. These tendencies are showed in Figure 1.3.

In public service provision, private characteristics and exclusion in consumption is becoming increasingly important. As we shall see from the country examples some of the urban public services have already been made private. It is implemented in two ways. One form is to decrease the amount of public or mixed goods, like the sale of the great part of social housing stock. The other is to eliminate particular services as public ones, for example cultural centers as institutions in transition countries, and to transfer all these services to the group of private services, which are supposed to be provided by the market.

The other form is the involvement of private service organizations in the service production, but keeping the public control over service performance, financing, quality control, et cetera. Privatization is not the only solution for cutting back on public spending. Another widely used policy is to prefer market based instruments in remaining a part of the public sector: creating incentives for competition; establishing independent regulatory functions; widening contractual relationships; and so on. These critical elements of private sector involvement are in the background of the changing character of services, when they move from public goods to toll goods.

Intervention may also lead to government failures. There are a few groups of theories focusing on this issue.¹¹ Although the main problems analyzed in our comparative project may fit properly into the theoretical framework described above, what so far has been less highlighted are the actual differences to be found in the social and economic systems.

Figure 1.3
Change of Communal Goods



Both welfare state and socialism are criticized because of their exaggerated intervention. However, influencing the conditions of existing market systems is not the same task as replacing regulatory mechanisms in a command economy. Therefore—despite some similarities—the challenge to change the previous regimes is different to some extent.

Through destroying state-owned structures from the previous regime, governments find themselves with highly complicated reorganization tasks. In the case of CEE countries, the disintegration of the command economy is also linked to establishing market conditions and new public positions in public service provision at the same time. That is why West-European

examples on market orientation in the public sector cannot be applied directly, because their reforms were built on a relatively plural structure of service provision. There was no need to restructure the basic social structure of property or institutional framework of public involvement. For the further analyses it is better to make a distinction between traditional government failures and 'state' failures, as that type of public failure which originated under state socialism. In the latter case, a correction of failures is directly linked to the wide restructuring of extremely nationalized ownership structures.

3. PROVISION OF URBAN SERVICES IN CEE COUNTRIES

What is the relevant framework of local service provision? According to Oates' (1972) decentralization theorem, each service should be provided in that area where costs and benefits have arisen in an optimal way. In the case of the transformation in CEE countries, this question is raised as the allocation of power and assignment of functions to different levels and types of local governments. In Central and Eastern European countries, reallocation of public functions was realized in a parallel way with division of functions.

A new allocation is based very much on the general level of development. Its known crucial character is the political, economic and social transformation process in the 1990s. The beginning of changes was a purely political process [Ágh, 1998]. It meant that crucial changes in social and economic circumstances were initiated by the political transformation, instead of a gradual development, by which 'revolutionary' institutional reforms could have been prepared.

Basic data are showed in Table 1.1–1.3 General characteristics of the studied countries as a sample of the whole region are as follows:

1. These are relatively underdeveloped countries in comparison to Western European ones. The urban population ratio is far from the developed level, as well as per capita GDP.
2. Transformation led to more serious decline because of the high social costs of restructuring. For example it is showed by unemployment rates. Some of the countries have already reached the pre-transition level of development and economic growth was begun. Others have not been out of the transformation shock, like Romania and Latvia.
3. The quality of urban infrastructure according to some basic parameters is also underdeveloped, although differences are higher to some extent, for example Czech indicators are closer to Western ones. At the other end of the scale, the Hungarian ratio of public sewerage services is unacceptably low. In these circumstances, it is difficult to make any general statement about the effectiveness of service delivery. Modernization should first focus on extending the delivery of some communal and utility services. Nevertheless, this task cannot be defined separately from the rationalization of the service provision.

Table 1.1
Selected Social Indicators, 1999 and 1990–1999

| | Latvia | Poland | Slovakia | Hungary | Czech Republic | Romania |
|---|--------|--------|----------|---------|----------------|---------|
| Population [in thousands] | 2 389 | 38 741 | 5 381 | 10 075 | 10 263 | 22 402 |
| Growth rate of population 1995–2000 [% per annum] | –1.5 | 0.1 | 0.1 | –0.4 | –0.2 | –0.4 |
| Life expectancy at birth [women and men, year] | 74/62 | 77/68 | 77/69 | 75/67 | 77/70 | 74/66 |
| Urban population [%] | 69 | 64 | 57 | 63 | 75 | 55 |
| Share of population in poverty [%] | 23 | 13 | 1 | 2 | 1 | 30 |

SOURCES: World Statistics Pocketbook, 2000;
 Nemzetközi Statisztikai Zsebkönyv, 1999;
 Transition report, 2000, EBRD.

Table 1.2
Selected Economic Indicators, 1999

| | Latvia | Poland | Slovakia | Hungary | Czech Republic | Romania |
|--|--------|--------|----------|---------|----------------|---------|
| GDP/per capita [US\$] | 3 019 | 3 987 | 3 650 | 4 853 | 5 148 | 1 512 |
| Level of real GDP (1989=100) | 60 | 122 | 100 | 99 | 95 | 76 |
| Unemployment [%] | 14.0 | 10.4 | 15.6 | 7.8 | 7.5 | 10.4 |
| Inflation [annual average consumer price level] | 2.4 | 7.3 | 10.6 | 10.1 | 2.1 | 45.8 |
| Cumulative foreign direct investment (1989–2000) per capita [US\$] | 1 027 | 751 | 669 | 1 935 | 2 102 | 303 |
| Private sector share [%] in GDP (mid-2000) | 65 | 70 | 75 | 80 | 80 | 60 |
| Institutional performance of transition ¹² | 2.6 | 3.3 | 2.8 | 3.5 | 3.2 | 2.3 |

SOURCE: Transition report, 2000, EBRD.
 Transition report update, 2001, EBRD.

Table 1.3
Selected Infrastructure Indicators, 1999 and 1990–1999

| | Latvia | Poland | Slovakia ¹³ | Hungary | Czech Republic | Romania |
|---|--------|--------|------------------------|---------|----------------|----------------|
| Population [in thousands] | 2,389 | 38 741 | 5 381 | 10 075 | 10 263 | 22 402 |
| Dwellings supplied with water pipe network [%] | n. a. | 89.8 C | 82.3 G | 84.6 E | 96.9 A | 51.4 B 54 F |
| Dwellings supplied with bath, shower [%] | n. a. | 77.9 C | 89.0 D | 79.9 E | 90.9 A | 46.1 B |
| Dwellings supplied with WC [%] | n. a. | 77.8 C | 80.0 D | 76.5 E | 88.5 A | 44.9 B |
| Dwellings supplied with central heating [%] | n. a. | 68.4 C | 74.7 D | 48.2 E | 59.0 A | 38.9 B |
| Population connected to public sewerage network [%] | n. a. | 46.6 D | 54.7 G | 22.0 E | 59.2 E | 51 F |
| Average of EBRD index of infrastructure reform | 3.1 | 3.2 | 2.1 | 3.8 | 2.8 | 3.3 |
| General government expenditures [% of GDP] | 46.8 | 44.7 | 43.3 | 44.8 | 42.0 | 36.8 |

SOURCES: World Statistics Pocketbook, 2000.
 Nemzetközi Statisztikai Zsebkönyv, 1999.
 Transition report, 2000, EBRD.
 Magyar Statisztikai Zsebkönyv, 1999.
 Slovak data: Statistical Yearbook, 2000; Annual Bulletin EC, 1996.
 A: 1991; B: 1992; C: 1995; D:1996; E: 1997; F: 2000; G: 1999.

This description of present and historically developed process shows that problems of the transition model are different from the Western one, because the circumstances and level of service provision are not the same. Liberalization of the market here serves first of all modernization, rather than improving the level of services. By modernization, we mean changes in methods of service provision, notwithstanding quality improvement. Above all, a particular environment of the market should be established. In the first stage, the existence of a sufficient number of providers was the question, because the market was absolutely virtual, it was monopolized by state-owned companies.

By the late 1990s, the number of providers increased in all these countries. Private service providers had a more active role. However, the remaining influence of state owned or regionally organized

public enterprises still exists, but it is different by countries. For instance, their role is more extended in Romania ('regie autonomes'), than in Slovakia or Poland. However, even in these latter ones there are sectors where privatization has not yet begun (for examples the provision of drinking water in Slovakia or electricity in both countries). Provision of public utility and communal services are divided amongst central and local governments, and, on the other hand, between different levels of local governments.

The typical feature of the CEE region is the crucial role of the basic (municipal) level of territorial governments [Horváth, 2000]. Most of the public utility and communal services are provided by municipal governments. Division of work is accepted only with state administration, and to a much lesser extent with higher territorial self-government level. The elected middle tier was typically weak in these countries in the first period of transformation.

This problem is important from the point of view of technical services, because the economies of scale is evidently linked to larger territories, i.e. to more integrated units of municipal governments, or to intermediary levels of government. The weakness of this form of integration leads paradoxically to better chances of integration, led by private service providers. The alternative option would have been service provision by the state administrative, which was not a preferred solution.

As far as the second main stage of local development is concerned, the re-establishment of middle tiers is highlighted. Based on the direction of recent changes it is hard to predict the future, modernization projects will probably be managed by new or newly strengthened levels of territorial governments. This progress of administrative regionalization is supported by the common aspirations of the European Union. Structural policies of the EU also focus on regional levels, as units of modernization.

Depending on the scale and form of decentralization, local governments play different roles in the financing and managing of local public utilities. The models of the six studied countries diverge by the forms of local service assignment; transfer of municipal property; and autonomy in local revenue raising. These indicators of decentralization are determined by general factors, like the share of local budgets in GDP and general government expenditures or the role of the intermediary level of government.

These two latter factors define the fiscal and legal environment for public utility services. After the first decade of transition the public sector has a similarly limited role in the economy. In most of these countries consolidated general government expenditures are 36%–44% of the gross domestic product. These figures show a substantial decrease in public expenditures, which used to dominate the economy through extensive redistribution under the communist systems. The reorganization of the state functions was implemented partly through decentralization and devolution. According to the scale of decentralization, the studied countries might be grouped into three categories. The share of local budget expenditures in relation to GDP are the highest in Hungary (12%) and Poland (12%). Two countries belong to the second group as well: Czech

Republic (7%) and Latvia (9%). The least decentralized countries are Romania and Slovakia, both of them with a 4% share of local expenditures in GDP.¹⁴

Another important factor of decentralization trends is the role and function of the intermediary level of government. The middle tier of the government had an important role in the service delivery and reallocation of resources under the Soviet rule. In the least decentralized countries, where the state administrative and local government functions are not clearly separated, the districts, counties, and regions dominantly have a non-elected administrative character. This is the case in both the Czech Republic and Slovakia, however, reforms are under completion.

Where the intermediary levels of sub-national government are elected and public functions are assigned to them, there the relationship between the municipal and county level matters. In Romania the 'judets' have broader functions and in Latvia the districts seem to have the inherited, informal functions of equalization, so they can influence the municipal decisions to a greater extent. In Hungary and Poland, the responsibilities and competencies of the middle level governments are clearly separated and no forms of subordination is accepted between the two levels of elected local government.

There is no detailed and comparable fiscal information on local utility services in the six studied countries. The terms and budget classification are diverse, so expenditures on local public utilities are found under different mixed categories, like communal services, municipal services, economic services, and so on. The available data shows that there are two groups of countries. In Hungary and Latvia local government budgets seem to play minor roles in utility services, as only 15–19% of local government expenditures are used for these services. In Poland and Slovakia the broadly interpreted municipal services are 29–44% of local government budgets. (see Table 1.4)

Table 1.4
Public Utility Expenditures in Local Budgets

| HUNGARY | | | |
|---|-------------------------------|----------------------|--------------------|
| FY 2000 | Local government expenditures | | |
| Housing, community and public services: | 6.6% | | |
| Economic functions: | 10.9% | | |
| FY 1998 | Current expenditures | Capital expenditures | Total expenditures |
| Housing | 1.9% | 5.1% | 2.3% |
| Communal services | 6.1% | 10.7% | 6.2% |
| Public transportation | 1.2% | 5.7% | 1.9% |
| Water management | 0.3% | 21.4% | 4.2% |
| Total | 9.5% | 42.9% | 14.6% |

Table 1.4 (continued)
Public Utility Expenditures in Local Budgets

| LATVIA | | |
|--|------|---|
| FY 1999 | | Self-government expenditures |
| Economic services | | 16% |
| Of which: housing, public utilities, environmental protection | 93% | |
| Transportation, communication | | 3% |
| Total | | 19% |
| POLAND | | |
| FY 1999 | | Local expenditures at gmina and powiat level |
| Municipal services | | 29% |
| | | Capital expenditures |
| Gmina municipal services | | 16% |
| Powiat municipal services | | 14% |
| SLOVAKIA | | |
| FY 1999 | | Local government expenditures |
| Local economic services | | 8.1% |
| Of which: Public lighting | 3.5% | |
| Funeral services | 0.6% | |
| Public welfare facilities | 2.4% | |
| Environmental services | | 6.6% |
| Of which: Municipal solid waste management | 2.5% | |
| Street cleaning and snow removal | 2.1% | |
| Park maintenance | 1.8% | |
| Water supply | | 2.1% |
| Housing construction and management | | 15.0% |
| Public transportation and road maintenance | | 12.2% |
| Total communal and utility services | | 44.0% |

SOURCE: LGPP project country reports, 2001.

This data does not present the differences in local mandatory service competencies. In all the six countries, local governments have rather broad responsibilities in public service delivery, so not only these communal services, but also wide scale of human services (education, welfare and

health services, etc) is decentralized (with some exceptions, like Slovakia, before the planned reform). A lower percentage of utility services in local budgets might reflect the differences in the organizational form of service delivery. A lower proportion in municipal expenditures might be caused by the fact that state owned enterprises still provide the service (for example the heating supply in Latvia).

This reduced budget share of public utility services could also mean that these services are more privatized and that they are less dependent on local budget transfers (for example Hungary). In most cases even the locally set user charges are not presented among the local budget revenues, because they are collected by the service organizations.

Fiscal information collected by the authors of the country reports also present the differences in terminology and data collection. However, the more detailed data from Hungary shows that in a decentralized system—when services are mostly provided by companies from arms length—local current and capital expenditures might be significantly different. Public utility services are high priority target areas of local capital investments (43% of total capital expenditures). Only 9% of local current expenditures used for the operation of utility services. According to our investigation, the modernization of urban services consists of the following main changes:

- i) decomposition of formerly monopolistic providers (re-structuring);
- ii) sale of assets and shares (privatization in a narrower sense) establishing liberalized market environment.

Different models have arisen in specific sectors of the studied countries, but there are common processes as well. Public utility and communal enterprises used to be owned by the state in former socialist systems. They were in monopolistic positions, although these monopolies were relatively weak in comparison to the state owned companies in the manufacturing sectors. It means that priorities in the development of public services only followed preferred ambitious political programs on the forced increase of production in heavy industry, mining, et cetera. Therefore, monopolies of public services were not really strong in relation to other sectors of the economy, but their behavior was typically monopolistic in their own sectors.

In most of the infrastructure sectors, service provision was divided among large enterprises, combining production, transmission, distribution and other related activities. Some activities were also connected to the basic services, like the operating of sport clubs, networks of social care institutions, financing a relatively wide range of exclusive services for employees, and so on.

Under these circumstances, the first step of transformation was the re-structuring of monopolies. Practically it meant the preservation of monopolies in another structure, in order to prepare them for real changes in the system of ownership and the establishment of the market environment. In the second stage of transformation, privatization is implemented in all of the possible service areas.

The content of these changes is different in the case of services according to their character as natural monopolies or mixed goods, because the role of public sector cannot be defined in the same way as in market economy. This difference is shown by Table 1.5.

The present changes of the public utility sector in countries of Central and Eastern Europe are parts of a longer process in the economic transformation. During the decades of state ownership and planned economy, the infrastructure and public services were secondary objectives. Industrial development, mostly in manufacturing and military sectors, was regarded as the primary goal of economic policy. This has supported the modernization of typically agrarian countries of the CEE region.

It has required extensive regrouping of available economic resources to the preferred activities and sectors. With the exception of some services (e.g. public education, urban housing) various mechanisms of the planned economy caused serious under-investment in the infrastructure services. In the centralized public administration and local government systems, the methods of allocating public utilities assisted the large scale industrial projects and did not respond to local needs and priorities. Extremely high income centralization has prevented any form of public choice based model of infrastructure financing.

Table 1.5
Stages of Transformation in Public Utility and Communal Services

| | Public utilities (natural monopolies) | Communal services (mixed goods and services) |
|---------------------------------|---|---|
| First stage (Re-structuring) | <ul style="list-style-type: none"> • modest breakup of state-owned monopolies (devolution of assets) • modest unbundling • establishment of independent regulatory authority | <ul style="list-style-type: none"> • rationalization • establishment of competitive environment |
| Second stage (privatization) | <ul style="list-style-type: none"> • privatization of competitive assets (de-monopolization) • development of regulatory function • liberalization | <ul style="list-style-type: none"> • de-monopolization • management of public shares • privatization |

The past decade of transition raised the claim for dramatic changes in this field. The crisis of the Soviet economic rule coincided with the neo-conservative shift in economic policy. It has significantly changed the perception of public services and role of the government in service delivery. Separating the responsibilities of public service provision and the actual form of service production was the basic principle of reforms also in CEE countries. Various forms of privatization,

together with new, decentralized forms of infrastructure financing have created a new environment for public utility services.

The lack of public funds for infrastructure development and the low level of public service performance raised the claim for a higher service efficiency, and the siphoning of more resources in this sector of the economy. Through the reallocation of internal sources and by attracting foreign direct investment, more funds were also made available in the local public utility sector. 'Municipalization' of state owned property of utility services, adaptation of new forms of private enterprises in service delivery, changing the rules of infrastructure financing through user charges and local taxation were the key elements of transformation. This process is still under implementation, as the studied countries started it at different moments and followed their own rules, which resulted diverging routes and speed of transformation.

4. RE-STRUCTURING SERVICE PROVISION

An indicator of structural changes in local public utilities is the scale and form of transforming the service organizations. According to the decentralization and privatization policies in a country, as a result of several transition waves, models are different also by sectors. In Table 1.6 a possible classification of organizational changes is summarized by sectors.

In the water services, three basic models were followed. In Hungary and Poland, the former large state owned and regional water works were fragmented, and several hundred small service organizations were created by local governments. The organizational forms are various: budgetary organizations, companies and private businesses provide water services. This model was not followed in Slovakia, where still a few state enterprises operate the water system and privatization is exceptional. Only the large and probably the best companies are taken by private investors. Romania has its own way by splitting the large national companies into semi-public forms of 'regie autonomes'.

District heating services were transferred to local governments in Hungary and Poland, which led to some privatization and slow amalgamation of these municipal service organizations. The other extreme case is Latvia, where heat production is still part of the national energy system and only a few cities have received the assets and set up their own company. This 'random municipalization' was combined with national government bail out of the indebted companies.

Transfer of public state property to local government, followed by privatization is most typical in municipal solid waste management. Local ownership is typical in several countries, slowly creating joint, economically rational size companies for waste disposal and collection. In Poland and Slovakia different methods are used for waste disposal and for collection: generally creating larger

service organizations for disposal at regional level, whilst supporting competition in collection. In Slovakia, strong administrative measures were used for closing the sub-standard landfills.

Organizational models in communal services are determined by the country’s characteristics and they are, in general, decentralized. In Hungary and Slovakia multi-purpose urban management service organizations were fragmented, by separating some revenue making and more market oriented activities from the rest. In Poland and Latvia, where the privatization of the social housing stock is lower, multi-profile companies provide combined services.

Table 1.6
Transformation of Service Organizations

| |
|--|
| WATER SERVICES |
| <i>Extensive fragmentation</i> |
| Hungary: 5 national and 28 regional water and sewage companies were dissolved to 5 state owned regional companies and 400 local government service organizations in 1991/92 |
| Poland: 50 single purpose water enterprises (40 is managed by the regions) were fragmented. A survey in 1999 showed that water services are provided by 369 budgetary enterprises, 344 companies, 19 state owned enterprises, 10 budgetary entities. |
| <i>Changes in organizational forms</i> |
| Romania: by creating the regie autonomes, former SOEs were split among the county local governments, under semi-public forms of operation. |
| <i>Exceptional ‘municipalization’ and privatization</i> |
| Slovakia: 5 state, 2 local and 2 private companies, with a mandate to transfer them by December, 2001. (Similar process is followed in the Czech Republic, where the Prague water works had been recently privatized.) |
| DISTRICT HEATING |
| <i>Transfer to local governments</i> |
| Hungary: 290 local heat generation and distribution companies transferred to 103 local governments |
| Poland: 55 regional heat supply companies were transferred to app. 600 heat suppliers at ‘gminas’ (local authorities). |
| <i>National networks prevail, with random ‘municipalitization’</i> |
| Latvia: exceptional, heavily subsidized privatization in a few cities (e.g. Riga, Jelgava) |

Table 1.6 (continued)
Transformation of Service Organizations

| |
|---|
| MUNICIPAL SOLID WASTE MANAGEMENT |
| <p><i>Transfer to local ownership, random privatization</i></p> <p>Czech Republic, Hungary: Single municipality or joint local government service organizations. (Hungary: majority private ownership in 4% of sample cases).</p> <p><i>Wide scale privatization in collection</i></p> <p>Poland: in waste disposal 1 500 enterprise (600 corporations); collection is widely privatized (e.g. companies in Warsaw).</p> <p>Slovakia: separating collection and landfill management, enforcing regionalization: 60% of 17 large regions are managed by private companies¹⁵</p> |
| COMMUNAL SERVICES, HOUSING MANAGEMENT |
| <p><i>Splitting multi-profile companies</i></p> <p>Hungary, Slovakia: creating smaller units; sale or leasing, contracting arrangements; some exceptions for buying back companies (Slovakia)</p> <p><i>Continuing multi-purpose communal companies</i></p> <p>Poland: transforming to enterprises (gmina), 200 social housing associations operating independently</p> <p>Latvia: local government companies, providing great variety of services indicate more frequent use of budgetary organizations, or more extensive fiscal transfers to municipal enterprises.</p> |

4.1 Re-structuring Communal Service Provision

The transformation process of service providers is similar, although stages having reached are different by countries and by sectors. Actual differences do not seem to lead to separate models. We suppose that the same process is going on, although different stages have been taken.

The first step is the rationalization of formerly state-owned enterprises. First of all, it means the clarification of public profiles and the separation of different supplementary activities. Practically, the number of employees are decreased in this phase, in some cases radically. The pressure to rationalization is derived from the crises of the transformation. Fiscal limits became hard both at the national and local levels.

Then, transformation of public enterprises to companies under the company law was implemented without ownership changes. 100% shares of local or other state actors were realized, as a prerequisite to the following sale. At this stage, a system-specific event occurred: a search for adequate owners. In principle, there were different options as follows:

- direct sale by state property agencies, in a centralized manner;
- devolution of assets to local governments (in this case local authorities should transform their enterprises and budgetary units);
- creation of at least partial other owners by law, especially managers, employees.

At this stage of transformation rationalization was going on. In spite of the relatively stable structure of owners, performance expectations increased. It is difficult to measure outputs and outcomes, but there had been a decrease in improving service efficiency inputs (measured in the number of employees).

At the same time another phenomenon emerged, on the other end of contracting relationships. From different reasons, public clients are forced to strengthen the tendering process, even in those cases when their own company was selected. A competitive or quasi-competitive environment started to develop. It was a rather contradictory situation, because mechanism and practice were not developed properly. Neither rules, nor contracting techniques were prepared well or detailed enough [See Chapter Two, Ken Baar's study].

There were advantages and real dangers in this situation for future development. Obviously designing the competitive environment is very important, because it is one of the most important prerequisites of market development in public services. On the other hand, if some important details are missing in a regulated system, it easily discredits the competition. Without organizational guarantees, a prescribed process, and an implementation of rules—formal tenders may support only corruption and personal bias.

Communal group of urban services is a relatively market oriented area. The first phase of transformation was prepared quite well in the following stages, i.e. the incorporation of the private sector. However, public influence on urban services remained relatively wide, realized mostly through budgetary and direct linkages. Dependence from government measures remained almost unchanged at this stage.

4.2 Re-structuring Public Utility Service Provision

Compared to the public management of communal services, the transformation of public utilities is more complicated because of the natural monopoly characteristic of services. Transformation of urban utility services cannot be separated from the reorganization of other utilities, like telecommunication, energy supply, national public transport (railways, airways), et cetera.

However, development is necessary for economic modernization purposes, and governments are not in the position to finance and manage all the required capital investments. Furthermore, private and other additional resources might be directed only to a transformed system, where public and private functions are clearly separated. These constraints push the transformation process in these sectors as well.

Models followed by the investigated CEE countries are the same, although different stages are reached in each country and sector. Firstly, monopolies were broken up modestly, i.e. following regional boundaries of large service delivery areas. The measures used in different services were as follows:

- a structural reorganization of state enterprises by territorial administrative units (Romania);
- the devolution of assets to local governments (Hungary);
- a discussion on local government shares (water and sewage works in Slovakia, gas works in Hungary).

In the second step, regional enterprises are transformed to companies under the commercial law with 100% shares of the national or local governments. In the meantime ownership, management and regulatory functions are being separated, initiated by the national legislation. Among urban services the energy sector (electricity and gas supply), water and sewage services, and district heating were the relevant ones. It is common that local governments are involved to some extent in this process as owners, managers and regulators.

The most complicated element of this stage is ‘*unbundling*’, i.e. the disintegration of monopolistic organizations and the ordering of their confused roles, especially by separation of different private and public functions. It can be implemented by separating those segments of natural monopolies in service provision and the promotion of new entry and competition in areas, which potentially can be easily opened to competitors.

It is relatively rare to establish regulatory function in its final format in the stage of re-structuring. According to experiences, the required functions are known quite well, however guarantees are premature and the independent character of regulatory bodies is missing. The organizational requirements are as follows:

- i) *Independence*. Independence would be necessary to realize public regulatory functions. Control and leadership of the regulatory organization should be based on different professional and social interests. The overall administrative influence of the government should be avoided. Involvement of different interest groups does not mean necessarily their direct representation in the management. It can be solved in other way, like regulation on specific rights of nomination, making regular Parliamentary reports, et cetera. The organizational model must not be integrated in the state administration or in the hierarchy of traditional subordination of government offices.

- ii) *Separation of public regulator's functions.* The independent regulator's function should be separated from different other state tasks linked to the provision of public utility services. There are other roles influenced by state policies: taxation, urban planning, regional development, and so on.
- iii) *Types of regulators.* Regulators usually operate at the central level. It is one of the most important guarantees of their independence from the state administration. Local governments may also be regulators of some local public services, like solid waste management, water and sewerage supply. However, this function is not separated from general local functions. In this case, institutionalization is involved in the development of the whole codification on local authorities. This solution can be criticized, because of the controlling influence of local politics.

4.3 Sequencing, Motives and Implementation

4.3.1 Sequencing Transformation

Based on the examples from the studied countries, there are four major stages of transforming the local public utility service organizations:

- i) 'communalization', i.e. the transfer of state owned property to local governments. It is combined with some form of 'unbundling' (as previously described);
- ii) 'corporatization', which is the transformation of the budgetary organizations to arms-length corporate entities, operating under the company law;
- iii) 'privatization', by inviting foreign or domestic investors, attracting external capital in different forms of alternative service delivery (contracting out, concession, Build-Operate-Transfer {BOT});
- iv) 'regulation' as a key precondition of full liberalization in the utility and communal sector.

These steps do not follow each other in this sequence, but they were used mostly in those countries which started decentralization in the early 1990s. In the unstable legal, political and financial environment methods of radical changes had to be developed and learned by all the participants. That is why sometimes deadlines were set for selecting the 'best' form of service organizations, which fits into the local political environment (e.g. in Hungary: 1996; in Latvia: 2002). Those countries where the decentralization process was slower, these steps do not necessarily follow each other in this sequence. However, there are chances, that in Latvia district heating privatization will be implemented in parallel to the transfer of assets to local governments or the Romanian 'regie autonomes' will keep their mixed, semi-public character in the future.

- i) The first stage of transformation, when the monolith state enterprises were dismantled to relatively independent units is an important step towards realizing the efficiency gains of decentralization. Despite the lack of information on the transformation of local public service organizations, all the potential forms of ‘unbundling’ were implemented in the six studied countries. In the case of communal service organizations, and sometimes in public transportation only the accounts and functions were separated within the large entities. This helped the local governments to realize the total costs of services and to identify the subsidies needed for specific activities. Cross subsidies are still prevailing and they are widely used for minimizing corporate income tax burden.

The vertical separation of service organizations was typical in the energy sector, where local heat distributors (and sometime generators) were transferred to local governments. In the water sector, state owned enterprises still operate some parts of the national networks, but often the regional and urban companies are ‘municipalized’, i.e. they are transferred to local governments.

The Romanian ‘regie autonomes’ are examples of regional or horizontal unbundling, when specialized or multi-purpose companies provide services for one region. It may support competition, but less efficiently, when service organizations are vertically separated.

- ii) Creating new entities under corporate law is the next significant stage of transformation. Both service providers, client local governments and service producers, and contracting organizations learn the new rules of management and control. They operate under quasi market conditions, when service performance indicators and forms of financing are more or less determined. Obviously with one or a limited number of local government owners and under the supervision of local councilors the service organizations are more directly connected to their clients, than in the case of privatization.

However, clear assignment of responsibilities could make this form of operation beneficial for both parties. Local governments and service users do not have to pay for the profit in the service charges for the private owners. Service companies with municipal support might be operated as market entities and their market position can be improved (for example by receiving guarantees from the owner local governments to capital investment loans).

- iii) Real changes in economic incentives are expected only after privatization. Rules on the transfer of state ownership to local governments sometimes does not allow the privatization of networks, so only the operational assets can be used as municipal equity in the privatized companies. Local governments often keep the ownership of key components in service delivery (e.g. landfills in municipal solid waste management).

The impact of privatization on service delivery greatly depends on the contractual relationship between the client local government and the service contractor. Selection process of partners, performance specification, agreement on price setting, service monitoring and renegotiations are the key elements of this contractual relationship.

The obvious consequence of this sequential transformation, that these stages should be supplemented with stage (iv).

- iv) Regulation in a broad sense should include the rules how the market can be entered, what functions and responsibilities remain at the local governments and in what financial environment operate these service organizations. These components will be discussed later in this summary chapter.

4.3.2 Motives Behind Transformation

The pace and form of transforming the service organizations in local public utilities greatly varies in Central and Eastern Europe. Diversity can be explained partially by the differences in motives of policy makers. Here some of the most important general incentives are discussed briefly. This list is far from complete, but these arguments were most frequently used during the transformation process.

Primary reasons for transforming the traditional public service organizations to local, market oriented entities was the desire to increase the efficiency and to improve the quality of the local public utility services. In the early 1990s there was a strong belief in the CEE countries, that market based mechanisms are superior to the old rules of service delivery in public sector. Based on the strategic goal to cut back public expenditures, most of the public sector reforms were pushing the transformation of budgetary organizations to commercial entities and initiated own revenue raising by public service organizations.

The objective of decentralization and incorporation of public service institutions all served these long term goals. Critical conditions of implementation are significant investments in these very capital intensive sectors. It was obvious that without sufficient domestic resources and under very limited local government borrowing capacity, only foreign direct investments will provide sufficient funds.

Another factor for attracting foreign investors was the dramatic decline in the consumption of some public services. Especially in the water sector, where the under utilized network capacities have increased the unit costs, only further extension of services helped. For example, large sewage treatment plants without sufficient collection networks could have never reached their optimal size of operation. The deteriorated public service had to be reconstructed, which also required external resources.

Lessons from the Western European countries on privatization in the public sector, introduction of alternative service delivery arrangements and competitive tendering procedures showed that market conditions cannot be simulated, but implemented. The real market mechanisms will provide that legal and financial environment, which will encourage the professional investors to

enter these countries. Privatization of service organizations was one solution for attracting external resources.

Parallel to privatization, innovative local governments and service company managers were capable of adapting those rules, which have forced the modernization of management techniques. Local governments started to create a competitive market environment by specifying performance criteria, establishing some forms of contractual relationship and especially by decreasing municipal subsidies together with the pressure to increase the role of user charges in financing utility services. In response, public utility companies were forced to introduce efficiency measures, lay-off personnel, invest in their equipment, improve their revenue administration and learn new management techniques. The emerging market environment improved efficiency also at those municipalities which did not launch privatization of local utility companies.

However, there were some arguments against wide scale privatization. It might lead to further deterioration of local government assets and could in fact increase the unemployment in the period of economic crisis. In many cases local governments are large employers and the overstuffed communal service and utility companies might be the first targets of staff reduction in the public sector. So local governments—which have legal or informal responsibilities for local economic development—were reluctant to make the employees of public service organizations redundant. As one obvious consequence of privatization was the dismissal of employees, these fears have delayed structural changes in the local public utility sector.

4.3.3 Characteristics of Implementation

Due to great differences in the legal and financial environment in these countries and the competing arguments for or against privatization of service organizations, the process of transformation has also showed some peculiarities. The implementation was characterized by compromises, forced by the national rules of privatization and also by political debates at local governments. In the following paragraphs four special characteristics of this transformation process will be described.

The rules of municipal ownership were most important factors influencing the organizational changes in the local public utility sector. In some countries (e.g. Hungary, Poland) the general principle of state owned property transfer was the separation of core assets and negotiable or enterprise property of local governments. The core property was those type of assets which are used for delivering basic public services and cannot be transferred or sold to businesses. Public utility networks are the best examples of this type of property. Other assets (equipment, machinery, buildings, et cetera) which are used in the operation of the core property were not controlled by the regulations on property transfer.

In other countries, where the ownership and control was stronger or the rules of property transfer were sometimes violated, the privatization process was distorted. A typical form of intervention

was the involvement of national privatization agencies in the transformation of local public utility services. In the Czech Republic, where the state ownership dominates the water sector, the privatization deals are made by the State Property Agency. As the example of Prague shows, local governments are only invited to this decision making process, but they are in the minority (only two city representatives in an eight-member committee of the SPA, awarding the concession contract to the foreign service organization).

In Romania, even the local concession agreements have to be endorsed by a government decision, which requires the approval of the National Privatization Agency and the Ministry of Industry and Trade. The privatization of natural gas service in Hungary was also managed by the State Property Agency, which violated the rules of local property transfer. Municipal assets were sold to foreign service companies and local governments were compensated only several years later, following the decision of the Constitutional Court decision.

Lack of general rules on public utility services encourages preferential treatment of some forms of organizations and even sectors or cities. The purposes of these exceptional actions are usually to make the service organizations more attractive to investors. They are financed through public funds, which means that exceptions are made on the costs of general taxpayers.

In Romania since 1997 the incorporation of the 'regia autonome' was encouraged by a government emergency ordinance, which rolled back 60% of the potential privatization revenues to the new companies. It is mostly used for paying the debt of the 'regie autonomes', but it simply made the sale or concession cheaper for the investors. In Latvia the 'municipalization', and later privatization of the Riga district heating company was accompanied with significant national government bail out, because all the debt and arrears of the local unit of the national energy company was taken over by the remaining part of the state enterprise.

Legal forms of service companies also showed particularities in the CEE countries. Some form of local government public enterprises survived the economic changes for a limited period in several countries. For example in Hungary and Latvia, these special mixtures of not-for-profit commercial entities had to be transformed to legal entities under the budget or commercial law by a certain date. According to a survey, in Poland between 1993 and 1995 the share of these municipal enterprises in service delivery decreased from 19%; by 10% and at the same time proportion of budgetary organizations in service delivery increases by 4% and ratio of companies by 6%.

During the first years of transformation some forms of direct public ownership were also developed in the communal sector. Management buy outs and allocation of shares to company employees or to a foundation of employees were the typical instruments. This model was used in communal and housing management services in the case of Hungary and Poland. Employee's shares were always in minority (up to 5%), but they made the transformation acceptable for many local governments. Later these shares were sold or their influence was only symbolic.

The slowly emerging regulatory environment was supposed to influence the transformation process. In Latvia, the stated primary function of the future local regulators will be to take over the political burden of privatization from the elected local governments and to provide technical, financial arguments for privatization. In Hungary the introduction of compulsory competitive tendering in some sectors (e.g. municipal solid waste management) aimed to improve the service efficiency. It is another story as to how the general rules were violated, by saying, that competitive tendering should be used only under certain conditions: if the local government does not provide the service with its own service organization and only in the case of new contracts.

Price regulations also might have an impact on selecting the form of service provision, like in the case city of Komarno in Slovakia, where the 100% city owned service company shifted from a joint, sub-regional service management to a contractual relationship with the neighboring towns and villages. Under the regional model the water charges, set by the Ministry of Finance were equalized, so the city residents paid partially the more expensive service of the surrounding area. Under a contractual relationship each municipality pays a different price, based on its own costs and service performance.

Finally, a very recent characteristic is the appearance of political clientalism in the public utility service organizations. Local government ownership rights are accomplished through the appointment of company managers and the delegation of councilors to management and supervisory boards. Earlier these positions were taken by those councilors, who had some management or technical skills, but now they are mostly political appointees. Obviously there is no empirical evidence on this trend, but the issues discussed and the style of debates proves that it does exist.

This is another reason for improving the regulatory environment, before the strong local political influence destroys the efficiency gains in the transformed companies. It is especially important to have clear rules of conflict of interest and to regulate the councilors' compensation for participating in these boards. Otherwise there is the danger of forced amalgamation and stronger involvement of national state in the service management.

5. PRIVATIZATION AND REGULATION

After these preparations, the privatization is the second stage of transforming urban services. Privatization is the key phenomenon of economic transition in the CEE region. When analysts compare different countries, they focus on models of privatization followed by particular regimes [Kornai, 2000]. In local public utility sectors, speed and radicalism of privatization are not discussed, because changes only follow the manufacturing sectors. The limits to privatization are also different, because some public functions remain. Privatization of natural monopolies and

mixed services is implemented through different actions, including the transformation of the economic environment. Three basic components will be discussed here:

- 1) The searching for real owners;
- 2) The establishment of a competitive environment;
- 3) The development of public regulatory functions.

5.1 Searching for Real Owners

Seeking real owners was the strategic goal of the general privatization model, primarily followed by Hungary and Poland. Other solutions in the business sector, like the voucher based privatization were mainly preferred in the Czech Republic. Out of the group of countries investigated in our analysis it was also typical in Russia. In urban services this model was not widespread, presumably, because of technical reasons.

i) Mixed Goods and Services

In the case of mixed urban goods (communal services) a model of small-scale privatization could be followed. Formerly local monopolies are attempted to divide these services into smaller units and give to private ownership. Typically park maintenance services, road maintenance, public cleaning, solid waste removal, individual liquid waste removal, and so on, was reorganized in this way.

Methods of small-scale privatization are various. Most typical forms are as follows:

- selling to managers (especially former budgetary units, and enterprises);
- re-privatization/restitution (formerly social housing sector in Czech Republic, Slovakia);
- right to buy (selling social dwellings to sitting tenants, e.g. in Hungary);
- sale of assets or shares (like profitable companies dealing with road maintenance, etc.).

In some cases, public functions are eliminated by the privatization, in others responsibilities remain public to some extent. For instance, provision of park maintenance remains a local responsibility even if private firms implement it. With re-privatization or sale to sitting tenants of formerly state-owned dwellings, municipalities reduce most of maintenance costs. Finding owners seems to be easier in these sectors in most of the CEE countries, that is why reorganization was more flexible here than in other utility services.

ii) Natural Monopolies

Public utility services as natural monopolies are subjects of large-scale privatization. Generally speaking large-scale privatization means breaking monopolies of large state-owned firms and giving them into private property.¹⁶ This step can be made at least in two ways. One is to transfer assets to private property without any crucial changes. In this case

state-owned property is transferred to private monopoly, for example in Russia in the energy sector, including gas and electricity.

The other route is to transfer to competitive companies, whilst preserving necessary public functions under the public control. It is more complicated, requires political commitment, along with more time and conception. Problems and conflicts are shown by the reluctance in changes. In most of the countries there are sectors which remained under state supervision for the time being. However, the speed does not seem to be crucial. More important is the specification of the development. 'Unbundling', as a necessary step is going ahead in a quite conflicting way. National governments are reluctant to diminish their influence. For different reasons it is more attractive to preserve state positions, as directing authority or at least as owner of majority shares.

5.2 Establishment of Competitive Environment

The biggest challenge of restructuring is if a competitive environment does not emerge in the region. It seems to be a real problem, when formerly state-owned monopolies are transferred to private monopolies. Even if they are international ones, as soon as they get strong positions on the market, they are not interested any more in the further market-oriented development. Their usual argument is that modernization of utility services requires a high level of capital investments, financed by companies having preferential status and temporarily enjoying higher returns.

Sometimes, national governments are also counter-interested in real changes after the first phases of transformation. The momentum of modernization is sufficient for the denationalization of public services in a mechanic way (i.e. simply transferring to private monopolies, or more typically supplementing state positions with private monopoly interests). After this there is no real motivation to continue the development of a competitive market. Monopoly interests and other motivation of particular interest groups for a short period are against the strong competition.

An interesting example is the Hungarian one, where the national government influenced price setting in gas and electricity sectors. It was implemented without any negotiations with market actors, increasing the disapproval of investors and service providers of these clear (social) policy motivations. Consequences of this government decision were clearly certified by the stock exchange.

This influence was made possible because of the purely functioning regulatory body and with the help of the crucial (golden) share of the state in the remaining monopoly gas production company and state-owned electric transmission company. Energy plants, distributors in the electric and gas sector have already been privatized and competitors have been on the market. However, transferring grid and distribution remained monopolized, and it was sufficient to anti-market influence.

Similar tendencies have arisen in communal services in the CEE region. Local governments, as public actors, are not in an equal position with other clients in many respects. Their influence on policy formation is not institutionalized to the necessary extent, freedom of choice is quite uncontrolled. It means that effectiveness of service provision is not the primary criterion for local decisions. Elected bodies may be motivated by other reasons than public interest, sometimes by the councilor's own private ones. The transparency and publicity of local decisions are not effective enough to force local decision makers to follow unwritten or formal rules. These circumstances are against the emergence of a real competitive environment of public service provision.

A competitive environment can emerge in different phases and forms. In the case of communal services the process is relatively simple, because of the break up of former monopolies easily creates a favorable environment for competition. Local governments are dealing with several, almost equal actors for organizing and managing service delivery. A great variety of alternative service delivery forms (contracting out, management contracts, franchises, et cetera) helps them to use market incentives and also to create legal, financial environment for competition.

The situation is more complicated in the utility sector. Firstly, active liberalization policy is needed. Secondly, liberalization might not follow the privatization, because huge costs of modernization should be financed by guaranteed high returns. In this case, the establishment of competitive environment is implemented in a specific way, with the help of a conscious policy to open the markets. Liberalization can be achieved by opening the access to networks, or by eliminating temporarily accepted monopolies.

According to research carried out for this report, privatization is a more complex process in the utility sector than simply shifting from public ownership to another form of dominating property. Preconditions for market competition are as important as the transformation of ownership. Active policies are required for establishing the market environment, by allowing different actors to enter the market.

However, the process does not end with privatization and liberalization. Special features of the utility sector, described as market and government failures, further special regulatory functions should be established for ensuring sustainable development.

5.3 Regulation

5.3.1 Regulatory Concepts: Conflicting Areas

The term 'regulation' is used in a broad sense in the local public utility sector of Central Eastern European countries. It covers all the different pieces of legislation and various forms of government

intervention, which influence the behavior of market entities. Based on the approaches and attitudes learned during the former decades of state ownership regulation, it includes more activities than the traditional forms of regulation like licensing, setting technical standards, taxation and planning, price regulation, and so on.

It is also used for elements of competition rules, like the prohibition of collusion, review of mergers, tendering and procurement procedures, providing third party access to networks, defining forms and specification of contracts, et cetera. These competition rules are used in both cases of competition: when companies compete for the market and when they are already rivals in the same market.

The third block of regulatory practices is the other forms of intervention for protecting the public interest. They are the government capital investment policies (grants, loans, guarantees), social policy subsidies, measures for customer protection and other ways of interference on the market.

All these three components of regulation are very much influenced by the privatization practices of the studied countries. Privatization has two interpretations in countries of Central and Eastern Europe. Sometimes the transfer of state owned property to autonomous local governments is regarded as privatization, even if this is a shift from one type of public ownership to another one. (This is the case in Latvia (e.g. water, district heating), where decentralization meant significant change from the soviet rule to a diverse and deconcentrated system.)

Another level of privatization, when local governments have some discretion over their newly gained property, but their autonomy to exercise ownership rights is limited. (For example the privatization of Prague waterworks was implemented by the national property fund, only with the involvement of the city officials, who were in minority during the decision making process.) A transitory form of privatization is when the transferred state property unit should be operated as an incorporated entity, as an organization under the company law. Under these schemes the service organization is managed and controlled like a real business entity, but the only shareholder is one public body.

The other interpretation of privatization is slowly developed, when real private owners take over the public service delivery organizations. Their share is dominant in the company, long term profit motivation is behind the investors actions. Social policy considerations are separated from the operational efficiency objectives.

This gradual development of regulatory mechanisms was influenced by the trend of legislative changes in the transition countries. The first step after the political transformation was the design and approval of a new constitution. Under the multi-party political system, in the transition towards a market economy, the basic principles had to be revised. The redesign of the local government act was part of this constitutional process. In this first period most of the countries set the basic concepts in company and privatization laws, even if the economic transition was started later.

The second wave of the legislative process was longer, and raised all those detailed questions, which were not clarified by the basic laws. The most important pieces of legislation for the local public utility sector were the fiscal and sectoral laws. They have identified the new forms of intergovernmental fiscal relations, expenditure and revenue assignment, forms of subsidies, price setting authority in public services, budgeting rules and procedures, forms and competencies of budgetary organizations. This was accompanied with the general economic legislation, when the competition rules, public procurement procedures, customer protection regulations were defined. Another broad and long process was the redesign of the various sectoral laws. In a decentralized public sector, under market conditions, the rules of managing water, solid waste, district heating and other services had to be modified. Not only the technical standards and actors have changed, but new concepts and procedures had to be built into the sectoral laws (e.g. identifying who is the waste producer: the municipality in Slovakia, or the citizens in Hungary). This sometimes required a rather long legislative process, because the new laws did not fit into the slowly transforming institutional environment. For example in Hungary, the law on waste management was debated for almost five years, because various governments and the Parliament were not in agreement as to how detailed the legislation should be, who should take the burden of higher technical standards, and so on.

This complex legislative process took sometimes a decade to come about, and due to political shifts and changes in concepts, it still today has not been completed in several countries. For example, the privatization of the Latvian energy company was refused by a referendum; whilst the volume based method of setting waste collection charges, required by several constitutional court decisions was made compulsory only by the Act on Waste Management several years later in Hungary.

As these different pieces of legislation are not always harmonized, the broad regulatory environment is sometimes contradictory. The principles laid down by the constitution and local government acts are not always in line with the general rules of competition and tendering. The local governments prefer to set exceptional rules for their own service organizations, while the public procurement and tendering regulations treat all the economic entities equally. This has raised conflicts, for example in Hungary and Latvia, where municipalities wanted preferential treatment of their own service organizations. Another typically argued area is price setting, where the economic principle of full cost recovery and social policy considerations are always opposing. The third broad area of legislation, the sectoral laws, have also raised several conflicts. As sector specific laws are designed by the relevant ministries, which can be more easily influenced by lobby organizations, and they often reflect the interests of the large service organizations. Line ministries claim more responsibility for these service organizations, which were even 'owned' and managed by the central administration a decade earlier, under the system of state ownership. One example is the Hungarian municipal waste regulation, which—under some conditions—requires the compulsory use of communal grants for compensating the losses of service organizations, originated from uncollected user charges. Often safety and stability of services is protected by these sectoral laws, creating tension with the principles of local autonomy and general rules of economic competition and market behavior.

5.3.2 Elements of Regulation

Following the broad interpretation and use of regulation, the most important components will now be briefly discussed. They influence local public utility service delivery to a different degree, but our purpose is to identify all the relevant elements of regulation. Without this inventory, the present status of regulatory mechanisms in the studied countries of Central Eastern Europe cannot be understood. These components are as follows:

- a) Legislation on organizational forms and taxation rules;
- b) Licensing, service permits;
- c) Sectoral planning and strategic decision;
- d) Capital investment financing schemes;
- e) Contracting and tendering regulations;
- f) Setting user charges and prices of the service;
- g) Forms of consumer protection.

These seven groups of tools and instruments cover the major types of regulatory means. Their significance is different for local public utilities and for communal services. The scale of government influence is also different by services. Licensing, price setting, and consumer protection is more important for the widely privatized services; while planning, capital investment financing and contracting is the typical way of influencing services closely connected to local governments. Obviously the techniques also vary by sectors: for example price setting methods are not identical for the network based monopolistic services and in sectors with high competition and contracting out practices.

a) Legislation on Organizational Forms

Organizational forms of local public utility service delivery are similar in all these countries. These services might be produced by the local administration (departments) or by different forms of budgetary organizations. These local government institutions are under the control of local governments, but their property rights and autonomy in managing their own finances are different. They are usually part of the local budget, except in Slovakia, where the ‘contributory organizations’ establish a net fiscal relationship with the municipal budget. In this case they collect own revenues, enjoy higher discretion in employment and they are allowed to keep the operational surplus.

A mixed form of operation is the ‘municipal enterprise’, which are public sector entities, but have some characteristics of businesses. This was a typical solution for transferring the former state owned companies to local governments, whose possibilities as owners were limited. Sometimes these organizations were transitional forms, when a deadline was set by the national legislation for deciding whether they will operate as budgetary or as business entities. (This was

the case in Hungary, where these ‘inherited’ enterprises were forced to be transformed by 1996, or in Latvia, where the companies in the energy sector have to be transformed by 2002).

In Romania the ‘regie autonomes’ operate in natural monopoly services, with high capital investment needs, where competition can be developed only in the long run. They are legal entities under the public law and in the case of corporatization, their assets must be recorded separately. In the case of privatization, only the management functions and not the assets can be transferred to new owners under concession agreements. Most of the water, communal waste, and district heating services are provided by these special mixed organizations.

The third group of service organizations are the business entities under the company law. They are the traditional forms of joint-stock companies, limited liability companies, partnerships or some forms of public purpose (not-for-profit) companies. They might be owned exclusively by the local governments, or by different owners, under different proportions of shares.

These three groups of service organizations operate under different taxation and accounting rules (e.g. depreciation rates, VAT rules are different according to their legal status). In the energy sector the bookkeeping rules are also different, because as a first step towards ‘unbundling’, the costs and revenues of generation, transmission and distribution are reported separately (for example Poland). Countries, such as Poland, with a significant local social housing stock provide preferential treatment for housing management companies. Here, construction and reconstruction is subsidized through PIT allowances and reduced VAT rates for building materials.

Generally in all countries, there are expectations towards some mixed forms of service delivery organizations. Arguments for combining profit and public motives are social policy considerations, cross subsidization of loss making activities, higher grants from local governments for operation and capital investment projects. These expectations are usually not met and obviously all the benefits of clear profit motivation are lost under these schemes. So despite the higher service costs in a for profit company, the efficiency gains and better service quality in these capital intensive sectors are the advantages of the business companies.

Data on company forms in some selected sectors (water, solid waste management, district heating) are based on surveys. Information from these samples is not really comparable, but it shows some country particularities. For example, in Hungary the most typical service organizations in the solid waste and water management sectors are government enterprises (44% of the total number of service organizations) and budgetary institutions (38%). In Latvia, local government institutions are the most frequent operational forms (52% in the water sector and 37% of solid waste management units).

In Slovakia, where only aggregate numbers are available, local service organizations with 100% municipal ownership are mostly budgetary organizations (72%) and companies are less frequently

used (28%). When several local governments run joint businesses, they prefer limited liability companies (55%) or joint-stock companies (42%). The rest of the service organizations are partnerships and cooperatives. In Romania, out of the approximately 400 service operators 'regie autonomes' (35%) and companies (35%) are the most frequent organizational forms; but in-house units are also widely used (30%). 'Regie autonomes' serve

Table 1.7
Legal Forms of Service Organizations

| Hungary | Budgetary institutions | Companies | Private Entrepreneur | Other | Total |
|---------------------------------------|------------------------|-----------|----------------------|-------|-------|
| Municipal solid waste, water services | 38% | 44% | 11% | 7% | 100% |

| Latvia | LG Institution | LG Enterprise | State Enterprise | Joint Stock Co., Ltd. | Private Persons | Total |
|--------------------------------|----------------|---------------|------------------|-----------------------|-----------------|-------|
| Water sector (N=300) | 52% | 28% | 3% | 9% | 8% | 100% |
| Solid waste management (N=300) | 37% | 22% | 3% | 28% | 10% | 100% |

| Romania | In House Units | Companies | Regie Autonomes | Total |
|------------------|----------------|-----------|-----------------|-------|
| N=app. 400 units | 30% | 35% | 35% | 100% |

| Slovakia | Budgetary Organizations | Companies | Total | | |
|--------------------------------------|-------------------------|-----------------------------|--------------|--------------|-------|
| Exclusive local government ownership | 72% | 28% | 100% | | |
| | Joint Stock Companies | Limited Liability Companies | Partnerships | Cooperatives | Total |
| Joint local ownership | 42% | 55% | 2% | 1% | 100% |

SOURCE: LGPP country reports, DFID-LGI, 2001

the largest proportion of the population (70%), as they are mostly organized at the 'judet' (county) level.

Local public utility services are operated under various legal forms. Both public and clear private entities are present, but some mixed forms have also survived. They and the public institutions give wider competencies and more options for influencing the local public utility services. This regulatory authority is more indirect and general in the case of business companies.

b) Licensing

For providing local public utilities, any type of the above mentioned service organizations should go through the licensing process. Permissions are based on various pieces of sectoral legislation: technical standards, environmental protection requirements; employment rules; and financial criteria supplement the service licenses. Some areas of these sectoral regulations are more developed, as traditionally they were subjects of legislation: for example in Hungary, which is geographically located in a basin, regulations on the water management standards are more matured than the rules of other services.

There are also new fields of licensing process, for example the energy sector, after the privatization and devolution of some responsibilities to local governments. District heating is an example which should fit into the changing institutional environment. Based on the example of the Hungarian law on district heating, the following new elements of service regulations were set (similar elements of regulation are specified by the Act on Energy in Slovakia).

First of all, the competencies of the central and local governments have to be specified. They should be harmonized with the requirements of consumer protection, involving such components as: access to information; justification of costs; managing complaints, and so on. Conditions for the issuing of licenses of heat generation are regulated in great details, specifying also the rights and duties related to heat transmission and grid ownership. A contractual relationship has to be established between the heat generators and the transmission, distribution companies on one hand and between the distribution companies and the customers on the other hand. Critical elements of this relationship are the metering, restriction on service delivery and payments of user charges.

It is a different issue as to how these new rules are enforced, which level of government and under what organizational form, lies the responsibility of the implementation. Typically, sector oriented regulatory bodies are established. Models will be discussed later, but the example of energy supply shows three basic methods.

The most centralized form is when a central government unit (ministry) is responsible for the regulation (e.g. Ministry of Economy in Slovakia). In other countries, independent regulatory agencies were established with a great variety in their rights and competencies. In Romania, the

regulatory agency is involved in the design of an energy policy (price setting, allocation of subsidies, and so on), so it is closer to the actual government. In Hungary and Poland, the regulatory agencies enjoy greater independence from the political influence of the government. Finally the most decentralized system of 'local regulators' has been set up recently in Latvia, even before the real privatization of the energy sector was started.

Control of other local public utility services is organized according to the public administration system of a given country. These regulatory and licensing functions might be part of the higher (intermediary) tiers of sub-national government, which also implement central public administration functions (districts, regions). In other countries, local and regional units of central government agencies are responsible for licenses, control of technical standards and procedures (decentralized units of water, environmental, public health agencies).

c) Planning

Beside licensing and permit procedures, there are other ways and indirect means of influencing local public utility services. Depending on the scope of decentralization, different levels of local governments are responsible for the planning and strategy design. Local government environmental protection programs (affecting municipal solid waste management, communal services, and so on), plans for energy and heating supply, water sector development strategies are the most direct forms of influence. They might be assigned to lowest level of elected local governments or hierarchical relationship exists between municipal and regional government plans and strategies.

Other public utility services are designed as a part of the physical planning process. Land use planning is the most obvious form of local planning competencies, which has an impact on public utilities. They might create favorable conditions for the development of public utility services.

d) Capital Investment Financing

Without sufficient financial resources, these planning competencies have only a limited influence on public utility services. There are various capital investment financing schemes in each studied countries, providing funds for those local capital investment projects, which are in line with the national development policies.

The most targeted forms of capital grants are designed and allocated by the central budget. The Public Investment Program in Latvia (3–5% of GDP), or earmarked subsidies from the central budget to local investment projects (e.g. in Romania) are traditional forms of capital grants. In a more decentralized local government structure targeting is achieved through matching grants schemes (e.g. in Hungary, where municipal water projects and solid waste landfill construction are subsidized in 30–40% of the total investment costs; their share is usually 5% of local budgets).

Other preferred forms of allocating targeted subsidies are the funds and special appropriations, managed by sectoral ministries. They might be controlled by the general budgetary policy or

often they enjoy greater independence as separate funds, allocated by the relevant ministries (e.g. water management, environmental protection, transportation). The amount and spending of extra-budgetary funds are obviously controlled by the national fiscal policy (Ministry of Finance) to a lesser degree than subsidies through other centralized appropriations. On the other hand, they support sectoral development policies and programs more efficiently. Often these sectoral ministries manage and allocate the subsidies through international donor and assistance programs. These sources of capital investment might be significant in the EU accession countries under various environmental and regional development programs.

In the period of economic decline, when demand for capital investment in public utility services is high and increasing, there is a need for external funding. They might be provided through national budget loan schemes or ensuring direct access to international financial institutions and commercial banks. Local government borrowing is controlled through various schemes. Before 1999, local governments in Romania were allowed to borrow on the international finance markets only after obtaining government approval. In Latvia, a special borrowing council evaluates specific municipal projects financed by loans. The limit of local government borrowing is set by the annual budget. In other countries like Hungary, there are only general rules on local government debt burden (and issued guarantees), set in percentage of total own source revenues. Here also, the procedures of local government bankruptcy are set by law, this way avoiding the national government bail-outs and improving the financial discipline of local decision makers.

Other indirect forms of supporting local government borrowing also exist in some countries in local public utilities. In Latvia special guarantees are issued for local utility company loans to a very limited scale (one or two cities per year). Some international lending organizations require a sovereign guarantee issued by the national government. This is a widely used technique in Romania, but to a lesser degree in countries where local governments have easier access to international financial markets (Hungary, Poland). Besides guarantees, national governments may influence local capital investments through specific interventions like the writing off municipal debts or not claiming dividends on their shares (e.g. Latvia).

Modern forms of public-private partnership schemes in local utility services are less developed than in the studied countries. Concessions are the only widely used techniques, but not all the local public utility services fit into framework of concession laws. Other BOT (Build-Operate-Transfer) techniques are slowly developing, partly because of underdeveloped banking services, lack of professional experiences and management capacity on the local governments' side and sometimes because of incomplete local regulatory environment (e.g. price setting, forms and scale of owners' influence).

e) Competition Rules

Contracting and tendering for public contracts are parts of the broad regulatory framework. In typical cases, public contracts are made between the local government entitled to provide the

service and the service producers. Here, the local government as a public authority establishes a contractual relationship with the service organization. It might be even an in-house unit or any arms-length entity, partly or entirely independent from the municipality. Content and format of these contracts are regulated mostly by sectoral laws or in specific cases (like the concession agreement) by separate laws. Contracts are also made between the customers and service producers, which are mostly regulated by the civil code (water services, district heating, waste collection, etc.).

This raises the first problem, whether the citizens should accept the service organization, selected and designated by the local government. In the case of Hungary where citizens have the technical possibility to choose among different service producers (for example municipal solid waste management, or chimney sweeping) the mandatory use of the service was set by the law. So the citizens have to use the benefits of the locally organized service (that is, they have to pay for it) and the contracts have to be signed with that specific service organization, as selected by the local government.

Other problems of the contracting process were related to tendering and public procurement. The basic principle of the tendering regulations is that if public contracts are made, then the general rules of public procurement have to be followed. This rule is often under pressure or not adhered to, because formally the contract is signed between the individual customer and the service organization assigned by the local government. Formally, no public money is used during the contract, because customers pay directly to the service organization. This gives various misinterpretations of the public procurement rules. The fact is that in this relationship, the local government acts on behalf of all the local citizens and represents the community.

Another argument against the use of public procurement rules is that the local government as the shareholder of a service company or founder of a budgetary institution is limited in the use of its own property. That is why public procurement and tendering regulations are interpreted differently even in the same country. Consequently following the hierarchy of laws, the transparency and efficiency requirements of the public sector supersedes the demand of public entities to exercise their own property rights.

Public contracts should be awarded through public tenders. These rules are already developed in all the studied countries. Public procurement legislation was among those new laws, which were approved in the early stage of preparing a developed market environment. Following the international standards subjects, thresholds of public procurement and procedures were set. Public entities, including local governments and their budgetary institutions have to follow the general procurement rules.

Value limits of public procurement in all the three categories of purchase (goods, services, construction works) are usually lower in the CEE region than in other countries. The value limits are developed parallel to public procurement and tendering rules. Organizational forms

show great variety: the Czech Competition Protection Authority operates as a central government agency, the Latvian Purchase Supervision Bureau is under the Ministry of Finance, while the Hungarian Public Procurement Council is appointed by and reports to the Parliament.

It is frequently debated whether municipal companies, using public funds, are forced to follow the public procurement rules or not. The general principle of public procurement would claim the broad interpretation of tendering obligations, so any subsidiaries of local governments have to use the tendering regulations. In local practice this is not the case.

Another problem is that public utility services are usually not mentioned by the public procurement acts. If the sectoral laws do not specify the tendering requirements, then local governments escape from the strict tendering and contracting rules. This has a disadvantageous impact on service efficiency and transparency of local governments.

f) Price Formulation

Price setting is the critical component of the regulatory system. In the market environment, user charges should reflect the total costs of the service, and at the same time should signal the demand for the public utility service. Both of these requirements were new for these countries, where consumer prices were heavily subsidized, and service companies were compensated for their lower revenues. Social policy considerations determined the price levels and preferences, so they did not indicate the real needs for a particular service.

During the transformation of public utility sector each country went through a similar process, only the speed of changes was different. The basic factor behind these changes was the cut in state and other government subsidies on public utility services. In some countries, this was accompanied with the decentralization of price setting competencies, parallel to the devolution of service ownership and management functions.

The present price setting authority follows the characteristics of utility services. The more connected the service provision to networks and the greater chances of monopolies, the more regulated and centralized is the method of price setting. User charges are often defined as official prices, calculated at different levels of government. The greatest chances of centralized price setting are in the energy sector (district heating). In Latvia, Poland, and Romania, user charges of district heating are defined by the central energy regulatory agencies, mostly after consultation with the competition offices or boards.

District heating is the subject of subsidies for example in Romania, where the 'national reference price' is set for the customers. This is driven by the costs of the large national energy companies and it is accompanied with a subsidy to local governments, where the local price is above the national reference price.

The basic problem of the energy sector and the related local utility services is that because of the declining industry, consumption is also decreasing (e.g. in Latvia use of energy was decreased by 40% in the period of transition). In this sector, where the fixed costs are relatively high, declining consumption will lead to increasing unit costs. Due to the capital intensive production, amortization, replacement and maintenance costs remain high, even if the consumption is decreasing.

Price setting mechanisms and related regulatory institutions are also underdeveloped in the region. Prices are approved or controlled by some national agencies (ministries and boards), but they are usually calculated on a cost based method. Modern techniques of price capping, or profit rate regulations with some exceptions (e.g. Hungary) are not introduced. This fact does not support privatization and structural changes in the energy sector. Government subsidies and various forms of 'bail out' still exist. All these factors have an unfavorable impact on those local utility services, which are dependent on or part of the energy sector.

The privatization effort in the Latvian capital city district heating system is a clear example of these bad practices. The assets of Riga district heating company was first separated from the national energy company. Some of the heat generators and the distribution network created the basis of a local company. Obviously it was loaded with significant debt, because of the high arrears, but this debt was taken over by the national energy company, which meant practically a government withdrawal. It was followed by the privatization, improving the quality of the service and efficiency of the company. Because of the exceptional character of this privatization process, no other municipalities were able to follow the example of the capital city.

In the energy sector, the decision on the consumer's 'ceiling price' (maximum price) (in Slovakia) or 'reference price' (in Romania) involves the definition of two other component of prices. The setting of production prices by heat generators is a part of the process and consequently subsidies are also specified during these negotiations. This is partly based on the technical specifications of the sectoral (energy) laws, partly influenced by social policy and welfare payment systems (e.g. what type of benefits and how they will compensate for the price increase). Problems fall back on service organizations, when subsidies do not cover the difference between the producer price and the maximized consumer prices (e.g. this happens often in countries with a high level of social housing stock, where the condominiums and housing cooperatives cannot enforce payments of tenants).

Depending on the system of public administration, user charge setting competencies might be decentralized to a lower level of government. In Slovakia, where the district offices operate as non-elected, state administrative units, in most cases public utility service prices are set by them. The Ministry of Finance determines a range of services, where price calculation is the mandate of district offices. These maximum prices are set "in consultation with the municipalities" and several other organs of state administration are involved in this process (e.g. Office of Financial Control, Slovak Trade Inspection). District offices define prices of district heating, water and sewage, waste disposal, public transport, parking services, et cetera.

In a decentralized Hungary, the price setting authority of the central state was transferred to local governments in the early 1990s. Within the general framework of price formulation and anti-monopoly regulations ('Prohibition of Unfair Market Practices') local governments set the official prices of public utility services. So prices of water supply and sewage treatment, district heating local public transport are calculated through administrative procedures. User charges of communal waste management, chimney cleaning, services in public cemeteries as official prices are regulated by local government statutes.

These price setting methods are influenced by the broader economic environment. Primarily the cutback in national government and local subsidies forced the changes in service financing. There are some generally accepted principles of price calculation which also have to be followed. Based on the 'equality of services rendered and prices paid' principle, volume based pricing has to be accepted. This excludes sometimes the differentiation among various groups of customers. It may also increase the costs of the service, if the metering is expensive.

The design of user charges is highly influenced by the metering techniques and the possibilities for cost allocation among different customers. Large social housing estates were built in the era of subsidized low public utility services, when individual metering and control of individual consumption was not required. In these housing blocks, options for installing metering equipment is expensive or technically not feasible. The old one-pipe district heating systems need huge investments for redesigning, and tenants of these social apartments cannot afford the installation of any type of metering equipment (for example individual meters and cost allocation devices). Methods of price setting and the calculation of price increase are usually regulated. They are typically cost based techniques of designing user charges (cost factors are weighted and extrapolated according to generally accepted principles and reflected by agreed multipliers). Sometimes general principles are followed: "prices should cover the costs and profits of efficient service providers", in the case of energy prices in Hungary. In Poland a general rule is centrally set for regulating the municipal rents, which should not exceed annually the 3% of replacement costs.

Another basic problem is the price setting policies. The inherited practice of user charge setting is that individual customers are subsidized and large users of bulk services pay higher prices of energy. This prevailing practice has built wrong incentives into the energy sector and into the related local utility services. For example, consumers enjoying lower gas prices opt out of the large district heating systems more easily, because they compare their future investment and maintenance costs at a subsidized level of natural gas. This is frequently used in Romania (30% of users opted out from the local heating network and installed their individual systems), but also in other countries with extended district heating system (for example Latvia and Hungary). Local governments are simultaneously the owners and regulators of municipal utility services. In addition, councilors as local politicians are faced with social problems created by decreasing subsidies and transformation of utility services. These three conflicting functions also create tensions in the local price setting decision.

However, the price formulation function is an emerging and efficient component of regulation. The assignment of the price setting authority, allocation of competencies to influence the methods of designing user charges, is part of the public administration and local government reform process.

g) Protecting Customers

Demand for consumer protection was raised immediately after the traditional state institutions lost their influence on production and service provision. When organizations 'protecting the public interest' did not exist any more and the private property became the dominant form of the economy, new forms of consumer protections had to be designed. Several new areas of legislation provided basic conditions for supporting the consumer's relations to producers. Anti-monopoly and competition laws, acts of price setting, and contracting regulations are all passive ways to ensure a balanced relationship between buyers and providers of a service. Some additional general requirements on goods and services (e.g. labeling) were also part of the newly formulated consumer protection acts in all the studied countries in the very early 1990s.

In the area of public utility services and contracts, there is a need for more active forms of consumer protection. For example, free access to information is a critical condition for protecting the consumer's rights, when local public services are contracted by the municipal. Also customers should be involved in the regulatory process, when service standards, conditions and prices are determined.

In most of the studied countries, some institutions for consumer protection have survived at a national level. They might be independent agencies like the Consumer Protection Chief Inspection (Hungary), Office for Protection of Competition and Consumers (Poland), Bureau of Protection of Consumers (Latvia), or belong to a ministry, like the Commercial Inspection (Slovakia), Czech Commercial Inspection reporting to Ministry of Commerce and Industry.

In some sectors the regulatory agencies might have a stronger influence on service provision, so they indirectly have more means to protect consumer rights. Especially in the case of district heating, energy regulatory agencies are involved in price setting, which is the critical component of consumer-producer relationship. In Hungary, the public utility contract is also subject to the consumer protection procedure.

There are other decentralized forms of consumer protection, which can influence public utility service provision. Consumer Associations in Slovakia, or the tenant association in Latvia might be involved in the specification of service performance and conditions. Local government associations also play a role in these negotiations (for example in Latvia they are represented in the energy council), or the newly established system of 'local regulators' in Latvia is also an attempt to decentralize the problems and solutions of consumer protection.

Another question is what means are available for consumer protection agencies to enforce their clients' interest. Generally legal procedures, in some cases penalties and fines, are the only available

measures. They are not a very efficient means for influencing specific actions of the service producers.

5.4 National Regulatory Functions

Independent regulatory function is one of the most important element of public roles under market circumstances. In theory, independence and autonomy have two dimensions: regulatory mechanisms should be exempt from the influence of public (state) administration and also from the pressure of large service producers, often being in a monopolistic position. The interpretation of autonomous regulatory organizations is even more confused, because in many respects the interest of bureaucracy is similar to private monopolies. That is why other public actors should be also involved in key policy decisions.

In CEE countries the first steps have been made by the establishment of regulatory organizations. There are experiments to build into their structure some elements of independence from the administrative structures. However, these are quite weak solutions. Practically, most of the existing regulatory institutions are traditional offices, subordinated to the administrative hierarchy, rather than public bodies with autonomy for policy formulation in particular sectors.

Local governments might also be in a regulatory position. But without sufficient guarantees, the decentralization of regulatory functions is questionable. The only positive example might be the Latvian one (see Chapter 5). The newly introduced legislation on local regulators seems to be the most developed one, hoping to establish a real independent regulatory organization at a local level.

Without independent authorities, necessary controls over natural monopolies is hard to imagine. Guarantees must be established, for instance by controlling the entry to the market. It is one of the techniques for supervising providers by limiting their harmful monopoly aspirations. In the case of unintended influence of authorities, public control may be transferred to state organs, that is to another type of monopoly. Then, instead of an independent public regulation, nationalized bureaucratic administration governs this important task.

Regulation in the narrow sense covers certain aspects of service provision: licensing, monitoring and supervision of the regulated activities, price formulation and consumer protection by providing information to the general public. These activities are clearly separable from other areas of utility service management, which are controlled by competition rules.

Anti-monopoly regulations focus on other aspects of market behavior, like limitation of competition, unfair market actions, and the inappropriate price setting of companies in monopolistic position. Market regulations also deal with other areas of competition, like procurement rules

and procedures. In the studied countries, organizations of supervising public procurement have already been established: for example in Hungary the Public Procurement Council under the Parliament; and in Latvia the Purchase Supervision Bureau, reporting to the Ministry of Finance.

Organization of the regulatory framework follows various patterns in the studied countries. Models are different in three aspects: (i) whether the regulatory organization is established at national level, or it is managed locally; (ii) how independent it is from the government (state administration) and consequently from politics; (iii) scope of services covered by the regulatory agency (single sector or comprehensive, covering several ones).

In most of the cases, the existing regulatory organizations were set up at central level of government. As they deal with issues affecting the entire country, their competencies cannot be easily decentralized. Examples of these nationwide regulatory agencies are from the energy sector: State Energy Inspection (Slovakia), Energy Regulatory Office (Poland), National Electricity and Heat Regulatory Authority (Romania), Hungarian Energy Office, Energy Regulation Council (Latvia). They are such well established organizations, that even a regional association of energy regulators has been recently created.¹⁷

Tasks and competencies of these energy regulators are highly differentiated. Obviously all of them issue licenses and monitor compliance, but some of them operate as sectoral ministries: they determine production limits (Albania, Estonia), set financial and performance indicators (Bulgaria, Estonia, Romania), supervise foreign trade (Estonia, Romania)¹⁸.

However, there are examples of locally managed regulatory organizations. In Hungary, the smaller district heating suppliers are licensed and controlled by the local governments. This covers 30% of heat production and it is managed by 102 city administrations¹⁹. The rest of licenses were issued by the central agency (14 major power plants). This assignment of regulatory competencies is a typical characteristic of the Hungarian decentralization: shared functions and mandates reflect the two levels of the local governments' joint responsibilities.

Another interesting decentralization experiment is under implementation in Latvia. According to the approved legislation (Act on Public Service Regulators), after the local elections, starting from September, 2001 local regulators will be appointed by the local governments. The concept of this legislation is that regulators work as 'mediators' between the public authorities, consumers and service producers (suppliers). Their mandate is licensing and supervision, approval of tariffs, dispute resolution and facilitation of competition.

These new organizations will deal only with local public utility services: communal waste management, water supply and management of sewage, and heating supply under local government authorization (without co-generated electricity). Other public services remain under the control of the national regulatory agencies (power generation, telecommunication, railway, et cetera).

This new legislation was designed after four years of discussion and it fits into the general trend of separating national and local government functions. With the appointment of municipal service regulators, the need for regional state organization bodies will be lower. Within the specific Latvian environment there are high hopes that new local regulators will support privatization and competition. They might facilitate the transformation of municipal enterprises to commercial entities, they would encourage local governments to issue a guarantee for borrowing by companies, and as non-elected regulators they are supposed to represent the service rationality and promote competition.

However, municipal regulators will be appointed for four years by local governments, so their political independence is questionable. Each local council will nominate one regulator with two deputies. Administrative costs of the decentralized regulatory organizations will be financed by a regulatory fee. It is collected by local governments from the service organizations, which have to pay less than 0.2% of their turnover. This form of financing raises another problem: initial estimates show that several municipalities have to cooperate for financing a properly paid, staffed regulator. This will require good cooperation from municipalities during the nomination process, or the professional quality and capacity of local regulators will be lower.

This might increase the local political influence, when the broad expectations cannot be fulfilled. Separation of responsibilities in service provision and service production is less feasible, whilst the possibility of informal or political influence will not decrease. There are also some issues not regulated by the present legislation, like the salary of local regulators, which might be high, and the ban on future employment by service organizations. Despite these minor problems, perhaps this decentralized and comprehensive regulatory model might work efficiently in the specific Latvian economic and legal environment.

In the case of national regulatory agencies, their relative independence from the actual governments is the critical issue. There is always a high pressure on regulatory agencies, because they set the methods of price calculation, and this way influence very sensitive social policy and company financing issues. They might influence the presence of international investors in the regulated sector, which is also a sensitive political issue. National governments tend to keep the critical elements of regulation or they directly control these agencies through the ministerial system. Ministry of Energy (Slovakia), Ministry of Economic Affairs (Hungary) or other government units deal with the regulatory agencies.

The last question of the regulatory organizational setting is how many sectors or services are controlled by them. Previous examples show that the energy sector is the only one, where regulatory organizations are widely established. However, there are efforts to introduce similar organizational forms in other countries. In Poland, under the Office of Housing and Urban Development, a board was set up for designing regulation on water and wastewater services. Within the framework of a major international technical assistance program, all the representatives of the relevant actors (ministries, anti-monopoly office, local government association, chamber of water companies, association of sanitary engineers) participated in the work of setting basic standards. Based on analytical work, these standards were publicly discussed and the results were built into the national legislation.

6. INFLUENCE OF THE EUROPEAN UNION

There are two external incentives for the development of utility and communal provision of services in CEE. One is the perspective of enlargement of the European Union. The second is pressure from Western investors. These two are not independent from each other, but their manifestations are different. The international political integration is first discussed in this section. EU legislation refers to public utility services only in a specialized manner. Communal services are under the general competition rules, notwithstanding environmental ones. In addition, policy on services of general interest derives from cases of the Court of Justice.

6.1 General Rules

One of the most important areas of rules on competition refers to state aid. According to Article 92 of the Treaty of Rome, any aid granted by a Member State which distorts competition by favoring certain undertakings or production of goods is incompatible with the common market. The article enumerates exclusive circumstances, for example, when aid is allowed to be compatible with the common market. Local government aid that is relevant in communal services, is also interpreted as state subvention.

Equal criteria for competition is guaranteed by the definition of aid and restriction of it in particular circumstances. According to the main rule, cumulative aid is to be avoided. This principle looks like a restriction on decentralization because of the limitation of its possible influence, but it really means that decentralization cannot mean a strong local part of a large powerful state. Decentralization should be closely linked to a decrease of bureaucratic roles. From this point of view, the decentralization principle also refers to the social context of the public sector.

Urban services are influenced as a part of utility services in general. ‘Public undertakings’ consist of telecommunication, post, transportation, and energy supply. From our point of view the last one is the most important, because urban public utility services are closely linked to provision of energy.

According to Article 90 of the Treaty of Rome, public undertakings and undertakings to which Member States grant special or exclusive rights—which entrusted with the operation of services of general economic interest or having the character of a revenue-producing monopoly—shall be subject to the general rules contained in the Treaty. It means, first of all, the rules on competition.

Different consequences derive from this obligation. In the field of public utilities, the development of competition is necessary. It means not only breaking monopolies with ex post measurements but also adopting a specific regulatory and institutional background in the public sector.

Development of competition and regulation is needed at the same time. State regulation includes monopoly supervision and consumer protection as its most important elements.

Debate on services of general interest within the EU shows that there are efforts to put short term social considerations above the long term economic interest. There are plans to design “ways of ensuring predictability and increased legal certainty in the application of competition rules relating to services of general interest.”²⁰ According to this line of planned EU regulations, state aid might be acceptable, as it does not distort competition, but only offsets the burdens imposed by specific obligations on these undertakings and it is essential for equality in competition.

6.2 Specific Rules

Specific ruling issues consist of legal regulation on particular utility sectors and relevant cases of the Court of Justice. As far as directives referring on public utilities are concerned, electricity (Directive 96/92/EC on electricity) and gas (Directive 98/30/EC on gas industries) should be pointed out which have been implemented at national levels by most of the Member States. These particular regulations represent a model at the same time. More important selected issues are as follows:

- a) *Open access to networks*: From the point of view of the content of regulation, the most important aspect is to identify monopoly elements and the sphere of competition. In the field of public services it means, first of all, that utility networks are monopoly elements, the owning of which may restrict competition in the direct provision of services. In order to break monopolies, access to networks is to be guaranteed for any providers.

Third party access (TPA) is good from the point of local governments and consumers as clients, i.e. buyers of public services. They encounter market-based circumstances in different fields of public service provision.

- b) *Separation of different functions of the state*: Mainly the position of the owner and the regulatory function should be distinguished. In the latter case, the authoritative character is necessary to be independent from the interests as an owner. This separation is important at different levels of the state, like in local governments. Known public functions like pricing, supervision, and so on, of the public sector are subordinated to these types of expectations.

The establishment of independent regulatory authorities as discussed above is grounded on this demand. Although this creation is not prescribed, the majority of the Member States adopted and implemented instructions of Directives in this way.

- c) *‘Unbundling’*: Separation is also important on the provider-side, in order to split the possible competitive part of natural monopoly services. For this purpose, the transmission system operator should be divided from the supply system. The minimum requirement is the ‘unbundling’ of management and accounts of transmission grid operation and supply business. At the same time, any information limits are also important to maintain, in order

to guarantee the ground of competition for providers. Many of the Member States opened up their market more widely than it was required.

TPA, separation of state functions and unbundling are conditioned by each other. Together serve the liberalization of the energy market, restricting monopolies and division of market with national borders. Anti trust legislation is strengthened further by legal principles [Kende–Szűcs, 2000: 551–586] postulated by the Court of Justice.

- d) *Restriction of cross-financing*: Cross-financing limits competition is allowed only when non-competitive activities are (like supply of remote places) financed supplementary from the profit of competitive activities. However, it is prohibited if one commercially opened area is subsidized from another one, or from a non-commercial activity. This principle is linked to the limitation of aids granted by states, mentioned above, adopted for utility services, in the case in which cross-financing is regular because of the specific character of delivery.
- e) *'Creaming-off'*: Taking unfair advantage of profit, or 'creaming-off', is prohibited according to the main rule. It must not make an attempt to limit competition only to profitable activities, leaving only the loss from particular areas for other providers. It refers also to the case in which only most profitable activities are selected. However, through delivering supplementary (extra) services, a provider cannot be condemned.
- f) *Proportionality*: A minimal limitation of competition is accepted, which is sufficient for getting closer to the particular accepted policy preferences. It is good to avoid too wide an influence. This principle derives from the Treaty of Rome as a fundamental document of the EC.

There are also other regulations of the EU, but these refer to the quality of services. These are not necessary to detail here, only main groups of them should be mentioned, for example:

- service performance standards (electricity, gas supply, etc.);
- environmental legislation (e.g. on water, waste management).

7. IMPACT OF INVESTORS

The high need for external sources in the local public utility sector has attracted various types of investments and funds. During the past decade, CEE countries were targets of numerous donor and international aid programs. These programs have not only provided funds for new investments in the region, but they have also influenced the operation and management practices.

Some of the programs had specific objectives to support institutional development in the local public utility sector. The first structural adjustment loans, which were combined with development

projects and several waves of technical assistance projects of international and bilateral donor programs, have all focused on different aspects of service delivery. These programs transferred not only new technical standards and modern technologies, but they have also started to introduce a new organizational and administrative framework for market based service delivery system.

Preferred topics of these programs supported the introduction of business-like operation include: cost center based management information systems; design of capital investment financing schemes; tariff setting methods and adjustment techniques of user charges; tendering and contracting practices; regulatory mechanisms; public information systems; code of ethics in municipal decision making; and so on. These new rules had to be disseminated both at the newly created service organizations, and at different levels of government.

Central administration and legislators had to develop a new legal, regulatory and fiscal transfer system in a decentralized sector, without having proper information on the permanently changing public utility services. At local government level, the elements of a new client-contractor relationship had to be developed: service specification, performance indicators, competition, contracting and monitoring rules, details of corporate finances, and social policy consequences of service decisions all had to be learned and adjusted to the standard rules and procedures of municipalities.

External funds were provided in forms of grants and loans. International programs provided grants for environmental and regional development projects, as local public utility services are parts of the two broad program areas. Technology transfer was usually combined with some form of borrowing. By the end of the 1990s, the economy in some of the CEE countries had improved, and so the loans from the large international finance organizations were slowly changed with the credits from the more flexible commercial bank. Despite the huge efforts to develop a municipal bond issue in the CEE region, only large, mostly capital cities used this form of financing in a few cases.

All these actions have not significantly changed the financial setting of local public utility services. In more decentralized countries, national and local governments involve a more extensively private sector in the service delivery, but a competitive subnational finance market has not been developed²¹. Local government borrowing in many countries requires sovereign guarantee, which deteriorates municipal innovations and activities. The market for municipal securities is not favorable and the banking and taxation environment is not supportive.

However, those countries, which have mostly benefited from these transfers and loan programs, have learned the new 'rules of the game' during the past decade. Especially in the European Union, the needs of accession countries for capital investments are declared in relation to EU standards. As environmental protection is a key area among the conditions of EU accession, grants, loans and domestic funds are jointly planned for financing capital investments.

There are various estimates on the costs of EU accession in the environmental sectors (see Table 1.8). In three countries of our research, international studies have planned the short and long

term capital investments needs for meeting the EU standards. These figures range from EUR 11 Billion (Hungary), EUR 15 Billion (Romania) to USD 42 Billion (Poland). Priorities in the first round of accession countries are the water and wastewater sector, while in Romania it is the heating supply.

Table 1.8
Costs of EU Accession
Capital Investment Needs in Infrastructure Development²³

| HUNGARY | |
|---|---------------------|
| <i>National Environmental Protection program (1998–2002)</i> | |
| EUR 11–13 Billion | |
| Annually 1.7% of GDP should be used directly for environmental protection purposes | |
| <i>National Program for the adaptation of the acquis (1999–2001)</i> | |
| Water quality: | EUR 825 Million |
| Improving the quality of drinking water: | EUR 107 Million |
| Municipal solid waste management: | EUR 180 Million |
| POLAND | |
| Capital expenditures required for meeting EU standards in environmental protection: | |
| Total: | USD 22–42 Billion |
| Of which: water, wastewater: | USD 10–17 Billion |
| solid waste disposal: | USD 3–4 Billion |
| ROMANIA | |
| Capital expenditures required for meeting EU standards (short and long term needs): | |
| Water supply: | EUR 1.5–3.5 Billion |
| Sewage systems: | EUR 0.9–2.0 Billion |
| Wastewater treatment: | EUR 1.9–4.6 Billion |
| Heat supply: | USD 6 Billion |
| Sanitation, urban environmental protection: | USD 2.5 Billion |
| Communal services (street, park maintenance): | USD 1.3 Billion |
| Public lighting: | USD 0.9 Billion |

This rather high demand for investments cannot be financed from one single source. Domestic and international funds, both in forms of grants and loans should be made available. (Estimates on Hungary show that by the year of targeted EU accession, local governments have to invest

3% of GDP and in addition local public utility companies investments will be 3.2% of GDP²². According to these estimates, they will be mostly financed by loans, especially at the company level (2% of GDP), but at local governments it is still 0.5% of GDP).

Assuming that a similar trend will be followed by the other first and second round accession countries, new local public utility service organizational and management methods have to be developed. Donors, professional investors and especially financial institutions require modern mechanisms of service delivery, which are adjusted to the market. Otherwise cost recovery, profitability or repayment of loans cannot be expected. This pressure from investors will have a significant impact both on local public utility sector and local government finances.

In some of the studied countries basic changes are needed for having access to capital markets. In Romania, local governments should be allowed to hold accounts at commercial banks, instead of the presently authorized National Bank of Romania; assessment norms of local governments' credit risks should be made different from other commercial entities, because municipalities have a more stable revenue flow.

Rigid administrative structures might also limit local government and service company borrowing capacity. In most of the EU accession countries, regionalization is required for planning and programming purposes, but transforming the regions to administrative units will have an adverse affect: central allocation of funds and establishment of artificial service areas will create inefficient units. Hungarian and Latvian examples show that administrative regions might hinder spontaneous cooperation among local governments or service organizations. Irrational catchment areas of services, and inefficient service organizations do not support inward investment, or the inflow of funds for public utilities.

Autonomy in local government property management is also a basic condition for attracting external funds. In Romania, where the county ('judet') level service organizations dominate the public utility sector, municipalities should be encouraged to cooperate in service delivery. As regional services are controlled by the county councils, other local governments cannot invest in joint-stock companies. This will not make the municipalities as users of these services interested in management and finances of local public utility services.

Limitations on local government borrowing are also important factors of local public utility financing. The European Union criteria on public debt (60% of GDP) and public budget deficit (3% of GDP) are also used for local government budgets, as they are parts of the general government expenditures. These requirements have initiated the introduction of local government borrowing limitations even in the most decentralized countries.

In Latvia, where local governments finances are rather dependent on national transfers a special borrowing council issues the permits on municipal loan projects. There are approximately 100 local applications for loans and to issue guarantees for local borrower. The total amount of increase

in local government liability is set by the annual budget (e.g. it was LAT 21 Million, 85% loans). The loans are mostly used for infrastructure (43%) and power (24%) sector investments. The guarantees are issued primarily for the district heating (44%) and water (26%) sector.

The Ministry of Finance makes the detailed assessment of the loan requests both from technical and financial point of view. As a basic rule 20% of local own and shared sources should cover the principal and interest payments. The borrowing council may recommend the use of a different bank than it is indicated in the request, if more favorable conditions are achievable.

In the decentralized local government system of Hungary and Poland, indirect rules are set for limitations on municipal borrowing. In both cases, the scale of municipal borrowing is connected to local government revenues. Municipal debt service (including guarantees) cannot exceed 70% of own source revenues in Hungary; 15% of total local revenues in Poland. The Polish legislation is more sophisticated, because the limit is further decreased if the total public debt is getting closer to the EU criteria (60% of GDP), by declining the limit to 12% of revenues, when the debt is at 55% and prohibition of municipal borrowing, when it reaches the 60% threshold. For developing an efficient capital finance market at a local level, the role of the national government should be regulated as well. It is partly the interest of the international lenders and other investors to clarify how can the national budget intervene in municipal finances. It is especially important to regulate the local bankruptcy procedures. When conditions of national budget bail-out are set, it will encourage local government borrowing.

Example of the Hungarian legislation shows, that procedures set by the law on local debt adjustment have prevented municipal bankruptcies and increased the chances of liable council decisions. The concept of municipal bankruptcy regulations focuses on procedures to be followed in case of unpaid debt by setting deadlines, defining minimum service requirements, order of payments and gradually limiting the competencies of elected bodies.

Both loan limits and legislation on bankruptcy procedures support responsible local government capital investment decisions. In some cases these regulations were initiated by international technical assistance programs and favorably influenced the inflow of external investments and creation of stable capital markets. They are important factors for developing the local public utility services.

A similarly high emphasis was put on price setting mechanisms in local public utilities. It was a relatively new practice in the CEE countries to finance local public utilities mostly through user charges. It required strong political commitments from the decision makers; accounting practices should have provided the relevant information for cost allocation; local (municipal or company) revenue administration should be developed to support user charge based service financing; welfare system should be capable to deal with the new problems; whilst methods of price setting and techniques of price increasing formulae should be widely known.

All these conditions were developed slowly during a learning process. It was in the investors' and companies' interest to widely advertise and disseminate these models and methods of price setting. Following the first decision on the assignment of price setting authorities, the other conditions of user charge based financing systems were established differently in particular sectors.

Those services were preferred, where metering was feasible: water and waste water management, and municipal solid waste deposition. Other services like district heating, rents, and solid waste collection were more based on indirect measures of consumption. Countries with high social housing stock (e.g. Latvia, Poland, Romania) are especially faced with the technical problems of allocation of service costs. In large housing estates, individual metering and regulation of service consumption is complicated and costly. This makes the market based solutions of public utility financing less attractive and less manageable.

Professional investors in local public utility sector intend to develop public-private partnership arrangements. Concessions were regulated in the early stages of transition, but local utility services were not always part of this legislation. Practices of managing build-operate-transfer schemes are also slowly developed. Lack of responsive banking services, professional and management capacity both at local governments and service organizations, along with revenue instability are the main obstacles of complex forms of partnerships.

Finally, the efforts for transforming the energy sector had an impact on local public utility services, as well. Local public utility services are closely connected to the energy sector. They provide models for decisions affecting local governments and they have an impact on municipal services.

The energy services influence municipal utilities in several ways. First of all electric and gas supply are both strategic services, which are in the focus of privatization and the competition regulations in countries of transition. Some of the local public utilities have similar characteristics to these services (limited number of producers/generators, large transmission and distribution networks, capital intensive services, etc.), so the models developed in the energy sector might be examples or basis of changes of local services.

Most of the international examples of regulation and competition rules are based on the principles developed in the energy sector (and partially in the telecommunication). International patterns and regulations are quite clear: monopolistic position should be avoided by vertical separation of the services (production/generation, transmission and distribution) and by providing third party access to networks. This is mostly regulated third party access and not a negotiated one. These principles have to be followed in the area of local public utility services.

Secondly, local public utilities are either part of the energy sector (e.g. district heating) or they are large users of electric energy. Consequently they are heavily dependent on the rules followed by the energy sector. Mostly on the organizational forms of generation and transmission, procedures of energy price setting, defining subsidies, decentralization of distribution network.

In summary, it may be concluded, that investors have had a strong indirect impact on the development of municipal public utility sector. They have initiated those techniques and conditions of public utility management which are useful for efficient and modern services. Besides the introduction of new technology and transfer of know-how, investors had influenced the legislation and municipal practices. The investors' impact through international organizations and donor programs helped to increase the general level of expertise and also brought additional capital in the form of grants

8. TRANSFORMATION FAILURES

There are not only incentives for transformation, as were mentioned in previous sections, but also heavy barriers. Conflicts derive from recent changes, so sustainability of the present results of development become questionable.

According to Figure 1.1 (section 2.), an imagined linear development was outlined. It was simplified in order to make the explanation and analysis more understandable. In reality, different stages cannot be separated so clearly, they are mixed together. For instance privatization as asset sale was going on from many respects without achieving progress in procurement or contracting. There are advantages and disadvantages of this situation. On one hand, the so-called 'spontaneous' privatization in that period, when rules and procedures were not developed, was built on the logic of searching for new owners. On the other hand, very often unfavorable agreements were made between public and private actors. Liberalized markets and regulatory environment are as yet underdeveloped. Due to it being almost impossible to expect an entirely conscious institutional development, these conflicts can be seen as natural consequences of transformation. However, the general public is not so forgiving in these situations. In Table 1.9, those elements of transformation are added, which were accumulated in this process.

As Table 1.9 shows, examining the details of transformation, and adding results to the model of gradual development, some parallel phenomena emerge. At the first stage early privatization is highlighted, which might be more conflicting in the case of natural monopolies, mixed goods and services, than for the large scale privatization in general. At the second stage, guarantees were missing partially in public procurement, other tendering process, contracting out practices. Due to various reasons, transformation has been postponed in some sectors.

This accumulation of transformation effects leads to six phenomena, at least, will be discussed here:

- i) transformation to private monopolies;
- ii) corruption;
- iii) counter-interest in further changes;

- iv) social policy implications;
- v) problems of small local governments.

Table 1.9
Basic Failures of Transformation Process

| | Public Utilities (natural monopolies) | | Communal services (mixed goods and services) | |
|---------------------------------|---|---|---|--|
| | Objectives | Conflicts | Objectives | Conflicts |
| First stage (Re-structuring) | <ul style="list-style-type: none"> • modest breakup of state-owned monopolies (devolution of assets) • modest unbundling • establishment of independent regulatory authority | <ul style="list-style-type: none"> • privatization neglecting real liberalization • creating new monopolies • strong bargaining position of service organizations • under-developed regulatory institutions | <ul style="list-style-type: none"> • rationalization • establishment of competitive environment | <ul style="list-style-type: none"> • early privatization |
| Second stage (Privatization) | <ul style="list-style-type: none"> • privatization of competitive assets • development of regulatory function • liberalization | <ul style="list-style-type: none"> • postponing transformation in particular sectors • moderate public procurement | <ul style="list-style-type: none"> • de-monopolization • management of public shares • privatization | <ul style="list-style-type: none"> • non-formalized contracting • under-controlled tendering |

8.1 Emergence of Private Monopolies

When conditions of guarantees are missing, there is a real danger that state-owned monopolies are transferred to new private monopolies.²⁴ After the large national and international investors had gained positions in a relatively early stage of transition, they were interested in postponing full liberalization. It was made possible, because their market position became dominant, before building up a perfect regulatory mechanism. This situation is typical mainly in the utility sector.

Liberalization is more complicated than previously expected. Present monopolies are more interested in preserving existing conditions, than supporting the opening of the market to new entries. In addition, liberalization here is not necessarily equal to decreasing prices and more effective service provision.²⁵ Due to the collapse of the former regime, artificial low prices of energy can no longer be maintained. That is why arguing the position of monopolies is quite strong in price negotiations. It might be uncontrolled depending on the power and position of the interested municipalities.

8.2 Lack of Transparency

After the long decades of lacking almost any institutions and procedures which would ensure the transparency of public decisions, this is the most important task for the governments in the studied countries. Corruption, political or business influence in the public sector are widespread. These phenomena are caused partly by the fact that the whole transformation process was poorly planned. Perhaps this unfavorable direction of development could not have been avoided.

Problems arose from the first instance, when the privatization process itself was not designed and managed in a transparent way. This was nothing to do with the applied model or method of privatization, but rather the lack of public information, and professional and public control over the techniques of demolishing state ownership were the reasons of subsequent scandals and failures.

The more recent type of corruption derives from new possibilities. Tendering and procurement procedures are announced, only in order to cover the process of decision-making which was actually already completed. Under these circumstances, when guarantees and controls are missing, it is relatively easy to misuse procurement rules. In Hungary, for example, exceptional tendering procedures are used surprisingly often, whilst the criteria for selecting the best bids are fixed subjectively.

Problems of public procurement and tendering culminate in public utility and communal sectors. Although new legislation was passed recently in most of our countries meeting EU requirements, in practice quite a lot of insufficiency emerges.

8.3 Counter-incentives of Future Changes

Shortcomings are crucial in:

- the regulation of conflicts of interest;
- restricting corruption;
- missing the preparation of regulatory institution and functions;
- the decentralization of regulatory institutions.

Although the position of local governments can be highly appreciated, their regulatory function within their overall policy formulation is often very conflicting. This function is conditioned to supply in a unified way, and possibly independently from, direct influential linkages. The most conflicting problem is that politicians and practitioners are counter-interested in changes from many respects. That is why it is not expected from them to prepare and accept regulation of restriction on their own influence.

Modernization is firmly linked to the interested bodies, even when they are elected ones. This is true, of course, at the national level. According to a recent example, the chairman of the Hungarian parliamentary committee, responsible for supervising public procurement process was arrested due to bias committed by him passively in the investment tenders on sewage systems. However, the position of local governments, both small and large, are also regularly accused of illegal behavior.

Transparency is, in fact, a systemic problem, and not only a question of policing. Sustainability of the development reached so far is in danger. Without consciously built and forced implementation in specific institutions, it is difficult to imagine any other changes as important. It is not by chance that utility and communal sectors are highlighted in connection with this general issue. Among public functions, infrastructure is always one of the most frequented from the point of view of commissions to private undertakers and providers.

8.4 Social Policy Implications

Local public utility services were traditionally parts of the welfare system. Heavily subsidized prices and almost free access to services made public utilities key components of social policy. They were financed through cross-subsidies, nationally funded systems of in-kind contributions and equalization schemes. In reality, there were high differences in the level of local public utility services by regions, size of cities, by urban and rural communities and also among different groups of customers.

All these problems and inequalities became suddenly visible after the transformation process had already begun. In those sectors where the decentralization of service management and financing was widely used, social policy consequences were transferred to municipalities as well. This made the problems even more open, because often the low fiscal capacity and the scale of problems in service provision coincided (for example in large cities with high social housing stock, industrial regions and towns hit by economic decline).

The first stages of privatization and the transformation of service organizations have also increased the prices and consequently the social problems. Under the new market conditions, prices have suddenly multiplied in those countries and service areas where the national price control was withdrawn. Other mechanisms of the market based service provision caused social problems, for

example the need for the termination of services, management of evictions, and adjustment of service costs to household income.

Subsequently, expenditures on local public utilities, including housing costs, were sharply increased. Broadly calculated housing maintenance costs became one-third of the average family income. This was significantly higher than the former share of housing maintenance. Behind the general trend, the social differentiation was the least manageable problem at a local level. Various factors behind impoverishment have multiplied, so unemployment, poor social housing conditions, and family problems jointly appeared with the arrears in public utility service payments. The price increase was partly caused by the abrupt decrease in government subsidies. Direct grants to services have disappeared in a relatively short period of time (for example in Slovakia heating subsidies have decreased to 5% between 1997 and 2000; in Hungary, the decentralization of water and solid waste price setting authority was automatically combined with a cut back in direct price subsidies). Obviously other components of the welfare system tried to compensate for these losses, but methods were not prepared for the new conditions, and demand was above the financial possibilities.

The transformation of public utility sector and local regulatory steps were very much influenced by social policy considerations. Decisions on privatization, contracting out and the introduction of other elements of competition was always assessed alongside two dimensions: impact on service quality, financial efficiency and the expected social consequences. Local government policy options were influenced by the national regulatory environment.

Primary factors were the scale and form of housing privatization. In those countries where the municipal social housing stock remained important, rent policies and organizational forms of housing maintenance have disguised the social problems. Low rents were supposed to cover expenditures of some public utilities, but the real costs were put on the semi-public management companies. Consequently, ownership and management aspects were confused at the service organizations (e.g. in Latvia), which were not able to cope with these problems. In those countries, where the low price privatization led to broad private ownership of deteriorated apartments with typically low income families, the housing management and reconstruction costs were deferred. Price control mechanisms in some countries were designed for controlling the social problems. Centralized price setting techniques in district heating, water services (Latvia, Romania, Slovakia) are aimed at keeping the unified service charges at the lowest possible level. The other extreme solution in price setting is complete decentralization, where local government decisions are not regulated at all. There are models in between, like the rent control in Poland, where the annual amount of rents maximized in 3% of replacement costs.

The most visible sign of social problems is the high level of arrears in local utility services. District heating service is the most hard hit by unpaid user charges. In Hungary, the overdue debt is 12% of total user charges and 21% of households belong to this group²⁶; in Poland 13% of families in municipal houses have had arrears for more than three months. Very often different

types of debts are concentrated at the same households, so those who cannot afford district heating, also do not pay the rents, electricity bills, et cetera.

These most vulnerable groups cause the greatest problem for the local governments and for the service companies. The longer is the non-payment period, the higher is the chances of intensifying the problem of arrears. Local governments and service organizations are faced with financial difficulties because of the long collection period, which might create financial traps in an inflationary environment. They have to put a higher financial burden on those customers who regularly pay, because the fixed costs have to be recovered. This increases the chances of pushing more service users closer to their financial limits.

One of the last potential measures of the service organizations and local governments is to terminate services. Disconnection of utility services is technically not always feasible and might be rather costly for local governments. There are some public health regulations which are also against the termination (for example the water service). Indirect costs of eviction are also very expensive, when other forms of institutional services have to be provided (for the children, for the separated families, and so on).

As this is a relatively new area of legal regulations, the procedures are also complicated or cannot be implemented (for example there are no sub-standard flats to move non-paying families). Legal process might take several years and it does not have preventive effect. For example in Poland 5% of tenants were sued for non-payment of rent. The court decision and number of executed evictions have increased in comparison to the previous year.

Local governments also have other tools to deal with the social consequences of transformation of public utility services. The social benefits systems are still operated at a certain level. Under centralized structures (Romania, Slovakia) they are directly paid by the national budget: in Romania 40–60% of tenants receive benefits, which are set at a regressive scale to income; in Slovakia district authorities provide housing subsidies. In a more decentralized models (Hungary, Latvia, Poland), local governments are responsible for welfare payments and they are partially reimbursed or granted by the national budget.

Local autonomy is partially regulated by setting the types and forms of these benefits. Within this framework, municipalities disburse payments for those recipients who meet the local criteria. In Hungary only the types of locally provided social benefits are set (for example housing maintenance benefit), but local governments receive a general grant for all the local social benefits. In Poland, local housing benefits are connected to a nationally set income (in percentage of minimum pensions).

Means testing and targeting of benefits at a local level raises the problem of measurement and public access to information systems. Both local governments and service organizations have a more or less detailed register of citizens with social problems. In a privatized local public utility

system the service companies are not authorized to transfer their information on non-payers and delayed payments to local governments, who in principle allocate benefits. This personal information cannot be merged with other databases, even if the recipients would benefit from it.

The social policy problems of transformation in service delivery should be solved within the frameworks of the privatization. In those countries where key components of service management are still controlled by the national government (price setting, service provision, etc.), there the general benefit system should deal with the social problems. In a decentralized setting, where local governments are responsible for all the technical, organizational, management and financing aspects of service delivery, they should also deal with the social issues. Assuming a national system of social insurance, general legislation on social policy measures, and through some forms of intergovernmental transfers, municipalities should be able to cope with the local social problems.

Within the national system of social policy, three actors have to develop the locally feasible and manageable solutions. Examples from the most decentralized countries show that municipalities, the service companies, and the indebted households should cooperate in developing a benefit and compensation system. They are all interested in decreasing arrears, diminishing delayed payments and reducing household debts to the minimum level. By creating common funds and designing joint policies on eligibility criteria and forms of subsidies, they would all benefit from the joint actions.

Service companies could get their uncollected charges, so the burden on average customers would decrease and the general image of the company would be improved. Local governments could target their benefit payments and might prevent the escalation of social problems. Service users will be identified more precisely and through new forms of support (e.g. counseling on household debt management) the 'debt-trap' might be avoided. It is crucial to develop preventive methods of social policy, because the accumulation of debts would make the potential solutions more expensive.

8.5 Problems of Small Local Governments

Local government systems in Central and Eastern European countries fit into two categories by the size of municipalities. The first one is the fragmented model of local governments, where the number of small size municipalities is high. The Czech Republic, Hungary, Latvia, Slovakia are the typical examples, where three-quarters of localities are below the population size 2,000. In these small towns and villages lives 20–25% of the population.

The other is the integrated model, where the lowest level of elected government consists of several geographical units. The best example is Poland, where only one-quarter of the population lives in villages with a population under 2,000. Here, the amalgamation of small municipalities and the creation of intermediary local governments was implemented (there are other integration models in the form cooperation, which will be discussed later).

Local public utilities have to be organized within this legal and administrative framework. The economic rationality of utility service provision requires large units in order to achieve optimal size of service production. In the very capital intensive service areas there are strong incentives at the service organizations to achieve economies of scale. Water service, district heating, solid waste deposition are the best examples of these sectors. Minimum average costs are different by activities, but usually they are above the threshold of a population of 150,000, so catchment areas in the water sector and solid waste management covers several municipalities.

Economic rationality is behind the present national financial regulations. For example in Hungary, cooperation in capital investment is subsidized by a higher matching ratio in municipal grants for landfill construction. In Poland, the share of fixed costs must not exceed 30% in the price formula, setting an incentive for establishing larger service organizations with lower network related costs.

There are different solutions for matching the administrative, political and economic considerations. Integration by mandatory amalgamation and assignment of regional service competencies to intermediary level of government are typical solutions. In Romania and Slovakia, the regional governments/administrative offices are responsible for these services. In Latvia, those local governments which do not have the service facilities are obliged to cooperate with other local governments, assigned by Cabinet of Minister's decision. In this case mutual payments are also defined. These compulsory forms of cooperation are mostly used in education and social care.

The other option is the voluntary cooperation, encouraged by legal and financial incentives. Countries with fragmented municipal structures have developed various structures and forms for joint service delivery. Legal forms of cooperation might be different by type of services or closeness and legal binding character of localities. Almost half of municipalities participate in some forms of cooperation. For communal services local governments usually operate joint institutional associations. In Latvia, co-operation agreements are signed and based on this, and local governments establish common service institutions or common enterprises. In Slovakia, municipal associations are used for joint service delivery. Under this scheme, local shares and financial sources are put together and associations have their own name, statutes, accounts, decision making bodies, et cetera.

Occurrence of cooperation forms in local public utilities depends on the scale of privatization. In Latvia, the joint provision of public services is most frequent in solid waste management (26% of surveyed municipalities), public transport (23%) and communal services (14%), unlike Hungary, where only 2% of joint forms of cooperation are in the communal sector. Here, the private provision of services is more typical, so integration is implemented through the market, when service companies establish contractual relationship with several small municipalities.

Market mechanisms always play integrative roles in local public service delivery. Even if service companies are owned by several municipalities, the smaller shares of individual municipalities

does not give enough strength to control the company's business decisions and expansion strategy. Sometimes the dominating share holder (e.g. central cities) has decisive power in these joint companies, which puts the smaller ones into a losing position. Only the competition rules and contracting procedures are able to protect the interest of the smaller companies in the private sector based service system.

9. POLICY FORMULATION PROCESS

Local public utilities are formed in a very complex policy environment. First of all several components of the legislation have impact on them. Sectoral laws set the basic technical regulations: organizational and management practices are influenced by the public administration structure, commercial law and related tax regulations; rules on financial competition, consumer protection, public procurement, and so on.

Within this legal framework, policy formulation is influenced by multi-level governments. International conventions, laws and especially the European Union directives set targets for the national and local legislation. There are also various actors who might be involved in the legislative and policy making process. Regulatory agencies, local government associations, representatives of the professional and business community, and consumer protection agencies are all involved in the policy formulation, in addition to the traditional political and government institutions.

That is one reason why often such a long time is needed for approving sectoral laws. It took two years to approve the water service act in Poland, the solid waste management law was approved after five years of debate in Hungary. After the agreement on the scope and approach of these basic acts, the adjustment to changing conditions will be faster.

Following the vertical dimension of policy making in the CEE countries, the European Union is the highest source of influence. Directives are built into national laws of the accession countries through the negotiation process, often with some derogations in the law harmonization. EU legislation is highly respected even in the second round accession countries, because of the grant system combined with the policy influence.

At the level of national parliaments, the political mechanisms influence the policy making process. This institutional setting is not very stable in the CEE countries. During the past decade, leading parliamentary forces were always changing after national elections, the typical coalition governments also made an additional twist in policy making. These conditions caused unexpected changes in the conditions of local public utility services, like the privatization policy, institutional system of regional development, and so on.

In the same way that public utility services are regulated by numerous pieces of legislation and government policies, the ministerial structure is also fragmented. Usually there is no one central government agency which would be able to represent even a group of utility services. Above the traditional acts, for example the environmental protection law, regional development system, fiscal planning rules, regulations on non-profit organizations are all new strong components in the policy making process. The sectoral ministries also have to learn new roles in this fragmented and decentralized policy environment, after they have lost their state ownership based on a direct means of influence.

The national level decision making process is made even more complex by creating new institutions. In some sectors (mostly in the energy sector), regulatory agencies were created with some limited autonomy. There are organizations for controlling the competition and public procurement process. Consumer protection is often still centralized in these countries. Law enforcement is a critical condition for the efficient operation of these agencies, which made the role of the court system even more important. Professional, impartial and quick legal decisions are critical for the policy formulation.

National policy making is influenced by other than political, juridical and government institutions. The three-party-negotiations between employers, governments and unions are critical in the labor intensive sectors, which provide services critical for the economy.

Local government associations are also heavily involved in the decision making, especially in those countries where they are unified (for example in Latvia and Slovakia). Here they function like national agencies, representing the multi-purpose local governments. In Latvia, the local government association representative participates at the weekly meetings of state-secretaries, and has a consultative right at the cabinet meetings. In countries with several competing local government associations, they are involved only in the legislative process by giving opinion on laws, annual budget, and other such matters.

In the decentralized and privatized system, professional associations of service organizations were established rather quickly. They are mostly organized by sectors or by other criteria (for example in region and size), and the cooperation is effective. They initiate changes in legislation and sometimes are able to take over some of the regulatory functions of the ministries as well. This potential of water, solid waste, and public transport company associations has not, as yet, been utilized properly in the studied countries.

This long process of policy formulation, affected by several actors and changing techniques is implemented when basic goals go through a transformation. A shift from efficiency goals to equity objectives made the assessment of policies even harder. The efficiency of local public utilities and communal services is not easily measurable. The performance measurement and cost allocation problems were expanded by the special conditions of transition.

Lack of information hampered sound policy design in local public utilities. In general, data is not available on local utility and communal service organizations. In those countries which went through the transformation process, the traditional forms of information collection and registration do not work. The sectoral ministries information basis is linked to the system of subsidies (if it exists), the ministries, department responsible for local governments have to rely on indirect data sources (local government property register, Central Statistical Office data on service performance and management).

New information sources are still under development: register of incorporated entities, chamber of commerce or professional associations of service organizations might also provide data on these sectors. However, they are never complete and comprehensive: the company register involves data only on potential activities; associations do not cover all the service entities. The most reliable data is based on surveys prepared for various purposes, for example for donor programs, like our research (for example in Latvia).

Information on the organizational forms of service providers is even less reliable. Only surveys are used for testing the ownership form, output, and efficiency of these service organizations. They focus mostly on the cities and urban areas, village and sub-regional entities are not properly represented in the analyzed countries.

Lack of information was not only problematic for our comparative research. It is a major obstacle for policy design in the relevant ministries and other actors of policy making (local government and professional associations, parliamentary committees, customer protection groups, and so on). The argument for any modification of legislation, or changes in regulations is based on incomplete data, using examples of extreme cases or averages, hiding the variations by type of local government.

Incomplete picture of these sectors does not help to develop competition rules (who is the subject of competition: private or public entities); does not support the transparency and targeted character of the national capital investment subsidies.

The problems of measurement and lack of information are not the only obstacles of policy design. The time elapsed since the transformation of these sectors is relatively short. The analysis, based on the available incomplete information cannot answer the long term trend of local utility and communal services. Short term costs in service provision might be caused by the structural changes, which will be compensated in the long run.

However, some practical lessons might be drawn from this multi-level policy making environment with several actors:

- all the actors of local public utility service provision should be involved in the policy making, otherwise the desired changes cannot be achieved;

- without creating active alliances, no significant changes can be passed through this heavily interdependent policy arena;
- forces out of parliament and traditional political institutions matter a great deal, so they might initiate and support policy changes.

10. POLICY PROPOSALS

The welfare state was built in a market environment. Later the neo-liberal theories—developed as a response to public failures—were also criticized because of their extreme economic views on the social aspects of growth, and the belief of the ineffectiveness of public intervention. These basic expectations were transferred by international organizations to transforming Central and Eastern European countries. In the framework of pre-accession to EU, the legal harmonization involves many of the systemic elements of this model as well. Liberalization of public utility and communal sectors is one of the most important elements of the re-organization of formerly state-monopolized roles. However, the EU principles and the real practices of the member countries also sometimes diverge.

There is pressure simply to follow the model, but in reality circumstances are very different in the CEE countries. Before the neo-conservative shift in the early 1980s, market circumstances were general in all the developed countries. A decade later in the Eastern block, the first task was to transform the state socialist economy. In the developed countries, public functions did have long traditions, whilst in the Central Eastern European region, modern public functions of the state were not widespread.

That is why in this period of transformation, the primary task is not only to establish the market in the state-owned monopolized sectors, but also to develop new public functions under market circumstances. It is necessary to avoid classical market failures, arisen from natural monopolies and the production of public and mixed goods. Instead of the formerly general direct state intervention, independent public regulation should be introduced.

This task is very complicated, because state functions and assets cannot be transformed overnight. Public administration is in a contradictory position: on the one hand it is necessary to eliminate old roles remaining from the previous regime, but on the other hand new institutions are to be build.

Government (that is state) and market failures have arisen at the same time. First of all, it should be emphasized that ‘state’ failures are not classical government failures. They are surviving elements of the former system. Privatization and liberalization on market of particular sectors are only just emerging nowadays. However, market-orientation in sectors having already been transformed is

more limited than it was expected. Market orientation policy means to diminish government failures in the public sector, and it should be the similar task in the CEE region as well.

Secondly, emerging market failures need to be faced. In those sectors which have already been privatized and liberalized successfully, market failures are necessary to be corrected by adequate institutions and other government techniques. Most of the urban services cannot be provided without any public influence. At present, market failures are very modestly limited in CEE countries. It is difficult to stop the traditional forms of state regulation and to transfer these new functions, required by the market to public regulation. Autonomy of regulatory bodies is questionable in most of the studied countries. Furthermore, public policy efforts to diminish market failures are very underdeveloped. Neither organizational structures, nor methods are built up properly.

Transformation failures therefore consist of remaining state failures and early market failures, which might strengthen each other. With more or restricted liberalization, the conflict cannot be diminished. Public sector orientation should be developed at the national and sub-national levels. A clear and complex policy formulation is needed for this field in the framework of the government program and also in local and regional development plans. The CEE region can expect less foreign capital investments in this respect, because investors are obviously mainly interested in opening the market, and they feel less responsibility for the quality of this market. A policy consistent with the Central Eastern European model of transformation should be the only possible way to avoid dangerous, populist political solutions. These policies might lead to extreme solutions, like the complete refusal of private initiatives and returning to state owned property or exclusive support of uncontrolled free market mechanisms. The strategic goal is to respond both to the challenges of state, and the newly created market failures.

In the field of local utility and communal services, progress in transforming the public functions is as important as the development of market orientation. Both of these mechanisms are dependent on each other. If transformation of the government functions was stopped before market liberalization, then the position of the state monopoly would be preserved. If privatization was implemented, but public regulation left underdeveloped, then the consumers would be threatened by unlimited power of the newly created private monopolies. Their position is further strengthened by the multinational firms, which increase their shares in the world market of public utilities. There are also chances of the worse case scenario, when unlimited public and private monopolies control production and provision of services. What is really dangerous for the new 'Wild East' is the uncontrolled private undertakings supplemented by the system of powerful, incompetent and corrupt national or local bureaucracies. In order to avoid this scenario and more exactly to diminish its existing harmful implications, a conscious and comprehensive policy formulation is required. Main elements of the proposed policies are as follows:

- a) Sequence of steps in the transformation of public utilities should be designed as an integral process.
- b) Developing all the critical elements of the new local public service management model.

- c) A conscious policy formulation to build—in parallel with liberalization—new public institutions and functions. First of all new regulatory functions and autonomy of regulatory institutions should be developed. Monitoring of the progress is also necessary, new institutions and procedures have to be revised regularly (e.g. public procurement rules). Changes should reach their critical mass and continuous revision has to be implemented, when it is required.
- d) Introduction of anti-corruption measures is also important on those areas which are influenced by public functions. Market segment of state orders is the least transparent field of public sector.
- e) In the legal harmonization process, European Union laws of transformation have to be preferred. But expectations of the EU are mainly liberalization criteria, in order to support the free movement of goods, services, capital and people. At the same time the transformation of public services must necessarily involve effectiveness and efficiency measures.
- f) Development of consumer protection is unavoidable. It is one of the most important guarantees, because the public is not equal to government.
- g) Finally, the policy design process on local public utility and communal services should be improved. There are various interconnected aspects of public utilities and consequently there are so many actors, that all of them should be involved in policy making, otherwise no long term solutions can be developed.

10.1 Arranging the Sequence of Steps for Creating Market Environment

Many pitfalls of transition countries can be avoided if the entire process of transformation in the public utility sector is properly planned. The first most important issue is the liberalization, which means the creation of the market environment and its support by public actors. There are quite a lot of counter-interests against liberalization in the public utility sector, because it has an impact on various state and private actors enjoying monopolistic positions.

On the other hand, modernization needs investments with guaranteed returns, by ensuring monopolistic positions, at least temporarily. Then, in an optimal case, a strengthened market starts to work in a favorable economic and social environment. Pace and sequence of implementation steps might be different, depending on sectors and countries. The market environment is emerged either at the beginning of the process, or at the end. For example, in typical cases electricity is re-organized gradually, but the water sector is liberalized in a different way.

There are various examples from countries in Central and Eastern Europe on inappropriately designed transformation processes. In several countries, the agency managing the state owned property launched widespread privatization before establishing powerful regulatory institutions.

Management buy-outs and other forms of ‘privatization’ were used before the conditions of property transfer and decentralization were designed. Tendering rules and procedures were not available, neglected or often misused in the early stages of transformation of the utility sector.

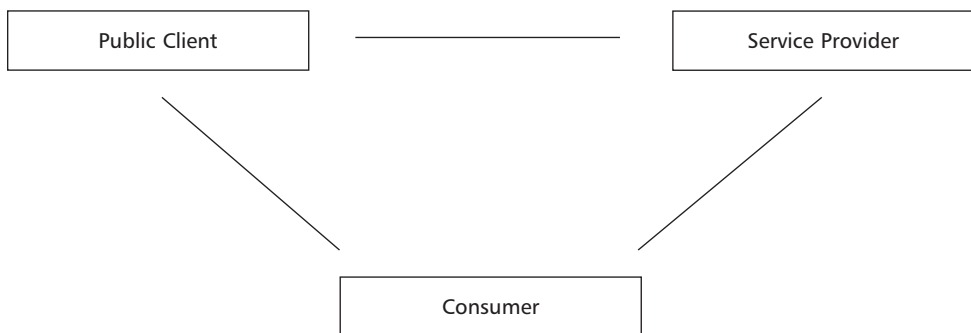
The general conclusion is that liberalization as a crucial stage of transformation should be put at the forefront. Otherwise monopolies are established without any control of the market. Full spontaneity of this process should be avoided. Liberalization is a key instrument in the fight against monopolization in many fields. Complex economic, regulatory, organizational and social welfare policies should be developed for the de-monopolization of utility and communal services. The policy actions discussed in the following sections are linked to one or other elements of this complex policy process.

10.2 Developing a New Model of Local Public Management

As mentioned in section 2, the main tendency in the provision of public services is the strengthening of private characteristics and to support exclusion in consumption. Some of the urban public services have already been made private. The other policy highlighted here is to prefer market instruments in the public sector: making incentives for competition; establishment of independent regulatory functions; and widening the basis of contractual relationships, and so on.

These crucial changes are in the background of changing the character of services, i.e. moving from public goods to toll goods. In the case of mixed goods, the tendency is the functional separation of different roles. At the same time, linkages between different social actors should become more formalized. Service provision in natural monopolies is also changing in this direction. Different positions are specified and separated from each other (for example, the client and provider split must be realized). The basis of functional separation is a demand to specifically localize and limit public responsibilities.

Figure 1.4
Public Service Management Relationship



Analysts and policy-makers faced this phenomenon in the process of privatization.²⁷ The borderline between ownership, management responsibilities and regulation should be defined. A similar distinction should be made in connection with the provision of public services, however the starting point here is not the relationship to property, but to service.²⁸ The functions of the three actors should be separated: service producers, individual consumers and public clients.

The roles of the three main actors consist of the following functions:

1) *The public client's* possible roles consists of the following functions:

- client in public contracts (park and urban road maintenance, public cleaning, waste removal and disposal);
- control of service delivery (specifying services, monitoring, managing complaints, etc.);
- setting prices (depending on the regulation and the extent of privatization).

Regulation is not mentioned among the public functions, because it is more linked to the correction of market failures and less to the public management of services.

2) *The role of the public service provider* (the contractor) is:

- to deliver public services;
- to make a contract with the public clients;
- to make a contract with individual consumers;
- to participate in price setting (depending on the extent of assigned public functions).

3) *The consumer's* role includes

- to benefit from the public services received;
- to pay fees and user charges;
- to protect their interest as consumers;
- to simultaneously vote as citizens.

The last one is interesting from the point of view of public and mixed goods, because some of them are provided as mandatory services, when provision is assigned by law (e.g. maintenance of basic urban infrastructure) and they are subjects of constitutional rights (human services).

The model of direct state service provision is followed by this three pole model. A typical argument for this model of new public management is that in this way, costs can be decreased and service performance improved. In CEE countries, it has not been proved that this separation of functions actually improves the service performance, but that a decrease of costs must be true on the service providers' side. The number of employees is declining in these sectors and service performance became modestly better. Involvement of private undertakings in provision of public services was not the only possible way to decrease costs. Other options were also arisen in these countries.²⁹ The common provision of services can be a good chance for the municipalities with

small capacities. It would be especially important in these countries, where local governments have quite limited capacities (Czech Republic, Slovakia, Hungary).³⁰ However, here municipalities are reluctant to cooperate with each other.

The other possible strategy is to purchase services from local governments with larger capacities. This solution is also conflicting at this stage of development, because cooperating rules are missing, and principles of compensation are not clarified. Finally, a formalized contracting out system would also be useful to guarantee clear linkages between the three parties in provision of public services.

The real question in the new model of local management of public utilities is not 'how far can we go with the market mechanisms?' Throughout this paper the conclusion is that external conditions of market mechanisms are the critical issues. Markets might create private monopolies, which should be avoided in the local utility sector by creating those regulatory environment and competition rules, which are mentioned in our paper.

Parallel to the development of market mechanisms through supply side techniques (for example 'unbundling') there are other possibilities as well. They are not discussed in our paper, but various techniques of New Public Management (NPM) are efficient responses to public failures. They are adjusted to specific conditions country by country, so emphasis of NPM is different: more competition in UK, and further private sector mechanisms (accounting, management, etc.) in Germany. Other micro level management (company, municipality) techniques are also important for improving service efficiency (for example strategic planning, technical and financial standards, and accounting practices).

10.3 Shift to Regulation

As far as regulation is concerned, more detailed codification has been missing for a decade. This lack of comprehensive legislation was due to rapid transition. First the basic conditions of service provision and efficient operation of the local public utility sectors had to be established. The sequence of institutional changes requires the second stage of transformation, which is a shift to regulatory issues.

The broad concept of regulation covers not only the classical techniques of regulatory activities, but includes competition rules and protection of public interest as well. As the examples of the studied countries showed, the regulation is very much influenced by the scale and form of privatization and the development of the legislative process. Usually, regulatory changes are started by the introduction of competition rules. The traditional institutions of consumer protection try to follow the changes in the market and to build responsive and capable organizations. The third, classical element of regulation is forgotten.

Components of the regulatory system were presented in section 6, so here only the most crucial elements will be highlighted. These are heavily discussed in all the selected countries, which try to develop a properly operating regulatory environment.

Third party access needs to manage market failures in order to avoid emerging monopolies. Developing efficient regulatory mechanisms is conditional for effective contracting mechanism. It is between equal partners that obligations can be enforced by court. CEE countries are, at present, far from achieving this stage. Now, regulation means here something more administrative and technical in this region.

As most of the local public utility services are financed by user charges to some extent, the price setting mechanisms should be developed. It is not a simple technical function, but all the related aspects of user charge based service financing should be considered. Aside from completing the tasks to design the methods of full cost pricing, a proper information basis for price formulation should also be established.

In several areas of local public utility services, benefits of user charged based service financing cannot be utilized, simply because of the lack of metering. The regulatory concept on pricing should deal with this problem, and metering should be incorporated into the proposed solutions. This requires capital investments (e.g. in district heating), changes in local government policy making (shifting from tax based financing to user charges) and improvement in revenue administration, both at local governments and at service organizations. There were numerous innovative techniques developed in particular service areas (e.g. in solid waste management).

Another similarly important condition for price regulations is the capability to deal with the social policy consequences of user charges. The economic advantages of priced based service financing can be realized only when the emerging social problems are solved at the same time. This aspect should not be neglected by the public utility policy makers, because all the three actors (client, contractor and customer) are interested in solving the social problems raised by the market. Their responsibility is common, so all of them should be involved in the financing and management of the available methods.

Another important element of the regulatory environment is to deal with the problem of the so-called 'services of general public interest'. In the European social tradition, the equal access to public services dominate the regulatory concepts. According to this approach, no limitations should be imposed on public property rights. It is especially important under the present circumstances when large, international organizations provide formerly local basic services. Tendering and contracting practices ensure efficient service delivery, but local governments may lose their traditional methods of influence.

If these mechanisms are not ensured, local governments may react negatively to this shift in controlling techniques and they may choose extreme solutions, like neglecting the entire practice of tendering. There are various attempts to deal with this problem: introduction of the 'best value' approach in

the United Kingdom or to interpret the compulsory tendering rules selectively in Hungary. This is an existing problem, which should be solved in CEE countries, where regulatory concepts are still under development.

For developing efficient regulatory mechanism, the administrative capacity of national and local governments should also be improved. Following the present stage of transformation, when legal harmonization and modernization of ownership structures are the most important goals, necessary human resources should be developed as well. Without qualified staff and administrative organizations, the regulatory functions will not operate efficiently.

Technological development also influences the methods of regulations in public utilities. The horizontal integration of network based services has an impact on the planning, administration, and human resource management of companies and competencies of local governments. The example of the German urban utility companies (e.g. 'Stadtwerke') showed that a new relationship was established between the service organizations and the local governments. Opening of the markets forced municipalities to re-design their core service activities and to adjust to new ownership and management structures. Similar changes are expected in countries of Central and Eastern Europe.

Finally, the regulatory systems are still influenced by the dominant public service, the energy supply. As we saw in the studied six countries, it is a sector which determines several other local public utilities. Energy supply is important, because some local services are a part of it (e.g. district heating) or because they are heavily dependent on it (e.g. water sector). The privatization of energy might be an example for other sectors, so the regulatory mechanisms are also adaptable in other areas. It might serve also as the basis of a comprehensive regulatory organization in the future.

10.4 Improving Transparency

Corruption and biased decisions are not only problems of public service management, but they influence the whole public life in CEE countries in this phase of transformation. Typical examples are public utility and communal services, in which budget sources; public procurement; and public contracts in general are widely used. The experience is that rules of public procurement work without sufficient guarantees and continuous monitoring of the systems is almost missing.

On the other hand, although conflicts of interest are always under discussion in parliaments, passing real effective regulation is restricted in different manners. Belief in any type of 'code of ethics' for public servants is also very weak, skepticism cannot be broken down against experiences like this.

Despite of the many inefficient attempts, local policy-making should have a role in changing these processes. It would be necessary to develop mechanism for the improvement of transparency at first local and regional levels. It depends very much on political consensus, that is hard to reach in this phase of development. However, efforts should not be neglected because of the present bad experiences.

The system of public procurement has already been introduced in most of the countries in the region. However, unfortunately, introduction is not enough, continuous development is necessary, because players can learn techniques to avoid barriers which are unpleasant for them.

Openness and transparency of the price setting mechanism is also important. Political decisions can be made when selection of methods is simply enough to define priorities. On the other hand, control should be done over actions of providers.

Conflicts of interest are widespread in the region, and their problems are heavily discussed by parliaments, local councils and the general public. However, very powerful counter-interest exists both at the national and local levels. Despite of this fact that several legal rules are legislated, the main problem is that restrictions are not supported by the political behavior of various actors. More detailed legal regulations, enforcement mechanisms and rules of public behavior are needed at the same time.

10.5 Adjustment to European Union Requirements

Local policy formulation should not directly adopt any EU norms before accession. In the process of legal harmonization a lot of requirements are passed, but these obligations derive from the national legal system. In this respect, adjustment does not mean more than following basic policy expectations. There is no intention to be exhaustive in mentioning some of the more important general policy expectations which may be relevant from the point of view of public utility and communal services.

Firstly, guarantees of competition should be focused. Preparing the ground for free competition and transparency is a precondition for the transformation of the former state sector. Direct, politically motivated or outside individual influence would be necessary to restrict.

At the same time, new forms of public regulation have to be developed, from which different roles are defined for subnational governments. Guaranteeing open access to networks is favorable for local governments as clients (buyers of services). Additionally, local responsibility exists for maintaining open access in some of the service areas which are exclusively under local control.

Furthermore, mutual trust among governmental, private and non-governmental sectors in the realization of communal and utility tasks is also important. This is not only a question of free competition. A specific view is also necessary to be adopted in order not only to implement EU regulations, but to realize same aspects continuously in working policy formulation processes. Implementation has some costs as well: legal harmonization has an impact on capital investments (e.g. MSW); law harmonization is a complicated legal task for the government administration and for the legislation (see conflicting pieces of legislation in some countries); long debates over some basic laws (e.g. environmental legislation).

10.6 Consumer Protection and Social Policy Considerations

During the past decade, the development of public utility services has been influenced by different factors. In the first period, the emphasis was on the improvement of service performance, demanding capital investments, and the raising of technical standards of services. Later it was combined with financial requirements because the necessary resources should be made available. Efficient service delivery and modern financial techniques were the necessary conditions for internal and external funding. Later, the social policy aspects of utility and communal services became high priorities. But these social considerations should be balanced with technical (capital investment) goals and financial (efficiency) objectives in the development policies. In the case of local public utilities, all these three aspects of transformation should be developed jointly.

One form of ensuring social policy objectives is to establish customer protection mechanisms. This is a crucial condition for developing a modern regulatory system. Independent and professionally sound regulatory institutions automatically protect the interest of the consumers. They have an impact on service performance through the licensing, and the monitoring of service delivery. They might prevent customers from a major breakdown of utility services by guaranteeing professional standards and financial disciplines at the service organizations. By controlling price setting, regulatory bodies may ensure the principles of lowest cost pricing, fair methods of price adjustment formulae, and the curbing of unjustified increase cost pressure of service organizations. This influence on price setting mechanisms is extremely important in an inflationary economic environment, which was typical in almost each of the CEE countries.

Social policy objectives are often misinterpreted in the utility sector.³¹ The example of the energy sector shows that keeping prices at an artificially low level will lead not only to economic inefficiency, but to unexpected social consequences. Low energy (or any other utility prices) or lower VAT tariffs will provide more subsidies to large consumers, who are probably better off than the poor ones. This will also lead to economic distortions and import dependent sectors for high budget subsidies. The preferred status of these public service providers might also lead to monopoly situations, which further accelerates inflation. So the present practice of flat low utility prices in many CEE countries should be moved towards market based prices. This shift should be combined with targeted social policy measures, with means tested subsidies and other social policy measures.

10.7 Impact on Policy Making Process

The complexity of local public utilities and communal services requires a multi-dimensional approach in designing the future of these sectors. Legal, financial, organizational, management and social factors are equally important components of development policies. The basic principles and rules have to be changed in a relatively short period. Under these circumstances implementation of any major shifts in service delivery moving from state control towards regulation cannot be built into the daily practice without changing the policy making process.

Some basic conditions of sound and professional policy formulation should be developed along the lines of an efficiently working public information system of local public utilities. There are several groups who are interested in the future of these sectors, therefore all of them should be involved in the policy making process. Despite the highly technical character of the utility and communal services, policy options and alternative solutions should be presented to all the interested parties.

It is especially important to involve those public and customer groups, who are not a part of the traditional political and administrative policy making process. Trade unions, consumer protection agencies, employers' organizations, local government and professional associations all should have a say in designing the future of the local public utility sector. However, the culture and methods of transparent and professional policy formulation can be developed in the CEE countries during a long learning process.

The roles of the policy makers and politicians are usually mixed in the utility sectors. In these sectors of 'strategic' importance and with direct linkages to market, politicians and practitioners have to cooperate closely. This might lead sometimes to a confusion of roles, like in the management and supervisory boards of local utility companies, in price setting authorities or in contract awarding bodies.

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⁶ see Hyman, 1989: 665.

⁷ see especially Mikesell, Lane, 1991, 1995: p. 24.

⁸ Sharp, 1990: p. 104.

⁹ Stiglitz, 1988: p. 72.

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¹¹ As a summary of groups of theories see Nemeč, 1997: pp. 82–88.; Hughes, 1994: pp. 97–103.

¹² Unweighted average of transition indicators for banking sector, non-banking financial institutions, competition policy, enterprise reform, corporate governance. The index is based on EBRD expert judgement, it ranges from 1 to 4. See Transition Report, 2000, EBRD.

¹³ Ratio of population supplied by these services.

¹⁴ Source: Horvath, 2000 and FDI Indicators, 2001.

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Open Competition,
Transparency, and Impartiality
in Local Government
Contracting Out
of Public Services

Dr. Kenneth K. Baar

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Open Competition, Transparency, and Impartiality in Local Government Contracting Out of Public Services

Dr. Kenneth K. Baar

1. INTRODUCTION

The contracting out and privatization of the provision of basic public services, including the operation of district heating, water and sewer services; refuse collection; and park and road maintenance is widespread in Central and Eastern Europe (CEE) and is steadily increasing in scale. Such privatization of service provision is taking place through short term contracts, long term concession contracts, and/or the sale of public service facilities.

In CEE, local governments are even more dependent on the contracting out and privatization processes than in Western Europe. Whilst governments in Western Europe can generally obtain capital at a lower interest rate than private companies in order to upgrade their systems, in Central and Eastern Europe the reverse is true—local governments are dependent on outside capital in order to undertake capital improvements. Furthermore, local governments in the CEE are under pressure to upgrade water and sewer services in order to meet EU accession standards. Also, they are under pressure to upgrade district heating systems in order to reduce the substantial financial burdens of their provision.

How the contracting out and privatization of services is conducted will determine the future costs of these basic services, which have a significant impact on household budgets, and it will determine the future ownership and control of substantial public assets.

The purpose of this chapter is to address basic issues related to the use of competitive bidding processes, transparency, and impartiality in contracting out public services in the CEE and to present a comparative discussion of practices in the EU and other nations. This chapter examines the contracting out practices in four CEE nations (the Czech Republic, Hungary, Romania, and Slovakia) and it provides a comparison discussion of practices in Western Europe and the U.S. It

is based on a combination of interviews and research and is subject to the caveats that while somewhat precise information could be obtained about legislation in the CEE, widely divergent views were presented about prevailing practices, and information on actual practices has not been collected on a systematic basis.

The issues that are covered include:

- a) The applicability of procurement laws and other provisions requiring competitive procedures for the selection of contractors;
- b) Public access to contracts and information considered in price setting proceedings. (freedom of information);
- c) Requirements of impartiality and the prevention conflicts of interest in the selection of contractors.

Each of the above may be seen as a basic prerequisite to the conduct of contracting out in a manner that best serves the interests of the public. If conflicts of interest are permitted, bidding is not really competitive. Without competitive bidding for contracts, there is no assurance that the public is obtaining the most favorable terms for the provision of its services. Without transparency, corruption is more likely and public trust in the fairness of selection process is eliminated. Furthermore, without transparency, the general public is excluded from the contracting out process. As a result, the potential benefits of independent public review, criticism, and expertise are lost.

In the past decade each of these issues has been the subject of intensive public interest and legislative reform in West Europe, as well as the countries in CEE.

While the purpose of contracting out is to increase efficiency, reduce costs and/or obtain investment resources that are not available to local governments, contracting out or privatization may result in either substantial public benefits or irreversible harm. It places governments in a role that may be even more complex than that of service provider, the role of contractor and regulator. The manner in which contracting out is undertaken is critical in obtaining beneficial results. This is especially true when long term contracting is undertaken, as is common when contracting is undertaken for the purpose of inducing private companies to upgrade public service systems. Although there is no prescription to insure that contracting out will work effectively, the process by which it is undertaken can play a critical role.

While the contracting out of public services has becoming increasingly widespread in Central and Eastern Europe, the degree of contracting out differs significantly among the nations of the region. Typically, national laws authorize the contracting out of services and govern long term concession contracts. In some nations the sale of utility infrastructure is prohibited.

In the Czech Republic, privatization has always had a high place on the public policy agenda. Commonly, the physical components of infrastructure as well as operating services have been

privatized. In larger cities, public ownership of water facilities has been maintained, but service provision has been contracted out on a long-term basis. In the mid-1990s, the French government funded education programs for local governments which advocated such an approach. In smaller cities, the privatization of water infrastructure as well as service has occurred. In the case of district heating, privatization of the infrastructure as well as the service provision is common in larger cities. In Prague, water service, refuse collection and park maintenance have been contracted out to private companies. Each of the city districts has authority over these services and contracts out for them individually. However, the districts have all elected to contract with the same company. The refuse and park collection contracts are for one year. As a matter of practice, they are renewed with the same company.

Under Hungarian law, local governments are not permitted to sell the physical portions of their infrastructure. It has become standard practice for cities to create one or more municipally owned companies which are responsible for park, road maintenance, snow clearing, refuse collection, and cemetery services. In turn, some of these services are subcontracted out to private firms. Typically, park maintenance services are divided into sections of the city and subcontracted out on a section by section basis, resulting in numerous subcontractors for this service. (The typical length of such contracts is 3 to 5 years). Refuse collection services are commonly contracted out to foreign firms when significant capital investments are required in order to create new disposal sites. In such cases, 25 year contracts are common. Interviewees estimated that about 10% of all water services are contracted out to private investors. Approximately seven of the 109 municipalities that have district heating systems have entered into long term concession contracts (typically 15 to 20 years) for the operation of their services. In addition, a few municipalities have entered into lease agreements in order to upgrade their systems. Under the agreements, specified improvements by a private company becomes the property of the district heating company after making monthly payments for a fixed term, typically about ten years.

In Romania, the contracting out of services is less common than in the neighboring countries. The sale of publicly owned assets is prohibited.¹ However, concession agreements are becoming widespread. Bucharest has entered into concession contracts for the provision of water and sewer and has executed five year contracts with three different companies for refuse collection. Other cities have contracted out refuse collection and/or park maintenance.

In Slovakia, about half of all cities have contracted out waste collection. Other commonly contracted out services, which are contracted out by cities and the individual districts in Bratislava, include park maintenance and street maintenance. Typically park maintenance contracts are broken down into sub areas of the contracting jurisdiction and are short term.² Unlike in the neighboring countries, the state is just beginning to transfer ownership of water and district heating facilities to local governments. Bratislava has sold its district heating company to a foreign company. Komarno officials indicated that plans are under consideration to sell its district heating facility.³

2. LAWS REQUIRING COMPETITIVE PROCEDURES

2.1 EU Directives

The EU is conditioning accession on conformance with its public procurement standards. As a result, EU regulations are viewed by the CEE nations as the standard for required practices. The EU extensively regulates the conduct of tendering in its member states pursuant to its free competition objectives and it places a high priority on conformance with its standards. Furthermore, conformance with EU procurement standards has been a precondition to EU accession. Public procurement processes have been considered as essential tools for bringing about fair competitive processes and transparency in public contracts. In the EU, as well as in Central and East Europe, policies and practices with regards to these issues are in an evolving state and detailed discussion.

Each of the CEE nations has adopted detailed procurement legislation, largely based on EU models. In the CEE countries, EU standards operate as a *maximum as well as a minimum* for the coverage and standards of procurement laws. While requirements of competitiveness and transparency are critical for effective contracting out, exceptions to the such requirements are widely exploited.

In the past decade, the EU has been taking steps to expand the applicability of its procurement standards to public service contracts. In 1992, the EU adopted a directive that is applicable to public services contracts. It includes a broad definition of 'contracting authorities' as follows:

- contracting authorities shall mean the State, regional or local authorities, bodies governed by public law, or associations formed by one or more of the authorities or bodies governed by public law. Body governed by public law means any body:
- established for the specific purpose of meeting needs in the general interest, not having an industrial or commercial character, and
- having legal personality and
- *financed for the most part, by the State, or regional or local authorities, or other bodies governed by public law; or subject to management supervision by those bodies; or having an administrative, managerial or supervisory board, more than half of whose members are appointed by the State, regional or local authorities or by other bodies governed by public law.*

EC Directive 92/50/EEC, 18 June 1992

However, the services directive contains some very significant exemptions. The Directive is applicable to contracts for "pecuniary interest".⁴ This clause is interpreted to mean that it is not applicable to contracts under which the payment to the service provider comes from user fees rather than from the contracting authority (for example a contract between a public agency and a private company for refuse collection, supported by user fees). In line with this concept, concession contracts have been excluded.⁵ This exclusion has been subject to wide criticism.

The services directive also excludes contracts for the acquisition or rental of land or other “immovable property”.⁶ This section results in the exclusion of the rental or sale of utility infrastructure.

2.2 Recent EU Communications

Although concession contracts and other contracts without a “pecuniary interest” are exempt from the EU’s public service directive, a recent (April 2000) Commission Interpretative Communication on concessions under Community Law sets forth the conclusion that such contracts are subject to the Treaty requirements of adherence to the principles of open competition and transparency. The Interpretative Communication notes the EC rules instituting and guaranteeing the proper operation of the Single Market, including:

- the rules prohibiting any discrimination on grounds of nationality
- the rules on the free movement of goods, freedom of establishment, freedom to provide services,⁷

It further notes that:

The principle of equality of treatment implies in particular that all potential concessionaires know the rules in advance and that they apply to everybody in the same way. The case law of the Court [...] lays down that the principle of equality of treatment requires not only that conditions of access to an economic activity be non-discriminatory, but also that public authorities take all measures required to ensure the exercise of this activity.⁸

2.3 Public Procurement Laws in CEE Countries

Consistent with the EU directives, the CEE laws have contained significant exceptions in their coverage which result in substantial exemptions for contracted out services and/or the privatization of public services. The most notable are exemptions from procurement laws and other types of public scrutiny, including:

- government contracts for services which provide that services shall be paid for directly by citizens (rather than by the local government) and, therefore, are not for pecuniary interest;
- concession contracts;
 - the transfer of stock within mixed public private companies which effectively transfer control to private companies;
 - the sale or rental of physical infrastructure.

In the case of Hungary and Romania, exemptions for public service contracts from procurement requirements are counter to the broader purposes of their procurement legislation. The purposes

of the Hungarian law include “{...} establishing the transparency of the use of public funds and its wide-ranging public controllability, furthermore, providing for the purity of competition in the course of public procurement,{...}”⁹ The Romanian procurement law sets forth similar objectives.¹⁰

The Czech Republic adopted a procurement law in 1994.¹¹ In 2000, the coverage of the law was extended to contracting out by private monopolies and city owned companies. The law exempts contracts for the purchase of water and energy, placed by producers, carriers, and distributors.¹² In addition, as in other nations, the law has been interpreted to exclude contracts for services when the services are paid for directly by the citizens, such as refuse collection, based on a provision which states that a “public contract” is understood to be a contract for “pecuniary consideration.” While city purchases are covered by the procurement law, other types of transactions, including city rentals or sales of public infrastructure are not subject to such requirements. For example, a city rental of a refuse disposal site is not controlled. Another route to privatization beyond competition and public tendering requirements has been the through the creation of a company which starts with a majority share of public ownership but then becomes mostly privately owned. Besides not being subject to the procurement law, such transfers can take place without the approval of the municipal council, because councils do not have legal control over the city representative of the company. Proposals for legislation to bring such transactions under public control have not been successful. The law contains a detailed list of the information that must be included in an assessment and evaluation report by the public procurement commission;¹³ however, it only provides for access to such reports only by other bidders, who may “view” the report (as opposed to obtain a copy).¹⁴ The manager of one local government indicated that it was common practice among local governments to select criteria for procurements so as to ensure that a particular company would win a contract.

In Hungary, as in other nations, a principle exemption is created by the limitation to services for which pecuniary consideration is paid for by the city are for solid waste services supported solely by user fees. If the service is partly paid for out user fees and partly subsidized, it is covered by the Procurement Act. Furthermore, while a contract with a private company to provide user fee funded services is exempted from the procurement law, purchase activities of that private company (e.g. the purchase of trucks by a waste disposal company pursuant to the performance of public service) are covered by the act. A separate act covers the contracting out of refuse collection and chimney services.¹⁵ But it does not set forth standards for these tenders. In some interviews, directors of municipally owned companies indicated that the activities of their companies were not covered by the procurement legislation and that their subcontracting for public services was not subject to the procurement act. Other knowledgeable sources indicated that localities were claiming exemptions on the basis that under the Procurement Act “public service providing activity” only covers activities “*qualified by ... municipal by-law* as public service, activity provided by an institution in the public service, public utility or communal service.”¹⁶

In the course of interviews, this author found substantially differing opinions as to the scope of the Hungarian Procurement Act and statements that the law clearly did not allow for some of the interpretations which other experts claimed were common. Further clarification and possibly simplification, which obviates the need for substantial cross-referencing to other legislation, might bring about greater uniformity of interpretation.

The EC Commission, while commenting that “Hungarian legislation on public procurement is largely compatible with EC directives in this field”, noted that: “... the Hungarian legislation does not meet all the requirements of EC Directives regarding the utilities sectors (namely energy, telecommunications, water, and transport).¹⁷ In 1998, interviewees from the Ministry of Justice and the Procurement Council indicated that plans were underway to take the steps that would be necessary to bring the Hungarian standards in conformance with the EU standards by the time of accession. However, there were differences in opinions among the interviewees as to the extent of diversion between the EU standards and Hungarian law.

Romania adopted a new procurement law in 1999.¹⁸ However, since then, its implementation has been delayed pending the implementation of regulations. The law contains a basic statement of principles which includes: free competition; efficiency in the use of public funds; and transparency; and introducing a national regulatory agency, publicity rules for tenders, and statistical reporting requirements; which were all absent from the previous legislation.¹⁹

Its coverage of entities which perform government functions is broad, including the operation of fixed networks which provide service to the public in connection with the provision of drinking water, electricity, gas, or heating. However, it contains an exemption for contracts where consideration consists of the right to exploit. As in the other nations, privatization can be accomplished through the creation of joint ventures without meeting public procurement requirements.

Slovakia adopted a new Public Procurement Act in 1999.²⁰ Concession contracts for the administration and control of physical assets of public services are now exempt.²¹

Exemptions from public procurement requirements for concession contracts and other types of public service contracts make little sense from a public policy perspective. The concept that there should be an exemption or a less stringent procurement rule because the payment for a public service comes directly from the private users rather than with public funds or that the service goes directly from the private company to the user exalts form over substance. Funds for all services come from taxes or fees paid by private individuals. Furthermore, in the case of a public service performed by a private contractor, the contractor has received a monopoly position, which has economic value, from the public sector. In light of the fact that the monopoly position has economic value, it is certainly a form of consideration. At the same time, the interests of the public in securing the benefits of the Procurement Act are the same whether the service and/or the payment for the public service is directly from the citizen to the service provider or via a government agency.

3. PUBLIC ACCESS TO PUBLIC CONTRACTS (TRANSPARENCY)

In several of the nations in the CEE region, it is common or standard practice for government agencies to take the position that contracts for public services are secret. Such secrecy has frequently become a major political issue, as result of discontent over public contracts.

Freedom of information is a relatively new right among the basic freedoms. Almost all of the nations in Europe have adopted a freedom of information law. However, nearly, all of these laws contain an exception for commercial information if it is of a “confidential” nature and/or if the release of the information will harm the competitive position of the company or discourage commercial contracting with the government. But, freedom of information laws do not contain definitions of what information falls within these parameters.

The difference between the national policies rests on how this undefined exception is interpreted. In some nations the mere claim or belief that information is of a confidential commercial character is sufficient to provide a basis for denying access to contracts for public services. In other nations only a very limited amount of commercial information is considered to be of a confidential nature, denials of access must be justified on very specific grounds, and public service contracts are public record.

Where a broad cloak of secrecy is still in effect, it is a vestige of a long historical concept that places government in the role of master rather than servant of the public. Significant reforms have taken place within the past few decades and the EU has started to adopt standards which apply to EU government and proceedings. However, it has not adopted freedom of information rules that are applicable to member states, with the exception of rules applicable to access to environmental information.

Most Central and Eastern European nations have adopted constitutional provisions which provide for a right to information and access to public records. Commonly these provisions contain exceptions or qualifications that may be used to severely limit their scope. Examples include exceptions for “the rights of others” or “economic interests of the state”. Others require that the party interested in obtaining the information must have a particular interest, such as a “sufficient legal interest” or the information must “concern” them. Some of the constitutions require implementing legislation defining the scope of exemptions or setting forth the procedures for availability of information. Typically, such legislation has not been adopted. (Appendix A contains the freedom of information sections in the constitutions of CEE nations.

Under the Czech Constitution (Article 17), the following is stated:

- (1) {...} the right to information is guaranteed;
- (4) {...} and the right to seek and disseminate information may be limited by law in the case of measures essential in a democratic society for protecting the rights and freedoms of others, the security of the State, public security, public health, and morality;

- (5) Organs of the State and of local self-government shall provide in an appropriate manner information on their activity. The conditions and the form of implementation of this duty shall be set by law.

A 1998 commentary on the Czech law noted that statutory limits to access to information included state secrecy, economic or professional secrets and that the rules for “secret information” and “commercial secrecy” were vague.²² In 1999, the Czech Republic passed a new freedom of information law. During the debates over the new law, opponents argued that city officials would be flooded with requests for copies of the contracts; but since its passage the flood has not emerged. The public officials interviewed indicated that contracts executed after the adoption of this law are made accessible to the public, but that earlier contracts are not covered. “Trade secrets” are an exception to the right to freedom of information. In order for information to qualify as a trade secret all of the following conditions must be met: it has to deal with:

- a) facts of trade, industrial or technical nature related to the company;
- b) it must have potential value;
- c) it cannot be commonly available in business circles;
- d) the entrepreneur desires that it be kept confidential.

Information submitted in price setting proceedings is not considered to be public record. For example, in accordance with national law, an office of energy regulation has to review the power over district heat prices set by local companies. In cases where prices exceed specified levels, rate increases must be justified under a cost and asset value formula. The proceedings for making these determinations are not public and the cost information submitted is not public record.

Under the Hungarian Constitution (Article 61) “... everyone has the right to ... information of public interest...” Furthermore, under the Hungarian Law “On the Protection of Personal Data and Accessibility of Data of Public Interest”,²³ the authorities are required to grant access for anyone to the data of “public interest”, unless the data is specifically restricted by law.²⁴ There is no specific exemption in that law for commercial information. Furthermore, “data of public interest” is broadly defined to include: “any information under processing by an authority performing state or local self-government functions or other public duties, except for personal data.”²⁵ Another section of the law states that: “Access to data of public interest may not be restricted to protect those data of a person acting on behalf of the authority which are conjunctive to his or her duty.”²⁶

Hungary also has a separate business secrets law, which protects “any fact, information, solution or data, connected to economic activities, the secrecy of which is in the reasonable interest of the entitled party.”²⁷ Its laws do not set forth the relation between the Accessibility of Data and the Business Secret laws. In the course of interviews in the spring of 1998 in over ten cities, in the majority of the cases, subject to the exception of a substantial minority, local officials took the

position that contracts by public entities with private companies were not public records and therefore, citizens do not have the right to obtain such documents. In some cases, inquiries as to whether such records were public made local officials rather uncomfortable. In some cases, mixed responses were given; the local official responded that in principle the contracts were public, but that in practice nobody had requested copies of contracts and they were not given out. In other cases, such requests were viewed as unreasonable. As in the case of public contracts, submissions used for public price settings are not treated as public records. The most significant example of this practice is that submissions to the Ministry of Transport, Communication, and Water Management, are used for setting the water price for the five regional companies, which set rates for 45% of the country, are not accessible under current practice. Furthermore, the submissions that are used to justify local tariff subsidies for hundreds of water districts are not accessible.

In opinions regarding the relationship between public funds and private business, the national ombudsman has stated that “The transparency and controllability of the privatization processes, as public interest, takes precedence over the private interest of protection of business secrets.”²⁸ In November 1998, in a case involving a challenge to the Transport Ministry’s decision to keep a highway concession agreement secret, the ombudsman commented that:

Citizens and their organizations can only keep a check on the activity of the state if they have sufficient information on their operation. {...} State or municipal organs learn business secrets very often when they deal with asset management and when they manage public funds. In these cases the principle of publicity has priority, since the utilization of public finances should be transparent. Since free access to information is a constitutional right, the right to have business secrets can not come before that. Private companies that apply for state or municipal subsidies or enter for a competition for subsidies or companies that have business relations with the state and municipality where public finances are involved, or if they manage public assets, often are exposed to the restriction of the right to have business secrets.²⁹

Subsequent to the ombudsman’s decision, the Ministry of Transportation has still refused to release the contract. (Appendix B contains the complete text of the Ombudsman’s decision.)

The Romanian Constitution sets forth the right to public information in broad terms. It states that: (*Article 31*)

- (1) A person’s right of access to any information of public interest cannot be restricted.
- (2) The public authorities, according to their competence, shall be bound to provide forcorrect information for citizens in public affairs and matters of personal interest.

Under the national law governing local authorities which has expired, one of the duties of local secretaries was to make sure that “decisions and orders of general interest are made public,” including “abstracts or duplicates of any act in the council’s archives”.³⁰ But these provisions contained an exception for documents with “a secret character under the law”. Up to this time, “secret character

under the law” has not been defined by any law. According to author-investigated information, as a matter of practice, public contracts and related information are kept secret. In the draft of the new law on local public services every person has the right to “access to information about the local public services” and the “right to be consulted, directly or by means of non-governmental organizations of the users, while the decisions, strategies, and the regulations on the activities related to local public services are drawn and adopted.” In 1996, freedom of information legislation was introduced in the parliament, but was not adopted.³¹ Since then, access to information in public contracts has become a major public issue in reaction to the execution of a secret contract between the national telephone provider (Rom Telecom) and a Greek firm. As of August 2001 a new freedom of information law had been passed by the parliament but had not been signed into law.

In March 2001, a shadow was cast over freedom of information in Romania by the introduction of a broad law for the protection of “classified information”. Classified information includes:

economic information which {...} affects national economic interests. Public officials and citizens who fail to turn over or fail to report their knowledge of such information to the national authorities.

The government indicated that the passage of such a law was necessary in order to join NATO. Subsequently, the Romanian Supreme Court struck down the law on the basis of procedural defects in adoption. The draft freedom of information law sets forth a basic right to access to information which contains the typical exemptions from public access. In addition to these laws, the procurement law contains specific provisions regarding public access which requires that the authorities maintain the confidentiality of commercial secrets.³² More importantly, all access to the information in contracts is effectively cut off by a provision in the implementing regulations which contains a model contract which states that a contract may not be released to the public without the consent of both contracting parties.

Under the Slovakian constitution:

State bodies and their territorial self-administration bodies are under an obligation to provide information on their activities in an appropriate manner. The conditions and manner of execution will be specified by law.³³

In 1998, the secrecy of a Bratislava contract with a foreign company (Siemens) for the provision of street lighting became a major public issue. Also, in recent years, public reactions to the policies of the Meclar regime led to strong pressures for more open government after its fall from power. On 1 January 2001, a new free access to information act became effective. That act covers:

- c) information obtained through public funds or relating to the use of public funds or state or municipal property,
- d) {...}information under Sec. 3, Sec. 2. [... information pertaining to the management of public funds and utilization of state property or the property of municipalities;

and [information] on the content, performance [of any concluded agreements] and activities carried out on the basis of any concluded agreement.]

The Act contains the standard exemption for any information “classified as a trade secret”.³⁴ (Commercial Code Sections 17–20). However, “Disclosure of the following information shall not be deemed as a violation or jeopardizing a trade secret: ... information obtained through public funds or relating to the use of public funds or state or municipal property.”³⁵ In the course of interviews, some public officials took the position that contracts for public services are available to the public as a result of the new freedom of information law and provided copies of the contracts, while others maintained that they were confidential. One city official took the position that contracts between the city and private companies were public record but that a contract governing the relationship between a municipal partner and a private partner in a joint venture was a commercial secret.

The Romanian Concession law,³⁶ which is modeled after the French concession act, contains extensive requirements on the terms and conditions of a concession contract. In addition, the law requires that the initiation of a concession has to be accompanied by an opportunity study which contains a statement of:

- 1) the reasons of an economic, financial, social, and environmental nature which justify the concession,
- 2) the necessary investments for modernization and extension,
- 3) the estimated period of the concession,
- 4) the minimum rent.³⁷

The contract is subject to the norms set up in a frame document to be approved by the government.

3.1 Transparency in Western Countries

Some nations, including Canada, Australia, Sweden, and the U.S. have developed strong transparency requirements, which include public access to public contracts. In these nations transparency is a fundamental right in the law and in practice. Exemptions are narrowly interpreted and some of the access laws provide that public interest in access may override the commercial exemption. Public contracts and information submitted to price setting agencies are both readily and easily available to the public.

Western European Declarations and Legislation on access to public documents contain broad statements of a principle of public access, which are subject to broad exceptions. In the past decade, EU nations have been moving towards stronger freedom of information requirements. Access to public documents has been an area of increasing concern in recent decades.³⁸ In 1982,

the Council of Europe Committee of Ministers adopted a “Declaration on the Freedom of Expression and Information”.³⁹ It states that they “...seek to achieve the ... following objectives: ... the pursuit of an open information policy in the public sector, including access to information, in order to enhance the individual’s understanding of, and his ability to discuss freely political, social, economic and cultural matters; ...”⁴⁰

The EC Code of Conduct Concerning Public Access to Council and Commission Documents, which was adopted in 1993, sets forth the General Principle that “The public will have the widest possible access to documents held by the Commission and the Council”.⁴¹ The Code requires that decisions of its institutions on requests for documents must be made within 30 days, that the grounds for a refusal must be set forth in writing, and that means of redress are available through judicial proceedings and complaints to the ombudsman.

Exceptions to Access under EC Code of Conduct

The institutions will refuse access to any document whose disclosure could undermine {...}

- the protection of the public interest (public security, ... monetary stability), ...
- the protection of commercial and industrial secrecy,
- the protection of the Community’s financial interests,
- the protection of confidentiality as requested by the natural or legal persons that supplied the information or as required by the legislation of the Member State that supplied the information. {...}”

However, EU standards for freedom of information of member states are limited to environmental information.⁴² The applicable directive contains the standard exemption for “commercial and industrial confidentiality.” Pursuant to this directive, the member nations have adopted legislation specifically for access to environmental information.

Under Austrian law, public agency contracts are not public record. However, a losing bidder in a tender has the right to see the contract that is made with the winner of the tender.⁴³

Under French law governing access to administrative documents,⁴⁴ there is an exception for commercial and industrial secrets.⁴⁵ A ‘Commission d’Acces aux Documents Administratifs’ (the Commission for Access of Administrative Documents) (CADA) is responsible for administering the law and making administrative determinations about access to particular documents. Its commentary on the French act notes the scope of the exception is not precise and that it has not been defined by the courts.⁴⁶ However, the 1999 annual report of the Commission states that all the financial elements, including the detailed prices, contained in a contract with a public agency, are public record because they reflect elements of the cost of the service to the public.⁴⁷ (In contrast, in the case of offers that are not accepted, only the global price offered is public record.) The report lists cases in which it has ruled that concession contracts are public record.⁴⁸

Germany has not adopted freedom of information legislation, except within its environmental legislation.⁴⁹

In Great Britain, the public access issue has been the subject of wide discussion and pressures for reform. In 2000, Great Britain passed a new freedom of information act.⁵⁰ The act contains an exemption for “trade secrets” and for cases in which disclosure would “prejudice the commercial interests of any person (including the public authority holding it).”⁵¹

Pursuant to the new act, the government is drafting a “Code of Practice on the Discharge of the Functions of Public Authorities...” In the draft version, public authorities are directed to severely limit the use of confidentiality clauses and only accept such provisions when their use is for “good reasons and can be justified by the Commissioner”.

*Code of Practice on the Discharge of the Functions of Public Authorities
under Part I of the Freedom of Information Act of 2000*

24. When entering into contracts public authorities should refuse to include contractual terms which purport to restrict the disclosure of information held by the authority and relating to the contract beyond the restrictions permitted in the Act. In particular, when entering into contracts, as when receiving information from third parties more generally, public authorities should not agree to hold information ‘in confidence’ which is not in fact confidential in nature.

25. Public authorities when entering into contracts with non-public authority contractors may be under pressure to accept confidentiality clauses so that information relating to the terms of the contract, its value and performance will be exempt from disclosure. Public authorities should, whenever commercially viable, endeavor to obtain the agreement of the non-public authority contractor that no such confidentiality can be set up against a request for the disclosure of such information.

26. Any acceptance of such confidentiality provisions must be for good reasons and capable of being justified by the Commissioner.

27. Public authorities should not impose terms of secrecy on contractors unless the information concerned would be exempt within the terms of the Act. However, except where paragraph 28 below applies, it is for the public authority to disclose information pursuant to the Act, and not the contractor. The public authority may need to protect from disclosure by the contractor information which would be exempt from disclosure under the Act, by appropriate contractual terms.

Under the former British Freedom of Information law, there was a non-statutory *Code of Practice on Access to Government Information*, which included an exemption for “commercial confidences, trade secrets or intellectual property whose unwarranted disclosure would harm the competitive position of a third party”. The “Guidance on Interpretation” issued by the Cabinet Office advised decision makers to ask three questions when deciding whether to withhold commercial information:

- (i) is the information {...} a trade secret, a commercial confidence, or intellectual property? The Code suggests adopting the Alberta *Trade Secret Act 1986* definition of a trade secret. If the answer is “no” then the exemption does not apply. If the answer is “yes” {...}
- (ii) would its disclosure be likely to harm the competitive position of the subject or source of the information? If the answer is “yes”, disclosure is unwarranted unless there is an overriding public interest in disclosure. If the answer is “no” {...}
- (iii) would its disclosure be likely to prejudice the future supply of information to the government? If the answer is “yes” then disclosure is unwarranted.⁵²

Some agencies, including the national agency which regulates water prices (OFWAT), provides public access to cost submissions which are used to justify price increases.

Under Swedish law, “access to official documents may be restricted only if the restriction is necessary having regard to ... 5. the public economic interest; 6. the protection of {...} economic conditions of private subjects.”⁵³ The term ‘document’ is broadly defined to include any document in the possession of a public authority.⁵⁴ All documents are public unless exempted by the Secrecy Act. In regards to commercial information that act exempts: A person’s business or management conditions, inventions or research results, if it can be assumed that the person concerned would suffer loss should the information be disclosed. However, the act also permits the government to override the secrecy provision “if the government deems it important that the information is provided.” As a matter of practice, contracts for services are made public.

Under the Canadian freedom of information act, public contracts are treated as public records. The exemption section of its legislation states that:

Subject to this section, the head of a government institution shall refuse to disclose any record requested under this Act that contains trade secrets of a third party; financial, commercial, scientific or technical information that is confidential information supplied to a government institution by a third party and is treated consistently in a confidential manner by the third party; information the disclosure of which could reasonably be expected to result in material financial loss or gain to, or could reasonably be expected to prejudice the competitive position of, a third party; information the disclosure of which could reasonably be expected to interfere with contractual or other negotiations of a third party.⁵⁵

As in Sweden, there is a provision which allows the public interest to override a commercial exemption. Judicial analysis of the exemption section illustrates the narrow interpretation of the

scope of the exemption. One decision notes application of the financial information exemption “require[s] a reasonable expectation of probable harm {...} speculation of mere possibility or harm does not meet that standard”.⁵⁶

Under U.S. laws, contracts by public entities are public record. The federal Freedom of Information Act contains an exemption for “trade secrets and commercial or financial information obtained from a person and privileged or confidential...”⁵⁷ State laws, which govern contracts by state and local governments, contain similar provisions. Typically the commercial exemptions are interpreted narrowly.

In a leading decision “trade secret” was defined as:

a secret, commercially valuable plan, formula, process or device that is used for making, preparing, compounding, or processing of trade commodities and that can be said to be the end product of either innovation or substantial effort.⁵⁸

Generally, commercial information that is used to demonstrate that a company has the financial resources to undertake a project or to protect trade secrets is exempted from public access. The common judicial test of whether a government agency can refuse to disclose business information is whether the release of the information would be damaging to the business or would discourage future competition for public contracts. For discussion of the commercial exemptions under the laws of Australia, Canada, France, Great Britain, Ireland, New Zealand, Sweden, and the United States see Baxter, Richard, “Commercial Confidentiality”, *Freedom of Information—Resolving Disputes* (1995)⁵⁹

3.2 Transparency and Public Participation in the Drafting of Contracts

Research in Hungary revealed that contracts with local governments are commonly drafted by companies that win a tender without serious review by the local government and without the assistance of an attorney reviewing the contract and negotiating on behalf of the local government.

Possible measures to improve the quality of contracts include:

1. Creation of local government subcommittees with responsibility for drafting contracts,
2. Public hearings on the content of proposed contracts,
3. Inclusion of experts in the contract drafting process,
4. Requirements that the contract be developed before the tendering process.

A Romanian lawyer who specializes in municipal contracts stated that contracting out was typically characterized by a lack of performance standards and monitoring. A proposal for the creation of

water board modeled after the British Water Board (OFWAT) includes the provision of free technical assistance to cities in the preparation of concession contracts.

Opponents of public access to contracts and price setting information claim that public access discourages firms from entering into contracts with public agencies. Among their concerns is that business will be afraid to submit business information because it will be used by municipal councilors who are competitors or who are likely to share information with competitors. However, there does not seem any evidence to support this conclusion and the experiences of nations with public access to public contracts have not been marked by any lack of commercial interest in obtaining public contracts due to such rules.

On the other hand, there is no question that maintaining the secrecy of public contracts contributes to corruption, lowers performance requirements for drafting such contracts by shielding them from public view, and undercuts the credibility of the contracting out process.

4. CONFLICT OF INTEREST LAWS

Just as it is impossible not to taste honey or poison that one may find at the tip of one's tongue, so it is impossible for one dealing with government funds not to taste, at least a little bit, of the King's wealth.

Kautilya, Prime Minister
of a state in Northern India

4.1 Conflicts of Interest and the Law in CEE Nations

Throughout the CEE, interviewees stated that conflicts of interest are standard in the public contracting process. Typically, members of City Assemblies vote on contracts in cases when they also have an interest in the enterprises that are awarded the contracts. Conversely, interviewees recounted instances in which city assembly members opposed contracting out because they were on the board of the publicly controlled company which currently provided the service.

Conflict of interest laws are spread among laws governing national and local governments and commercial companies. In addition, national procurement laws prevent the participation of persons in the selection process of the procurement procedure with an interest in the outcome of the procedure. Sometimes the scope of the national laws is limited to a few specifically mentioned types of conflicts.

While broad principles about the impropriety of conflict of interests are present in national laws, conflict of interest legislation is characterized by a lack of any penalties and/or enforcement mechanisms for violations. None of the interviewees mentioned any instances in which public officials of any type had been penalized for conflict of interest violations or of cases in which contracts had been annulled due to such conflicts of interest. At the same time, there is general public disgust with such conflicts of interest.

The ineffectiveness of the national laws may be evidenced by the fact within each country widely differing answers were given about whether there even were conflict of interest laws and/or their scope. Commonly, interviewees who were knowledgeable about public law and policy stated that there were no conflict of interest laws. It seems that the laws which do exist act as theoretical statements of public objectives without much real significance.

Furthermore, some interviewees stated that persons who claimed that particular public officials had conflicts of interests faced the threat of lawsuits for defamation. After making such a claim, a deputy mayor of a major Polish City was subject to a defamation claim, which took five years to resolve. In the end, the former deputy mayor prevailed in national supreme court. at a cost that most people could not bear.

Conflict of interest laws can provide some relief by prohibiting direct and open ties between the decision making authorities and parties that are awarded contracts. Obviously, they cannot prevent secret ties. However, interviewees repeatedly indicated that such legislation would be very useful, even though it may be circumvented.

While this section provides describes the conflict of interest laws in the CEE, the EU, and the US, the real differences are in the political climate which determines whether or not the laws are enforced.

The Romanian procurement law addresses conflicts of interest in the procurement process by prohibiting the following interested parties from participating in a Procurement Evaluation Commission decision⁶⁰:

- a) a spouse or relative to the third degree of one of the tenderers,
- b) persons who in the last three years have worked for or signed a contract with one of the tendering parties or what have participated in its Council of Administration or a leading administration body.
- c) persons who hold shares in a significant percentage of the capital of one of the tenderers.

Furthermore, parties that participated in the draft of the tender announcement and/or selection of tender criteria may not participate in the tender procedure and the party that is awarded the contract may not employ anyone who has served on the Evaluation Commission. Similar provisions are contained in Hungary's procurement law.⁶¹ One district of Bratislava indicated that it requires

that members of procurement selection committees must sign statements indicating that they do not have any conflict of interest.

Interviewees in Romania indicated that there were no conflict of interest laws other than the provisions in the procurement law. In addition, persons who claim that a public official has a conflict of interest but fail to prove that claim may be subject to significant sanctions.

Czech interviewees stated that there were no real conflict of interest laws. However, the Czech administrative procedure law contains general and broad conflict of interest exclusions, which provide for the disqualification of an administrative authority's employees or members. It applies to situations in which "unprejudiced" consideration may be "doubted owing to his relationship to the matter, parties to the proceedings or their representatives".⁶² Furthermore, any party to the proceedings is required to report any basis for disqualifying themselves or other employees which they are aware of.

The Public Service Law describes conflict of interest in very broad terms. It states that:

in the performance of his or her office, a public servant must proceed in a responsible manner, must respect and protect human dignity and human rights and freedoms: must avoid anything which would generate doubts regarding his or her objectivity in protecting the public interest.⁶³

The views of knowledgeable persons that there are no conflict of interest laws in the Czech Republic, notwithstanding the above quoted sections, demonstrates the dormant state of the laws in this area.

Various Hungarian laws include provisions against conflicts of interest. For example, the Local Government Act excludes participation in decision making in a case where a person (or their relative) is personally affected by a matter.⁶⁴ A Civil Service law prohibits civil servants from pursuing activities which would endanger objectivity and impartiality in public service.⁶⁵

Interviewees in Slovakia had different views about the state of the law, ranging from views that there was no conflict of interest law, that the law only applied to state employees, to the view that the law applied to municipal employees.

4.2 Conflict of Interest Laws in the EU and the US

In recent years in the EU, conflict of interest laws have been the subject of widespread national legislative activity and EC discussions as a part of the anti-corruption campaigns of the region.⁶⁶ In France and Great Britain, national agencies have been created for the purpose of enforcing compliance by local government officials with conflict of interest laws. Also, the laws commonly require local officials to disclose their assets.

The EC “Model code of conduct for public officials”, promulgated by the Committee of Ministers to Member States on Codes of Conduct for Public Officials, includes the following conflict of interest standards:⁶⁷

Article 13—Conflict of Interest

1. Conflict of interest arises from a situation in which the public official has a private interest which is such as to influence, the impartial and objective performance of his or her official duties.
2. The public official’s private interest includes any advantage to himself or herself, to his or her family, close relatives, friends and persons or organizations with whom he or she has or has had business or political relations. It includes also any liability, whether financial or civil, relating thereto.
3. Since the public official is usually the only person who knows whether he or she is in that situation, the public official has a personal responsibility to:
 1. To be alert to any actual or potential conflict of interest; take steps to avoid such conflict;
 2. To disclose to his or her supervisor any such conflict as soon as he or she becomes aware of it;
 3. To comply with any final decision to withdraw from the situation or to divest himself or herself of the advantage causing the conflict.
4. Whenever required to do so, the public official should declare whether or not he or she has a conflict of interest.
5. Any conflict of interest declared by a candidate to the public service or to a new post in the public service should be resolved before appointment.

The public official who occupies a position in which his or her personal or private interests are likely to be affected by his or her official duties should, as lawfully required, declare upon appointment, at regular intervals thereafter and whenever any changes occur in the nature of those interests.

Article 15—Incompatible outside interests

1. The public official should not engage in any activity or transaction or acquire any position or function, whether paid or unpaid, that is incompatible with or detracts from the proper performance of his or her duties as a public official. Where it is not clear whether any activity is compatible, he or she should seek advice from his or her superior.
2. Subject to the provisions of the law, the public official should be required to notify and seek the approval of his or her public service employer to carry out certain

activities, whether paid or unpaid, or to accept certain positions or functions outside his or her public service employment.

Great Britain adopted extensive conflict of interest legislation in 2000.⁶⁸ The Act provides for a national standards of conduct board, with investigative powers and adjudicatory powers, including the power to suspend officials from their public positions. In addition, the law and requires that each locality adopt a code of conduct and a local standards committee.

French law provides for an inter-ministerial inquiry committee which is charged with assuring the regularity and impartiality of public contracting procedures⁶⁹ and contains strong sanctions against violations of conflict of interest standards. Penalties of up to \$100,000 and \$200,000 are included.

The Danish conflict of interest law is very broad. It requires exclusion from participation in all public matters where there is a potential financial or personal interest. Furthermore, it requires exclusion in the event of “circumstances {...} are likely to lead to any doubt about such persons impartiality.”⁷⁰ Any person who has notice of the types of circumstances covered by the conflict of interest provisions is required to notify a superior as soon as possible. The Act does contain exceptions in the case that “no risk may be assumed to exist that the decision to be made may be affected by extraneous considerations.” or “it would be impossible or attended with substantial difficulties or misgivings to arrange for another person to act in his stead in considering the matter.”

In the US, conflicts of interest in local governments are covered by state laws.⁷¹ Typically, these laws contain broad definitions of conflict of interest; they require public office holders to submit disclosures of their assets; specify a time period during which former public employees cannot represent private companies before the former employing agency; provide for substantial penalties; and establish independent commissions which are responsible for the enforcement of the laws. In the US, unlike Europe, financial disclosures which public officials are required to submit are accessible to the general public. U.S. law review articles contain detailed discussions of the practical strengths and weakness of the laws and their specific provisions.⁷²

The US, laws expressly prohibit public officials from using their office or employment to obtain any financial gain for themselves, members of their family, or businesses with which their associated. Public officials are prohibited from accepting or soliciting anything of value if their vote would be influenced.

Other types of provisions include:

- prohibitions of substantial severance payments by private companies to employees prior to their assuming public positions;
- provisions which enable private parties, as well as the enforcement agency, to bring civil court actions;

- protections of ‘whistleblowers’ (public employees who report violations of the laws by their superiors).

The State Ethics Commissions typically have responsibility for:

- 1) conducting investigations and making determinations of these investigations;
- 2) insuring the filing and public availability of statements of financial interest;
- 3) issuing advise and opinions to persons about their obligations under the law.

5. CONCLUSION

In the CEE nations which were surveyed in this study, public policy and regulation in regards to contracting out public services is marked by severe shortcomings. A substantial portion of contracting out is exempt from competitive procurement requirements, contracts are widely treated as secret, and conflicts of interest are largely unregulated. Under these circumstances, the public has little reason to have faith or respect for the contracting out process and the essential elements of public participation and scrutiny are lost.

Reform in this area should include the following:

1. All contracts for public services (except for very small contracts) should be subject to a competitive bidding process.
2. Sales and leases of public facilities and sales of ownership shares in public facilities should be subject to the same competitive requirements as contracting out of public services.
3. All public contracts with private companies for the provision of public services should be accessible to the public (with very narrow exceptions for specified portions of contracts based on exceptional circumstances).
4. The drafting of public contracts should be an open process subject to public input and review.
5. Information submitted in price setting procedures should be public record.
6. Conflict of Interest Laws should include:
 - a. Broad definitions of conflicts of interest;
 - b. Requirements for disclosure of assets by public officials that are open to the public;
 - c. Prohibitions against representation of private companies by former public officials for specified time periods;
 - d. Protections of ‘whistleblowers’;

- e. Penalties for violations of the law;
- f. Independent national commissions responsible for enforcing conflict of interest laws.

Badly needed public investments in public service provision may not be undertaken or may be contracted out because otherwise they would be unaffordable. However, the types of reforms proposed here do not require public expenditures, and they provide possibilities for greatly improving the investments in public services which are undertaken.

APPENDIX A

Text of Constitutional Provisions and Legislation Covering Freedom of Information, and Exceptions to Freedom of Information Requirements (Including Commercial Secrets Legislation) in Central and East European Nations

Albania

Albanian Constitution, Article 23

1. The right to information is guaranteed.
2. Everyone has the right, in compliance with the law, to get information about the activity of state organs, as well as of persons who exercise state functions.

Bulgaria

Bulgarian Constitution, Article 41 (Sec. 2)

Citizens shall be entitled to obtain information from state bodies and agencies on any matter of legitimate interest to them which is not a state or official secret and does not affect the rights of others.

Czech Republic

Czech Constitution, Article 17

- (1) ... and the right to information are guaranteed, ...
- (4) ... and the right to seek and disseminate information may be limited by law in the case of measures essential in a democratic society for protecting the rights and freedoms of others, the security of the State, public security, public health, and morality,
- (5) Organs of the State and of local self-government shall provide in an appropriate manner information on their activity. The conditions and the form of implementation of this duty shall be set by law.

Estonia

Estonian Constitution, Article 44 (Sec.2)

At the request of Estonian citizens, and to the extent and in accordance with procedures determined by law, all state and local government authorities and their officials shall be obligated to provide information on their work, with the exception of information which is forbidden by law to be divulged, and information which is intended for internal use only.

Latvia

Latvian Constitution, Article 100

Everyone has the right to freedom of expression which includes the right to freely receive, keep and distribute information

Lithuania

Lithuanian Constitution Article 25 (Sec.5)

Citizens shall have the right to obtain any available information which concerns them from State agencies in the manner established by law.

Macedonia (FYRM)

Macedonian Constitution, Article 16 (Sec.3)

Free access to information and the freedom of reception and transmission of information are guaranteed

Poland

Under the Polish Constitution the right to obtain access to public documents is subject to the "Limitations ... *imposed by statute* to protect freedoms and rights of other persons and economic subjects, public order, security or important economic interests of the State." However, efforts to include a right for business secrets in the Constitution were rejected.

The Constitution states:

Polish Constitution (Article 61)

- (1) A citizen shall have the right to obtain information on the activities of organs of public authority as well as persons discharging public functions. Such right shall also include receipt of information on the activities of self-governing economic or professional organs and other persons or organizational units relating to the field in which they perform the duties of public authorities and manage communal assets or property of the State Treasury.
- (2) The right to obtain information shall ensure access to documents and entry to sittings of collective organs of public authority formed by universal elections, with the opportunity to make sound and visual recordings.
- (3) Limitations upon the rights referred to in Paragraphs (1) and (2), may be imposed by statute solely to protect freedoms and rights of other persons and economic subjects, public order, security or important economic interests of the State.
- (4) The procedure for the provision of information, referred to in Paragraphs (1) and (2) above shall be specified by statute, and regarding the House of Representatives (Sejm) and the Senate by their rules of procedure.

Although this article directs the legislature to adopt a statute governing procedures for access to information, no statute has been adopted up to this time. Also, no limitations in access have been adopted by statute. Nevertheless, according to the various sources contacted, contracts are regarded as secret.

Romania⁷³

Romanian Constitution (Article 31)

- (1) A person's right of access to any information of public interest cannot be restricted.
- (2) The public authorities, according to their competence, shall be bound to provide for correct information for citizens in public affairs and matters of personal interest.

Russia

Russian Constitution, Article 29 (Sec. 4)

Everyone shall have the right to seek, get, transfer, produce and disseminate information by any lawful means. The list of information constituting the state secret shall be established by the federal law.

Slovakia

Slovakian Constitution Article 26 (Sec. 5)

State bodies and their territorial self-administration bodies are under an obligation to provide information on their activities in an appropriate manner The conditions and manner of execution will be specified by law.

Slovenia

Slovenian Constitution (Article 39, Sec.2)

Except in such circumstances as are laid down by statute, each person shall have the right to obtain information of a public nature, provided he can show sufficient legal interest as determined by statute.

Ukraine

Ukrainian Constitution (Article 34)

... Every person has the right to collect, keep, use and disseminate information ...

The execution of these rights may be limited by law in the interests of national security, territorial integrity or the public order for the purposes of preventing disturbances or crimes, to protect the health of the population, to protect the reputations or rights of other people, to prevent the announcement of information received confidentially, or to support the authority and impartiality of justice.

APPENDIX B

Decision by Hungarian Ombudsman —Public Access to Highway Concession Contract (1998)

Data Protection Commissioner

recommendation

relating the publicity of concession contracts

I. Launching an Inquiry

The president of the Legal and Advocacy Protection Committee of the Hungarian Automobile Club presented a petition to the Data Protection Commissioner asking for a position to be taken in connection with the content of the concession contract concluded between the Ministry of Transportation, Telecommunications and Water Management and the First Hungarian Concession Motorway Rt. (ELMKA) for the construction and operation of M1/M5 motorways. The petitioner holds the opinion that the business interest of the economic company and that of the Ministry concluding the contract can not be more important than the principle of having access to data of public interest. A similar opinion is aired by the president of ELMKA published in an article published in the monthly 'Autósélet' and attached by the petitioner. In this article, the president says: Issues in connection with the public service should be transparent, so the contract is practically open to everyone.

In connection with this issue I asked the Minister of Transportation, Telecommunications and Water Management to take position. The public administration State Secretary trusted by the Minister declared that the concession contract is a legal entity, not a fact, therefore it can not be considered as data, so the 1992. LXIII. act on the protection of personal data and publicity of public data is not applicable. According to his view, the concession contracts should be handled as any other contracts: the content of any contract can be known to a third party only if this is not excluded in the contract for business reasons.

Since the winners and creditors of the concession tender for motorways M1/M5 insist that the content of the contract should be handled as a business secret, the State Secretary is of the opinion that the Ministry applied the right step when denied publicity.

II. The Legal Background of the Case

1. Section 10, paragraph (2) of the Constitution states that the exclusive property of the state and the circle of exclusive economic activities of the state is defined by law.
2. The preamble of Act XVI of 1991 on Concessions (hereinafter: ConAct) sets forth the following: ‘one possible way of way of efficiently operating the property exclusively owned by the state, or the local government or the associations of local governments, and of the exercise of the activities referred to the exclusive competence of the state or the local government is the assignment of all these by way of a contract of concession’.

The aim of contracts of concession is to assure the right to pursue activities. In the Act, there is a list of activities that the state is obliged to announce and then operate through concession. The concession contract can apply not only to the managing of already existing assets, but also for assets that will be the result of a future investment. One way of renouncing the right to operate is that the contracting party partially or solely undertakes the financing of big value investments where the capital requirement is very big.

The ConAct contains the following about the publicity of the concession procedure:

“ Section 4, subsection (1) The state or the local government shall invite tenders, with the exception of the aforesaid under Section 12, subsection (2), for the conclusion of a *contract of concession*. *Tenders - except when national defense or security reasons necessitate a closed tender, are open to the public. In this case Law-Decree No. 19 of 1987 on Tenders need not be applied.*

Section 8, subsection (1) Invitation for open tenders shall be published in at least two dailies of nation-wide circulation, and, in the case of local government, in the local daily paper at least 30 days prior to the first day of the period of submitting applications. In the case of a closed tender, the invitees shall be invited to tender concurrently and directly.

(2) The invitation for tenders shall contain the aspects of evaluation and as to the activity subject to concession, it shall

- a) list any other related activities*
- b) define the period of concession to be granted*
- c) define the geographical-administrative unit in which the activity is to be pursued*
- d) define the legal and financial conditions upon which the activity is to be pursued*
- e) define the conditions upon premature termination of the contract of concession,*
- f) contain information as to the rights of the state (local government) concerning the supervising of the terms of concession,*

g) *contain information as to who has the right to pursue activity subject to concession in the area affected by tender, at the time of inviting for tenders, and whether the invitor tends to grant the right of pursuing the activity subject to concession to other economic organisations during the term of concession.*

3) *If necessary, the tender shall also contain:*

a) *professional conditions pertaining to the pursuit of the activity, which exceed or depart from, those described by legal rules or standards (e.g., environmental protection, health protection),*

b) *conditions relating to the employment of domestic labour force and domestic entrepreneurs and suppliers, in the course of the exercise of the activity,*

c) *the minimum amount of the concession fee,*

d) *rules and collaterals with regard to the delivery and return of the property owned exclusively by the government (primary assets of the local government) provided the pursuit of the activity subject to concession requires the assignment of the possession of this property*

e) *information as to whether the sectoral Act prescribes parliamentary approval for the conclusion of a contract of concession,*

f) *the rules of price calculation of the licensed activity, including the methods and principles of defining and changing the price and charge,*

g) *any other information that the invitor deems necessary.”*

As to the evaluation of the tenders and the publicity of the concluded contracts of concession, no rules are mentioned in the ConAct or the Act I of 1988.

Section 19 sets forth that “*Unless this act provides otherwise, the provisions of the Civil Code shall apply to a contract of concession*”.

3. Act LVII of 1996, subsection (4) on unfair market behaviour and the prohibition on the restriction of competition states that “it is forbidden to acquire and utilise business secrets in an unfair way, or to inform non-competent persons about business secrets or to publicise business secrets.

4. Act IV of 1959, subsection 81 on Civil Code sets forth:” *Persons who violate mail secret, who—in an unauthorised way—get hold of private, company or business secret and reveal it or abuse in any way, violate rights related to persons.*

5. Section 300, subsection (1) of Act IV of 1978 on Penal Code sets forth that “a person who in an unauthorised way abuses, publicises business secrets to benefit by it, thus causing material damage, is committing felony and is subject to imprisonment up to 3 years.

6. Section 61, subsection (1) sets forth “*in the Hungarian Republic everyone has the right to express an open opinion, furthermore has the right to have and publicise public data.*”

7. Act LXIII of 1992 (hereinafter: Avtv.), Section 2, subsection (3) on the protection of personal data and the publicity of public data sets forth: *“data of public interest: data that do not constitute personal data and which are managed by persons or organisations providing state or local governmental services or any other services defined by law.*

Section 19 of Avtv sets forth the following: any organisation providing state or local governmental services or any other public services defined by law - including services in connection with its own management—, is obliged to provide precise and quick information to the public. It is the task of such organisations to assure that all public data managed by them are available to everyone except for cases when the data are declared by entitled entities to be state or service secrets, furthermore if the right to have access to a certain type of public data is restricted for reasons of national defence, national safety or for reasons of criminal prevention and prosecution, central financial or foreign exchange policy reasons or reasons related to foreign policy, relations with international organisations, court proceedings.

8. Act IV of 1978, Section/A, subsection f) states that *“ data managers who is secretive in connection with public data or falsifies public data, is committing felony that can lead to imprisonment up to 1 year, to public work or penalty.”*

III. Conclusions of the Inquiry

The right to have access to public data, the freedom of/for information is a basic constitutional right. Citizens and their organisations can only keep a check on the activity of the state or municipalities if they have sufficient information on their operation. In harmony with the data protection Act, the above mentioned organs are obliged to provide all possible information. As a general rule, they should assure the access to all data managed by them.

8/2 paragraph of the Constitution should be applied also for the freedom of information:

Examples for the legal restriction of information freedom is the Act on state secrets and service secrets, or the legal provisions concerning the protection of business secrets.

The right to have information on public data and the right to have business secret can contradict each other when organs with public activity have business relations with private companies, e.g. when they engage in a Public Procurement procedure, privatisation or concession or through the process of state and municipal property management or in cases when a state or municipal budgetary subsidy or favour is granted to a private company.

State or municipal organs learn business secrets very often when they deal with asset management and when they manage public funds. In these cases the principle of publicity has priority, since the utilisation of public finances and the state economy should be transparent. Since free access

to information is a constitutional right, the right to have business secrets can not come before that. Private companies that apply for state or municipal subsidies or enter for a competition for subsidies or companies that have business relations with the state and municipality where public finances are involved, or if they manage public assets, often are exposed to the restriction of the right to have business secrets.

Through concession the state, municipality renounces the right to carry out activities (there is an official, legal itemised list of these activities) temporarily. They conclude an onerous contract (consideration contract) which assures partial share of the market monopoly. The concession fee is usually transferred to the central budget. The ConAct declares:

When the state, municipality outsources the activity, the competition for the outsourcing activity is defined by law. Organisations or entrepreneurs should enter a competition that is defined by law and is public. The state, municipality can then select the best possible organisations or entrepreneurs that can serve the state, municipality and their community.

It is obvious from the data protection law and also from the above mentioned regulations of the concession law that when the state, municipality concludes a concession contract, it disposes over public funds. This explains why the content of this contract can not be considered as business secret, given the present system of information right.

In connection with the publicity of privatisation contracts and results of competitions for various budgetary subsidies and favours I have made some inquiries (528/A/1996., 503/K/1997., 227/K/1998. no. cases), and I still hold the opinion that based on the quoted laws, information found in a concession contract are public information and should be available to everyone.

Any agreement worded in the contract of concession concerning the obligation of the state, municipality to hold the content of the concession contract in secret contradicts Section 2, subsection(3) and section 19, of Avtv

Based on the quoted laws of Avtv. the obligation of publicity is binding not only for the content of the contract but also for the result of the competition. But at the same time, it is in the interest of those whose work did not win on the competition that their business data do not get publicised. The state, local government do not have the confidentiality obligation if the applicants reveal their business secrets when they appeal because they have complaints in connection with the results.

For legal safety it would be advisable to amend the ConAct so that all the participants: the state, municipality that announce the competition, the applicants that enter the competition would have clear knowledge as to what data can be public and what data should be public. (A good example for the clear, legal regulation is the 1996/I. Act on radio and television. The 96th paragraph (4th) section of this act defines one by one which data of a concession contract are subject to publicity after a concession contract was concluded for the provision of radio and television services).

IV. Recommendation

Based on the above mentioned, I propose the following:

- I request the Minister of Transportation, Telecommunications and Water Management to assure that all data are public to the petitioners or any other parties that hold interest in connection with the content of the concession contract concluded between the Ministry of Transportation, Telecommunications and Water Management and the First Hungarian Concession Motorway Rt. (ELMKA) for the construction and operation of M1/M5 motorways.
- I request the Minister of Justice to initiate an amendment of act XVI of 1991 on concession so that interested participants could practice their constitutional right to have access to all public data.

Budapest, 1998. november

Dr. László Majtényi
Data Protection Commissioner

NOTES

- ¹ Law on Concession, 1998, Law No. 219, Article 2.
- ² Some interviewees noted that this approach for park maintenance improved performance by bringing about competition among the various park maintenance contractors to provide the best quality service. One district representative noted, with regret, that his district had significantly limited its future options in contracting street maintenance services, by virtue of its sale of its maintenance equipment to one company.
- ³ Interview with City Staff, February 2001.
- ⁴ Council Directive, 92/50/EEC, Article 1(a) (18 June 1992).
- ⁵ Arrowsmith, Sue, *Public Private Partnerships and the European Procurement Rules: EU Policies in Conflict?*, *Common Market Law Review* Vol. 37, 709, 713 (2000).
- ⁶ Council Directive, 92/50/EEC, Article 1(a)(iii) (18 June 1992).
- ⁷ Commission of the European Communities, *Commission Interpretative Communication on concessions under Community law*, Brussels, 12.4.2000, p. 15 (Official Journal of the European Communities, Vol. 43, 29 April 2000 (2000/C121/02), (http://europa.eu.int/comm./internal_market/en/publproc/general/conc2.htm).

- ⁸ Commission of the European Communities, *Commission Interpretative Communication on concessions under Community law*, Brussels, 12.4.2000, p. 16.
- ⁹ Hungary, Act XL of 1995, Introduction.
- ¹⁰ Ordinance No. 118. (1999).
- ¹¹ Act 199 of 1994, published in English by Trade Links, s.r.o., Prague (Miscellaneous Acts in 2000).
- ¹² Act 199, Sec. 1 (r) and (s).
- ¹³ Section 37.
- ¹⁴ Section 37(2).
- ¹⁵ Act XII of 1995.
- ¹⁶ Act XL of 1995, Sec. 10(e).
- ¹⁷ Commission of the European Communities, “Commission Opinion on Hungary’s Application for Membership of the European Union”, (Brussels, 15.07.97; COM (97) 2001 final).
- ¹⁸ Ordinance No. 118 of 1999.
- ¹⁹ Ordinance No. 118, Sec. 2.
- ²⁰ 1999, Act 263, (on the internet in English: www.uvo.gov.sk/vo_e.htm).
- ²¹ 1999, Act 263, Article 2, Sec. 3. v & x.
- ²² Regional Environmental Center, *Doors to Democracy*, pp. 158–159, Szentendre, Hungary, 1998.
- ²³ Act No. LXIII of 1992. For a discussion of the Act and related background information see Hungarian Civil Liberties Union, *Data Protection and Freedom of Information*, Budapest: 1997. The report is published in English and includes a translation of the Data Protection Act.
- ²⁴ Article 19, Sec. 3.
- ²⁵ Article 2, Sec. 3.
- ²⁶ Article 19, Sec. 4. One exception to the above rules is that: “Unless an Act provides otherwise, data generated for internal use and in connection with the preparation of decisions shall not be public within thirty years following their inception.” (Article LXIII of 1992, Sec. 19(5)). However, according to the legal experts interviewed, the apparent intent of this section is to protect drafts of proposed regulation prepared by a ministry, rather than to protect commercial information.
- ²⁷ Act IV of 1978, Sec. 300.
- ²⁸ Case No. 528/A/1996. (28 November 1996).

- ²⁹ Data Protection Commissioner Recommendation Relating to the Publicity of Concession Contracts, Nov. 1998.
- ³⁰ Law No. 69/1991, Article 49, sec. i.
- ³¹ For background information on freedom of information in Romania see Andreescu, Gabriel; Stefanescu, Manuela; Weber, Renate, *Access to Information in Romania*, Center for Human Rights, Bucharest: 1996.
- ³² Ordinance No. 118 (1999), article 44 (as modified Ordinance No. 202 (1999) published in Official Monitor of Romania, Pat I, No. 431 (31.VIII.1999).
- ³³ Article 26 (Sec. 5).
- ³⁴ Section 10(1).
- ³⁵ Section 10(2).
- ³⁶ 1998, Law No. 228.
- ³⁷ *Id.*, Article 7.
- ³⁸ For discussion see McDonagh, *Freedom of information developments in Europe*, from the *Freedom of Information Review*, pp. 58–61 Australia: August 1995.
- ³⁹ 70th Session, 29 April 1982.
- ⁴⁰ Declaration, *ibid*, Sec. II(c).
- ⁴¹ 93/730/EC Supplemented by Council Decision 93/731/EC.
- ⁴² Council Directive 90/313/EEC. For extensive analysis of access to environmental information see ed. Hallo, *Access to Environmental Information in Europe* (1996, Kluwer Law International) and Regional Environmental Center, *Doors to Democracy* (1998, Szentendre, Hungary).
- ⁴³ *Federal Law Gazette* I 1997/75, (Reissue), Sec. 56.
- ⁴⁴ *Code Administratif*, Loi no. 78–753 du 17 juillet 1978, modified by Loi no. 2000–321 (12 April 2000) (www.cada.fr).
- ⁴⁵ *Id.*, Sec. 6.
- ⁴⁶ Commission d’Access aux Documents Administratifs, *Guide de l’acces aux documents administratifs*, (3d. Edition 1998).
- ⁴⁷ Commission d’acces aux documents administratifs, 9e rapport d’activite, p. 15.
- ⁴⁸ Commission d’acces aux documents administratifs, 9e rapport d’activite, p. 13.
- ⁴⁹ However, three German states (Brandenburg, Berlin, and Schleswig-Holstein) have adopted freedom of information laws.
- ⁵⁰ Laws of 2000, Chapter 36.
- ⁵¹ Laws of 2000, Chapter 36, Sec. 43.

- 52 Open Government, *Code of Practice on Access to Government Information*, Guidance on Interpretation, Cabinet Office, 1994, Paragraph 13.3.
- 53 Freedom of Press Act, Ch.2. On the Public Nature of Official Documents. Article 2.
- 54 *Ibid*, Article 3.
- 55 Access to Information Act, Sec. 20(1).
- 56 *Air Atonabee Limited v. Minister of Transport*, 27 F.T.R. 194, 207 (1989).
- 57 5 U.S. Code Ann. Sec. 9(b)(4). For discussion of the commercial exemption under the Freedom Information Act see American Civil Liberties Union, “Exemption 4, Business Information”, *Litigation under the Federal Government Open Government Laws* (Ch. 6, pp. 75–85, 1992); Kuersteiner and Herbach, “The Freedom of Information Act: An Examination of the Commercial or Financial Exemption”, 16 *Santa Clara Law Review* 193–213 (1976).
- 58 Public Citizen Health Research Group v. Federal Drug Administration, 704 F.2d. 1280, 1288 (D.C. Cir. 1983).
- 59 (Report prepared with British Government Research Fellowship). (Contact address for publication, rsb@clara.net). Also see Baxter, “Public Access to Business Information Held by Government”, *The Journal of Business Law*, May 1997, pp. 199–219.
- 60 1999, Law No. 118, Article 55, (Official Monitor of Romania, Part I, Nr.431/31.VIII.1999.
- 61 Act XL of 1995, Sec. 31.
- 62 Administrative Procedure Code, No. 71 (1967) as amended by No. 29 (2000). Sec. 9 (1).
- 63 Act 283 of 1993, Sec. 24 (1).
- 64 Act LXV of 1990, Sec. 14 (2).
- 65 1992 Act. 23, Section 21(5)(a).
- 66 See e.g. European Parliament, Directorate General for Research, “Measures to Prevent Corruption in EU Member States” (Legal Affairs Series, JURI 101, 03-1998) .
- 67 Recommendation No. R (2000) 10.
- 68 Acts of 2000, Ch. 22, Local Government Act of 2000.
- 69 Law No. 91–3, Art. 1 (1991) creates the committee.
- 70 The Danish Public Administration Act. Act No. 571, Part 2 (Disqualification) (19 January 2000).
- 71 The complete texts of most, if not all, U.S. state laws are available on the internet. In addition, state agencies which are responsible for enforcing conflict of interest laws commonly prepare reports which summarize their laws, which are also available on the internet.
- 72 Kennedy and Beck, “Interest of Public Officers in Contracts Prohibited by Law”, *Southern California Law Review*, Vol. 28, pp. 335–347 (1955); “Conflict of Interest in Public

Contracts in California”, *California Law Review*, Vol. 44, pp. 355–377 (1956); Kaufman and Widiss, “The California Conflict of Interest Laws”, *Southern California Law Review*, Vol. 36, pp.186–207 (1963); “Pennsylvania’s Public Official and Employee Ethics Law of 1989: Strengthening the Faith and Confidence of the People of the State in Their Government?”, *Dickinson Law Review*, Vol. 94, pp. 997–1029 (1990); Davies, “Article 18 of New York’s General Municipal Law: The State Conflicts of Interest Law for Municipal Officials”, *Albany Law Review*, Vol. 59, pp. 1321–1351 (1996); DeSario and Freel, “Ohio Ethics Law Reforms: Tracing the Political and Legal Implications”, *Akron Law Review*, Vol. 30, pp. 129–152 (1996); Lawrence, “The Proposed Michigan Government Ethics Act of 1999: Providing Guidance to Michigan Public Officials and Employees”, *University of Detroit Mercy Law Review*, Vol. 76, pp. 411–482 (1999).

⁷³ For background about transparency issues in Romania see Centre for Human Right, “Access to Information in Romania” (1996).

Czech Republic

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1. OVERVIEW OF THE CZECH LOCAL GOVERNMENT SYSTEM

Czechia (the Czech Republic) has been an independent state since its founding on January 1, 1993. The Czech Republic is the legal successor of the territory that was, up until December 12, 1992, part of federated Czechoslovakia. The split of Czechoslovakia had practically no influence on the course of the transformation process which started at the end of 1989 with the fall of the communist government.

The Czech Republic has a population of 10 million, and a relatively high number (about 6,000) of self-governing units or ‘communities’, each of which is run by a local board of representatives who are elected in local elections. The possibility to significantly reduce the number of communities in order to increase the efficiency of public administration is not commonly considered politically feasible.

Larger communities not only have the responsibilities of self-government, but also perform some functions of state government. The way a community delegates tasks of state government amongst its organs depends partly on the nature of set agendas, and partly on the realistic ability of the local community or town hall to carry out the tasks entrusted to it in a sufficiently qualified manner.

Up until November 2000, communities represented a single level of self-government administration. Now there are fourteen regions, representing the second level of self-government. The real impact of this significant structural change on the effectiveness of public administration cannot, however, be estimated at present.

Before 1990, the then Czechoslovak State did not have municipalities but rather city or local national committees. Independence and decision-making powers of these committees were much less than they are those of communities today. They were more executive components of state government rather than representatives of local government. Another important fact is that they were not independent legal entities, they did not own property—they only administered state property—and of course they did not conduct business. From a financial point of view, it was more a redistribution of state funds. This meant that a fundamental part of local budgets consisted of state subsidies.

Local utilities were mostly secured through locally designated state companies—such as transportation companies (municipal mass transit); housing companies (state housing authorities in cities or communities, residential heating); and technical services (street cleaning, road maintenance, waste management, street lighting). Similarly, services of a more detailed nature were also secured, such as laundries, cleaners, hairdressers, gardening, cemetery maintenance, and even bakeries. As already mentioned, these businesses were strongly subsidized by city budgets. Some of these

organizations have persisted long after 1989 in the form of state companies. However, the common trend was that they were transformed into other types of institutions, as will be discussed later.

A decisive change in the functioning of cities and communities in the Czech Republic came with the ratification of Communities Act No. 367/1990 Coll. (Collection of the Czech Acts). This law defined cities and communities as legal entities that independently administer their own assets and manage their own financing. The law also states the basic obligations for each of these municipalities, especially in the areas of: approving a local development program and annual budgets; duties in the areas of education, social care, health and culture; and ensuring local public order, sanitation, waste removal, water supply, waste water disposal; and setting types of local fees and their rates. Communities may also establish special legal entities in order to carry out their activities.

A direct state impact on communities and their management, including the placing of sanctions if necessary, does not exist under common regulations. The great freedom communities have in handling their assets, relies on the constitutional principle, mainly in the fundamental equality of ownership rights for all owners.

1.1 Community Financing and Local Property

The period 1990–92 was a transitional period with a gradual decrease in the significance of purpose-based and non-purpose-based subsidies from state and local funds and the strengthening of local revenue base (for example local taxes and fees, and property sales). A decisive change in municipal financing came as a part of complex tax reforms coming into effect at the beginning of 1993. Briefly, the law defined what part of the total collected tax revenues would be allocated to communities each year and by what criteria. The community could then use these funds autonomously. A stricter regime exists in the case of state purpose-based subsidies whose importance, however, has fundamentally decreased. They are provided for the development of selected areas—for example housing construction or infrastructure development.

Since 1993, communities have received personal income taxes, income taxes from businesses of natural persons with residence in the city, and property taxes. Since 1996, cities and communities have been receiving a share of corporate income taxes while personal income taxes are currently lower. The revenues of these four taxes makes up roughly 60–70% of local budget revenues, which is relatively high. This is a stable source that can be relied on for as long as the government and parliament do not change the law. From this point of view, communities at present cannot regard income tax as a fully established, stable entity. This has a certain impact mainly on a community's long-term financial planning.

A specific problem is the fact that cities cannot—with the exception of property tax rates, though not so important financially—influence the amount of their tax revenues. The tax laws are statewide, passed by the parliament, and affect the budgetary rules as determined within the

structure of allocating such taxes among individual cities and communities. This situation has been partly changing since 2001, when regions began to function as central elements between the local and state government. Regions will also have their own finances and property, so that financial resources will once again be close to regional areas.

Czech municipalities have a relatively wide freedom in terms of both the income and expenses of their budgets compared to other countries. With expenses there is freedom as to where money can be spent, provided, of course, it is approved by the relevant city or community organs. Regarding income, there are bank loans, revenues from communal obligations—in short—other possible sources besides state redistribution of taxes and local fees. There is no limit to the degree a community can become indebted. Other relatively important sources of income to local budgets have been the sale of property.

In terms of independent asset management, the most important law for cities and communities was Act No. 172/1991 Coll. on the transfer of certain state property to communities. It was partly a change in the so-called ‘right to manage’ property originally owned by municipal and local national committees, to the real ownership of property by the cities and communities. It also involved the return of property that the communities and cities had owned before 1949.

Another important law was Act No. 92/1991 Coll. on conditions of state property transfer to other persons, the so-called law on Large-Scale Privatization. The specific ministry, the National Property Fund, was in charge of this privatization. Every subject—including a private person, commercial company, or municipality—could apply for the state property, the only condition was to describe the ‘privatization project’ where the proposed conditions of the transfer and the expected future use of the transferred property were described in detail. The Fund would then decide about the transfer, and would have the transfer contract prepared, containing the conditions with which the new owner would be obliged to fulfil. As a part of this transformation of state property, the cities and communities were able to acquire property or a part of the stock of future joint-stock companies, provided there were logical reasons in terms of ensuring local utilities, i.e. that the property transferred to the community would help to fulfil the duties and tasks of the community as defined by law. In such cases immediate transfers were, as a rule, mostly free of charge.

Through these two laws, cities became the owners of enormous properties, and it was just a question as to how they wanted to administer it. The common trend now is for the city to keep that part of the property which is directly needed for its basic activities as well as property that is the source of long-term benefits. This was accompanied by relatively large sell-offs, which are known as ‘secondary privatization’. This relates to, for example, a portion of public housing; stock shares in regional companies whose activities do not relate directly to the functioning of cities; or small stakes in companies that offer no possibility to influence their operations. The decisions involved in these sales, as with purchases or exchanges, are exclusively in the hands of the local board of representatives.

Through these unforced transfers, cities have also acquired property of former transportation companies, technical and other local utilities. The fates of these former local businesses are varied. As a rule, cities converted them into new businesses, always in keeping with the relevant purpose which brought about its original establishment. A somewhat complicated situation occurred with the waterworks and sewerage, where joint-stock companies were directly created, with individual communities and cities having a proportionate share. At present, some of this property has already been privatized. Analogously diverse is the situation with waste water treatment, which in some cases are built by the city itself, whilst in other cases belong to private entities. This requires a sensitive coordination of negotiations for the most efficient operation, and with terms agreeable for citizens.

2. CHARACTERISTICS OF LOCAL PUBLIC UTILITIES

2.1 Defining the Sector

The basic legal standard by which communities are administered is the community law. This law specifies the rights and obligations of communities. The state may intervene in community activities only in cases to uphold the law and only using ways allowed by law.

Most community duties are stated in the law in rather general terms, but some of these obligations are specified directly by the law. Among these are: household waste removal; the cleaning of public city spaces; a drinking water supply; and the removal and treatment of liquid waste (sewage).

Other duties of a community depend on local conditions, specified by law only in general terms. The community government is responsible for a number of them, but part of the responsibility is also shared with the state government. They include: matters of local order (including the management of community police as independent organizations, i.e. organizationally not dependent on police stations); economic development; social development; along with cultural and environmental development. Typical areas include specifically: the maintenance of green areas; local public transportation system; local road maintenance; street lighting; residential heating; administration and maintenance of community property; administration and maintenance of cemeteries, and so on.

Finally, these also include services which are secured partly by the state and partly by the communities, based on a division of activity as prescribed by law. Among these are mainly education, social care and public health services.

To explain the exact division of tasks between the state and the municipalities is very complicated and goes beyond the purpose of this report. This division differs by individual agenda, and is different for different categories of communities. Among the individual community activities as

named below, there are no fundamental differences in matters of securing the relevant utilities. A somewhat different situation is in the case of utilities with natural monopoly features (water-works, street lighting, etc.).

Among services that as a rule are secured by a community, the most important are the following:

- a) drinking water supply,
- b) sewer system,
- c) household solid waste,
- d) hazardous and bulk waste,
- e) residential central heating,
- f) city cleaning (pavements, streets),
- g) maintenance and renewal of green areas,
- h) local road maintenance,
- i) parking,
- j) cemetery administration and maintenance,
- k) local public transportation, integrated regional transportation,
- l) leisure time facilities (playgrounds and sports facilities),
- m) social housing,
- n) administration and maintenance of community property,
- o) share in crime prevention, drug prevention,
- p) health services,¹
- q) municipal information system,
- r) street lighting,
- s) cultural activities directly organized with the support of local government,
- t) sports activities supported by the community.

The significance of the local utilities sector depends on the longstanding situation in a given community. It is definitely dependent on its size and in view of the large number of small community governments in the Czech Republic, it is clear that in the range of cases a solitary community will not be able to ensure the utilities it expects to receive. Concerning the ownership of respective organizational forms of securing utilities, it has been noted that at present there are none that meet satisfactory standards.

For example, in Prague, the city districts independently manage their entrusted property. This has led in one city district to a change of administration of household property from the care of

the community to private entities, because securing this service by community powers was deemed insufficient. In other city districts during this same period, the process was decided as exactly the opposite, again for reasons of bad experience with private firms.

There is always a certain tension here to maximize controllability of the process to the benefit of one side, which is often awarded to one's own organization or community component. There is a natural effort towards the internal economy with one's own private entity, while entities living from public money lack natural motivation. A satisfactory solution so far has not been commonly found—experience indicates that the situation can be improved by a stabilized market with sufficient supply of firms able to substantiate certified good references.

A classic problem is the difficult question of effective quality control of supplies to the public sector. This problem cannot be solved by improving legislation and especially with one-time supplies (where a settlement will establish and expand in the future, which the utility customer must rely on), it seems practically unsolvable.

The impact of the public utilities sector on local budgets differs of course from city to city, but some regularities can be generalized. A major expense of each local budget is traffic infrastructure maintenance and transportation—mass transportation is subsidized everywhere, single rides on covered expenses is not enough, so these components can amount to a significant proportion of budgetary expenses.

In roughly the same terms, the same concepts apply to expenses for city cleaning, the maintenance of roads and public green areas, waste management and street lighting. In bigger cities, support of culture has become a relatively major expense, for example subsidies for theater, culture houses, musical organizations and cinemas. As previously mentioned, the support of sports, mostly mass and performance, in several cases were subsidized to the highest level.

2.2 Availability of Information on Local Utilities

Communities are obliged to provide the most available information on their activities, decisions and plans under several laws. Among these, the most significant are the law on communities, the law on free access to information and the law on public contracting. Unfortunately, information provided according to these laws relates only to a relatively narrow target group. This results in a constantly insufficient level of information about the work of local government, which could, and should, ensure more efficient cooperation with the public in the broadest sense of the word. Most communities realize this insufficiency and search for additional ways to inform the public, especially in larger cities where this problem is the most severe. A standard means of informing the public is via the media, which is owned solely by the municipality.

A major change in availability of information is represented by the gradual transfer of some data registries into public form, accessible by internet. This includes the commercial registry, which already is accessed by this method; in near future the real estate registration office should be similarly accessible. The law on public contracting placed the obligation to provide defined contract information in electronic form. In exactly this way the law on the free access of information commissions, community offices, and other public administrative offices can provide information via the internet.

Another problem which authors have met is the lack of relevant statistical data. The reason is not only that the data itself is not at disposal but actually in most cases there is no person or group authorized to collect and publish this data. The main problem is that statistics could collect the data characteristic for some formally specified reality (e.g. how many economical subjects are registered and qualified to offer household solid waste disposal) but considering the present conditions in the Czech Republic, it is quite unrealistic to expect that such data can give the information on how many subjects really do the activities regarding household solid waste disposal and to what extent and quality.

2.3 Managing Utility Services

Even though community governments have been in operation for more than ten years, it is necessary to state that optimal fulfillment of functions to which community management must enter has often not yet been found. There should be an equilibrium between the owner of communal property and the customer (user) of public utilities. Often, however, the utility provider has a role and is responsible for the status and creation of social policy.

When services are performed by municipal employees there is the advantage of closer access to information and (theoretically) better supervision of their work. In practice, however, supervision makes sense only when the non-fulfillment of required parameters could be threatened with effective sanctions. Regarding the type of protection the current labor law provides to employees in the Czech Republic, it is less possible to secure reparations, compared to the ability to sever relations with external subcontractors, who provide their services on a contractual basis.

The common model in the Czech Republic is that the community secures utilities by its own special organizations. As a rule, it is a contributory organization, often they are businesses in which the community ensures an adequate influence on decisions. Contributory organizations are used mainly in utilities with a lasting nature of subsidy of activities from the side of the community, for example in social services.

Some services are hard to imagine being secured by the community itself or with help of their own organizations. A typical example are social services provided to specialized target groups,

such as the homeless in the centers of large cities. Cooperation with the non-profit sector is common, which concentrates on these services, and the provision of community funding, but also, for example, space at subsidized rent. Some activities, such as special social care on city streets, attention to the handicapped, and so on, would not be possible at all without special types of private entities.

In the area of development, maintenance and repair of common municipal property disrepair of property has already demanded cooperation with private entities. A very frequent form are the various kinds of agreements, which de facto represent a gain of financial sources for quickly carrying out necessary repairs (long-term rent), or conversely transferring property into private hands (privatization).

The fields where the optimal forms in their development are searched, is a broader cooperation with private enterprises such as in areas of community development and regulation of the undesired phenomena. In many cases, public administration still deems private entities as a matter to be brought under control and regulated, rather than engaging in dialogue about development and regulation possibilities. (Even this dates back to the time of national committees, although not substantially, but importantly. Also from the entrepreneur's point of view, relations with local government are often felt rather limiting and unfriendly.)

The perspective of cooperation between communities and the private sector rests in long-term relations founded on mutual understanding. With entrepreneurs, there is the risk of a gradual worsening of quality in the provided utilities ('self-indulgence'). As long as the criteria used are as objective as possible and known beforehand (before concluding or renewing a contract), this risk may be avoided.

2.4 Financing Local Utilities

At the local level there are only a few services provided to individual or corporate consumers, whose price is reduced by city or community subsidy. Already unsubsidized are prices of drinking water, fees for sewage, heating prices, hot water, electricity, telecommunication fees, gas, waste removal.

On the other hand, financial support is always found when speaking about riders on municipal mass transportation systems, entry fees to non-private theaters, swimming pools, as well as tenants, where most rental agreements thus far do not cover the costs of long-term maintenance of the municipal housing stock.

Of course, all public utilities such as administration and maintenance of roads, parks and public greens, maintenance of school buildings, ensuring cleanliness of public free spaces and other duties secured by the community are subsidized. Costs for these activities are a standard part of the community budget, however they are secured.

Local utilities are often provided on a contractual basis under conditions that represent either direct or indirect community subsidy. With the beginning of the 1990s, when communities were just starting to gain experience, it was often the practice to intentionally provide private subjects with advantageous conditions. This was often out of fear that the given service would cease without major community support. A more common opinion was that the better the conditions a private entity receives for his business, the better the service provided to the end-user. Practice soon showed that these premises were mistaken. These persist to the present day, for example certain unsuitable business contracts which communities have great difficulties in abandoning.

From the development that followed in the Czech Republic, several conclusions can be drawn. Firstly, it must be very carefully considered whether the specific utility can truly be obtained under natural, unregulated market conditions. Another heritage of planned economy widely spread among public administration representatives (and often unconsciously), is that the care of public affairs consists above all of formulating and giving conditions under which to ensure public welfare. Communities that succeed in avoiding these obstacles are more successful, as a rule, in creating realistic living conditions in the community.

Secondly, if a specific utility really needs support or subsidy, this support must be carefully assessed to an adequate degree. Practice has confirmed that creating conditions inadequately advantageous does not lead to improved services, but rather to their devastation. Moreover, in a community that otherwise operates according to market principles, giving advantages to certain businesses puts them in a better position than the rest, which paradoxically puts community government in the role of harming economic competition.

Thirdly, if a certain utility cannot be provided without support or subsidy, it is appropriate to provide advantages according to the recipients, and not to the providers. The availability of the utility to target groups is thus supported or maintained without, however, the utility provider being exposed to the risks mentioned above.

2.5 Capital Investment Financing

As previously mentioned, Czech cities and communities have great freedom in seeking funding for their activities. The most common method is the use of budgetary non-purpose revenues, which are of course limited, and at the same time there exists many permanent recurring expenses (the operation of schools, the internal operation of city hall, and so on).

If the cities establish separate businesses for ensuring certain activities, they often use their own property instead of financing. For example, in the case of joint-stock companies that ensure the operation of mass transit, the city provides all the means of transportation, transportation networks, and buildings of operation.

Another source of funding is access to credits from domestic and foreign banks. One particular problem can be the strict requirements of these financial institutions in securing the money borrowed. It must be said, however, that the largest part of borrowed money has so far been directed at the reconstruction of neglected local technical infrastructure.

Otherwise, cities have a great freedom to support various business goals, they can even guarantee their credit (which is a rather risky operation, which was used especially at the beginning of the 1990s and later rightly abandoned for its demonstrated risk), of course only after discussion and approval by the board of representatives. It is necessary to maintain rules of law on awarding public contracts as well as the law on public support.

In financing the public sector in the Czech Republic, the subsidy system has a relatively rich tradition. It is very widespread and covers practically all areas of activities on the local government level. The most common case is the situation where a subsidy is granted from the state budget via the relevant ministry or other central organ. At present, several subsidies are being granted at the district office level. In recent times funds from the European Union are becoming a trend. The most important subsidies used by cities and communities of the Czech Republic are granted from sectoral budgets. In environmental services grants are provided for: the construction of sewers; waste water treatment plants; water supply; ecological solutions to waste management (e.g. support of recycling); support of protection of green areas (e.g. reconstruction and revitalization of municipal parks and orchards); revitalization of protected areas, protection of the atmosphere; and municipal park maintenance. In the transportation sector, investment support is provided for urban mass transit (for example buses and trolley buses).

Administration, maintenance and renewal of housing stock are granted by attractive loans for repairs, modernization and expansion of housing—very popular and largely utilized by citizens. This applies, however, also to community housing administration, maintenance and renewal. This includes support of leased housing construction and technical infrastructure—i.e. subsidies determined for a housing unit and for technical infrastructure, for meeting certain conditions ensuring the social aspect of this construction. This may also include subsidies for eliminating specific defects in panel construction. This is a much needed protection project, lengthening the life of panel buildings build from older technology.

As part of pre-entry assistance, candidate countries may upon entry into the European Union have access to financial resources from two funds:

- ISPA—support of large-scale projects aimed at the development of conveying environmental protection,
- SAPARD with the goal of modernizing agriculture and developing the rural environment.

In addition, there have already been several years of PHARE aid. For example, the PHARE CBC program is utilized for supporting various activities as part of cooperation beyond borders,

i.e. on the borders between the Czech Republic and Austria, Germany and Poland. The PHARE 2000 and 2001 programs in the meantime support selected regions in the Czech Republic. This support should be gradually expanded to all regions in accordance with regional policies of the European Union.

3. REGULATORY MEANS OF THE SECTOR

Basic regulatory means available to communities are to issue decrees (always within the legal framework), use of community property and finally setting levied local fees. Another group of regulatory means is the provision of grants or charging fees for services with regards to their possible regulatory function.

Use of community property is practically unlimited, responsibility is assumed by the elected board of representatives. Community ownership rights are just as broad as private ownership rights. The system of local fees (i.e. local taxes, because fees are not collected for concretely provided services) is practically the only direct means of regulation a community has. The regulatory role of local fees can be exerted in cases where the community is in financial difficulties and the attempt to maximize profits from fees can then represent limits to their regulatory role.

Defining standards or service performance can help to improve the regulation in the sector. Up until now, no commonly accepted or applied standards were accepted. Defining such a standard is up the municipality itself and should be a part of the public tender condition. Another possibility commonly used is to demand that the proposal of the performance standards will be offered by the bidder in the public tender.

3.1 Ownership Rights

Under Act No. 172/1992 Coll. on the transfer of certain property of the Czech Republic to community ownership, communities gained ownership rights to state property, which formerly they only had the so-called 'right to manage'. With the enactment of this law, communities and cities began to manage their property and the execution of an independent sphere of authority when securing community development and satisfying the needs of citizens, and providing public utilities, fundamentally changed. An independent community sphere of authority is logically founded on the possibilities to manage their own property and secure development of all sides of the community in accordance with the decisions of the community board of representatives.

According to traditional ideas, the owner is entitled to hold and use his property, to use the fruits and profits of his property and to charge for them. Ownership rights are also defined in this

sense in the civil code, as amended. Ownership rights and their protection are the same for all entities, even communities. The right of an owner to hold and use his property and to charge for it has been in effect on our territory within commonly binding legal regulations since 1811, when the general civil code was issued, with which certain modifications were valid up until 1950. From a formal viewpoint the contents of ownership rights were defined similarly, and with further legal modifications have been valid in principle up to the present day.

From the beginning of the 1950s to the beginning of the 1990s, the factual content and conception of ownership rights was deformed by legal distinctions made between many types of ownership imbedded in the constitution at that time. Socialist ideology, legal theory and practice was distinguished by the so-called socialist societal ownership, which was by the state, cooperative or by societal organizations (e.g. by the National Front political party, unions, or interest groups). Furthermore, personal ownership that served only to satisfy personal material and cultural needs of citizens were significantly limited by the law of permissible scope (e.g. a family house could not be larger than 120m²). Personal ownership could not serve business purposes. On the whole, district law permitted private ownership that served to limit individual business based on one's own labor.

Private ownership was instead formal, however, inasmuch as the owner could charge only permissible relevant state organs for use of his property. In housing under private ownership state organs (national committees) allotted housing for the use of citizens, and the owner was forced to respect decision of this allotment in his building. The owner could make his building available only with the consent of state organs. Decisions on housing exchanges in private houses were made by the national committee, not by the owner. Also, private owners of small workshops or other small operations could conduct business with their property individually only as an exception granted by the relevant state organs. Agricultural land also was in some cases formally in private ownership, but the owner could personally secure agricultural products on his land, which was quite difficult, and was forced to hand over his land free of charge for the use of agricultural cooperatives or state farms.

In the 1980s the concept of national property administration based on law was replaced by the concept of the right to manage state property that it administered. The concept of the right to manage in affairs of state ownership is to this day protected by law. It is applied to state property—for each state possession of the Czech Republic there is a relevant state organ, business or state institution of the right to manage.

A major part of community property today was acquired not by gradual acquisition but by transfer from the state once the Act No. 172/1991 Coll. went into effect on 24 April 1991. This law transferred property previously owned by the Czech Republic and managed by national committees to communities. The above-cited reasons for the transfer of ownership to communities was not related, however, to matters that served to fulfil the duties of smaller operations. For purposes of transferring this state property, small-scale privatization was undertaken. Small

enterprises were handed over to small and medium businessmen who the state wanted to assist in the speedy development of small and medium-sized businesses.

Small-scale privatization took place in the Czech Republic relatively successfully. A person who successfully privatized a small enterprise and acquired goods, supplies and operational equipment also had the right of rent control for the space where the privatized business was located. These spaces themselves were not, as a rule, the subject of small-scale privatization.

Communities, however, could intervene in small-scale privatization in other ways. If a community considered the privatization of a small enterprise of the former national committee inappropriate, it could apply to the relevant state organ for a transfer of what would otherwise have been privatized, to its own ownership. The relevant state organs, however, considered whether such a request from the community was suitable. Nevertheless, such cases were rather exceptional and quite unimportant except very small municipalities.

A special case of ownership is public housing. Under Act No. 172/1991 Coll., a majority of formerly state housing and plots of land creating a functional unit was transferred to the ownership of communities. This related above all to larger cities, which acquired the ownership rights of the housing.

The significance of this transfer of ownership rights of housing to communities was demonstrated with the start of privatization of community housing in many cities and communities. Some communities decided that privatization of housing would be carried out by selling selected houses to cooperatives or business associations created from the current tenants. Other communities decided to sell individual flats (apartment units) in accordance with the law on flat ownership.

3.2 Business Entities in the Utilities Sector

For an overall characterization of businesses in the Czech Republic, it is necessary to consider the current state of legal modifications contained above all in the commercial code, civil code, trade law, community law, as well as the law on public contracts.

The commercial code, Act No. 513/1991 Coll., is the basic legal regulation that established the position of entrepreneurs, commercially binding relations and other relations connected with conducting business. Relations between entrepreneurs are considered commercially binding as determined by the commercial code, as far as their business activities are concerned. Similarly, relations between entrepreneurs and the state or local government (community) are considered commercially binding, when related to securing public needs.

Commercial companies, cooperatives and other legal entities prescribed by law are registered in the commercial registry. A commercial company is a legal entity established for purposes of

conducting business. Possible forms of commercial companies include public commercial companies, limited partnerships, limited liability companies and joint-stock companies.

When providing public utilities, especially with public contracts, a community may conclude a contract and enter into legal relations with all of the above-mentioned types of commercial companies. At present, the most widespread type is the limited liability company, whose members are liable only up to the unpaid amount of starting capital as registered in the commercial registry. Unsatisfied claims of a community towards non-solid limited liability companies can become quite problematic, often even impossible. Other applicants for public contracts are joint-stock companies. Public commercial companies and limited partnerships do not often operate in the sphere of public utilities.

Other business entities in the sphere of public utilities can be cooperatives. These are associations without a self-contained number of persons established for purposes of conducting business or ensuring economic, social or other needs of its members. Various manufacturing and consumer cooperatives have a relatively long tradition in the Czech Republic, cooperatives such as socialist organizations were active even under socialist Czechoslovakia, even though somewhat deformed given the political and economic circumstances at that time. At present, cooperatives no longer operate as business entities. Mainly housing cooperatives established by tenants have an important position. Foreign legal entities or naturalized persons may also provide various utilities as business entities. With deepening European integration we can expect a greater number of foreign persons doing business in the Czech Republic. Foreign persons may conduct business under the same conditions and to the same extent as Czech citizens, unless otherwise stated by law. Foreign persons have to comply with more complicated conditions to acquire trade licenses and to register in the commercial registry; foreign persons may not legally acquire real estate in the Czech Republic; and for foreign persons it is more complex to receive permits to employ foreigners, and so on.

Each entrepreneur is obliged to register in the commercial registry: commercial name and legal form, place of operation, subject of business, persons authorized to negotiate for the company and other data. It is general practice for communities to request a submitted recent extract from the commercial registry when concluding contracts. Several years ago the commercial registry became more widely available through the Internet: it is difficult to appreciate the significance of this step towards improving the business climate.

Within the public utilities sector the community itself may conduct business. In fulfilling the duties in the area of an independent sphere of authority it may establish and run a legal entity or other subject. If the community itself conducts business, utilities are secured by community employees under employment contracts, or by persons who work for the community on the basis of an agreement on work activities or an agreement to perform work according to the commercial code.

To better satisfy the needs of citizens in the area of an independent sphere of authority, communities may also create voluntary association of communities according to communal law. An association of communities is a legal entity that acquires legal authorization by registering in the ‘registry of cooperatives’, kept at district offices. The main financial and/or property sources of the association are the direct contributions from the budget of the communities involved or the state subsidies. When providing services to satisfy public needs in communities and cities, there arises a whole series of diverse legal relations among the various legal entities and natural persons. Above all, there arises legal relations between the entrepreneur providing the service and the community (or the state) to whom the service is provided. In addition, there is the legal relation between the citizen (natural person) to whom the service is provided, and the service provider. Services to satisfy public needs are provided by various business entities—entrepreneurs (legal entities and natural persons), whilst in some cases services are provided by the community (or the state) itself. In some cases, services are provided not only for citizens (naturalized persons) but also for satisfying the needs of non-business legal entities operating in the community (e.g. schools, foundations, churches, charitable organizations, citizen’s groups, etc.).

Legal relations among the above-mentioned entities arise above all on the basis of various kinds of contracts that are set out in the commercial and civil code. In securing utilities to satisfy public needs, the commercial and civil code allows contracts to be concluded, even such contracts that are not stated specifically in the commercial and civil code. Such contracts, however, may not go against the contents or purpose of law, commercial custom or principles on which the law is established.

3.3 Rules of Economic Competition

Economic competition rules are set out in the commercial code. Its formulation is important, insofar as protection from unfair competition is concerned, according to the equality of Czech citizens positioned with foreign persons who conduct business in the Czech Republic. Otherwise foreign persons may insist on protection in economic competition according to international treaties to which the Czech Republic is bound, and which were publicized in the Collection of Laws, or if not, then on the basis of mutual agreement.

Unfair competition under the commercial code is taken as negotiations in economic competition that is at variance with proper ethics of competition and causes the detriment of other competitors or consumers. Examples of unfair competition particularly include: false advertising; falsely marked goods and services; parasitism on the reputation of another competitor’s business, products, or services; bribery; defamation; revealing trade secrets; and endangering the health of consumers or the environment.

Rights of protection from unfair competition according to the relevant sections of the commercial and civil code can be claimed in court, whose verdict is levied against the perpetrator for maintaining

unfair competition, to pay damages, provide the corresponding reparations (satisfaction), or pay his unjustified enrichment.

The law determines which agreements between competitors are prohibited and illegal, inasmuch as they lead to breach of rules of economic competition, unless the Office for the Protection of Economic Competition allows an exemption. Prohibited agreements include especially those which lead to a division or practical dominance of the market, those limiting market access of the other competitor, those containing direct or indirect price fixing, etc.

The law also determines when there is a monopoly or dominant position on the market and the obligations of the business entities resulting from such position. A monopoly or dominant position may not be abused by the competitor for the detriment of the other competitors or consumers, nor for the detriment of the public interest.

The law considers the following as an abuse of a monopoly or dominant position: directly or indirectly forcing inadequate terms in contracts with other market participants; binding agreements by concluding contracts under the condition that the other party takes more goods or other supplies not connected with the requested subject of the contract by fact or by commercial custom; fixing different conditions with the agreed to or comparable fulfillment towards individual market participants that are unsuitable for these participants in economic competition; halting or limiting production, sales or technical development of goods in order to gain unfair economic advantage to the detriment of the buyer.

The law also determines cases of disrupting economic competition by company mergers. The merging of companies that disrupts or may disrupt economic competition undermines the permission of the Office for the Protection of Economic Competition. It is considered to be a disruption of competition if, through a merger, the companies exceed 30% of total turnover on the world market or local market of goods.

In this connection, the Office allows mergers if by the participation of the competitors it can be shown that the disruption of competition which may arise is outweighed by the economic advantages this merger would bring. In other cases the Office does not allow such a merger. For cases of breach of rules of economic competition the Office for the Protection of Economic Competition places sanctions.

3.4 Methods of Determining User Fees

The question of determining fees is important where the end-user of a utility shares in the cost of the service, i.e. not paying the full cost. In such a case the question arises as to why a community instead of a private subject should provide a utility at market conditions.

In the sector, practically no prices are regulated at the national level except housing rent control. In other cases, the decision about the price regulation or price setting is to be made by the municipality and can be involved into the contract between municipality and the service supplier.

A characteristic problem in determining fees for a utility provided by a community is the question of the amount of the share of the community; i.e. the amount of granted subsidy. It is not always realized that the stated price represents not only the cost (and therefore the burden) for the utility user, but also simultaneously carries out other functions, especially regulatory and informational functions (providing the user with information on value of the provided fulfillment). A frequent mistake that communities commit is underestimating these additional functions because the price is considered only in terms as a burden for the customer.

Non-economic criteria also enters into the decision. These criteria are often the social aspects—unfortunately, the exact social data are in most cases not at disposal, and therefore the decisions are made as a result of political discussion only. Obtaining further and more detailed social data for the proper decisions, i.e. decisions effective from the economic and social point of view as well, is the task for the municipalities in the future. It is clear, and experience repeatedly confirms, that adequately determined prices for provided utilities lead to their better use and thus economic management of public funds.

In determining what form the amount for user fees should be set (or rather what discounts will be provided) discounts aimed at concrete users according to concrete situations should be given preference, rather than providing cheaper services indiscriminately. It is a fact that offering flat discounts of cheaper services has a long tradition from the days of planned economy on the one hand, and what is organizationally easier on the other. Whatever greater efficiency gained in allocating public funds in this latter way, it is definitely worth addressing the method of offering discounts everywhere possible.

3.5 Social Aspects of the Conversion of Local Utilities

The major conversions of local utilities took place in the Czech Republic at the beginning of the 1990s, simultaneously with small privatization and the freeing up of most prices. Against most expectations, it did not lead to an inappropriate growth in the prices of utilities. Of course in most cases it resulted in a balancing out of prices, especially where the utility was overtly or covertly subsidized by the central state planning of the former regime. With some utilities it even led to a significant increase in offered utilities reacting to demand and this new situation on the market has shown to be long-term.

Another important social aspect is the impact of these changes on employment. In this case the influence on employment was rather positive, in particular the development of utilities in regions

helped slow the impact of restructuring other branches of the national economy. One of the causes of this phenomenon was the fact that the utilities sector as it was in the Czech Republic was relatively underdeveloped. Its swift development at the beginning of the 1990s succeeded in utilizing the work force freed up from other sectors.

On the other hand, the utilities sector, which is largely provided by smaller companies, is very sensitive to state interference in the area of employment. So, for example, the mandatory raising of the minimum wage, which at first sight may appear as an appropriate social measure, particularly hinders small businessmen in the utilities sector (because they are as a rule more dependent to a larger degree on skilled labor than, say, certain manufacturing processes) and this has a negative influence on the offer of utilities.

A demonstrated trend is the gradual improvement of quality and solidity of entities active on the utilities market. This has led especially to sufficient supply on the utilities market, which resulted in non-solid and unqualified service providers from the market over several years to driven out of the market, unless they were let go before that.

One not-to-be-neglected social aspect is the changes in the utility customer's legal awareness. The balancing out of prices led to a more realistic look at their economy and to the control of its quality. Social aspects in a broad sense of the word—let's say the way people affected by utilities think—must be considered by each community according to their local conditions, and as a rule they do just that. The costs of solid waste can serve as an example. The success of the system that the community applies is as a rule a fundamental way depending on whether and how citizens are able and willing to accept it.

4. PRACTICE OF COMPETITION PROCEDURES AND CONTRACTS

The basic legal regulation that modifies the procedure when awarding public contracts in the Czech Republic is Act No. 199/1994 Coll. on awarding public contracts which regulates the ways of awarding public contracts (including the 'public tender' as a special case). The tender system in awarding public contracts in our country before 1995 had been missing for several decades. This also resulted in inadequacies in management of public funds. The importance of the tender system in awarding public contracts can be similarly deduced from the experience of member countries of the European Union, where the subsequently applied system of awarding public contracts on the basis public tenders brings savings of public funds. The savings gained by the awarding of public contracts through tender exceeds the costs for running the tender system in awarding public contracts in most member states of the European Union.

Earlier practice found preferential, with some exceptions, the system of awarding public contracts from free hands, which meant allocation of contracts to companies among several potential contractors without public tender. This system had several insufficiencies, above all, it did not ensure maximum efficiency when allocating public funds, since it eliminated the choice of the most suitable offer by being oriented only on one offer.

The spirit of the law on awarding public contracts is for the grantor and the bidder to gain advantages stemming from a free market. The grantor should gain namely technical and economic advantages from the ability to choose among offers of many businesses; the bidder has the opportunity of economic gain and winning the contract.

The regulatory function of a single market can be realized only when economic relations of two business entities manage their own funds (i.e. their own assets). If one of them manages public funds, it is necessary to enforce the law, which adequately regulates market mechanisms from the point of view of managing public funds, and ensures obligatory enforcement of the public tender system when awarding public contracts by methods common around the world. This creates conditions for transparent and indiscriminate procedures when awarding contracts and choosing the most suitable bidder on the basis of public tender.

When enforcing the law on awarding public contracts in individual cases it is a deciding factor whether the contract is paid (even partially) from public funds. Under this condition, the defined terms of the public contract are relied upon as the applicable contract between the legally determined grantor and chosen bidder.

Obligatory public tender does not relate to contracts whose subject is below a certain financial limit. The financial limit is defined in terms of the adequacy of total costs on the organization and the performance of public tender in comparison with the total value of the contract. Following a prescribed code when awarding public contracts has existed in the Czech Republic since 1991, but was not coordinated. The result of this effort were numerous decisions of state government organs that often conflicted, and suggestions of other institutions that were not legally binding. This ended with the issuance of Act No. 199/1994 Coll.

In order to operate a tender system of awarding public contracts, the state adopted article 67 of the European Agreement on Founding Associations to the European Community and in agreement concluded with European Association of Free Trade. The law on awarding public contracts is in accordance with international treaties, by which the Czech Republic is bound, and is compatible with the law of European Community.

The law to a certain ideological degree relates to the system of public contracts in effect in Czechoslovakia since 1920. During the period of planned socialist economy, free competition of independent business entities did not exist, and therefore special modification of tenders in

awarding public contracts had no meaning. The only exception was Decree No. 101/1973 Coll. on project competition.

What is defined as a public contract by the above-mentioned Act depends mostly on the Customer, i.e. the subject granting the contract. The Act applies to specified Customers such as ministries and other administrative bodies, autonomous territorial units (and in case of Prague the capital city and other statutory municipalities also to the municipal districts and quarters) and the budgetary and contributory organizations established by them, the budgets of district authorities and the budgets of the autonomous territorial units. The Customers may also be recruited from among manufacturers; carriers; water, electricity, gas and heat utilities supplying public networks; the operators of public transportation systems, telecommunications, sewerage systems and water purification plants; These persons or entities pay the cost of the public contract with the pecuniary means drawn from the state budget, state funds, the contributions of international organizations, the budgets of district authorities and the budgets of the autonomous territorial units.

To conclude a public contract, the Customer should announce a public tender, unless the Act stipulates otherwise. Another procedure other than the public tender is acceptable, provided the future obligation of the Customer brought about by the contract does not exceed the limits specified in the Act, and provided the conditions set in the Act are met. Upon enacting the initial release of the Act, the amount of these limits often proved impractical, and in some cases practically unfeasible.

Generally, the Act on awarding public contracts was developed on principles similar to the legal rules regulating public contracts in other European countries. Nevertheless, the legislation on the granting of public contracts currently in force in the Czech Republic is not fully compatible with the EU law. Comprehensive public tender legislation completely in line with the EU law should be enacted by 2002 at the latest. Foreign business entities can be excluded from participation in the public tenders, which is a fact not fully in correspondence with the effort to join EU.

The Act on granting public contracts has some adherents, who believe that the controls over the public means come first, and are willing to accept the hindrance often brought about by the lengthy complaint solving process, lengthy proceedings of the Competition Protection Authority (UOHS hereinafter) surveillance body, and possibly lengthy court proceedings needed to review some UOHS rulings.

On the contrary, the opponents of the Act on granting public contracts believe that the current procedure of granting the public contracts represents a futile interference in the contractual freedom of the Customers; particularly the municipalities/communities are limited in the independent use of their own property. The opponents of regulation of the process of granting the public contracts also emphasize the fact that some provisions of the Act can be easily sidestepped, and they see it as a reason for allowing contractual freedom and the free play of market forces even in

the area of granting public contracts, especially in case of the municipalities/communities, where the citizens can better exert control over the activities of the Community Board and its disposal of the public property.

As required by the Commercial Code the public tender shall be announced in writing; it shall define the subject matter of the contract; it shall quote the deadline for submitting a draft contract, as well as the deadline for announcement of the winning tender. The Announcer of the public tender shall select the best tender and shall communicate the decision as stipulated in the Tender terms and conditions. In case the Tender terms and conditions do not determine the method of selection, the Announcer is free to select the winning tender using his/her own discretion.

The Act on granting public contracts regulates the public tender procedure aiming to select the best tender in much greater detail than the Commercial Code. Therefore, in relation to the Commercial Code, this is a case of *lex specialis*.

The Act on granting public contracts governs in detail the procedures followed by Customers, interested parties and Tenderers in the process of selecting the best tender for a public contract. The public tender, its terms and conditions, and possibly its amendments and cancellations are announced by the Customer in the Commercial Bulletin, or at the central address. The Act specifies the time limit for submitting the tenders ("tender time limit" hereinafter), and the period of time for which the tenders remain in effect and binding for the Tenderers ("binding period" hereinafter).

In addition, the Act regulates the ways of submitting the tenders and the possibility of granting preferential treatment to some Tenderers—for example, it is permissible to prefer some domestic persons/entities, or to restrict the participation so that only domestic Tenderers are admitted; moreover it is possible to give priority to the Tenderers, whose workforce consists of more than 50% of employees with health impediments.

When announcing the public tender, the Customer is also entitled to ask the Tenderers to prove their qualifications in a pre-qualification procedure; this procedure will eliminate the Tenderers lacking the proper qualifications. To make sure that the Tenderer complies with his/her duties following from the tender, the Act requires that the Customer asks the Tenderer, by a stipulation in the Tender terms and conditions, to offer a guarantee amounting to 0.5% to 3% of the future monetary obligation. The Act also regulates in detail the procedure followed by the Customer when accepting the written tenders in envelopes; the process of opening the envelopes; and the way the process is documented by a written report.

The tenders are reviewed and evaluated by a commission. The requirements for the commission staffing and qualification derive from the amount of the future obligation. For public contracts generating an obligation in excess of CZK 200 Million the commission is appointed by the

pertinent minister or by the statutory body of the Customer; the commission shall include a representative of the Ministry of Finance, as well as representatives of two other ministries with related scopes of activities. For public contracts generating an obligation in excess of CZK 300 Million the commission is appointed by the Government in consideration of a proposal submitted by a relevant minister, or by the Customer's statutory body. The commission shall prepare a report on the review and evaluation of the tender; the report shall, first and foremost, contain the assessment of the individual tenders; it shall state the reasons leading to the best tender selection; and it shall arrange the tenders in order of the evaluation results.

The right to decide on selecting the best tender is not vested in the commission but in the Customer. The Customer is obliged to decide on the basis of the commission evaluation of the best tender, unless the he/she stipulated the right to reject all submitted tenders in the Tender terms and conditions. The best tender is the tender best meeting the criteria specified by the Customer in the Tender terms and conditions. The Customer is entitled to rule otherwise than the commission. In case the Customer's ruling does not honor the order of tenders as developed by the commission, he/she is obliged to submit a written rationale.

The right of the Customer to decide otherwise than the commission, is based on the fact that the responsibility for the result of the public tender (which is not the decision about the tenderer itself but getting the contracted service or supply in time and with expected quantitative and qualitative parameters) is always on the Customer and not on any commission.

The Customer is obliged to notify, within the binding period, all the Tenderers not excluded from the tendering procedure of his/her decision on the best tender, and state the tenders winning the second and third places. In the notice of the best tender selection the Customer shall quote the tender prices and shall notify the Tenderers of the possibilities of raising complaints.

The Customer is obliged to conclude a contract with the winning Tenderer within 30 days of the end of the binding period included in the Tender terms and conditions. The binding period shall be extended by this length of time. At the same time the binding periods of the second and third place tenders shall be also prolonged. Nevertheless, the Customer shall not conclude any contract before the complaint period elapses.

In case the selected Tenderer refuses to conclude a contract with the Customer, or provided the contract is not concluded for reasons on the Tenderer's part, the Customer shall call upon the second place Tenderer to conclude a contract. In case the second place tenderer refuses, the contract shall be concluded with the third place Tenderer.

There are alternative ways of granting public contracts. The Act also provides for other ways of granting public contracts than those based on a public tender—these alternative ways are used in specifically enumerated cases. They pertain mostly to those public contracts, whose performance is not associated with amounts in excess of the statutory limit value.

Except for cases in which the future value of performance does not exceed the statutory limit value, the public contracts may be granted by the method of a request for a tender addressed to several potential tenderers, or a request for a tender addressed to a single potential tenderer. These cases of urgent need are subject to a Government decision in a situation, when the public contract in question is a special one.

Nevertheless, even the above-mentioned alternative ways of granting the public contracts are governed by some mandatory regulations, whose observance is enforced, among others, by the possibility of filing complaints against the actions of the Customer; moreover, this area is supervised by a surveillance body (Competition Protection Authority—UOHS), whose ruling can be revised by an administrative court.

If the contract is concluded on the basis of a request for a tender addressed to several potential tenderers, the Customer is obliged to conclude the contract solely with the Tenderer, who submitted the best tender as evaluated according to the criteria specified in the request. The criteria set shall be the same for all potential tenderers. If the contract is concluded on the basis of a request for a tender addressed to a single potential tenderer, the addressed Tenderer shall submit, before the contract is concluded, just his/her Trade Certificate.

Only when under surveillance can an Act become really effective. The Act defines the prerogatives associated with the surveillance activities and the principles applicable to the surveillance body—UOHS. Nevertheless, the surveillance executed in conformity to this Act of law in no way restricts the supervisory activities of other relevant bodies, or the powers of courts of law.

The possibility to perform surveillance and to introduce remedial measures improves the Tenderers' chances of successfully seeking redress in case the Customer violates the law. The observation of the Act on granting public contracts is enforced mostly by the revisions of the Customer's acts and decisions; by the inspections of the Customer's procedures followed when the public contracts are being granted; by checking the security of statistical data on granting the public contracts and by imposing sanctions when the law has been violated.

The Tenderer, or possibly the participant of the pre-qualification proceedings, is entitled to complain against the acts of the Customer performed in the course of the tendering procedure, or when the contract is granted other than through a public tender, and claim violation of the Act on the Customer's part.

The complaints may not be raised against the Customer's decision to introduce a two-round public tender; against the decision to hold the pre-qualification proceedings; against the decision to reject all tenders, provided the Customer had stipulated this right in the tender documents; against the decision to restrict the tendering procedure so as to embrace only domestic persons or entities; against the requirement that the Tenderer produces a guarantee; and against the correction of obvious calculation errors.

The complaints should be submitted in writing within the time limit stipulated by the law. The Tenderer's complaints shall be assessed by the Customer's statutory body, or, as far as the municipalities/communities are concerned, by the Mayor. If the statutory body (or the Mayor) finds that the law was breached, the decision on remedial measures shall be issued no later than 10 days of the complaint receipt. If the statutory body (or the Mayor) finds the complaint unfounded, the Tenderer shall be notified of the fact, as well as of the possibility to ask, within 10 days, for a revision of the Customer's decision by the UOHS surveillance authority. UOHS shall fully review the contested Customer's decision, without being bound by the Tenderer's proposals.

In a case that the submitted proposal contests the Customer's decision on the selection of the best tender, the UOHS Authority either cancels the contested decision, provided it finds that the law was violated; or orders the Customer to repeat the process of selection; or cancels the granting of the public contract; or rejects the proposal and confirms the Customer's decision, provided it finds no breach of law.

In a case in which the proposal requires a review of other acts of the Customer, the UOHS Authority, upon scrutiny, rules either that the law was not violated and consequently the proposal is turned down, or that the law was violated and consequently UOHS orders the Customer to remedy the situation, or possibly UOHS cancels the granting of the public contract. The process of reviewing the Customer's acts by a surveillance body is governed by the Act on administrative proceedings No. 71/1967 Coll., Administrative Code.

In accordance with sec. 61 of the Administrative Code, the ruling of UOHS, which is a central body of a state or government administration, can be challenged and a remedial instrument can be asked for—the remedial instrument is 'remonstrance'; the right to decide on the remonstrance rests with the UOHS chairperson.

The UOHS Authority publishes its final rulings made in the previous calendar year in a Collection of Rulings on Public Contracts and on the Authority's website.

In 1998, for example, UOHS ruled on 235 cases concerning the granting of public contracts. In 88 cases the Tenderer's proposal was rejected; in 48 cases the Customer was ordered to revise the granting of the contract; in 51 cases the Customer was ordered to re-assess the selection of the best tender; in 26 cases the Customer was ordered to implement remedial measures; and in 22 cases the Customer was fined for law infringement. The UOHS reports to the Government.

UOHS intelligence can also be used to reveal the most common errors and deficiencies in the activities of the Customers granting the public contracts. These include mainly: the tender documents do not sufficiently specify the public contract; the tender documents require qualifications above the provisions of the Act; the requirements stipulated in the tender documents are on purpose made inadequate or useless in an attempt to grant the contract as a highly specialized job to just

one Tenderer; more than one tender is selected as the best tender; or when evaluating the tenders, the Customers disregard the contents, order and importance of the individual criteria.

The lawfulness of an UOHS ruling (the chairperson's ruling on the remonstrance) can be reviewed by an appropriate administrative court of law based on a filed claim. Then the one party of the lawsuit is the plaintiff (the tenderer) and the other party is the UOHS, which issued the contested ruling. If the contested ruling is found in conformance to the law, the action is rejected. If, on the contrary, the court concludes that the contested ruling is unlawful, or that the knowledge of the relevant facts is erroneous, the proceedings are canceled and the case is returned to UOHS for additional processing.

5. LEGISLATION TO PROTECT THE CONSUMER

Another Act of law regulating competition and free market that has not been mentioned yet in sufficient detail is Act 634/1992 Coll. On Consumer Protection. As is the case with the Act on competition protection, the Act 634/1992 is a public law regulation that stipulates the duties of product dealers and service providers—particularly the obligation to sell the products in proper quantity and quality at a negotiated price, always quoting the price of the goods put on sale, etc. The Act forbids any consumer discrimination; declares a ban on the sale of dangerous products; prohibits influencing the customer with deceptive information; orders the product dealers and service providers to inform the consumers on the goods and services, and prescribes other duties related to the sale of products and the provision of services.

The main surveillance body keeping an eye on the observation of the Act on consumer protection is Czech Commercial Inspection, a state/government body reporting to the Ministry of Commerce and Industry. In some cases the surveillance duties are being shifted to Czech Agricultural and Foodstuffs Inspection. In the area of health protection, particularly as regards the health hazards generated by products and services, the Act observation is supervised by the Hygiene Service.

The surveillance bodies are also entitled to inflict penalties in case the duties imposed by the Act are disregarded; such a penalty may occasionally reach CZK 1,000,000, and in case of manufacturing, importing or supplying a product, whose defect causes a loss of life or impairs health, the penalty can be increased up to CZK 10,000,000 (the same fine can be charged to a person who caused a loss of life or impaired health by providing a faulty service).

In addition to establishing the surveillance bodies, the Act also specifies public administration tasks for a given area of activity. The state/government administration bodies and the local administration bodies are obliged, within their respective jurisdictions, to make all provisions

needed to prevent dangerous products, or products dangerous because they can be mistaken for foodstuffs, from being put to use, or to stem their use in the future. The public administration bodies shall inform the consumers on the dangerous products using all available means, particularly through media.

Both the Act on competition protection and the Act on consumer protection represent a substantial impediment to the free market and regulate contractual freedom, but a similar legislation can be encountered in other European countries too, and in this area the necessity to regulate the free market and contractual freedom is generally accepted. Both the quoted Acts regulate the consumer and competition protection in a standard way. Therefore the Acts do not require substantial amendments, but according to the public perception some rather important deficiencies still persist in the performance of those state/government bodies that are charged with supervising the observance of the Acts and that are authorized to impose sanctions, or order the removal of the deficiencies found, in case the lawful duties were disregarded. Nevertheless generally it can be said that when implementing the Act these bodies do not perform worse than other state/government bodies, or worse than the local administration bodies in other areas of activities.

6. SPECIFIC PROBLEM AREAS

6.1 Relation Between Public and Private Sectors

The overall trends indicate quite clearly a gradual tilt towards the privatization of services wherever there are no substantial arguments against it. By privatization we mean not only a shift towards the profit-based private entities, but also towards the non-profit organizations—foundations, public service companies, interest groups and the like.

In contrast to the emergence of the business entities, the non-profit entities come to existence at a slower pace. They are also slower at making new relations with the local municipal administrations—the main reason can be seen in the fact that their results are more difficult to assess than the performance of a simple business contract.

For a multitude of reasons a private entity generally proves to perform better than the municipality/community. In some areas the municipality is completely ineffective, e.g. because its decision-making process is not, in many cases, sufficiently fast and the scope of authority sufficiently broad. Some important business decisions have to be made by the Municipal Board, so that by itself the municipality cannot respond to a sudden change of situation. Nevertheless in some areas such a change of situation is quite natural and consequently these areas are completely closed to the municipalities.

All in all, the public administration should concentrate particularly on supporting economic competition, in some cases the municipal decisions lead to partial monopoly reinstatement. For illustrative purposes one can look at the situation that has developed in Prague, where after several years of free competition among waste collection and disposal companies the municipality opted for dividing the city into sectors serviced by a monopoly supplier of services (of course, selected through a public tender).

When considering the possibility of charging a private company with a service, the risk of business failure of the private company is weighed against the sensitivity of the service rendered. One option for the future rests in a broader cooperation between the public and the private sectors (public-private partnership). It is a method, whose proper implementation is still sought for. In this area the situation is strongly influenced by business conditions regulated by the state or government, particularly by the tax strategy. The existing conditions do not motivate entrepreneurs to cooperate with the public sector.

As mentioned above, the current drift is toward the privatization of services. With the experience gained in the often dynamic changes of tide in the 1990s, we can say today that the balance between the private and the public activities basically reached an equilibrium, and if there are any shifts of demanded and supplied services between the sectors at all, they are always considered in view of the relatively subtle impact of the envisaged changes.

6.2 Organizational Forms of Public Companies

The possibility to achieve the goals of public service effectively and to produce optimal results of business competition is relatively independent of the organizational form. The risk of failure is naturally reduced when dealing with renowned companies with an established good will. Nevertheless this process will take some time needed to develop the entrepreneurial structure adequate to the place and time conditions, as well as to the overall legal and economic milieu of the country.

In some areas of business the services are still monopolized, which is true especially of the services provided by the key infrastructure (water supply, public transportation). In the case where the monopoly spreads locally due to the local conditions (e.g. waste management in large cities), it is the municipal bodies that should set the conditions so that the abuse of monopoly position is made as difficult as possible (to expect its complete removal would be unrealistic) and find efficient mechanisms of enforcing these conditions.

Generally, the monopoly regulation is mostly in the hands of the state or government and not the municipalities.

6.3 Influencing and Control of the Local Services

The best basis for control of the local services is a sound competitive environment and a well-phrased contract enabling to seek a new service provider whilst keeping the losses at a minimum. It is just another reason why the interventions of the public administration into the public tenders should be minimized (as mentioned elsewhere), though they are often inspired by the best of intentions.

A general problem encountered while trying to keep the local services under control is the fact that for a good number of them, is rather difficult to find objective performance criteria. Moreover, in some cases it is necessary to take into account the losses incurred when swapping the current service provider for a new one. Judging from the hitherto experience, such a change will pay. What is important here is not just the specific act of replacing the supplier, but the signal thus extended into the entrepreneurial community demonstrating that the local administration is ready to effect such a change and face the temporary losses.

6.4 Legislative Discrepancies

Even after ten years of development based on free economic and political competition, the Czech legislation has a good deal of weak spots. At first, the poor quality of legislation stemmed from insufficient qualification and training of the legislators, who lacked suitable technical expertise generated by practice. Several hundreds of laws enacted by the Parliament yearly just illustrate a situation which could hardly result in sound legislation.

It would be unrealistic to expect that the legislation will be improved so as to make a quality basis for effective society performance in the near future. Nevertheless both the professionals and the general public perceive one deficiency as more serious than just the poor quality of legislation—it is the frequent changes of and amendments to the Acts. Of course, this situation is society-wide and cannot be solved on the level of municipalities.

Generally, it can be said that despite a great deal of minor problems generated by mutually conflicting or half-baked laws, no legislative discrepancy is so grave as to put the municipality and utility performance in serious jeopardy. The above-mentioned legislative deficiencies also have a good side—in the case of a major conflict emerging, it is usually solved or at least alleviated in a relatively short period of time.

6.5 Social Impacts of Privatization

Since the 1989/90 break in political situation the attitude of service users to services has undergone a substantial change. The most important changes can be characterized as such:

After the price controls and deformations had been removed, the service users gradually came to accept the real price of services that became the sale price, and they substantially adjusted their behavior to the new situation. The adjustment rests mostly in a change of structure of the services used. As regards municipality rulings on market regulation and subsidizing of services, the changes effected testify of a more liberal approach, as the municipality is incapable of foreseeing the shifts in demand and supply at the service market.

Another important factor making the prices more realistic is the fact that the service users have become more sensitive about service quality. This sensitivity in itself replaces the previous controls and regulations, and as a result the factual aspects of control are much more effective. Consequently, it is the duty of public administration to create a supportive framework in which the consumer controls can come to full fruition; in many case the consumer can initiate an investigation, but cannot perform it by him or herself—then it is up to the public administration to execute the investigation in a qualified way.

6.6 Cooperation Between Small Municipalities/Communities

In the Czech Republic, the cooperation of small municipalities is important particularly due to their relatively large number and small average size. Owing to these characteristics there are inevitably plenty of municipalities incapable of meeting the responsibilities imposed upon them. The possibility of cooperation between small municipalities is regulated by the law, especially by the Acts on municipalities.

To achieve common objectives, the small municipalities usually establish ad hoc associations designed to accomplish costly development projects with complex logistics, for example the provision of potable water supply, the revitalization of waterways, waste water management, the issues of public transportation, sporting facilities (e.g. bicycle paths), and so on. In a similar way they cooperate in fulfilling strategic goals and processing land planning documentation (the compatibility of land development plans, the territorial systems of environmental stability, et cetera.)

Most of the small municipalities profit by cooperation with other small municipalities located nearby. In addition to improved solutions to the local affairs, this cooperation also brings about better chances of accessing financial sources, in some cases the sources derived from European Union sources.

6.7 Policy Development and Implementation

Recently, the participation of the local administrations in the process of legislation development has increased. In relation to the ongoing overhaul of public administration, this process appears

quite inevitable. The participation is effective on two levels. The Association of Cities and Communities, which represents over two thirds of the inhabitants of the Czech Republic, gives opinions on the drafts of Acts. The Association has established a special expert commission on each area of issues; proper attention is also paid to accepting the differences in positions between large cities and small communities.

The Association of Cities and Communities is an organization very effective at serving the needs of municipalities and communities in the Czech Republic; the strength of the Association derives from the relatively high percentage of the municipalities and communities involved, as well as from the qualified job it does, particularly through its expert commissions.

Of course, the process is not quite smooth; some areas of friction between the central and local administrations are here to stay. Nevertheless the obligation to consult the local administrations about all issues follows from the European Charter of local administrations, the greater number of whose provisions the Czech Republic embraced. The situation of cities and communities has gradually been improving and currently it seems that their share of concept development is adequate to their capacity and qualification capabilities.

The informal factors enhancing the decision-making and consulting mechanisms include the several elections that the country has gone through. The elections lift the people experienced in local politics into higher political positions, either elected positions or executive positions, or, conversely, they return people back to practice, where they can capitalize on the experience acquired and contacts made—in consequence, the situation leads again to the above mentioned improvement.

When preparing and processing the strategic developmental plans, the local public with some expertise can usually be successfully tapped to help with the job.

A weakness persists in the incapability of involving the general public into the process of concept preparation and negotiation. Perhaps it can be seen as a positive factor that the municipalities do perceive this fact as a disadvantage. Nevertheless, the search for ways of how to make the public more interested in community affairs and thus to improve the results achieved—be it actual or just publicly perceived improvement—is difficult. In an ever increasing degree the municipalities employ their own means of conveying information (City Hall Bulletins, local or regional periodicals), whilst dynamic development is obvious in the use of e-mail and internet.

APPENDIX

Conditions and Limits Stated
by the Act on Awarding Public Contracts

**Procedures for Procuring Public Contracts
for contracting authorities as stated in § 2b(1), (5), (6)
of the Public Procurement Act**

| For Real Estate or a Set of Machinery or Equipment (Excludes VAT) | For Other Cases (Excludes VAT) | Procurement Procedure |
|---|--------------------------------------|---|
| under CZK 500,000 | under CZK 500 000 | Small-scale public contract—direct purchase possible (§ 49b of the Act) |
| over CZK 500,000 under CZK 2.5 mil. | over CZK 500 000 under CZK 1 mil. | Simplified procurement—request bids from 3 interested parties (§ 49a of the Act) |
| over CZK 2.5 mil. under CZK 20 mil. | over CZK 1 mil. under CZK 5 mil. | Invitation to more interested parties to submit a bid—at least 5 interested parties (§ 49 of the Act) |
| over CZK 20 mil. | over CZK 5 mil. | Commercial public tender (Part Two of the Act) |
| — | — | Invitation to one interested party to submit a bid (§ 50 of the Act) |

**Procedures for Procuring Public Contracts
for contracting authorities as stated in § 2b(2), (3), (4) of the Act (except for
telecommunication network operators and telecommunication service operators)**

| For Real Estate or a Set of Machinery or Equipment (Excludes VAT) | For Other Cases (Excludes VAT) | Procurement Procedure |
|---|--------------------------------------|---|
| under CZK 500 000 | under CZK 500 000 | Small-scale public contract—direct purchase possible (§ 49b of the Act) |
| over CZK 500 000 under CZK 2.5 mil. | over CZK 500 000 under CZK 1 mil. | Simplified procurement—request bids from 3 interested parties (§ 49a of the Act) |
| over CZK 2.5 mil. under CZK 50 mil. | over CZK 1 mil. under CZK 12 mil. | Invitation to more interested parties to submit a bid—at least 5 interested parties (§ 49 of the Act) |
| over CZK 50 mil. | over CZK 12 mil. | Commercial public tender (Part Two of the Act) |
| — | — | Invitation to one interested party to submit a bid (§ 50 of the Act) |

**Procedures for Procuring Public Contracts
for contracting authorities of operators of telecommunication networks
and telecommunication services as stated in § 2b(2) of the Act**

| For Real Estate or a Set of Machinery or Equipment (Excludes VAT) | For Other Cases (Excludes VAT) | Procurement Procedure |
|---|--------------------------------------|---|
| under CZK 500 000 | under CZK 500 000 | Small-scale public contract—direct purchase possible (§ 49b of the Act) |
| over CZK 500 000 under CZK 2.5 mil. | over CZK 500 000 under CZK 1 mil. | Simplified procurement—request bids from 3 interested parties (§ 49a of the Act) |
| over CZK 2.5 mil. under CZK 50 mil. | over CZK 1 mil. under CZK 18 mil. | Invitation to more interested parties to submit a bid—at least 5 interested parties (§ 49 of the Act) |
| over CZK 50 mil. | over CZK 18 mil. | Commercial public tender (Part Two of the Act) |
| — | — | Invitation to one interested party to submit a bid (§ 50 of the Act) |

In determining the procedure for procuring public contracts, the amount of future monetary obligation excluding value added tax shall be decisive (viz. § 67 of the Act).

Interpretation of the Act: For consequences resulting from the violation of these provisions the actual amount of monetary obligation in the contract shall be decisive. (Pelc, Procuring Public Contracts, 4th edition)

Summary of the Limits

| TIME LIMITS | FOR PROCUREMENT |
|--|--|
| At least 14 days | To submit a bid in the case of an invitation to more interested parties (§ 49 par.6) |
| No more than 12 months from fulfillment of public contract | Invitation to one interested party to submit a bid in the case of an additional or repeated public contract, provided its scope does not exceed 50% of the original price of the public contract (§ 50 par. 1) |
| At least 36 days | Time limit for submitting public tenders (§ 7 par. 1) |
| No more than 90 days | Time limit for awarding contracts in public tenders (§ 8 par. 2) |
| 90 days | Extension of time limit for awarding public contracts in which foreign aid programs financially participate (§ 8 par. 2) |
| TIME LIMITS | FOR PROVISIONS RELATING TO QUALIFICATIONS |
| Up to 7 days | Tenderers may request the contracting authority for detailed information needed to demonstrate any further qualifying prerequisites (§ 2a par. 3) |
| In the last 3 years | A tenderer was subject to disciplinary action under specific provisions regulating performance of a specialized activity (§ 2b par. 1 letter e)) |
| Not older than 90 days | Age of extract from the Commercial Register (if registered) submitted by the tenderer proving his qualifications (§ 2c par. 2 letter. a)) |
| Not older than 6 months | Age of extract from the Criminal Register submitted by the tenderer proving his qualifications (§ 2c par. 2 letter b)) |
| Not older than 6 months | Age of confirmation from a health insurer and social security administration, submitted by the tenderer proving his qualifications (§ 2c par. 2 letter c)) |

| | |
|--|---|
| <p>Within 14 days</p> <p>No later than 25 days before expiration of the tender period</p> | <p>The tenderer must notify the contracting authority of any changes in qualifications (§ 2d)</p> <p>Time limit for notifying results of prequalification proceedings (§ 21 par. 2)</p> |
| TIME LIMITS | FOR PROVISIONS RELATING TO BID BONDS |
| <p>Within 7 days after announcement of most suitable bid</p> <p>Within 7 days after concluding a contract</p> <p>Within 7 days from delivery of notification</p> | <p>Release of bid bonds of tenderers whose bids placed fourth or lower in tender evaluation (§ 25 par. 2)</p> <p>The contracting authority shall release the bid bond of the tenderer whose bid was evaluated and chosen as most suitable and at the same time release the bid bonds of tenderers whose bids placed second and third in the tender evaluation (§ 25 par. 2)</p> <p>A tenderer who has raised objections which the contracting authority upholds is obliged to deposit the required bid bond again (§ 25 par. 7)</p> |
| TIME LIMITS | IN THE COURSE OF PUBLIC TENDERS |
| <p>At least 36 days</p> <p>No more than 90 days</p> <p>More than 7 days from receipt of request</p> <p>At least 3 days before expiration of time limit for concluding a contract</p> <p>After expiration of time limit for awarding public contract —no more than 14 days after receipt of contracting authority’s request</p> <p>Within 30 days after expiration of time limit for awarding public contract</p> | <p>Time limit for submitting public tenders (§ 7 par. 1)</p> <p>Time limit for awarding contracts (§ 8 par. 2)</p> <p>Time limit in which the tenderer is obliged to submit justification for an unusually low bid price (§ 36 par. 1)</p> <p>Time limit for submitting documents under § 2c in the contracting authority’s decision on the selection of most suitable bid (§ 38 par. 4)</p> <p>At the request of a tenderer whose bid was not accepted, the contracting authority is obliged to return any samples and specimens or parts thereof which were included in his tender offer (§ 39a)</p> <p>The contracting authority is obliged to conclude the relevant contract with the tenderer whose bid was chosen as most suitable; the time limit is extended for this period, after which the selected tenderer is bound by his bid; at the same time, the time limit for awarding the public contract for tenderers who placed second and third shall be extended, until such time resulting from provisions in § 41 (§ 41 par. 1)</p> |

| TIME LIMITS | IN TWO-ROUND PUBLIC TENDERS |
|---|--|
| <p>Within 52 days</p> <p>Within 30 days before expiration of the time limit for submitting first round tenders</p> <p>No later than 25 days before expiration of the time limit for submitting tenders</p> <p>Within 7 days from receipt of invitation</p> | <p>Time limit for the first round of public tenders (§ 44 par. 2)</p> <p>Invitation from the contracting authority to negotiate the specifics of awarding the contract (§ 45 par. 2)</p> <p>The contracting authority shall send the interested party the conditions or, if necessary, documentation related to the public tender (§ 45 par. 3)</p> <p>The tenderer shall confirm to the contracting authority his participation in the second round of the public tender (§ 47 par. 3)</p> |
| TIME LIMITS | IN THE COURSE OF THE INVITATION OF MORE INTERESTED PARTIES (§ 49) |
| <p>No more than 30 days</p> <p>30 days after termination of the time limit for submitting bids, after which tenderers are bound by their bids</p> <p>Termination of time limit under § 49 par. 7, no later than 14 days after receipt of request of contracting authority</p> | <p>Time limit after which tenderers are bound by their bids and in which the contracting authority shall decide on the selection of most suitable bid</p> <p>Extension of time limit for the tenderer whose bid was selected as most suitable, after which he is bound by his bid to conclude a contract</p> <p>At the request of a tenderer, the contracting authority is obliged to return any samples and specimens or parts thereof which were included in his tender offer (§ 49 par. 12)</p> |
| TIME LIMITS | IN REGULATIONS ON OBJECTIONS |
| <p>No later than 10 days after receipt of notification of the contracting authority's actions or receipt of notification of selection</p> <p>Within 10 days of receipt by contracting authority</p> <p>Within 10 days of receipt of contracting authority's decision</p> | <p>Submission of objections by tenderer to contracting authority (§ 55)</p> <p>Review of objections with the contracting authority (§ 56 par. 1)</p> <p>Submission of tenderer's petition to review the contracting authority's decision; one copy to the supervisory organ, one copy to the contracting authority (§ 57 par. 2)</p> |

| | |
|--|--|
| <p>Within 4 years from the day when the law was violated</p> <p>Within 7 days after receipt of a petition</p> <p>Within 7 days after receipt of notification</p> <p>Within 7 days after receipt of notification</p> | <p>Commencement of proceedings by the supervisory organ's own initiative (§ 57 par. 1)</p> <p>The contracting authority is obliged to send documentation to the supervisory organ relating to the public procurement concerned, including bids of the participants in the proceedings (§ 58) and its opinion on the petition (§ 57 par. 3)</p> <p>Tenderers may withdraw from the public tender (§ 57 par. 4)</p> <p>The contracting authority is obliged to release bid bonds of tenderers who have withdrawn from the public tender (§ 57 par. 4)</p> |
| TIME LIMITS | IN REGULATIONS ABOUT SANCTIONS |
| <p>Within 1 year from the day when the supervisory organ learned that the contracting authority had violated provisions of this Act, but no later than 3 years after such violation</p> <p>No later than 4 months after non-fulfillment of obligations is ascertained, but no later than 1 year after expiration of the period specified for its fulfillment</p> <p>At least 5 years</p> | <p>The supervisory organ may impose a fine for violation of provisions of the Act up to 1% of the value of the public contract (§ 62 par. 1)</p> <p>Fines may be imposed by the supervisory organ for not providing requested information or documents, or not attending the ordered verbal proceedings for non-fulfillment of the enforceable decision (§ 62 par. 4)</p> <p>The supervisory organ shall exclude a tenderer from participating in public procurement proceedings if the tenderer's employee is legally sentenced for a crime „intrigues during public tenders” (§ 63 par. 1)</p> |
| TIME LIMITS | OTHER |
| <p>Within 15 days after concluding a contract</p> <p>Within 30 days after concluding a contract under Part Two of the Act</p> | <p>The contracting authority shall send a “Record of the Public Contract” to the supervisory organ (§ 64a par. 1)</p> <p>The contracting authority is obliged to announce the identity of the tenderer with whom such contract was concluded at the Commercial Bulletin and at the central address of the tenderer, including the bid price (§ 64a par. 2)</p> |

| | |
|---|--|
| Within 30 days of revoking a public tender | The contracting authority is obliged to announce that a public tender has been revoked at the Commercial Bulletin and at the central address (§ 64a par. 2) |
| Within 15 days after fulfillment of the public contract | Should the pricing details differ from the actual prices by more than 10%, the contracting authority is obliged to send a “Record of the Public Contract” to the supervisory organ stating the actual prices and to publish the actual price of such contract at the Commercial Bulletin and at the central address (§ 64a par. 3) |
| For 5 years after concluding a contract or after a public contract has been revoked | The contracting authority is obliged to maintain public procurement documentation in its archives, including bids submitted by tenderers, with the exception of samples and specimens (§ 64b) |
| Within 3 days | Any action undertaken by a contracting authority or tenderer by means of telephone, fax or telex must be confirmed in writing (§ 68 par. 3) |

Commercial Bulletin

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NOTE

- ¹ Health care is not typical community activity. If health services are provided by the community, it is for necessary care guaranteed by the community or services provided based on the decision of the board of representatives (e.g. clinics and hospitals). Decisions regarding fundamental parameters of health services are practically, however, in the hands of the Minister of Health as well as insurance companies.

Hungary

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1. GENERAL CHARACTERISTICS OF THE SECTOR

1.1 The scope of the Public Utility Sector

The Hungarian local government system was established in 1990 by a relatively fragmentary act. More than 3 100 municipalities are working in Hungary which has a population of 10 million. The mean population is 3 242. 55 percent of settlements with an autonomous local authority have less than 1 000 inhabitants, although 7.7 percent of the whole population is living in such like small villages.

At the same time, a relatively wide range of responsibilities is delegated to local self-governments. Apart from these tasks, any other provision of services is allowed to be managed at a local level, depending on the decision of elected representative bodies. Municipality counties (nineteen in total) are working as the second level of local governance. However, they have less competencies in this field. Only the function of regional development is relevant from the point of view of utility and communal sector.

Public utility and communal services in Hungary consist of the following:

- healthy drinking water supply;
- sewage;
- liquid waste removal;
- solid waste removal and disposal;
- district heating;
- electricity;
- urban gas (delivered through pipelines);
- public cleaning;
- park maintenance;
- maintenance of public cemeteries;
- urban road maintenance;
- public lighting;
- services for chimney sweeping and technique of heating;
- social housing;
- public transport.

Most of them are provided at a local level, whereas some are managed at the national level. National public services include electricity (except the capital), public transport outside the boundaries of settlements, maintenance of national roads, and so on.

1.1.1 Local Level Public Services

Among public utility and communal services, some are provided at local level. Typical examples include:

- a) utility services:
 - healthy drinking water supply;
 - sewage;
 - district heating and warm water;
 - urban road maintenance.

- b) communal services:
 - public cleaning;
 - park maintenance;
 - maintenance of public cemeteries;
 - services for chimney sweeping and technique of heating;
 - liquid waste removal and disposal;
 - solid waste removal and disposal;
 - maintenance of social dwellings.

1.1.2 Performance Indicators

There are commonly used statistical indicators on the basis of official statistics, shown by Table 4.1.

These indicators show the relative level of development. From this data, some of the problematic issues are highlighted, for example:

- a considerable difference between the proportion of water and sewage network;
- limits in the extension of waste removal;
- an extremely low proportion of social housing.

Table 4.1
Indicators on Public Utilities

| Topics | Indicators | 1998 |
|---|--|-------|
| Public water supply | Percentage of dwellings connected to public water conduit network | 91.1 |
| Public sewerage network | Percentage of dwellings connected to public sewerage network | 47.6 |
| Length of public water and sewerage network | Length of public water and sewerage network per 1 kilometer of water network [m] | 341.6 |
| District heating | Percentage of dwellings connected to the networks | 16.7 |
| Hot water supply | Percentage of dwellings connected to the networks | 15.3 |
| Waste removal | Percentage of dwellings connected to regular waste removal | 81.5 |
| Road maintenance | Percentage of length of paved local roads connected to the length of all local roads | 73.3 |
| Social housing | Percentage of dwelling stock maintained by local governments | 4.9 |

SOURCES: Regional Statistical Yearbook 1998. HCSO, 1999, pp. 80–85,
Environmental Statistical Data on Hungary 1998. HCSO, 2000, pp. 120–126,
Yearbook of Housing Statistics, 1998. HCSO, 1999, pp. 29, 33.

Environmental conflicts are linked directly to the underdevelopment of some urban services. That is why in the pre-accession process to the European Union these areas are focused on intensively.

The situation in social housing is a result of the transition process that has taken place so far. The privatization process, involving the sitting tenants right to buy was quite rapid and extreme.

18.3% of the total dwelling stock was maintained by local authorities in 1990. This ratio has decreased below 5%, which is comparatively low to other countries.

1.1.3 Characteristics of Communal Service Enterprises

There is a potential competition in almost all of the fields of public utility and communal services in Hungary. Companies providing these services are mixed (ie dealing with different profiles) or specialized. On the basis of available data, the number of providing companies can be estimated as a total.

Table 4.2
Number of Local Providers

| 1 | 2 | 3 | 4 |
|--------------------------------------|---|--|--|
| | Number of Companies According to Their Registered Main Activity, 2000 | Available a More Exact Estimation from Different Sources | Number of Companies According to Their Other (Not Main) Activities, 2000 |
| Water | 258 | <i>cca. 400</i> | 735 |
| Sewage | 66 | | 1 011 |
| Solid waste | 192 | | 1 344 |
| District heating | 131 | 178 | 438 |
| Burial | 235 | | 209 |
| Liquid waste collection and disposal | 194 | | 1 151 |

SOURCE: Company register

It is not possible to collect the exact data on the number of providers. It is difficult to estimate according to the company register, because it is not a necessary requirement. Secondly, there is no obligation to register in any specific chamber or association. However, it is possible to draw some basic conclusions from the estimation.

In the former Soviet type council system, most of these services were provided by state owned enterprises directed by county councils. For instance, there were 33 water and sewage enterprises, which monopolized the provision in the territory of the country. Multiplication in the transition era is proved by this data. *Real estimated amounts are showed in column 2 or 3.* Column 4 is typical of the freedom of choice on profiles (as these companies are not necessarily practicing). On the other hand, these figures are to should be compared with the total amount of municipalities

(more than 3,000). It is clear that integration in service provision is more advanced, in spite of the fragmentation of former state-owned enterprises in utility and communal services.

1.1.4 The Chances of Monopolies

Most of the utility services and some of communal services are provided by monopolies, at least in given settlements or within a service district. In a group of services, mandatory use is prescribed for consumers by the law, as in the case of garbage collection and disposal, and chimney cleaning. Practically, the situation is almost the same in water supply and district heating if you want to use these basic services. However, obligation for use is not prescribed. Competition is guaranteed in the tendering process. In the working period monopolies provide services for consumers.

The other group of communal services, like park maintenance, public cleaning, and maintenance of cemeteries may be provided by competing providers simultaneously in one settlement or service district. This is the case in one of the utility services, for example road maintenance. Monopolies are not typical in these fields.

1.2 Local Significance of the Utility and Communal Sector

Communal services and water management have a much less significant weight in current expenditures than institutional services such as education, health and social care. Naturally, some of these services are financed directly by consumers, so they do not seem to be public functions from this point of view. In the case of public transport, Table 3 below shows a significant decrease from the beginning of the decade. To a large extent, this function has lost its public character.

As far as investment expenditures are concerned, the role of public works is much more significant. Water management is the first sector in this comparison, and public involvement in communal development is also important. It means that incentives offered by local governments play a crucial role in changes of service levels.

From 1998, official financial data have been in another system, integrating current and investment expenditures, as shown in the tables below. Communal and utility services are the sixth largest expenditure group of local public functions. Investment content of this proportion is more important. (See the Annex.)

On the revenue side, specific sources for utility and communal services are hard to find, because according to the basic principle of the financial system, revenues are typically not linked to a particular expenditure. Rather, it is dependent on the policy decision of local representative bodies. However, some of the sources can be defined.

At present, targeted grants are prescribed for three years in advance. For the period 1999–2001 the following targets and grant proportion were announced:

- i) *water management*
 - landfill for waste water treatment: 50%
 - landfill and treatment for collected liquid waste: 50%
 - construction of waste water pipeline-network: 40–50% or +10% connecting to working waste water works.
- ii) education
for the renovation of classrooms: 50%
- iii) health care
instruments for hospitals and surgeries: 40 %
- iv) *solid waste*
construction of landfill: 40 %.

We can observe that two of the announced group of targets (indicated in italics) belong to the utility sector. To these types of matching grants, own sources should be added. There is a right for particular municipalities to get this subvention, if they can fulfil all of the prescribed conditions according to their application. In the starting year, the total amount of grants are approved in annual details. Common constructions are preferred among small municipalities. In this case the proportion of grant can be more with 10–20%. To supplement the necessary own sources, local governments in depressed areas may apply for further sources from regional development subsidies.

1.2.1 Ownership Structures of Public Utility Companies

As there is no exact registration, we cannot have the full picture about the ownership structure of the public utility and communal companies. Neither the company register nor information sources of chambers or professional associations can be used effectively. However, there is a sample survey scrutinized by the ‘Local Government Know How’ program, which gives some relevant details on water and sewage, as well as on solid waste treatment companies.

a) *Water and Sewage Service Providers*

In the Public Utility Service Database created by the ‘Local Government Know How’ program, there is information on 106 owners, on what percentage they own of different companies working in the field of water management.

However, the list of owners does not shed light on the question of how many of them belong to a service provider. Only thirty-four companies are owned 100% by one organization, and the question is ambiguous in all other cases.

Of the thirty-four 'unambiguous' owners 27 (79%) are local governments, 2 (6%) are members of co-operatives, 3 (8%) is the Republic of Hungary (Ministry of Transport, Telecommunications and Water, and the State Privatization Agency) and 2 (6%) are some private enterprises.

On the basis of available data the identity of majority owners can also be analyzed, as there can only be one majority owner of a company, and if an owner has a share larger than 50%, then he is a majority owner.

There are 56 organizations that are majority owners of some service provider in the database. Of these, 40 (71%) are local governments, 2 (4%) are co-operatives, 7 (12%) is the Republic of Hungary, and 7 (12%) are some private enterprises.

Table 4.3. below summarizes the above¹:

Table 4.3

Ownership Structure Distribution of Water and Sewage Service Providers

| Owner | Service Providers with One Owner | Service Providers with a Majority Owner |
|---------------------|----------------------------------|---|
| Local government | 79% (27) | 71% (40) |
| Republic of Hungary | 8% (3) | 12% (7) |
| Co-operatives | 6% (2) | 4% (2) |
| Private enterprises | 6% (2) | 12% (7) |
| Total | 100% (34) | 99% (56) |

b) *Solid Waste Treatment Companies*

After performing the analysis that we have seen above regarding water management companies, it can be observed that there are 66 single owners and 79 majority owners of the 129 owners in the database.

Of the 66 with 100% ownership, 59 (89%) are local governments, 1 (2%) is a co-operative, 1 (2%) is the Republic of Hungary and 5 (8%) are individuals.

Of the 79 majority owners, 67 (85%) are local governments, 1 (1%) is a co-operative, 2 (3%) is the Republic of Hungary, 3 (4%) are some private enterprises and 6 (8%) are individuals.

Table 4.4. below summarizes the above.

Table 4.4
Ownership Structure Distribution of Solid Waste Service Providers

| Owner | Service Providers with One Owner | Service Providers with a Majority Owner |
|---------------------|-------------------------------------|--|
| Local government | 89% (59) | 85% (67) |
| Republic of Hungary | 2% (1) | 3% (2) |
| Co-operative | 2% (1) | 1% (1) |
| Private enterprise | 0% (0) | 4% (3) |
| Individual | 8% (5) | 8% (6) |
| Total | 100% (66) | 100% (79) |

This partial data has limited validity. Private involvement seems to be stronger according to the practical experiences. However, the common conclusion arises from this information that public and private actors can cooperate. Both are involved in a common market situation in the provision of communal services.

1.3 Different Sets of Regulation

1.3.1 Local Government Functions, Competencies

a) Mandatory and Important Services

According to the Act LXV of 1990 on Local Governments, the local government acts independently in the public affairs of local interest, which belongs to its sphere of duties and jurisdiction. *Local public affairs* are committed to providing the population with the services of public utilities, as well as ensuring the exercise of local public power in self-government, and the local creation of the organizational, personal and material conditions thereof.

The local government may regulate independently, and in individual cases direct freely, the local public affairs that fall within its scope of duties and jurisdiction.

The scope of duties and jurisdiction of local governments are highly varied. An act—in order for any cross-measures to be avoided—may also determine compulsory spheres of duties and juris-

diction for the local government. An act may also determine voluntary duties for the local government. Within the sphere of voluntary duties the local government may freely decide the extent of the duty it undertakes. It has no such authority of decision in the case of compulsory duties. Compulsory duties must be fulfilled, though the local government has certain independence also in these cases in terms of methodology, quality, and so on.²

The local government disposes independently of its municipal property; allocates independently its revenues; and it provides from its unified budget for the delivery of the municipal duties, whether undertaken voluntarily, or compulsory. It is also necessary to mention that the local government may pursue entrepreneurial activity of its own responsibility not only for the undertaking of voluntary and compulsory duties, but also on other—potentially economically profitable—fields of business³.

The Act LXV of 1990 nominates several duties that are worthy of highlighting due to their importance. Nevertheless, the list is not complete, though it contains both compulsory and voluntary duties. The Act Section 8, Paragraph (1) refers to the importance of the duties listed therein with the adverb “particularly”. It contains the following duties:

- development of the settlement;
- settlement planning;
- protection of buildings and the natural environment;
- housing management;
- water resources planning and drainage of rain water;
- maintenance of the public cemetery;
- canalization and sewerage;
- maintenance of the local public roads and public areas;
- local mass transportation;
- public sanitation and ensuring of the cleanliness of the settlement;
- participation in the local supply of energy.

Apart from these obligations, local government is responsible for the participation in the solution of employment; provision of kindergartens; primary education and instruction; health and social provision; looking after other duties concerning the children and the youth; ensuring the provision of community space or forum; support of public education; scientific and artistic activities and sports; ensuring the enforcement of rights of national and ethnic minorities; and the promotion of the community conditions of a healthy way of life. In total, municipalities have a wide range of functions.

Acts assign duties and public services for local governments that are compulsory for every single local government notwithstanding their size and capacities. These are thus the *mandatory duties*,

to which range belong duties that are indispensable for the basic support of the local community and the operation of the settlement. The Act requires the local government to perform the following utility and communal duties on a compulsory basis:

- provision for healthy drinking water;
- collection and disposal of normal (non-hazardous) solid and liquid waste of settlement;
- public lighting;
- maintenance of local public roads;
- maintenance of public cemeteries.

‘Mandatory’ means a general obligation for the provision of services. It does not mean, of course, a direct delivery by municipalities. They are responsible for provision notwithstanding the particular solution of management. However, this obligation should be fulfilled by all of the municipalities. Since the relative amount of municipalities is quite huge in Hungary, guarantee of these tasks is a control of sufficient capacities of municipalities.

b) Generally Provided Services

In the vast majority of settlements the local government provides the following services:

- supply of drinking water;
- sewerage, sewage water treatment⁴;
- maintenance of the public cemetery;
- maintenance of local public roads and public areas;
- public sanitation⁵ (including solid waste collection and disposal);
- ensuring of the cleanliness of the settlement⁶ (including liquid waste collection and disposal);
- chimney cleaning.

Except mandatory services optional are involved in this group, as well. The extent of municipal role depends on the actual capacities in principle. Practically, the other listed services are provided by larger municipalities (towns and cities), spreading their activities in many respects to their rural area. Some of the optional public utility services are supplied also by smaller municipalities.

1.3.2 Property Rights

The ownership of local government includes building structures, pipe-lines and conduits; fixtures and equipment of public works which serve the needs of the population within the inner borders of the settlement, with the exception of those owned exclusively by the state.

The electric or gas public utility property—due to the local governments of the localities - is part of the assets of the economic association operating the public utilities. Shares of municipalities will be paid although it is under a long discussion between the State Property Agency and associations of local governments.

Assets of local governments consist of entrepreneurial assets and primary assets. Primary assets serve directly in the carrying out of compulsory duties and so have limited saleability. Property belonging to the range of the primary assets is either non-saleable or saleable in a limited way:

- (a) non-saleable commodities are the local public roads and their structures, the squares, the parks and any other real and personal property which is designated as such by an act, or by the local government;
- (b) saleable in a limited way are the public utilities, institutions and public buildings, as well as real property and movable assets, so designated by the local government. Disposition of items of the primary assets saleable in a limited way may be made in accordance with the conditions defined in an act, or in a decree of the local government.

1.3.3 Forms and Operation of Commercial Entities

The Act CXLIV of 1997 on Business Companies (in this section referred to as the Act) re-regulated the Act VI of 1988 which had been in power until 16 June 1998. The Act does not provide an explicit definition for business companies, but from its decrees the following definition can be drawn: ‘company’ is a collective term for organizations that pursue business-like economic activities and which fulfils the requirements for one of the business forms that are listed in the Act.

Beyond the rules of the Act, the Act IV of 1959 on the Civil Code of the Republic of Hungary also provides rules on business associations. (See Sections 52 to 56 of the Civil Code.) According to Section 685 of the Civil Code, economic organizations are: state-owned companies, other state-owned economic agencies, co-operatives, business associations, professional associations, non-profit companies, companies of certain legal entities, subsidiaries, water management organizations, forest management associations, and private entrepreneurs. The provisions governing economic organizations shall be applied to the state, local governments, budgetary agencies, associations, public bodies, and foundations in connection with their economic activities, unless the law provides otherwise for such artificial persons.

There are five possible forms of business companies. Two of these are without legal personality: unlimited partnerships (Hungarian abbreviation: ‘kkt’) and limited partnerships (‘bt’). The three other forms have a legal personality: joint enterprises, limited companies (‘kft’) and joint-stock companies (‘rt’).

With the exception of limited liability companies and joint-stock companies, for which one-member formations are allowed, at least two members are required for the foundation of a business association.

For unlimited partnerships and limited partnerships the business companies' supreme body is the meeting of members; for joint enterprises the council of directors; for limited liability companies the members' meeting; and for companies limited by shares the general meeting. Issues falling within the exclusive competence of the supreme body of business associations are regulated by the provisions on the individual forms of business associations.

The liability of a member for the obligations of the business association varies depending on the form of the business company: before the termination of the company it is unlimited and joint in the cases of unlimited partnerships and the general members of limited partnerships, while it is limited and only extends to the value of capital contributions or shares in the cases of limited liability companies and joint-stock companies.

The 'Local Government Know How' program by the commission of the Hungarian local government associations made a sample-survey on the business forms of companies operating in businesses of public sanitation, water and sewage treatment in the years 1996 to 1998. Upon the basis of this research service providers can be categorized as follows:

Table 4.5
Distribution of Organizations Operating as Local Public Utilities

| Form | Ratio [%] |
|----------------------------------|-----------|
| Budgetary institution | 37.80 |
| Joint-stock companies | 11.42 |
| Limited company | 30.31 |
| Private undertakers | 11.02 |
| Limited or unlimited partnership | 1.97 |
| Non-profit organization | 4.33 |
| Other | 3.15 |
| Total | 100.00 |

Budgetary institutions, i.e. organizations that are institutions owned by some local governments, represent a significant share of organisational forms.

Of business companies, the majority of limited liability companies is apparent, this one is the most popular form. Private entrepreneurs also represent a high percentage. Non-profit

organizations rather unfairly only have a small ratio, even though their number has been recently increasing among public utility service providers.

In the case of local government owned companies three legal forms may be used in practice: limited companies, joint-stock companies, and non-profit organizations. The share of the private form is also significant.

Companies that have mixed ownership may be established and operated in any of the business forms listed in the Act on Business Companies provided that the limitations of the Act on Local Governments are also obeyed.

Joint ventures between local governments are a very important possibility for capital inflow for local governments. In such cases a local government lacking capital may elect to obtain capital by allowing private entrepreneurs to acquire part of its own company.

This type of co-operation makes it possible for the local government to keep its majority stake and voting share in its company without objecting to the ownership interests of the private sector. This solution may make higher efficiency, lower costs and a higher quality of services possible at the same time. This type of co-operation is generally more accepted by the public and politicians, as the presence of local governments in decision making represents a higher probability that the interests of consumers remains safe.

A special problem that may arise in such cases is the conflict of interests on the side of the local government, i.e. the conflict of the interests of the owner and the regulator. The local government as proprietor is interested in the increase of revenues, but as a regulator and the representative of the public interest, it is interested in keeping rates at low levels. Its partner, however, is not a representative of the public interest and usually does not aspire to political power, therefore is not participating in elections (at least not directly). For this reason the interest of the partners with respect to the question of prices may conflict, which could influence the operation of the company in a detrimental way.

In each one of the above cases it is important to emphasize that the responsibility of service provision still rests on the shoulders of local governments, and it is they who have to solve the problem of controlling the service provider, and have to stand ready to provide the service in some alternative way in the case of the faulty provision of service by the existing service provider.

1.3.4 Capital Investment Financing Schemes

Capital investment schemes are based on central government expenditure and local government expenditure. Central sources are involved principally in the budget of Ministry of Transport, Telecommunication and Water Management.

These are:

- central investment schemes (esp. development of regional water works);
- sources particularly defined for water management purposes (maintenance and investments);
- targeted sources for road maintenance and development.

As far as particularly local government revenues are concerned, it is a characteristic of subsidies that local governments usually receive it with obligations about its accounts; may only use it for the specified objectives; and may not transfer it to the fulfillment of other duties; and are fully accountable for their use.

The existence of these sources in development of public works shows the public responsibility in utility and communal services.

a) Addressed and Targeted Subsidies

Addressed and targeted subsidies are subsidies that support local governmental investments and (re)constructions, in order to stabilize the development potential of local governments. Such subsidies may only be applied for in order to complete investments that serve basic function purposes, that have been planned from technical, financial and economic aspects, and that are required for the efficient performing of local governmental duties.

A *basic function* is the professional and technical contents of an establishment prescribed compulsorily by building standards, and standards of the sector, which serves the purpose of performing a local governmental duty.

Targeted subsidies assist the accumulation of duties of local governments by partially financing the fulfillment of socially important tasks. The conditions of the use of targeted subsidies are determined by the Parliament. Local governments that fulfil these conditions may receive the subsidy. The amount of financial aid is provided by the annual central budget.

If the local government utilizes the subsidy in a mistaken or unlawful way or not for a basic function or not for the specified investment, it has to repay the subsidy together with applicable interests.

Addressed subsidies serve the purpose of financing investments that may not be aided by the targeted subsidy system but that help the fulfillment of local governmental, regional, national, roles. It may only be used for purposes outlined by the Parliament. Its use and accounting have to be done in a way that complies with the Act LXXXIX of 1992 on the Addressed and Targeted Subsidy System of Local Governments.

For local governmental investments that serve socially important (this is determined by the Parliament) goals, provided the set conditions apply, local governments may receive targeted subsidies automatically.

By the system of addressed and targeted subsidies, the central government can influence the investment of local governments in a given period. Some mention this fact as the negative side of these subsidies, but it has to be taken into account that this is an important tool of the state to dissect complex programs into manageable parts. Another reason that supports this kind of central governmental subsidization is that international funds also support pre-set objectives, which also have pre-announced preferences. The goal of the central government may also be to direct local governments towards these international funds and to encourage their use. The fact that international applications can be more successful if the central government supports local governments in this way. The table below shows the division of addressed and targeted subsidies in the 1990s.

Table 4.6
Addressed and Targeted Subsidies of Local Governments in the Period 1991 to 1998

| HUF million | | | | | | | | |
|--|--------|--------|--------|--------|--------|--------|--------|--------|
| | 1991 | 1992 | 1993 | 1994 | 1995 | 1996 | 1997 | 1998 |
| ADDRESSED GRANTS | | | | | | | | |
| Water management | 496 | 1 154 | 1 334 | 1 473 | 740 | 762 | 1 280 | 1 025 |
| Education | 546 | 1 350 | 1 838 | 1 344 | 963 | 1 867 | 4 196 | 5 646 |
| Health care and welfare | 5 620 | 7 343 | 8 553 | 8 676 | 9 025 | 9 179 | 12 034 | 10 520 |
| Other | 5 152 | 224 | 209 | 190 | 366 | 357 | | |
| Total | 11 814 | 10 071 | 11 934 | 11 683 | 11 094 | 12 165 | 17 510 | 17 191 |
| TARGETED GRANTS | | | | | | | | |
| Water management | 496 | 8 532 | 10 049 | 14 734 | 16 998 | 18 448 | 21 560 | 24 321 |
| Education | 546 | 4 868 | 2 772 | 2 711 | 2 038 | 1 073 | 581 | 547 |
| Health care and welfare | 5 620 | 2 977 | 3 944 | 3 861 | 3 470 | 1 732 | 1 376 | 1 380 |
| Other | 5 152 | 181 | 30 | 21 | | 611 | 1 446 | 1 092 |
| Total | 6 211 | 16 558 | 16 795 | 21 327 | 22 506 | 21 864 | 24 963 | 27 340 |
| ADDRESSED AND TARGETED GRANTS TOTAL | | | | | | | | |
| Water management | 2 146 | 9 686 | 11 383 | 16 207 | 17 738 | 19 210 | 22 840 | 25 346 |
| Education | 3 547 | 6 218 | 4 610 | 4 055 | 3 001 | 2 940 | 4 777 | 6 193 |
| Health care and welfare | 7 130 | 10 320 | 12 497 | 12 537 | 12 495 | 10 911 | 13 410 | 11 900 |
| Other | 5 202 | 405 | 239 | 211 | 366 | 968 | 1 446 | 1 092 |
| Total | 18 025 | 26 629 | 28 729 | 33 010 | 33 600 | 34 029 | 42 473 | 44 531 |

SOURCE: Department for Local Government Economy, Ministry of Interior

Addressed and targeted grants which are relevant, are mainly in water and sewage services, because the necessary added sources are available in these fields. Due to this reason, mainly targeted grants are relevant and increasing progressively, compared with all the other types of local public services. There are specific forms of economic associations, such as water management associations, which are available for concentrating consumers' financial sources for development.

b) Central Environmental Fund

The Central Environmental Fund subsidizes construction of landfills according to EU standards. The proportion of subsidy may not be more than 30% of the total investment cost. Regional projects are preferred and a strong incentive is working for cooperation among local governments.

Table 4.7
Subsidies on Landfills from CEF

| Index | 1993 | 1994 | 1995 | 1996 | 1997 | 1998 | 1999 |
|--|---------|-----------|---------|-----------|-----------|-----------|-----------|
| Number of regional landfills | 11 | 4 | 3 | 5 | 13 | 5 | 3 |
| Capacity of landfills [1,000 m ³] | 598 443 | 1 221 000 | 370 920 | 1 385 000 | 4 031 525 | 1 209 000 | 1 758 000 |
| Population involved | 79 460 | 97 350 | 82 725 | 1 544 384 | 626 372 | 113 500 | 414 500 |
| Total expenditure of investments [1,000 USD] | 922.5 | 2 519.5 | 868.7 | 4 077.6 | 14 543.3 | 3 942.6 | 8 844.1 |
| Subsidy from CEF [1,000 USD] | 218.4 | 532.3 | 245.5 | 706.5 | 3 101.8 | 933 | 2 461.2 |
| Proportion of CEF-subsidy in the total expenditure | 24% | 21% | 28% | 17% | 21% | 24% | 28% |

SOURCE: Dax and co., 2000: 7

1.3.5 Legislation of Main Service Sectors

Laws and government statutes for different sectors have been re-regulated since 1990. Key laws and connecting statutes refer to:

- water management;
- economics of waste;

- district heating;
- cemeteries and burial services;
- particular public services to be used mandatory (nowadays it is referring on chimney cleaning);
- electricity;
- gas services.

The essence of the new legislation is a division of different roles in provision in the circumstances of market economy or quasi-market environment. Apart from the position of public providers and consumers, tasks of local governments and state administration is clarified independently and in relation to each other.

- *State administration* is generally the regulatory authority. It does not require solely a legal position, but economic regulation including partial or full rights to set prices, influencing the level of services. State administrative authorities entitle providers to pursue their activities, however they are allowed to control conditions prescribed by laws. They do not have the right for discretion according to their own particular points of views. Technical and professional abilities of providers are given as evidence by the permission.
- *Local governments* are responsible for self-governing tasks, i.e. making policy-decisions in strategic issues of the particular local service delivery. They are responsible for managing services, setting prices in the framework of laws. Cooperation with consumer protection is also their task, although policy formulation is based on legitimacy in this case, rather than public consumer's representation. On the other hand, municipalities realize state administrative functions as well, like authoritative control, giving permission in matters with less importance, and so on. On most of the services local governments may regulate passing local decrees on the basis of authorization given by parliamentary acts.
- *Providers* are obliged to provide services in their area of operation. It means a direct obligation in making contracts for delivery, if consumers declare their demand and accept conditions. Bargaining on a provider's offer is almost always negotiable. However, the level of public service delivery is supervised by the authorities. Furthermore, consumer protection has a right to initiate modification of conditions of contracts.
- *The consumer's* main obligation is to pay fees and charges for services. Prices are expected to be in keeping with the quantity and quality of the service delivered. The right to complain is guaranteed, however mechanisms are not formulated too rigorously. Consumer protection is also not really strongly organized. Sometimes, local governments take overrepresentation of the consumer's interests.

The main importance of the new legislation is to make an attempt to separate and clarify different public roles and functions in public service delivery. From this point of view water management might be an exception. It is traditionally one of the most developed branches of administration

in Hungary. Due to geographical necessity (the Kárpát-basin is the water-collecting place of the whole surrounding area), defense against floods and water management in general is organized quite accurately, and legal institutions have been developed since the mid nineteenth century. The relatively detailed legal environmental rule preserved many of its specific features even in the communist era. Due to the relative autonomy of this sector, water management seems to be less opened to the mentioned direction.

1.3.6 Competition Law, Anti-monopoly Legislation

Competition in the field of public services is regulated through different areas. Main subjects of legal regulation are:

- public procurement;
- concessions;
- mandatory utilization of particular public services;
- competition.

The Act on Public Procurement (1995:XL.tv.—in this section referred to as the Act) governs the manner in which government contracts are awarded. The policy aim is development of transparency and control of the utilization of public funds ensuring conditions for open competition. The value limit of procurements regulated by the acts is defined by the annual budget. Until the end of 2000 limits are as follows:

- HUF 16 million (53 000 USD) in the case of procurement of goods;
- HUF 32 million (106 000 USD) in the case of construction projects;
- HUF 8 million (27 000 USD) in the case of utilization of services.

These limits are under EU requirements. From the point of view of public utility and communal services, the most important limit is referring to the services. However, the problem is that the eventually missing payment for services makes questionable the obligation for announcement of public procurement process. This is the situation, when consumers are paying for services. At this point the practice has not yet been unified.

The Act mentioned above specifies three types of procedure. According to the principal rule, the open procedure must be used, which starts with a call for tenders or a pre-qualification procedure. In both cases, the tenderer is obliged to publish the tender via a public notice. The content of the call for tenders, the nature of the necessary documentation and the preliminary notice, possibly the amount of guarantee undertaken are regulated in detail by the Act.

In addition to the open procedure, the Act provides for invitation and negotiation procedures for specific cases. Tendering by invitation takes place when only a limited number of bidders are

suitable for the performance of the contract, or if qualified bidders are being invited. A negotiable procedure follows if the open or invitation procedures have proved unsuccessful, if the period is too short for various reasons, or if other special reasons have arisen. An accelerated procedure is possible in both special methods if justified by urgency.

The Public Procurement council supervises the procedure in accordance with the Act. Public procurement committees are operating in conjunction with the council that is responsible for administering legal remedy. Members of these committees are civil servants, employed by the council. Appeals against the resolution of the committees are submitted to the court.

2. According to the Act on Concession (1991: XVI. tv.), activities subject to this process include the operation of public roads and structures as well as local utilities which form a part of the primary assets of local government. However concession is not the exclusive form of operation if the public ownership is overwhelming in the providing company.

In the case of the establishment of concession, public tenders are obliged to be announced. Elements of the announcement are prescribed by the law. Rules of the procedure are also regulated.

The winner of the tender becomes a subject of public contract, of which the basic content is based on the act, like the amount of concession fee (as a counter-performance for giving over the right of practicing the particular activity) or any other counter-performance (like investments). For the practicing of activity, being subject of concession, concession company is to be founded. New assets establishing by the company become the property of the contractor state or local government.

In the sectors of transport and water management, specific acts declare a more detailed regulation on the basis of the Act on Concession.

3. According to the Act of Compulsory Utilization of Specific Local Services (1995: XLII. tv.), local governments are required to call public tenders for delivering particular services, like public service activity of chimney cleaning and connected heating-technical services. The same obligation is prescribed by the Act on Waste Management (2000: XLIII. tv.) for the collection, removal and safe disposal of solid and liquid waste. Tendering rules are not so detailed in the case of procurements.

The given order of providing such public services needs to be regulated by a public service contract and a local government decree regulating either providers or consumers obligations. Consumer obligation on using the offered service and pay particular fee for it is based on the local decree as a legal rule. This fee can be collected as taxes. In the case of waste removal this possibility is based on the authorization of the Act.

4. General rules on economic competition refer on delivery of public services, as well. The Act 1996: LVII. tv. regulates prohibition of unfair market behavior and limitation of

competition. The State should ensure the fairness and freedom of economic competition through legal regulation. This requires the admission of rules of competition law which prohibit market practices violating the requirements of fair competition and restricting economic competition, and prevents the interlocking of undertakings in a manner detrimental to competition, providing also for the required organizational and procedural conditions.

It is prohibited to conduct economic activities in an unfair manner, in particular, in a manner violating or jeopardizing the lawful interests of competitors and consumers, or in a way which is in conflict with the requirements of business integrity. It is also prohibited to mislead the consumers in economic competition.

Agreements between undertakings which are aimed at the prevention, restriction or distortion of economic competition, or which may display such an effect, are prohibited by the law. There are also other restrictions, for example the prohibition of abuse of dominant position, controlling the concentration of undertakings. The Office of Economic Competition is obliged to supervise undertakings and conduct proceedings against firms distorting legal rules. Legal remedy is guaranteed by courts.

There are several problems with the legislation mentioned above. Firstly, the public procurement process can be hardly adjusted to the specification of public services. The whole system tries to react to EU-requirements, whilst Hungarian specifications remain in the background. For instance, many small local entities need regulation on their public decision-making which, due to the large amount of small issues, needs to be carried out in a more simple and effective style.

Secondly, the public procurement system is based on contracting mechanisms. While the tendering is mandatory to a certain extent, contracting-out is not prescribed, and public contracts are not detailed and elaborated in the practice. More severe conditions are linked to the value limit than the public-private contracting process in general.

Finally, tendering is not a general obligation, even its use is extending. Furthermore, it is relatively easy to avoid rules of the game. Generally speaking, continuous development and modernization of the system is slower than changes and techniques used in the practice.

1.3.7 Rules and Methods of Setting User Charges

There are two types of official prices that are relevant from the point of view of local public utility and communal services. One is the official price, stated in public proceedings according to the rules of administrative procedures. The other is based on local legal regulation (statute) of local governments. Preferences of local policy making may be realized more in the latter type, in which the regulation focuses apart from it other issues of the particular public service delivery. On the other hand legal remedy against the setting prices is more direct in the case of first type of procedures.

1. Official prices stated in public proceedings in the following public services:
 - drinking water delivered by municipal water works;
 - sewer delivered by municipal water works;
 - local public transport;
 - public heating and warm water.

2. Official prices stated by municipalities in their local legal statutes in the following services:
 - communal solid waste removal;
 - communal liquid waste removal;
 - chimney cleaning;
 - maintaining services in public cemeteries.

Other official prices in relevant services are set by national government, like electricity and gas delivered on pipeline network.

Setting user charges was under discussion in the whole period of transformation. Mainly waste collection fees stated by local governments were criticized by consumers. In many cases representative bodies linked charges to the size of houses, notwithstanding the number of inhabitants in them. The other typical discrimination was to order the same charges per year for the irregular inhabitants (especially owners of cottages) than regular ones. Because these charges were set in local decrees, the Constitutional Court was the only forum to revise them.

The Constitutional Court consequently used the Constitutional basic principles and the Code of Civil Law to solve the problem. According to the sentences, the key point is the principle of equality of delivered service and its compensation. Proportionality, these should be kept by local decrees. So, it is prohibited to use general prices and charges notwithstanding the real amount and quality of services delivered.

Consequently, in the recent legislation these principles have been adopted (Act on Waste Management, 2000). It is also interesting that the Constitutional Court did not respect any public element in this issue. That is why environmental problems and possible solutions to it are not calculated in these decisions.

a) Officially Set Prices

In market economies, the provision of the right to the freedom of competition requires that prices be regulated according to the principles of the market economy.

The primary rule in terms of prices and fees in Hungary is that they are set by the contracting partners, with regard to the Act LVII of 1996 on the Prohibition of Unfair Market Practices; and the Act LXXXVII of 1990 on Prices, and furthermore with regard to one another's interests and with co-operation.

In reality, set prices are an exception compared to this rule. The reason of their use is the fact that governmental intervention may be needed in the case of a market economy, if the complete rule of market mechanisms would lead to behavior that is in contradiction with the public interest. Such a case may present itself in the case of monopolies, i.e. the price setting of monopolies must be regulated. These interventions may hurt the operation of the market economy, unless they are limited to a tight set of market participants, and are regulated with laws and governmental institutions are not able to adversely affect market mechanisms through their use.

According to Hungarian law, an official price may be set by ministers or the assembly of representatives of a local government. This is supposed to ensure that official prices are set at places where appropriate professional knowledge and necessary organizational background are present. The products whose prices are subsidized by the central government or if the official price is set by a minister, the approval of the Minister of Finance is required.

The setting of the official price can transpire by setting an upper or lower price limit for the specified product⁷. The setting of the price may be resolved by determining a calculation method for the price. In connection with the setting of the price, conditions must be set up regarding the use of the official price. Such conditions can be: parameters regarding the quality of the product or service, the place of transactions (e.g. office of the seller or the buyer); payment conditions; size of the order (e.g. there are prices that have to be used above or below certain quantities); et cetera.

The price setting authority has to publish the newly set price in a decree. In this decree the starting point of the validity of the new price must be determined, which cannot be in the past. Market participants may not go above the set upper or below the set lower price limits, not even by mutual agreement.

Within the limits set by official prices, agreement on price is the right of the partners. However, if the parties involved do not specify a price or specify a price that is outside official limits, the contract must be fulfilled on the official price.

The Act on Prices declares regarding upper price limits as a general rule that it has to provide enough income to finance the “efficient”⁸ entrepreneur’s expenditures and necessary profits. In this sense it is the responsibility of the authority that sets the official price, not to set so low a price that would endanger the normal operation of the producer, and also not to acknowledge expenditures arising from inefficient operation. Therefore it is the duty of the authority that sets the price to analyze the operation and efficiency of companies for whose products the authority wants to set an official price. Furthermore, the Act on Prices requires the authority to continuously monitor whether the set prices are adequate for the efficient operation of the producer. If the authority finds that the official price at the time is inadequate, it should initiate a price change. In practice, there are few cases when the price setting authority is capable of such examinations and the tracking of the operations of the companies involved. That is why price increases are usually initiated by the companies concerned.

According to the Act on Prices, as a general rule, for contracts that are penned before a new official price becoming effective, but that are completed afterwards, it depends on the parties involved whether they modify their contracts with the new official price in mind. This rule ensures the safety of contract by not making it compulsory for the parties to modify their contract (i.e. if there is a valid agreement between two parties, the authority has no right to change it)⁹.

Of the public utility services examined, the prices of district heating, water and sewage services are official prices, according to the Act LXXXVII of 1990 on Prices. The prices of solid waste disposal services are not categorized as official by the Act on Prices, but by the Act XLII of 1995 on the Compulsory Use of Specific Public Utility Services they are, as when it declares that the right and duty of setting waste disposal prices belongs to local governments. The Act XLIII of 2000 on Waste Management, which comes into power on 1 January 2001 also declares that waste collection fees must be set by local governmental decrees.

In terms of the chimney cleaning service, the aforementioned Act XLII of 1995 on Compulsory Use of Specific Public Utility Services also declares that its prices must be set by local governmental decrees.

The Act XLIII of 1999 on Cemeteries and Burial Services declares that as the main rule, the right of setting the prices belongs to the owner of the cemetery. Regarding public cemeteries, however, it says that it is the local government that sets the types and amount of fees that must be paid for the use of the public burial service. This latter regulation is not in contradiction with the main rule, as the owner of a public cemetery can only be the local government. What is an addition in this regulation is the factor that the local government has to create a decree regarding the pricing of burial services.

b) Initiation of Price Increases

Public utilities have had to execute exceptionally frequent and high price increases in the past decade, and in the period that remains until the EU accession of Hungary further significant price increases are inevitable. Price increases are generally not well received, especially by consumers, but due to the tensions that arise when initiating a price increase, the management of the companies in question are often unwilling to get down to this task.

The most important reason of price increases is the increase of costs. One part of the cost increase is an external factor for the company, for example the increase in energy prices cannot be offset by a service provider. Another part of the price increases—the one that depends on the particular situation and circumstances—can be offset with economic measures. The most important prevention against cost increases is the increase in productivity¹⁰. Cost increases that are not offset by productivity increases are the factors that force companies to raise their prices¹¹.

The increase of the demand for a product or service may also lead to price increases. If the company is unable to meet the demand for its product, it may mitigate the demand by increasing the price.

Government measures may also cause price increases. Such are taxes that are built into the prices of products. The most characteristic example for this is the value added tax, which can be found in the price of almost every product. This type of price increase is completely out of the control of a single company.

There are cases when—against all efforts—a price increase is the only solution to offset the cost increases of the public utility service provider. If this measure is unavoidable, it has to be implemented in such a way that does not incur strong counter-feelings in consumers, which may create a worsening situation. As discussed above, price increases may be initiated within the range of officially priced products by either the authority that sets the prices, or the company that deals with the appropriate product or service. The most frequent method is that the company initiates the price increase in the form of filing a petition.

The company has to support its claim for price increases with data. This data has to be able to justify costs and the need for more profit. The price setting authority may also require further data, which extends the 30-day justification period.

The company may elect to periodically or when an exceptional cost increase happens, to revise its operations, and file a price increase plea if it so sees fit.

Another possibility is the enclosure of a *clause of constant value* to the contract regulating the provision of the public utility service. This is, practically, a price setting formula. The formula must contain all the factors that have (a significant) influence on the costs of the company. These factors must be weighed in the formula according to their weight in the real cost structure of the company. Afterwards, prices have to be increased proportionally to total cost increases.

The periods of price revisions may also be set in the clause of constant value, and in this way price increases can be automatic.

The advantage of the solution is that the continuous monitoring of operation and the examination of price increase claims can be greatly simplified. In this way, the price adjustment procedure can be shortened, the price increase can be executed faster and with fewer conflicts, and price changes can be more easily forecast.

The disadvantage of the use of a clause of constant value is that unless precise cost ratios are entered into the formulas when signing the contract, the distortions that arise can exist for longer periods of time or even increase. Both parties have the same chance when signing the contract of having to face the disadvantages that this presents.

Public utility service provider companies in Hungary can choose either the manufacturing cost or the capital cost based price setting model on the basis of the Act on Prices. The key element of both price setting methods is the determination of the unit cost, therefore public utility companies have to emphasize the correct calculation of unit costs when determining their accounting policies.

1.3.8 Social Policy Aspects of Local Public Utilities

Transformation of public utility services lead to social inequalities in different meaning. The whole process in the 1990s increased differences among particular groups of people, categories of settlements and the regions of the country.

1. *People's social inequalities.* As a consequence of the privatization of assets and devolution from state to local self-governments and radical decrease of subsidies, fees and charges are raised in a crucial way. In the same period a lot of people lost their job and were placed in crises. Many families cannot pay fees of consumed public utility services and the installment of their housing credits.

Table 4.8
Households in Arrears, 1998

| Type of Public Services | Number of Households in Arrears | Proportion to the Consuming Households | Amount of Arrears [million HUF/year] | Proportion to the Whole Amount of Charges |
|-------------------------|---------------------------------|--|--------------------------------------|---|
| Electricity | 603 871 | 13.2 | 2 700 | 3.0 |
| Gas (network) | 137 352 | 5.5 | 2 223 | 2.6 |
| District heating | 135 183 | 21.1 | 5 082 | 12.1 |
| In sum | | | 10 005 | |

SOURCE: Ministry of Welfare

Local governments choose different strategies to relieve this quite huge and complicated situation. Possible instruments are

- compensation;
- assistance;
- consulting to solve family and job problems;
- transfer of apartments;
- legal process in the case of non-welfare situation;
- bargain on charges with utility companies if local government has a competency in pricing.

The aim of these actions are to prevent people from getting into deeper crises, i.e. from eventual non-payment to cumulated arrears, or from cumulated arrears to losing dwellings.

2. *Inequalities of settlements* in social terms means that some communities have necessarily to cooperate in order to be provided with public utilities and communal services. Companies provide particular district or a higher concentration of the population. In contrast, influence

of local governments is quite selective. It depends on the size or other capacity of the community. For instance, a municipality can have a decisive or more influential role if it has own budgetary institute as service provider (an independent cost center), or it has majority share in utility companies, or it has other influential position in the companies.

In contrast, typically smaller communities have only minority share in the delivering companies. It means that their role in strategic issues of the management is not decisive. If they have no shares at all, they are in the position of contractor and public power. The contractor’s position is clear, based on Civil Law, and without any proprietor’s influence on the operation. The scale of public power is being decreased continuously. In some services it has already existed, like in the case of pricing in district heating, water supplement and sewage, although the range of activity is more limited if shares are restricted

In conclusion, inequalities are among different communities according to their size and capacities. Typically larger settlements have more influence on their own territory and they have the chance to control at least one district area outside their own legal power.

3. The third type of social *inequalities is based on regional differences*. The level of services is different in regions of Hungary according to their general and infrastructure development. Traditionally the central part of the country is the most developed and the western zones are also well provided. The Eastern part is less wealthy. Mainly small settlements and villages have limited sources produced in-site, in spite of having their own self-government.

Table 4.9

Data on Provision of Particular Public Utility Services by Regions in Hungary, 1998

| Regions | Ratio of Dwellings [%] Connected to Public Water-conduit Network | Ratio of Dwellings [%] Connected to Public Sewerage Network | Ratio of Dwellings [%] Connected to Regular Waste Removal |
|-------------------------|--|---|---|
| Central Hungary | 93.7 | 70.8 | 95.5 |
| Transdanubia | | | |
| • Central Transdanubia | 94.8 | 48.9 | 86.2 |
| • Western Transdanubia | 95.9 | 51.6 | 83.0 |
| • Southern Transdanubia | 93.0 | 42.9 | 80.4 |
| Eastern Hungary | | | |
| • Northern Hungary | 85.0 | 36.2 | 80.3 |
| • Northern Great Plain | 88.7 | 29.8 | 66.6 |
| • Southern Great Plain | 86.2 | 27.0 | 65.0 |
| Total | 91.1 | 47.6 | 81.5 |

SOURCES: Statistical Yearbook of Hungary 1998. HCSO, 1999, p. 138,
Environmental Statistical Data on Hungary 1998. HCSO, 2000, p. 123.

The table shows the regional differences in the country. Socially these figures are characteristic. Local policies should be adjusted to regional inequalities, as well. Chances for policy formulation seem to be more limited in less developed areas.

2. SPECIFIC ISSUES

2.1 Separation of Public and Private Functions

It was in the late 1940s and early 1950s when public utilities created their own national networks from regional companies in Hungary. Accordingly, because of their size and importance, public utilities became departments of Ministries or even constituted a whole Ministry. The ruling ideology declared that public services should be cheap and available for everybody. Only the first part of this maxim was fulfilled. Tariff structures of public services, contrary to the evidences from market economies, showed—in line with the concept of 'free public goods', like education or health care—the preferential treatment of households was in terms of prices.

Residential consumption was constantly under priced compared to industrial consumers, and cross-subsidization of consumer groups became a permanent feature of the tariff structure of public services. Tariffs of public services in general did not reflect real costs in Hungary. This was sustainable due to the lack of feedback mechanism between prices and investment. Investments in public utilities were covered by the central budget through taxation without any reference to revenues raised by the utilities. This was to conform with the general rules of investment: the Planning Office's selection amongst new investments was not based on rate of return analysis but on administratively set targets.

Energy industries (gas and electric utilities) were in a more advantageous position providing basic input to material production. In the system of the central allocation of investments, their development didn't yet go beyond what was regarded as strictly necessary, thus creating bottlenecks and 'black-outs' in rapid growth periods. The transport and the telecommunication industries suffered more from the rules of central allocation of investments, where planners first satisfied the requirements of 'material production' and the services obtained the remainder of financial resources.

This classification of activities could also be detected within each service. While network expansions in electricity or gas supply already showed some sign of preferential treatment of industrial or bulk consumers, the development of transport and telecommunication services made the

distinction between industrial/communal and residential/individual consumers more explicit. The standard classification of activities separated, for example passenger transport, as a non-material service, from the transport of goods, as a material service. The chance for getting a telephone line was much better for an industrial/communal consumer than a residential customer. These distinctions expressed, that instead of satisfaction of the consumers, the delivery of planned inputs and outputs and the communication among the commanding heights of the economy constituted the fundamental priorities in the services.

As a result, public utilities were relatively weak monopolies. Because of their low prestige, reflected in the investment allocation system, they were provided with less and less resources. Weak bargaining power among many other state monopolies; inefficient use of resources; permanent and severe shortages; and a low quality of services indicated the milestones of public utilities' development in Hungary between the 1950s and 1980s. The performance of energy industries, transport and telecommunications all lagged behind those of the market economies. The relative backwardness even grew in many areas and became a major factor contributing to the inefficient use of resources.

The inflexible and relatively cheap prices of public services led to an excessive demand and the intensity of service utilization was much higher in Hungary than in the developed economies. The performance of the transport sector influenced working capital requirements in the manufacturing sector. The high share of railways in transportation hindered inventory minimization and increased costs. Hungary was at the bottom of the European league in telecommunications. Moreover, the existing networks suffered also from technological backwardness due to autarchic development. The lack of technology transfer disposed of competitive pressure, often raised costs and separated public utilities from the rapid changes in technology in the West.

Before 1990 the economic regulation of utilities was not at all recognized as a separate activity in Hungary. It was carried out along with policy and the ownership and management of the state-owned enterprises by the relevant ministries. The regulation of investment and prices was not recognized as separate from policy or from the running or financing of the enterprises.

Economies in transition inherited from the previous system an inadequate infrastructure provided by under-capitalized and inefficient firms. They also inherited a disadvantageous tariff structure characterized by prices generally below economic costs and relative prices containing a strong element of cross-subsidy. This situation has placed the governments in a difficult situation. Raising tariffs and correcting the tariff structure may increase prospects for raising new capital and returns from privatization, but imposes heavy social costs, as it is residential tariffs which require the greatest increases to eliminate subsidies. Governments are therefore reluctant to incur the unpopularity and inflational consequences of permitting such price increases.

The pressure for the rationalization of prices and for privatization are equally powerful. Utilities are attractive to private investors, and in most cases the private investors are the only source of funding for development in the infrastructure on the scale required. The governments of economies

in transition are balancing between their macroeconomic and social objectives and the need for access to capital and technology. The dilemma takes on different forms in different countries. In Hungary, the governments were committed to selling substantial stakes in the country's utilities, whereas in other countries progress is much slower.

A further key issue facing governments is how to structure the sector in question. The maintenance of a monopoly potentially increases privatization proceeds, but may be against the benefits from competitive entry, in the form of greater efficiency, more innovation, or lower prices. Irrespective of the form of ownership, the economies in transition are still groping for suitable institutions for regulation. Current evidence suggests that governments will more or less continue to be directly and centrally involved in the regulation of entry and price, so that the scope for independent regulatory agencies is limited. Governments face issues in sequencing the privatization and regulation process. Privatization may speed up the reorganization of the former regulatory framework, although as the Hungarian experience suggests, it may create more formal solutions, where departure from the existing structures needs much more efforts than expected.

Municipalities bear the basic responsibilities of government and its lowest tier for allocating resources and for ensuring the provision of local public goods and services through partnerships with the private sector. Local governments, or designated agencies such as public utilities, have essential roles to perform in providing local public goods, in ensuring coordination through planning and policy corrections, if needed, to account for positive and negative externalities of private activities (such as pollution), and in protecting public safety. These vital functions require the local government to support markets and correct sources of market failure as well as sources of government failure, such as inappropriate regulations that create excessive transaction costs and risks for local investors.

Delivering local services to a consistently high standard at an acceptable cost means, that the local government needs to be clear about the services which local people expect and the resources and opportunities available to deliver them. Most authorities recognize that providing everything themselves is both unrealistic and unnecessary. They need to establish priorities and to set them out clearly. These priorities flow from an authority's performance as an organization and as a provider of services. It needs to know how its work relates to other service providers. It needs to know what local people think of its performance, and what others are capable of achieving, and it needs to know where improvements are most needed. To help authorities establish objectives and performance measures, governments should introduce performance indicators, standards and targets.

Severe shortages, poor quality of services, drying up of central financial sources, all are characteristic features of public utilities entering the era of transition to a market economy. The bureaucratic conduct, while determining the role and development of public utilities in the previous system, fundamentally contributed to the striking condition of utilities. After more than four decades of total state intervention many argue against any form of intervention.

Two challenges have to be faced in the transition process. One is an increasing role of private providers in the sector. A new scheme emerged in which competition, and the public–private partnership has been highlighted. On the other hand, the role of the state is not only diminished, but as far as its remaining part is concerned, has changed quite basically in its character.

Basic functions are separated according to the following logic. *The state* preserved its regulatory position, but losing direct influence. Regulation means passing legal rules in particular competencies, and economic regulation on fees and charges, basic conditions of delivery allowed by acts. The next state function is to give operational permission to applying providers. It is a clear authoritative function based on Parliamentary Acts. The sense of it is to control minimum standards of public service delivery. There is no right for the authority to make individual discretion, only normative rules are allowed to implement.

The state, including local governments remained owners of some basic public assets, like public roads, some elements of networks and conduits. In its position, the present and future task is to guarantee the equal accession for any providers.

Private actors occupied all the fields where competition is possible. Different providers appeared, such as

- private undertakers;
- private companies;
- NGOs;
- different forms of cooperation.

Systems of tendering and public procurement emerged as a symptom of real competition even in this field.

However, the process occurred not without conflicts. Privatization process was criticized from many aspects by the opponents. The second group of critics focused on contracting processes, because selection process is greatly influenced, neglecting professional or cost–benefit points of view.

Critics in general are against extremist solutions. Neither radical contracted policy, nor exclusively state orientation can get too many supporters. The reduction of the strength of the State was regarded as one of the most important task of governments. The exaggerated belief in the omnipotence of market mechanisms could render the transition period more difficult. There are areas in which markets do not necessary function well and some kind of regulation is demanded. The terrain of public utilities certainly falls into this category. On the other hand, in many situations of state influence, conflicts cannot be limited to basic market mechanisms. For instance, in the case of a government decision on freezing the price of pipeline gas, shareholders were panicked and as an answer different unwanted transactions were realized in the stock exchange, for example unfriendly buyout.

2.2 Private Roles in Public Models

Private roles emerged in different ways. One of the most promising processes, is that private investors can take part in different models in constructions and operation. The second is that the privatization process may link the building up of state regulation functions into the process. Finally, devolution of a part of the assets to local governments is an important element to establish public owners.

Models of *public—private partnership* involves several variations¹². As already mentioned before, large industrial users offer loan or additional sources to the project company or the municipality in return for quicker construction or construction at all. In this way subsidies can be substituted or a loan may be offered which is covered by a promised subsidy realized later on. There are several contracting and institutional forms to implement this option.

Another variation is to involve a build—operate—transfer (BOT) arrangement between a private concessionaire and the municipality. In this case, the concessionaire finances builds conduits and later transfers ownership to the municipality in return for a guaranteed rate of return. Another technique is that a piece of infrastructure is built with public funds, then sold by the State Property Agency or municipalities to a concessionaire.

Privatization and regulation options. The most advanced progress among infrastructure sectors was realized in the gas and electricity industry. Because of the recent local involvement, the gas privatization process will be followed step-by-step. In the natural gas industry, after breaking up the former monopoly, the gas supply and distribution companies were re-established as separate enterprises in 1991. Work on their privatization began in the same year, mainly on their own initiative. The distribution companies appointed an Austro-Hungarian firm as financial adviser. Its work resulted in a tender document, issued on behalf of the five gas distribution companies to potential investors in May 1992. Bids were invited by August 1992. The information provided by this tender document was, however, not complete and rose concerns amongst potential investors. At this stage, the State Property Agency (SPA) decided to play a more active role in the preparatory work on the privatization of gas distribution companies and postponed the date for the submission of bids.

It was envisaged that the privatization of the gas distribution companies could not proceed prior to the approval of a new Gas Act (1994: XLI. tv.) . The new Gas Act (approved in March, 1994) established the regulatory body (Hungarian Energy Office (HEO)—for gas and electricity regulation) under the auspices of the Ministry of Industry and Trade (from 1998 the Ministry for Economic Affairs). Its decisions can be appealed to the Minister and to the courts. The HEO is accountable to the Parliament. It has the following core duties: issuing licenses; preparing rules for price regulation; proposing price changes; and ensuring consumer protection. The licenses are for an indefinite time period. The Act opted for exclusivity in gas distribution in a given settlement. The regulator became responsible for the elaboration of details in pricing policy, but the Minister of Industry and Trade has continued to determine the price formation. Economic regulation

included provision on the application of the least cost principle, on the requirement of financial stability of licensee and on the separate account keeping of separate businesses.

The Gas Act reflected that there was little effort to encourage potential competition in the industry. There were few or none recommendations on the structure; operations; organizations; gas purchase arrangements and finances of the gas distribution companies; the cost and tariff structures for each business segment; and the extent of cross-subsidies between business segments.

After the elections in 1994, the new government decided on the merger of the two, often concurring agencies (creating the State Privatization and Holding Company—SPHC) and on the timing and method of privatization of the energy sector. The government intends to hold only a golden share in gas, electricity distribution companies, and in power plants except the nuclear power plant. Other parts are planned to be sold.

In the gas privatization, the problem was the proportion of municipal property. According to regulation of the Act on Local Government, the assets of gas public conduits belong to the primary assets of self-governments. However, utilities had been privatized before local assets were handed over to municipalities. In spite of its illegality, there proved no other obstacles for implementation, and so was it that privatization was realized, and to some extent to foreign companies and investors.

In the meantime, a long debate developed between SPHC and the largest association of local governments in order to implement regulation of the Act. Particular judges interpreted the law in different ways. Finally, Supreme Court unified the interpretations making it obligatory for all judges. The Constitutional Court annulled another Parliamentary regulation, who tried to diminish the responsibility of the state. So now the SPHC is responsible for compensation of concerned municipalities. The implementation of these sentences has not yet been implemented. The whole debate shows the position of local governments and linkages to the privatization process. In this case, the process was going on its route, influenced in a very limited way by central–local compensation. The compensation issue was split from the privatization.

Competition, contracts between public and private parties and the role of regulation in market environment are key elements in the management of the common supplying of functions and tasks in a contemporary society. Transitive countries, like Hungary, after decades of state hegemony, try to follow a more flexible way of public policies than simply reproduction of the monopoly of state. In this section, the Hungarian characteristics are summarized, highlighting mainly the important processes and linkages among different phenomena, and at the same time neglecting all other redundant supplementary information.

Summary

The first point is that competition, contracts and regulations are naturally not local issues. Even in the utility sector these are only symptoms at the local level. In fact, national (or international)

economic environment is determining on emergence and development of these basic relationships. Therefore the question is, what effects the market environment has on local institutions in the circumstances of the system transformation in Hungary. A broader, more prominent issue is a summary of the influential details between the economic and institutional transformations in the field of technical infrastructure services. In this respect, Hungary might be represented as a model, with its characteristic development and the specific restrictions which obscures its path.

The four stages of changes can be summarized as follows:

- 1) the structuring process of the utility and communal sector;
- 2) privatization, fitting in the whole national system of privatization;
- 3) the emerged system of policy formulation; and
- 4) the mechanism of sustainability.

2.3 Structuring

As far as the process as a whole is concerned, a key issue facing governments is how to structure the sector in question. The maintenance of a monopoly potentially increases privatization proceeds, but may be against the benefits from competitive entry, in the form of greater efficiency, more innovation, or lower prices. Irrespective of the form of ownership, the economies in transition are still groping for suitable institutions for regulation.

1. The first step was *decomposition* of former trusts in order to make a new structure of the market. It was a prerequisite to involve real owners to the business. Selling assets made it possible for foreign undertaker and shareholders to participate. This stage has been realized relatively early in Hungary in comparison with other countries. However, it cannot be concluded that restructuring is finished with this action. The end of the whole line of development is to split the public and market sector individually in all of the areas of natural monopolies. From this respect, the process in some of the sectors of utility is currently ongoing.

As a sign of commitment of the Hungarian Government to restructure monopolies and to increase competition, a number of organizational changes have occurred within most companies and sectors. Within the energy industries, the oil and gas company OKGT as a monopoly was dissipated on the field of gas supply. Twelve out of the twenty two subsidiaries were separated from the 'core' businesses. The core companies formed a joint stock company from 1st October 1991 under the name of Hungarian Oil and Gas Company (MOL). The gas supply and distribution companies were established as separate enterprises, but transmission system remained under the control of MOL.

It is important to speak about electricity separately. Although local characteristics are questionable in general, this sector is model of transformation in many respects. The

influence of sector changes made quite a big influence on other utility sectors, such as gas and central heating. That is why it is hard to neglect this area from the analyses.

Electricity generation, transmission and distribution companies were merged and came under the control of the Hungarian Electricity Board (MVMT—Magyar Villamos Művek Tröszt) in 1963. The structure of the MVMT remained intact up to 31 December 1991. The Board comprised of eleven power stations, six regional distribution companies, one company for controlling the transmission grid, and four companies to construct, install and maintain power plants and networks.

In accordance with the 1989 Company Act, preparations for transformation from state owned enterprise into joint stock company began in early 1991. After some mergers, the number of generating companies was reduced from eleven to eight. Restructuring the MVMT, some enterprises providing subsidiary services were separated from the core business. The new joint stock company (MVM Rt.) was established on 31 December 1991, as a holding company comprising of eight generating, six regional distribution companies and the transmission company.

Similar structural changes were witnessed at other public utilities. The Hungarian Post Office was also broken up in 1990 and three new companies were created: the Post Office, Antenna Hungária (broadcasting) and Matáv (telecommunications). In the water sector the twenty-eight smaller and five regional companies were transformed into nearly four hundred local companies and five regional companies during 1991 and 1992. In transport industries the separation of tracks from operating and other business activities at the Hungarian railways was one of the most important steps in the restructuring process in 1993, whilst in urban transport the separation of core and non-core businesses was a common feature in many cities in the early 1990s.

This strategy on the dissolution and breaking up of monopolies should be followed by the national government first of all. In the process of privatization, the first step typically was to establish as many providers as was rational. Local governments may also follow this policy in their territory, although their intention was less dependent on the different type of their representative bodies.

The breaking up of monopolies is implemented in two senses. The first is to split the links of providing activity. For instance, garbage collection is separated from the disposal. In this way, the market area can begin to establish in two fields at the same time. The next type of solution is to separate the same provision physically in its providing of territory. In particular, garbage collection may be divided in the settlement. This solution should be based on the decision of the local council body.

2. The second stage is the development of *independent and normative regulation*. Institutions have already been established. However, the operation can be criticized because public regulation is not autonomous enough from the State as authority, and eventual bargains with the highest monopolies are played off the other private investors' interests.

Current evidence suggests that governments, more or less, will continue their policies to be directly and centrally involved in the regulation of entry and price, so that the scope for independent regulatory agencies is limited. Economies in transition along with many Western countries face issues in sequencing the privatization and regulation process. Privatization may speed up the reorganization of the former regulatory framework, although as the Hungarian experience suggests, it may create more formal solutions, where departure from the existing structures needs much more efforts as expected.

Here the conflict is that regulation includes different instruments, for example:

- permission to entry;
- control of operation and services according to standards;
- participation in price setting;
- guarantee of competition.

However, rights of influence are based on the legal authorization and do not depend on personal consideration. So, regulation means a relatively wide scale of instruments, ruled by the law in a strict way. It is problematic in the Hungarian example, that the regulating authority exists as an office, but it works as an autonomous (not necessarily State administrative) institution to a much lesser extent. Unfortunately, the Hungarian solution is relatively simplified, when bureaucratic character of regulative function is overestimated. For instance, consumers' aspects and representation is missing from the present structure of operation.

3. Public influence on utility and communal pricing is really divided between the national and local level. Municipalities have right to state some fees of services, but this position is not general.

Price control is an element of the supervision of monopolies. Local government may supervise monopolies in public utility and communal services if legal rules allow powers for it. This position is very important mainly in that situation, when competition is less developed or restricted. Price regulation can be based on legal empowerment or the majority owner's position. Quality requirements may be introduced in contracts or by other means.

As far as the national level is concerned, pricing is based more on legal rules than the owner's position. Municipalities, mainly the larger in size, can use both legal causes. Legal empowering is valid for all the local governments notwithstanding their capacities. However, smaller ones can realize their will against the monopolist provider with difficulties. The owner's position with majority shares in utility companies, is generally for city governments, so they can make more influence this way.

The Hungarian regulation system gives a relatively wide range of influence on local governments, however typically in market circumstances. It means that the pricing authority in its decisive autonomy is not unlimited. There is legal regulation on framework of pricing and, of course, economic realities create obstacles as well.

2.4 Privatization

The most important result of the Hungarian *privatization process* is the successful involvement of direct and professional investors. The most advanced progress among infrastructure sectors was realized in the gas and electric industry.

The electricity industry provided another example for the importance of sequencing privatization and regulation. In the early 1990s there was no clear privatization strategy to follow, and consequently there was no consent on priorities between the two agencies responsible for privatization issues (beside the State Privatization Agency, the State Holding Company was established in 1992 with assets having the character of certain strategic importance). The SPA's intention was to sell 15% of existing shares in distribution companies in 1993, with a commitment of the buyers to purchasing another 10% following capital increase. The list of advisors to the six distribution companies was announced in mid September 1993, whose task was defined as to assist the SPA in technical matters but not in forming an overall privatization strategy. The SPA's confidence in a successful sale was based on the activity of potential foreign investors allegedly eager to buy at least a minority stake in distribution companies.

Announcing the tender of sale of distribution companies, an open rivalry broke out between SPA and SHC. By the end of September, 1993 the SHC also selected its privatization adviser. The adviser has been selected to advice on strategic issues of privatization, including the structure and sequencing of sale. The SHC insisted that any sale of minority stakes before concluding a comprehensive strategy may discredit the whole privatization process. To settle the debate between the two agencies on privatization strategy, the Government transferred all shares of the electricity industry from the SPA to the SHC by a decree on 12 November 1993. Then the SHC announced that the sale offer was unsuccessful; the bids were too low. It was also stressed that investors required a firm legislation.

In 1992, work started on replacing the former act on electricity. By the end of the year, a draft was produced by an expert team (with the participation of foreign advisers) and set up in the Ministry of Industry and Trade. The managers of MVM Rt. were little represented in the team, and they were dissatisfied with the strong regulatory framework developed in the proposals. The blueprint focused on economic regulation of the industry and stressed the importance of competition.

After a reshuffling of the Government in late 1992, a new Minister and under-secretary of State for Energy were appointed to the Ministry of Industry and Trade. A new commission was set up for preparing such an Electricity Bill which would receive the consent of the management of the industry. A draft Bill was produced by May 1993, and was submitted to the Parliament in September and it was approved in April, 1994 (1994: XLVIII. tv.). The structure and logic of the Bill followed the one for gas supply plus specified the responsibility of the State in electricity supply.

Licenses in generation are for a definite period, in transmission and distribution they are unlimited in time. The licenses provide exclusivity rights in transmission and in distribution, in both cases together with the obligation to supply. It should be noted that it became the responsibility of the transmission company to initiate the necessary expansion of generating capacity and to secure electricity imports. Third party access to transmission was not regulated in the Act. Consumer protection issues are discussed briefly, there was no word on fostering competition. Cross-subsidization was not forbidden, but accounts must be separated for separate businesses. Economic regulation included provision on the application of least cost principle.

MVM Rt., retaining full control over the nuclear power plant and the national grid, planned to be sold by 50% minus one vote. Because of a political stalemate (even the later dismissed Minister for Industry and Trade opposed the sale of majority stakes) the final share offer was 47–49% of the six electricity distribution companies, with an option to buy more shares within two years, 38–49% of generating companies (except the nuclear power plant) with an option to raise capital and gain majority stakes, 24% of MVM with an option to buy shares up to 25% plus one vote and 50% plus one vote of gas distribution companies.

By the second half of 1995, the preparations gathered speed: 6 governmental, 21 ministerial decrees and 15 governmental resolutions were issued. Bids were received for all companies except two power companies with underground coal mines. All distribution companies (6 gas and 6 electricity) and the two biggest base load power station were sold in 1995. After some unsuccessful attempt for selling the remaining power stations, the SPHC decided to offer majority stakes in them. Four generating plants were sold between 1996–1998, and one remained in the hand of the state owned MVM. The winning bidders were mainly French and German companies, but American, British, Austrian, Belgian, Finnish, Japanese and Italian companies forwarded bids as well.

Most of the firms were sold to foreign investors/trade partners. Their initial (minority) shareholdings were raised through purchasing and/or increasing the capital very quickly to the level of simple majority ownership or above 75% of shares. In the case of previously unsuccessful offers, the privatization agency decided to offer majority stakes. All but one of the remaining companies were sold under these terms. Not only the foreign investors were eager buyers of shares. The MVM also raised its stake above 25% in two base load power stations (Dunamenti, Mátra) securing board membership in the board of directors. The state retained a golden share in each privatized companies.

Because of the local involvement now the gas privatization process is going to be followed step-by-step. In the natural gas industry, after breaking up the former monopoly, the gas supply and distribution companies were re-established as separate enterprises in 1991. Work on their privatization began at the same year, mainly on their own initiative. The distribution companies appointed an Austro-Hungarian firm as financial adviser. Its work resulted in a tender document, issued on behalf of the five gas distribution companies to potential investors in May 1992. Bids

were invited by August 1992. The information provided by tender document was, however, not complete and rose concerns amongst potential investors. At this stage, the State Property Agency (SPA) decided to play a more active role in preparatory work on the privatization of gas distribution companies and postponed the date for the submission of bids.

It was envisaged, that the privatization of the gas distribution companies could not proceed prior to the approval of a new Gas Act. The new Gas Act (approved in March, 1994) established the regulatory body (Hungarian Energy Office (HEO)—for gas and electricity regulation) under the auspices of the Ministry of Industry and Trade (from 1998 Minister for Economic Affairs). Its decisions can be appealed to the Minister and to the courts. The HEO is accountable to the Parliament. It has the following core duties: issuing licenses; preparing rules for price regulation and proposing price changes; and ensuring consumer protection. The licenses are for an indefinite time. The Act opted for exclusivity in gas distribution in a given settlement. The regulator became responsible for the elaboration of details in pricing policy, but the Minister of Industry and Trade has continued to determine price formation. Economic regulation included provision on the application of least cost principle, on the requirement of financial stability of licensee and on the separate account keeping of separate businesses.

The Gas Act reflected that there was little effort to encourage potential competition in the industry. There were few or none recommendations on the structure, operations, organisations, gas purchase arrangements and finances of the gas distribution companies, the cost and tariff structures for each business segment and the extent of cross-subsidies between business segments.

As an effect of privatization, Hungary's energy industry is majority privately owned. It is the task now to establish more competition on the restructured energy markets. Third party access, pricing, non discrimination are the most important issues to be solved. This is to require a more independent role of the Hungarian Energy Office and further steps in the unbundling process of transmission, foreign trade and wholesale functions at electricity (MVM) and gas (MOL) industries. It should be much easier to do in the electricity industry, where these companies are owned by the state as in gas industry, where the state has only a minority stake. Privatization of transmission facilities and the remaining power plants are also viable options.

All in all, the whole structuring seems to be quite successful, because there are real owners in the sector and private investors are also in the market of public utility and communal services. Nevertheless, the timing of policy implementation could have been better. Where the restructuring of a particular utility sector was not implemented before the privatization, there is a danger that former state monopolies become private monopolies without any real strength or control. The public position, interested in market mechanism is better in sectors, in which monopolist positions are controlled by competitive market conditions. Another disadvantage is that privatization contracts may consist of promises, especially guaranteed fees for years in advance which can be realized only with disproportional efforts of the society, i.e. consumers. So, the 'success' mentioned above is not without conflicts in particular cases. However, these conflicts are not general, the

basic importance of the process is professional investors' presence, that all-in-all seems to be successful in recent years.

2.5 Policy Formulation

Assessments should be more ambiguous about policy formulation of national governments in the utility and communal sector. Regulation, programming and implementation of strategic issues is less coherent in the first decade of transformation.

The Directives of the European Union on the electricity and gas internal markets have speeded up the regulatory changes in these industries. Nevertheless, the Hungarian regulatory system has not been as consistent with EU best practices yet. The institutional set-up of regulation in Hungary causes concern. The Hungarian Energy Office does not have full responsibility for regulation and the regulatory process has no sufficient transparency. The Minister of Economic Affairs still retains the most important regulatory powers. The Minister's final authority over user charges opens the door towards price distortions motivated by all kind of concerns relating to macro-economic developments, social policy objectives and regional policy considerations. It is very important to strengthen competition law enforcement in the energy sector, particularly with respect to market access and anti-competitive conduct and mergers. The Hungarian Energy Office and the Competition Authority should consult regularly, particularly on changes in regulations that affect competition.

The EU liberalization process has reached many other sectors as well, including telecommunications, postal services and transport, particularly railway services. One key element was the *unbundling of services* for competition. By isolating the natural monopoly segments of an industry, unbundling promotes new entry and competition in segments that are potentially competitive. Unbundling is desirable because it makes cross-subsidies between different lines of business more transparent, identifies more precisely the subsidies needed to deliver services to the lower income households, and improves management accountability.

Once sectors have been unbundled, *competition* can be used to increase efficiency and new investment. Several market-based provisions are possible. The threat of losing customers to suppliers of substitute products could provide motivation and discipline. Multiple providers can compete directly with each other, while regulatory control ensures fair competition. Competitive conditions could be created through leases or concessions. In this case firms compete not for individual consumers but for the right to supply the entire market. When direct competition or competition from producers of substitute products will not work, competitive forces can be replicated through comparisons with performance elsewhere. A utility in one region can be motivated to perform better by promises of greater rewards if its performance exceeds that of a similar utility in another region, known as yardstick competition.

The other type of competition is based on the division of services according to its natural monopolistic or possible competitive character. In public utility services the principle of *open access* to networks is one of the most important factors to establish competitive sphere. In order to break monopolies free access to providers should be guaranteed by the norms of the EU.

However, especially at local level the requirement to use and develop *competition* as an essential management tool should not be interpreted as a requirement to put everything out to tender. There are a number of ways that an authority might meet the test of competitiveness. It could, for example:

- commission an independent benchmarking report so that it could restructure the services to match the performance of the best private and public sector providers;
- provide a core service in-house and buy in support from the private sector. This would enable comparisons to be made that could help improve in-house performance or result in more of the service being bought;
- form a joint venture or partnership following a competition for an external partner;
- tender part of a service with an in-house team bidding against private sector and other local authority bidders, before deciding whether to provide the bulk of a service internally or externally;
- dispose or sell-off competitively a service and its assets to another provider.

Although these practices begin to develop, basic regulatory (not only legal) environment is very incomplete. That is why many legalized options are working in quite a formal way.

Another part of missing regulation is linked to the accession to the EU in a lesser extent or indirectly. These are issues of particular sector policies, which would be good to use or introduce in a practice, but basic principles have not been passed because of different economic or political reason, in spite of their great social importance. One group of issues is connected to the whole sector, i.e. the clear definition of system capacities in public service delivery. It would be good to harmonize it with local government competencies. The second group consists of more important specific problems, like landfill regulation. The realization of systemic expectations needs incentives and prohibition. These may be introduced even in the present institutional circumstances, however, some economic counter-interest should be convinced.

As a final result these requirements are leading back to the EU again. The principle of lowest load of environment or expectation to use new sources of energy are both based on new standards of existing public utility services. Formulation of policy oriented to this direction is not really coherent in Hungary. As far as outcomes are concerned, these have been quite contradictory until now.

The implementation of policies are also ambiguous. Incentives and system of prohibition are not working satisfactory enough. Concurrent regulatory principles are a lot stronger than the

viewpoint of public provision. The typical example is local government financial regulation, in which environmental or systemic principles are difficult to incorporate, because these are against municipal interests, at least in the short term.

In contrast, local policy-making seems to be more effective in many respects. There are different options for municipalities and they select following their interests, and try to preserve influence in the new marketable circumstances. Although there are quite a wide range of good practices, traditional methods to keep positions are also widespread.

One is reserving the majority owner's position. The most typical control was, mainly in the first period of transformation to control by keeping proportion of property in the assets of providing company. In this case policy preferences were introduced directly. It was not the best way to assign main priorities. Although monopolies can be restricted in this way, but on the other end market relations are distorted regularly.

The second example is making concession contract. Concession contracts in water and sewer services are eligible at local level. Some successful examples show the possibility of strategic transformation and establishment of company autonomy and preserving public involvement in strategic decisions. On the other hand, conditions of concessions can be assessed very differently from the point of view of involved communities.

2.6 Sustainability

As we could see, the Hungarian development may be the best in its institutional progress (restructuring and privatization). The operational experiments are more contradictory. Outcomes of policy formulation in public utility and communal sector are contradictory to a lesser extent. The main problems arise from the operational practice.

Quite a lot of institutions, not necessarily new organizations work for the competitive market environment, with a relatively short history, for examples:

- contracting out;
- public procurement and tendering in general;
- consumer protection;
- performance management.

The main framework of these instruments has been established. It is clear that practice needs much more time to really develop than to prepare a draft law for these questions. However, to make further steps, continuous development in guarantees, regulation, and used methods is needed. If the work stops at the point of institutionalization, outcomes will be restricted.

In Hungary there are different mechanisms which should preserve the operation of mentioned instruments, like the system of operational permission, regulation of authoritative prices (most of them in the utility sphere), supervision of competition, et cetera, notwithstanding the general state mechanisms of control.

In spite of these, operational experiments are very contradictory, especially after some years of practice. The following phenomena should be highlighted:

Corruption. Although we do not have data, but it is known, that corruption in public procurement process is very widespread. There is not any difference from this respect between national and local level. The fragmentation of the system seems to be favorable to the activity. Of course, not only procurement is infected, but all of the tendering processes.

It is important to emphasize here, that public utility and communal tenders play an important role, because of their relatively high budget, in these matters.

Unfortunately, continuous modernization of rules was dropped. That is why different interest groups began to work in an increasingly uncontrolled way. Controlling institutions (like the Council of Public Procurement involving special arbitrators' bodies) and mechanism, which has seen its influence waning to a non-effective state.

Uncontrolled monopolies. This phenomenon may be less widespread, but it exists, and it is also a danger for further spreading. Monopolies sometimes are really in the position of excludability. If the (concession) contract made by local governments is against public interests, there is not any effective way to protect the consumer's position.

It is sometimes the case that a when the particular municipality promises the possibility of fees progressively for a long time in advance, notwithstanding the effectiveness of the provision. In this situation the possible realization of political responsibility is not an adequate response, because the following leadership is obliged by the existing contract.

In Hungary, circumstances are such that the biggest danger is that institutional successes are threatened by operational conflicts. Naturally, this situation is a criticism of the institutional development. On the other hand, the institution-building must not be stopped at the stage of passing the law. In this case (which is the most common), institutional reforms become burdened with compromises.

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NOTES

- ¹ The percentage figures may not add up to 100% due to rounding errors.
- ² It is an important requirement that the solution of the local public affairs, undertaken voluntarily, may not endanger the performance of municipal duties and jurisdiction, prescribed compulsory by the Act. In other words: the performance of compulsory duties precedes the solution of voluntary ones. Simultaneously with these compulsory duties, Parliament ensures the financial conditions necessary for their being carried out; as well as deciding on the extent and method of the budgetary contribution.
- ³ There are two basic limits to this entrepreneurial activity: on the one hand no enterprise by local government may jeopardize the performance of its binding duties. On the other hand, the local government may participate in an enterprise provided its liability therein does not exceed its financial contribution. [Act LXV of 1990. Section 80, Paragraph (3)]

- ⁴ The treatment of sewage water that is produced in apartments, factories, institutions and other water consumers, the drainage of this sewage water through the canal system, and furthermore the cleansing and storage of sewage water.
- ⁵ Public sanitation is the collection, transport, temporary storage, treatment and placement of the solid non-hazardous waste produced in households, production, service provision and public areas. It also includes the collection, transport and placement of household litter and construction debris. It furthermore includes the cleaning and watering of public areas, as well as the removal of snow from and the salting of public roads and airports, etc.
- ⁶ The „ensuring of the cleanliness of the settlement” in Hungarian jargon is the emptying and cleaning of liquid waste collection vessels, pits and other substitutes for proper public utilities, as well as the transport of the thus collected sewage water.
- ⁷ In terms of public utility services, Hungarian law only allows the setting of an upper price limit.
- ⁸ In a microeconomic sense, production is efficient if the economy is on the frontier of its production possibilities, i.e. the output of a product cannot be increased unless the output of another is decreased. Efficiency means that there is no loss. Legislators seem to have created a law that cannot be kept.
- ⁹ A piece of legislation may, as an exception, declare that a heightened upper limit be the part of an existing contract.
- ¹⁰ Productivity is the output gained by a unit of labour or capital. Therefore, if the efficiency of using either labour or capital increases, productivity grows.
- ¹¹ The increase in productivity is not automatic. This goal can only be reached by the continuous and determined initiation of technological advances, the exploration and termination of loss-making areas, i.e. very detailed and persistent work. For the monopolist it is a much easier way to maximise profits by simply raising prices.
- ¹² Jókay at al. 1998: 6.

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Note 304

1. GENERAL CHARACTERISTICS OF THE LOCAL UTILITY SECTOR

Explanation of terms and corresponding laws:

- *'Self-government'*: see the law On Entrepreneurship [33] which determines that an entrepreneur can also be self-government.
- *'Self-government institution'*: an institution established by the self-government and subordinate to it, a manager of institution is appointed by self-government.
- *'Self-government enterprise'*: the enterprise of one owner, the activities of which are regulated by the law On Self-Government Enterprise [34], which determines that a self-government enterprise is an independent economic unit with rights of juridical person, which performs entrepreneurial activities with separated part of self-government property assigned to it. Self-government enterprise sells its products, work, services and other values according to tariffs and for prices, which are determined in self-government or state order, or for contract prices if such ones are determined in laws and other normative acts. Profit, which remains in self-government enterprise after settling taxes and other payments determined in laws and agreements, is divided between self-government and enterprise according to the statutes. Enterprise uses the remaining profit according to statutes and collective agreement.
- *'Joint-stock company'*: an enterprise (or statutory company), capital of which consists of aggregate amount of nominal values of shares. In state and self-government joint-stock companies the functions of stockholders' meeting is performed by attorneys (representatives), who are appointed according to the procedure determined in the law On Administration of State and Self-Government Property in Enterprises.
- *'Limited liability company'*: a foundation. The operation and administration of limited liability companies is determined by the law On Limited Liability Companies [36]. Self-governments have rights to transform self-government enterprises into limited liability companies. The law On Change of State and Self-Government Enterprises into Joint-Stock (statutory) Companies regulates such transformation.

Latvia is unitary state, otherwise known as a parliamentary republic. Public functions are considered to be state functions if, only according to the law, they are transferred to district self-governments, local self-governments or non-governmental organizations. There is an exception in this system—local self-governments can voluntarily choose their functions, but only if these functions are not in the competence of another self-government or state institution. In the law On self-governments [1] functions chosen this way are named “voluntary functions”.

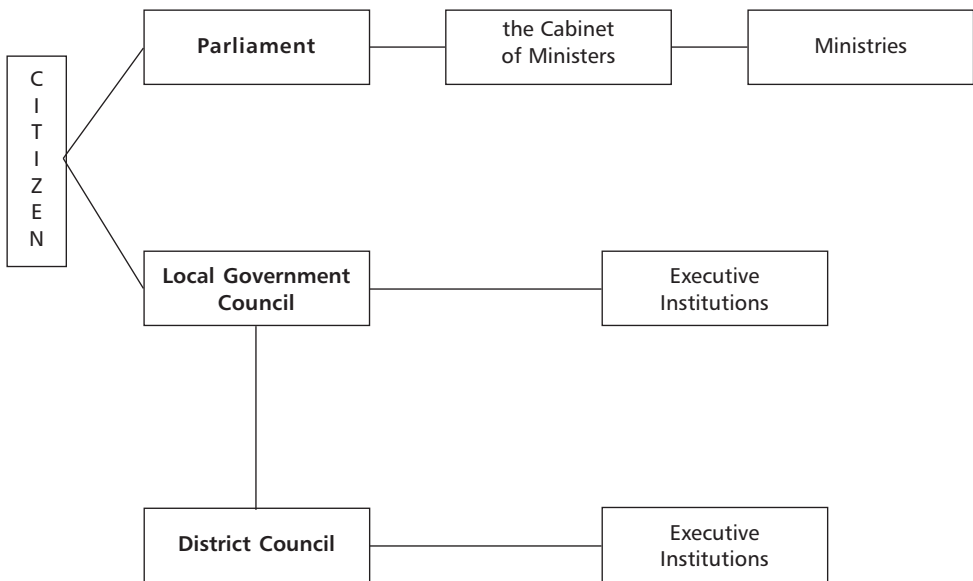
When performing their functions self-governments have the following rights:

- To establish institutions, enterprises and participate with their own finances in enterprises;
- To obtain and expropriate movable property and real estates and perform other private juridical transactions;

- To introduce local fees and determine their size.

The citizens of Latvia fulfil state public power through the highest decision making institutions: Parliament and local governments, which are elected in direct elections, and district councils formed by local governments. According to the Constitution, Parliament establishes the highest state executive power when approving the Cabinet of Ministers offered by the Prime Minister and ministries.

Figure 5.1
Public Administration Scheme



In the perception of Latvian legislation, public services are the services which are provided by enterprises acting according to exceptional rights assigned in the law or other normative acts, or license issued by state or local government institutions. According to the law On Construction, Supply, Rent and Services for Needs of Public Service Enterprises. [19], public services are the following:

- Energy supply;
- Extraction of drinking water and supply, distribution, maintenance of networks;
- Installation and maintenance of sewerage networks and wastewater treatment facilities;

- d) Administration of airport and sea port;
- e) Exploration and extraction of lodes of oil or gas;
- f) Maintenance of public telecommunication network and provision of telecommunication services;
- g) Maintenance and administration of railway infrastructure of public use;
- h) Passenger transportation with busses, trams and trolleybuses.

This list has to be complemented with the rent of dwelling apartments, which is regulated by a special law, and the maintenance of dwelling houses which in the process of privatisation transforms into service of free competition.

The law "On Self-Governments" [1] determines that self-governments in the sphere of public services perform the following functions:

- a) organizing public utilities to inhabitants (heat and hot water supply, water and sewerage),
- b) taking care of improvement and sanitary cleanliness of administrative territory (domestic waste collection, treatment and disposal of waste, maintenance of streets and parks, street rain waters, street lighting, cemeteries);
- c) providing of assistance to inhabitants in settling housing issues (rent and maintenance of housing fund);
- d) organising public transport services;
- e) voluntary maintenance of fire brigades

Self-governments have to the right to choose the form of public service provision. This choice takes place when determining if self-governments deliver services directly or hands over this service provision to enterprises. In small self-governments, mainly rural municipalities, these services are provided by self-governments themselves when establishing institutions or in separate cases one or several employees deal with these services. But in the majority of towns for the rendering of these services, self-government enterprises are either established, or the rendering of these services is transferred to private enterprises.

Information on the forms of public service provision was collected by a survey of the Union of Local and Regional Governments (ULRGL)¹ The question was who provides public services in their territory: self-government institutions, self-government enterprises, state enterprises, private enterprises, or inhabitants themselves. In rural municipalities 50% of public services are provided by self-government institution. (see Figure 5.2)

In the case urban self-governments 44% give preference to self-government enterprises. (see Figure 5.3)

Figure 5.2
Public Services in Rural Municipalities in 2000

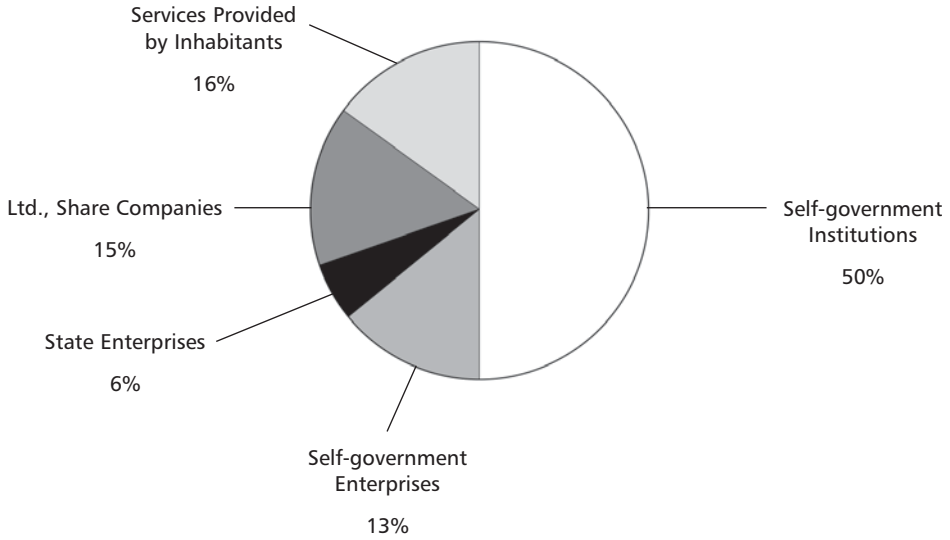
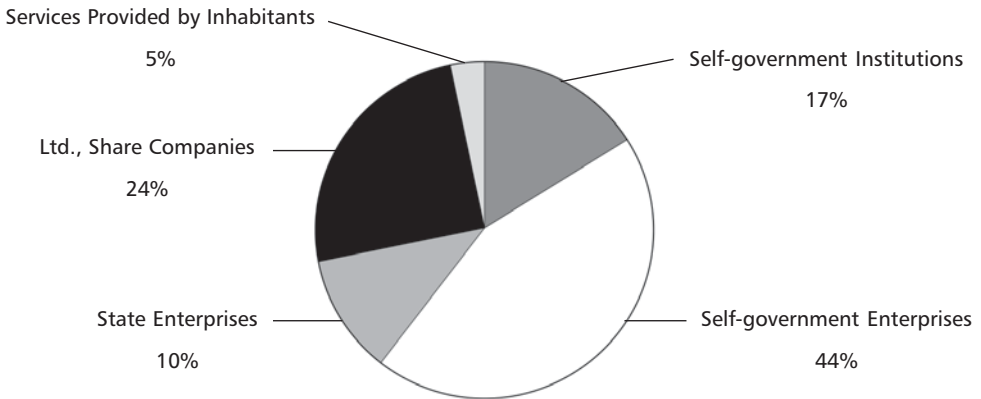


Figure 5.3
Public Services in Cities and Towns



Organization of public service rendering is a self-government function, for the performance of this function there are two possible variants: services are rendered by the self-government; the self-government establishes an institution for the rendering of services; or the self-government delegates this task to self-government enterprises, limited liability companies and joint-stock companies.

Table 5.1
Organizational Forms of Local Utility Services

| Public Services | Self-government Institutions | Self-government Enterprises | State Enterprises | Ltd, Joint Stock Companies | Services Provided by Inhabitants |
|---|------------------------------|-----------------------------|-------------------|----------------------------|----------------------------------|
| Heat supply and hot water | 100 | 63 | 10 | 27 | 55 |
| Water and sewerage | 156 | 83 | 10 | 26 | 23 |
| Household wastes | 109 | 66 | 8 | 83 | 30 |
| Housing management | 223 | 125 | 1 | 39 | 187 |
| Public transport | 49 | 30 | 60 | 125 | 6 |
| Street lightning | 107 | 20 | 24 | 17 | 4 |
| Roads, streets, squares, parks, greenery (repair and maintenance) | 166 | 42 | 29 | 70 | 4 |
| Cemeteries | 156 | 33 | 0 | 6 | 26 |
| Total | 1 066 | 462 | 142 | 393 | 335 |

The choice of self-government to provide public services themselves or delegate provision of services to self-government enterprises or entrepreneurs is affected by the type of public services, which have to be provided by self-governments. In Table 5.1 results of a survey on 246 self-governments are summarized. Data shows that how many organisations with different forms of property provide public services.

The draft law "On Procedure of Coming into Force of Commercial Law" is currently being reviewed in Parliament. The most important norms of this draft law which regard state and self-government enterprises are the following:

- Until December 31, 2002, state and self-government enterprises have to be either transferred into companies and have to be declared for registration in commercial register, or its liquidation must be started, according to the decision of its owner.
- Enterprises, which are registered as non-profit organizations have to be transformed into companies or be liquidated. After the Commercial law will come into force entrepreneurship can be established as non-profit organization only in the form of a company.
- The special regulations are applied to a company, which is established as a non-profit organization on the procedure of use of reserve funds foreseen in the statutes, liquidation and dispossessing of shares.

During the further course of the reform it is foreseen to update the norms of the law On Non-Profit Organisations. The important matter is that companies—non-profit organizations—will continue to exist.

During the reform the existing agencies which have been established according to private legislation on enterprises have two possibilities:

- i) to be transferred into agencies whose status is determined by public legislation;
- ii) to be transferred into ‘non-profit entrepreneurs’ whose status is determined by the Commercial law and the law On Non-Profit Organizations”.

The legal successors of self-government functions and obligations will lose the privilege to make state or self-government procurement when evading the legislation on public procurement.

The gradual transformation of self-government enterprises goes on independently from the new legislation. As an example, the share company called the ‘Riga Heating Company’ should be mentioned. The change of status and property forms of this enterprise characterizes the development of the process in the cities of national importance in general (see Table 5.2.)

Self-governments fulfil representation of their interests in self-government enterprises whilst appointing the manager of enterprise and determining of tariffs for services rendered by enterprise. The essential form of control of self-government enterprises is when self-governments, with the help of their auditing commission, can perform control of economic activities of these enterprises. But in joint-stock companies and limited liability companies where there is self-government capital, the representation of local government interests is fulfilled through authorized representatives whom the self-government delegates to administrative institutions of these enterprises.

Self-government rights to regulate provision of public services are provided in the law On Self-Governments [1], which determines that self-governments have the competence to fix charges for:

- Rent (lease) of self-government dwelling and not-living fund, which is closely connected with the covering of expenditure for the maintenance of apartment houses, as well as to fix maximum rent charge in the territory of the self-government;
- Use of self-government water main and sewerage;
- Heating supplied by self-government;
- Collection of household wastes;
- Other services which are provided by self-government institutions and enterprises.

This self-government competence to fix charge for use of self-government water main and sewerage, heating supplied by self-government and collection of household wastes concerns to all enterprises, which provide these public services on the territory of self-government.

Table 5.2
The History of the Transformation of the Enterprise the ‘Riga Heating Company’

| Years | Enterprises | Legal form |
|-----------|---|--|
| 1990–1992 | State enterprise ‘Latvenergo’ Boiling houses of separate enterprises | State enterprises |
| 1992–1994 | State share company ‘Latvenergo’ as the owner of DHP1 (district heating plant) and DHP2. Riga City municipality establishes the Board of district heating and take possession of networks and boiling | State share company + self-government institution + enterprises which supply heat to the network. |
| 1994–1995 | DHP1 and DHP2 within the structure of ‘Latvenergo’, ‘Board of district heating’, Self-governments of districts of the city establishes the subject of private rights—share company ‘Pārdaugava heat supply’ | State share company + self-government institution + private company where self-government capital is dominating + private enterprises |
| 1995–2000 | DHP1 and DHP2 within the structure of ‘Latvenergo’, share company ‘Rīgas siltums’, privatized enterprises | State share company + private company where 49% belongs to self-government, 49% belongs to state s/c ‘Latvenergo’ and 2% to Baltija Tranzit Bank |
| 2000 | Unchanged | Unsuccessful attempt to privatise DHP1 and DHP2, which has been rejected by referendum |

2. LOCAL GOVERNMENT MANAGEMENT PRACTICES

The decision making institution of self-government has exclusive rights to:

- approve statutes of self-government;
- approve territorial division of self-government and its administrative structure;

- establish, reorganize and liquidate self-government institutions and enterprises, to approve the regulations of self-government institutions and statutes of self-government enterprises;
- appoint and to dismiss managers of self-government institutions and enterprises as well as another officials in the cases determined in the law and the statutes of self-government;
- appoint and dismiss the executive (managing) director;
- decide on alienation, mortgaging and privatisation of self-government real estates as well as purchase of real estate into self-government property;
- decide on the use of the right of first refusal on real estates being sold in corresponding administrative territory;
- determine the procedure how transactions with movable property of self-governments are concluded as well as the procedure how the receiving and management of donations and devises takes place, and how loans and other economic commitments are undertaken on the behalf of self-government;
- decide on other issues especially those, which are mentioned in the law On Self-Governments [1].

The decision-making institution of self-government issues statutes to regulate the work of self-government institutions. To regulate the work of managers and other officials of self-government institutions instructions are issued. Self-government statutes has to correspond to model statutes approved by the Cabinet of Ministers, but these model statutes determine only a range of issues which have to be reflected in statutes, but do not limit the content of statutes.

Specifically the self-government statute, but not national laws or the regulations of the Cabinet of Ministers, determines the mutual competence of politicians and executive institution. Thus in Latvia this is the matter of deputies of local and regional self-governments—how much they trust their employees and what structures to establish to implement the functions.

Regarding public utilities (water supply, electricity, sewerage, waste, heating) several forms of contractual relations are allowed for recipients:

- an agreement can be signed directly with a tenant of a separate apartment;
- an agreement can be signed with the manager of an apartment house;
- an agreement with owner of apartment house.

The tenant, but not the owner of an apartment house has the right to choose the form of the agreement. The first form is more favorable for those who intend not to pay or because of objective reasons cannot pay. If the tenant does not pay for public utilities services, but pays rent, then the charge cannot be brought against this tenant on eviction from the apartment. Provider of public utilities can try to recover a debt through the court, but it does not concern the rights of rent at all. Theoretically, it is possible to stop some types of services, but in the majority of cases, big

capital investments would be needed because the law forbids the stopping of services to other apartments which do make payments.

The most common form of agreement is with the manager of an apartment house. In this case, it is not advantageous for the enterprise to save energy or other resources. The manager of an apartment house receives the invoice for a full payment sum not dependent on those tenants who have or have not paid. In such cases both the legal and political circumstances are against the management of the apartment house. The following should be taken into account:

- laws limit possibilities to recover a debt;
- agreement with providers of public utilities envisages penalties for each day of payment delay;
- politicians who favor strong measures against non-payers risk losing the next elections.

According to this scheme, problems also arise to the providers of public utilities as well. Users of services delay payments, therefore service providers have to continuously work in a regime of advanced service. Enterprises make an advancement to the management of an apartment house from whom they have not received full payments for delivered invoices. But the state calculates taxes for the provided services immediately, as if money has been received. Therefore without the interference of self-governments with the giving of additional grants, the above-mentioned scheme does not work.

The ones who suffer most of all from such a system are the regular payers. Over a long period of time, the need to balance expenses with incomes leads to an increase of tariffs. Thus regular payers and self-governments pay for everything.

2.1 Separation of Public and Private Functions

The separation of public and private functions is usually motivated by the consideration that admitting the coexistence of private and public activities in any of the spheres would distort the competition.

This division would also create instability in relation to the changes of dominating political ideology, which follows almost every election. For example, for quite a long time the successive governments considered that it is necessary to privatize the production and supply of electricity. But left wing parties succeeded to have enough signatures for organizing the referendum. As a result, the government had to give up its programmatic directions in this particular issue of the public utilities sector.

There are attempts to determine the legal status of state and self-government agencies. According to the concept of Public Administration Reform passed by the Cabinet in 1995, it was advised to remove uniform administrative and service functions from ministries, whilst establishing state agencies for this purpose. Since at this time there was no appropriate legislation on these institutions—agencies, then the form of private companies—limited or joint-stock companies were chosen.

In the special law of the regulations of the Cabinet of Ministers, a public competence, procedure of establishment and functions of an agency were determined. The main task of an agency became the implementation of normative acts under the supervision of state attorneys. An agency obtained a quite high level of independence, and at the same time became the subject to all supervision procedures of the private companies sphere.

At the same time the ministries, who now had an established agency under their supervision, were not able to control the situation sufficiently. State attorneys were quite often chosen because of political reasons and not for professional principles. Thus the government kept the political responsibility, but lost the possibilities of policy implementation.

The Ministry of Finance also expressed discontent. While setting the task to strongly control the formation of debts and obligations, it was not satisfied with financial reports of agencies—about the enterprises. Dissatisfaction was also expressed by journalists. State agencies refused to give complete finance reports by basing their arguments on the procedure of proclaiming the commercial secrecy as determined by the law.

Similar problems during the same period also arose within self-government agencies. Mainly they exist in the form of co-operation enterprise—for example, tourism or development agencies. There are also mixed type institutions (state together with self-governments) with the features of agencies—port management boards, patients funds and so on.

There are attempts to cut down the possibility that during the decision making process state and self-government officials are influenced by the private interests. For this purpose there is the Corruption Prevention Law [26] and the institution system for its implementation.

According to the law, a situation of a conflict of interest is when an official has to perform his or her mandate in a matter where at the same time the material or other personal interest of this official or his or her relatives exist.

The law [26] determines that the officials to whom the restrictions applies are:

- The chairman and vice-chairmen of self-government, executive director and vice executive directors of the self-government;
Deputies of self-government decision making institution;
- Managers of state and self-government enterprises along with their deputies;
- Managers and their deputies of private companies if the public share in aggregated capital of these enterprises exceeds 50%.

The law delegates to the Cabinet of Ministers the rights to determine the list of the officials who are subordinate to the restrictions of the Corruption Prevention Law, if they pass administrative acts or deal with state or self-government property or financial means.

The following restrictions are applied to the mentioned officials regarding:

- the decision making which concerns them, their relatives or enterprises, where they own more than 1% of capital or their relatives are in management institutions of enterprise;
- the implementation of controlling, inquiring and punishing functions in above mentioned cases;
- the rights to be the representative of the state or self-government in relations with physical or juridical persons representing his/her own interests or interests of relatives.;
- the rights to receive presents or additional payment;
- the combining of several posts.

When taking up the post as well as once a year officials fill in the special declaration, which is controlled by the Department of Corruption Prevention of the Ministry of Finance. Such declarations have to be filled in three years or more after leaving the post. But the Corruption Prevention Law does not prevent the main cause of corruption expansion which is an excess of regulation. Much permission, many licenses and many controllers create a corruptive environment.

2.2 Co-operation among Small Local Governments

The aim of inter-municipal cooperation, as well as administratively territorial reform is to provide qualitative services to inhabitants. There is a point of view that qualitative services with minimal expenditures can be provided only by big self-governments. While following this point of view the administratively territorial reform is implemented while putting emphasis on the administrative, territorial and economic amalgamation of self-governments. As a result of amalgamation the newly established self-government is economically and administratively strong, but the negative fact is that in these new self-governments, whilst the possibilities of inhabitants to directly influence the development of their territory decreases, the centralization of power goes on.

The co-operation of self-governments creates the possibility to keep the elected representation of each of self-governments when providing efficient use of financial means of each municipality and via commonly established institutions to implement the main goal—to provide qualitative services.

The legal status of co-operation is determined in the law On Self Governments [1], which determines the rights of self-governments to co-operate. According to this law two forms of co-operation are possible. The obligatory co-operation for the implementation of some functions assigned to self-government by the law and voluntary co-operation for the implementation of tasks linked with different issues of common development issues and preparation and implementation of projects as well as for the implementation of concrete functions.

The obligatory co-operation is determined in the case if some self-government do not have their own infrastructure, then the obligation of these self-governments is to sign agreements with other self-governments in order to provide the implementation of functions foreseen in the law. In these cases the Cabinet of Ministers determines the procedure of mutual inter-payments of self-governments. Usually such a scheme is applied to provide the social care services and education. It has to be noted that in the cases when the obligations are not fulfilled regarding the payment for provided services—the self-government which is service provider have rights to turn to the State Treasury to recover these means through the self-government financial equalization fund. The voluntary co-operation of self-governments for the implementation of the functions of their competence is also determined in the law On Self-Governments [1], which states that in order to solve the tasks which are the matter of interest of several self-governments they have rights to co-operate. The legal base of the co-operation, is the co-operation agreement signed between interested self-governments. Such co-operation agreements have to be signed within the frame of the self-government budget, if corresponding decision of self-government council has been passed or signing of the co-operation agreement is foreseen in the statutes of self-government.

The law On Administratively Territorial Reform [40] determines the procedure on how, after the investigation of administrative territories, the co-operation projects of rural municipalities and towns have to be prepared. These projects are the basis for co-operation.

When implementing co-operation, self-governments have rights on the base of mutual agreement to establish common institutions for the performing of common tasks. Such institutions operate on the base of the statutes approved by the corresponding councils, which sets the competence of the common institution, its financing and supervision procedure as well as other issues of work of the common institution.

If we look at the experience of Latvian self-governments in the implementation of co-operation projects, then the biggest proportion is towards the creation of co-operation associations, which are authorised to carry out the following tasks:

- development planning;
- attraction of investments;
- establishment of common institutions;
- establishment of common enterprises.

The main target of development planning is to elaborate mutually connected development plans of self-governments when using the intellectual potential of each municipality.

The attraction of investments is a complex issue. Each small self-government has touched upon the problem of attracting finances to the projects elaborated by this self-government. But also several municipalities when having elaborated some common project, for example, infrastructure projects,

which have a problem in attracting financial resources. Since it is not determined in the legislation that institutions commonly established by self-governments can be juridical persons with their own budget, then the problem arises with receiving credits. Even several self-governments have elaborated common projects, in the case of taking credit each self-government has to do it separately.

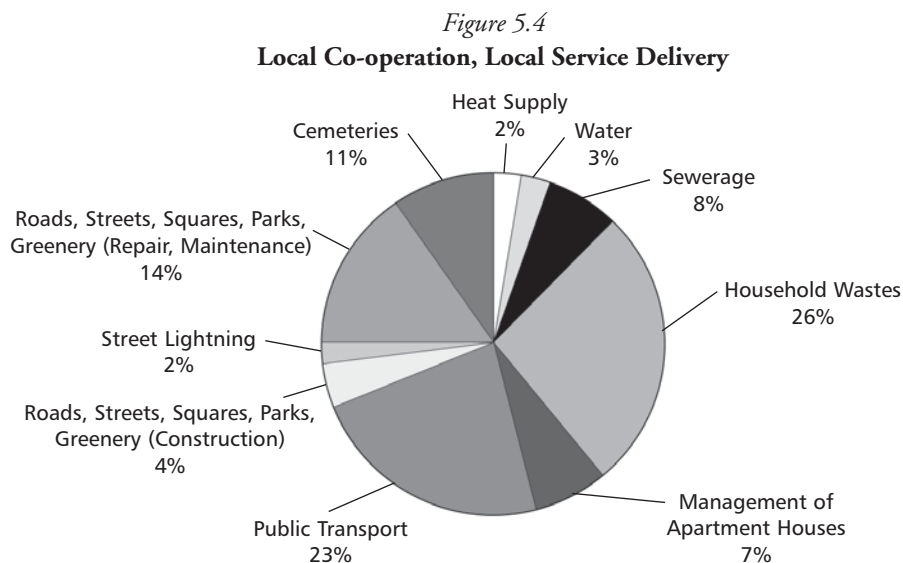
Within the frame of co-operation projects self-governments establish custody courts and construction boards.

Some self-governments establish common enterprises mainly of:

- 1) The provision of water supply and sewerage services. The biggest such common enterprise is being established in the North Kurzeme self-government co-operation association. The biggest possible problems, which such common self-government projects can meet is the passing of common decision on the basis of common agreement and the implementation of agreements.
- 2) Waste management. The establishment of common enterprises for the provision of this service is, in fact stimulated from above and is linked with the implementation of the strategy of waste water management elaborated by the Ministry of Environment and Regional Development.

When establishing common public service enterprises the important sphere appears in the regulation of these services—that is in the establishment of the regulators of public services.

The Union of Local and Regional Governments in the questionnaire mentioned above set the question to self-governments on co-operation. The following data characterizes the co-operation of self-governments in the sphere of public services. (See Figure 5.4.)



2.3 Extension of Private Roles and Activities

The privatization process in the public utilities sector proceeds more slowly than in other forms of entrepreneurship. With the exception of some state monopoly enterprises, the privatization has already been completed in other sectors, whereas in the sector described, it has reached only the ‘middle stage’.

The public utilities sector is socially sensitive. The obligation of self-government is to provide the accessibility of corresponding services to poor inhabitants as well. Theoretically the scheme to accomplish the privatization consists of several stages:

- 1) *Communalization.* Giving of state enterprises in charge of self-governments. State refused from responsibility on whole sectors assigning them to self-governments with all debts. The most characteristic measure of such big scale was the transfer of heating supply enterprises to self-governments in the heating season of 1992–93. At that time, self-governments had to take big credits for purchase of fuel, because state assigned its unprofitable enterprises without fuel or finance reserves. During this period each self-government chose an independent strategy for the balancing of social and economic matters.
- 2) *Liberalization of prices and tariffs.* During the years of USSR occupation the introduced centralized planned economy were under unified tariffs, but the state ‘supplied’ the services under their prime costs. In order to stop the budget subsidies to the sector the liberalization of prices was necessary. The salaries were increasing more slowly than prices for other resources, therefore this liberalization of prices became a big problem for many households. Gradually, during the space of a few years, the prices for services increased ten times in comparable prices.

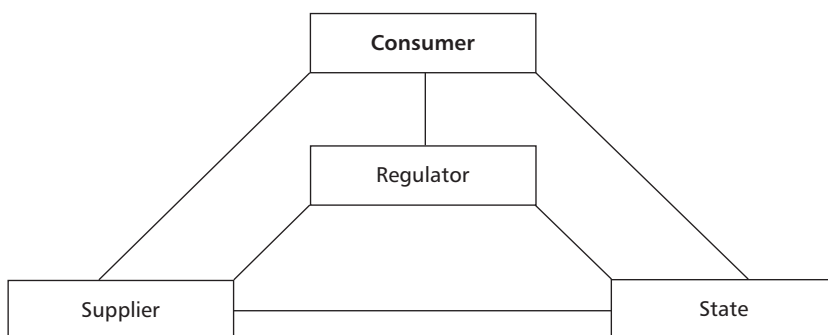
It was ‘allowed’ for self-governments to determine tariffs independently. The determination of economically based tariffs was difficult before the self-government elections of 1994. Thus the Riga self-government ‘voted’ for a determination of heat supply tariffs in amount of 60% from possible minimum amount, what caused the debt to heat supply enterprises within one heating season to the amount of 25 million Lats. The councilors who voted for formation of such big debt were more successful in the elections because the electorate wanted to pay less. In some spheres, as for example the determination of rent for flats, the liberalization still has not been completed.

- 3) *Establishment of a regulator.* The establishment of public utilities regulator started shortly after the liberalization of tariffs and prices. It was motivated with classical theme how a ‘non-political’ regulator will ensure the balance of state, suppliers and consumers interests. (See Figure 5.5.)

The first state regulators were established in the spheres of power industry (at the beginning—to the Regulation Council of Thermal Energy, which later was transferred to Power Regulation Council) and telecommunication (Council of telecommunication tariffs). At the same time the

norm on the 'assignment' of functions to self-governments was elaborated. Thus, the Power Regulation Council assigned the regulation of heat supply to all self-governments, except Riga City who refused to partake in this assignment.

Figure 5.5
The Position of Public Utilities Regulator



Initially the role of regulators expressed itself in three main spheres:

- Approval of tariffs;
- Licensing;
- Settling disputes.

It should be pointed out that from the beginning, licensing was not only the form for the determining of tasks, but also as the factor hampering competition. The enterprise when receiving the task to provide the service according to the terms set in the license gets the exclusive rights, which protect them from the competition.

In several spheres—waste management, water supply, rent of apartments, sewerage the role of regulator was taken over by self-government decision-making institution. Starting with year 2001 all self-governments will have to establish separated regulators to which self-government directions will not be binding.

a) Restructuring of Enterprises

In order to prepare the conditions which would draw services closer to the market the initial restructuring of big monopoly-enterprises could be necessary: introduction of separated accounting by branches and by types of services; dispersion of management and the strengthening of horizontal co-operation against the concentration of resources and power. It was essential for several state enterprises in public utilities sector such ones as 'Latvenergo', 'Latvian railway' and others.

In the case of self-governments restructuring sometimes went in the opposite direction. Thus from several self-government enterprises dealing with house maintenance the common institutions were established for the provision of services, big heat supply monopoly from several competing enterprises was formed et cetera. Such restructuring was more as hampering factor to the privatisation process. Politicians succeeded to stop the development for several years but in any case life proved later that it is necessary to return back to the started schemes.

b) Creation of Competition

As it was mentioned above the mentioned measure is more characteristic to big state enterprises. Usually it is the separation of networks from production and supply. Such strategy in Latvia was chosen for the privatization of electricity and railway branches. Such scheme can be used also in the communal sector. Sometimes it happens and sometimes not.

In some cases waste disposal is separated from collection and treatment. This scheme can be used also in heat supply, but temporarily the producers try to keep in their charge also networks.

c) Privatization

Privatization can be done while implementing both the all mentioned activities and part of them. In any case it has to be taken into accounts that private enterprises in public sector work for the profit. Therefore liberalization of tariffs is obligatory. When interfering in the processes of price regulation and 'imposing' on private sector excessive tasks to implement social functions instead of the state or self-governments the processes are delayed and the whole society suffers as a consequence.

Consistent policy in this meaning is the separation of *social and economic functions*. In such cases the marketing of services develops most rapidly and sooner the advantages created by competition mechanisms become apparent. In this respect, the good example is passenger transportation with motor transport. The mechanism of subsidising the unprofitable routes opened the way to real competition. Hundreds of enterprises compete each with other on the sale of routs. As a result it succeeded in renewing the routs to remote rural municipalities.

d) Consolidation of Small Companies

Self-governments inherited the communal service sector from the times of socialism and got them of different development stage. In big cities and towns of district centres these were enterprises under the subordination of town or district executive committees which started in 1991 when the implementation of local government reforms was in the hands of local town governments and transformed into self-government enterprises

On the territories of present rural municipalities the dwelling fund and public utilities infrastructure of Soviet time villages were the property of collective farms. Collective farms organised communal

services on these territories. When implementing the transformation from the socialistic system, rural self-governments were established and all public utilities infrastructure was given into their charge. At that time in every rural municipality self-government could pass decision on how public services will be provided on the territory of rural municipality. In majority of self-government while continuing the procedure established during the Soviet times all services were given in charge of one institution—self-government institution or self-government enterprise either the provision of services was taken over by rural municipality through its services (departments).

Consolidation of public services in self-government, its institution or enterprise has hampered the formation of separate enterprises of public services. There are several reasons for this:

1. *Keeping Administration*

The will of local politicians to keep the administration of services, whilst obtaining in this way the assurance that this way the possibility is created to provide faster implementation of self-government policy in self-government structural units.

The issue on keeping the administration, which means the complete retaining of public services in the hands of self-government is a political one. Councilors have to decide how much they interfere in solving everyday issues of provision of public services.

2. *Potentiality of Cross Subsidies*

Cross subsidies create the possibility to self-government politicians, (when taking into consideration the political situation and when evaluating the law solvency of inhabitants), to regulate the tariffs of public services according to the needs of a concrete time period. In fact, it means that self-governments determine tariffs lower then they should be. The losses caused by these lowered tariffs are covered by other incomes of the particular enterprise. In the cases when the services are provided by self-governments or its service (department) there is possibility to cover these losses from self-government budget.

3. *Small Amount of Public Services, Solvency of Inhabitants and their Debts*

This could be the main obstacle for division of enterprises or the separation of public services from self-government. This obstacle can be eliminated through the co-operation of self-governments or self-government amalgamation while increasing the quantitative necessity for public services. Such solution of this issue has another problem. Self-governments can pass the decision on consolidation of its enterprises or on creation of new enterprise, which in fact is also consolidation. The new enterprise becomes strong and it would be difficult for other enterprises to get into this particular market.

4. *Limited self-government budget*

It is closely linked with the previous condition, especially in the case with self-government services or institutions, because when retaining the common self-government service provision there is the possibility of a redistribution of means.

2.4 Legislation on Consumer Protection

In Latvia the consumers rights are protected with the law “On Protection of Consumers’ Rights” [42], the aim of which is to provide possibilities to customers to perform and protect their legal rights when signing the agreement with producer, seller or service provider.

The rights of customers are violated when purchasing goods and receiving services the free choice and expressed will of customers is not observed:

- The equality principle of contracting parts is not observed and the terms of a contract are not fair;
- There is no possibility provided to receive overall and complete information on goods and services;
- Unacceptable quality or unsafe goods are sold or unacceptable quality services are rendered;
- Payment for purchase and weight and measure are not determined correctly, as well as there being no possibility provided to make this certain;
- Contracts terms have not been sufficiently performed;
- Consumer is not possibility given to fulfil refusal rights to annul the signed agreement or other legal and contractual rights.

The obligation of seller or service provider is to provide true and complete information on quality, safety, price, guarantees and the possibilities of guarantee repair, regulations of use, name and address of seller or service provider (company) showing that in tag, in attached guidance of use, technical specifications or other written information.

The consumer also has the right to ask to have the additional information also orally. If the information in regulations on use is in a foreign language the translation to the State language must be attached.

The supervision and control of protection of the consumer’s rights is performed by the Centre of Protection of Consumers’ Rights, other competent and authorized state institutions in co-operation with self-governments and public organizations dealing with protection of consumers’ rights.

The Centre of Protection of Consumers’ Rights is an institution of state administration, which is under supervision of the Ministry of Economy. Its main task is to perform the protection of rights and interests of consumers.

The main functions of the Centre of Protection of Consumers’ Rights are:

- To perform control in the spheres of non-food trade and service provision;
- To perform control in estimating correct weight and measures of food and non-food goods;

-
- To organize and co-ordinate the co-operation of institutions involved in implementation of state policy in the sphere of protection of consumers' rights and non-governmental organizations;
 - To review claims, organize check-up of quality of purchases;
 - To provide the legal advice, to protect consumers' rights in the court.

Customers have rights to submit a claim on violations of requirements of normative acts of consumers' rights to the Centre of Protection of Consumers' Rights which has the right to determine the term to the producer, seller or service provided within which it is obliged to sent an answer on the violations mentioned by the consumer.

Consumers have rights to submit requests to the producer, seller or service provider regarding the found faults of purchases or services immediately after discovering them but no later than within a year from the day of purchasing or receiving of service.

Consumers have rights to voluntary join together in public organizations (clubs, societies, associations), where the aim of activities is to protect consumers' rights and which act according to normative acts and statutes of corresponding public organisation of consumers' rights protection.

The public organizations of the protection of consumers' rights have rights:

- Together with the supervision and control institutions of protection of consumers' rights to participate in check-outs which are connected with the observation of quality demands of produced and sold goods;
- To review the claims and proposals of consumers, to provide the necessary assistance to consumers in the cases when their rights have been violated;
- To file a petition to the court for protection of rights and interests of consumers and represent consumers in the court.

A consumer who has bought or got for his use the purchase of insufficient quality has rights to request that producer or seller decreases the price of the purchase, eliminates defaults of purchase, changes this purchase to the same one of sufficient quality or equivalent purchase, cancels agreement and repays to consumer the sum of money paid for the purchase.

The loss compensation is determined according to the Civil law when taking into consideration that:

- Consumer has no special knowledge on features and characteristics of purchased goods and received services;
- The reference of a seller that the information of the producer on purchase does not correspond to reality does not acquit a seller from responsibility.

Supervision and control institutions have to take over the responsibility on loss compensation to producers or service providers in relation to baseless action of supervision and control institutions.

The local public organizations of the protection of consumers' rights have elaborated the recommendations of how consumers have to protect their rights. They suggest turning to the Centre of the Protection of Consumers' Rights and the Committee of Thermal Energy Consumers only when attempt to settle the issue with service provider has ended unsuccessfully with the refusal from its side.

- The first step to settle an issue is to turn directly to the service provider. Such rights are provided to the consumer by the regulations set by the Cabinet of Ministers: 'Procedure how a tenant or owner of a flat settles accounts for received public utilities'. They determine that a consumer has to provide complete and true information on indicators shown by meters installed in a house and how the charge is accordingly calculated.
- If expanded calculation as a proof for price of service is not received, then it is necessary to turn to self-governments, whose function is to regulate service enterprises and to protect consumers;
- If the answer is not received from self-government and the issue is not settled, then support has to be looked for in state, self-governments or the public organizations of the protection of consumer rights or in the prosecutor's office.

In order to stimulate the activities of Non Governmental Organizations (NGOs):

- It is necessary to establish a favorable judicial system and to increase the understanding of decision makers, NGOs and society on the importance of NGO sector while regularly being aware on, analyzing and popularizing the role of NGO sector input;
- Self-governments would have to participate actively in the facilitation of the work of NGOs while providing the accessibility of information;
- To maintain an up-to-date data base on existing NGOs and their activities;
- To provide assistance to NGOs in project preparation and co-ordination;
- When using the capacity of self-government employees to provide assistance in various educational activities;
- Self-government officials should provide support to NGOs both with personnel and other resources.

3. LOCAL SELF-GOVERNMENT FINANCES

The analysis of self-government expenditures for three years period (1997–1999) show that 19–20% from self-government means are allocated to economic sector. Thus in these were 61.8 million

Lats or 20%, in 1998—69.9 million Lats or 20% and in 1999—63.5 million Lats or 16%. The decrease of financing in 1999 is explained with decline of the common self-government financial situation. Most of funds are allocated to education, this part includes state earmarked subsidies for teachers' salaries.

If analyses are carried out with regard to self-governments, then the conclusion is that cities of national importance are ones which allocate most of their finances to the economy, comprising of 23% from the total expenses, in towns 22%; and in rural municipalities 18%; but in district self-governments only 2%. This is because the public utility sector is the function of local self-governments.

In 1999 self-governments all together channelled 63.5 millions Lats into the economic sector, from then on 93% (60.2 million Lats) were allocated to housing, communal sector and environment protection.

4% or 2.5 million Lats from expenses in the economic sector were channelled into the purchase of fuel and services and measures in the power sector. These expenditures include expenses for the management of services and fuel in the power sector, investments, fuel, electricity and others (See Figure 5.7.)

Figure 5.6
Self-government Expenditures 1997

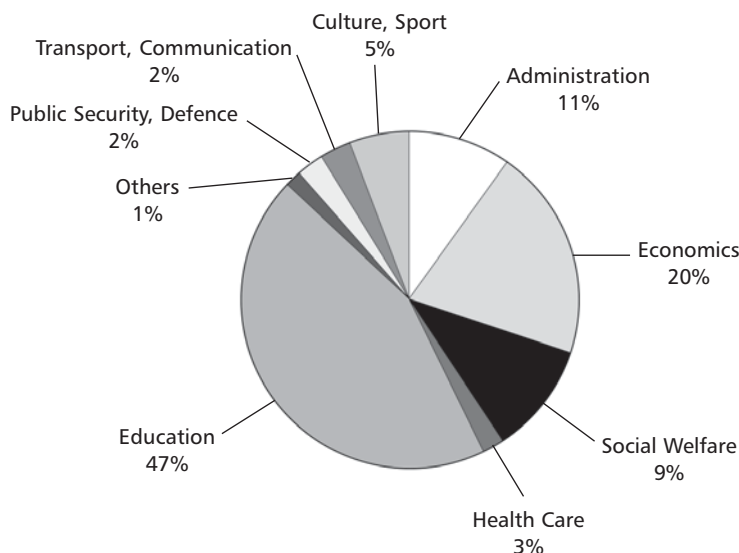
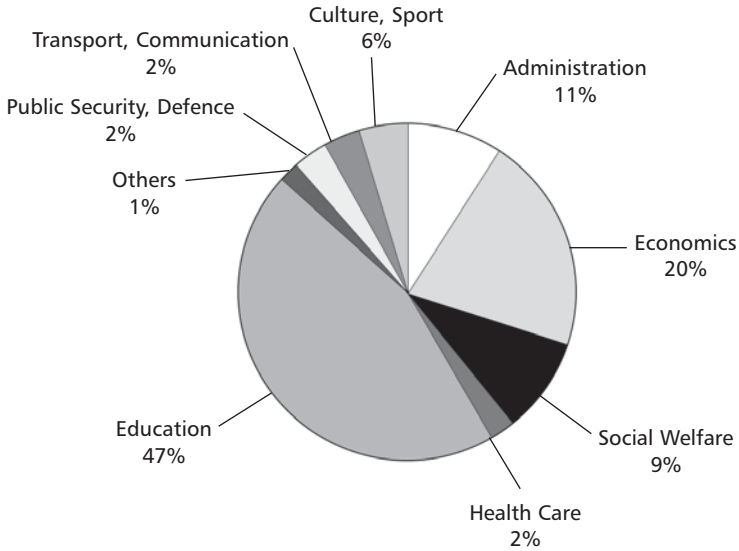


Figure 5.6 (continued)
Self-government Expenditures 1998



Self-government Expenditures 1999

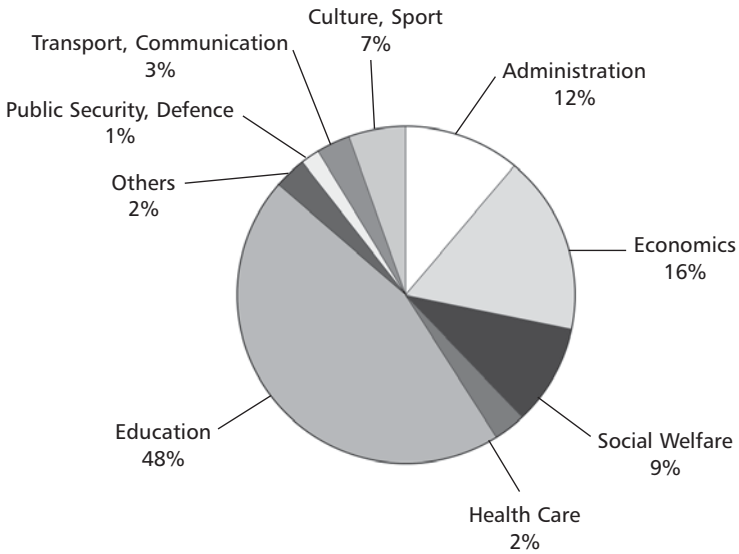
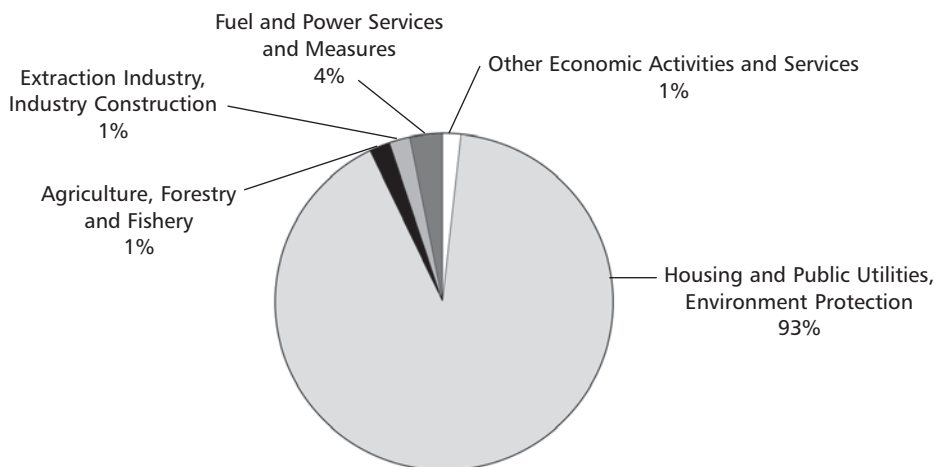


Figure 5.7
Self-government Expenditures in Economic Sector in 1999



Total self-governments expenses for the transport and communication sector are 2–3%. This expenditure now includes expenses for the management of transport and communication services, investments, motor transport (management road and highway construction, including maintenance town roads, streets and pavements, services which regulate system of public roads and determine tariffs for use of public transport), grants for organizations of public transport, railway transport, and communications.

More than 90% from total revenues of self-government budgets were channelled for covering the current costs. But 60–65% from expenses of current budget are used for salaries and current subsidies mainly in the spheres of social welfare, housing and education and 30% for goods and services.

The analyses of self-government revenues for three-year period show that the biggest part of self-government revenues is formed from tax incomes—in average 40–60% depending on the type of self-government. Only district self-governments do not have their own tax base.

Non-tax revenues form only approximately 10–12% from total self-government revenues. This part of revenues is linked with the public utility sector. The biggest proportion of non-tax revenues is made of revenues from payable services—50% or 26.3 million Lats.

20% or 8.7 million Lats are revenues from housing and public utilities services. If we compare self-government expenditure for housing and the public utilities sector and purchase of fuel then

for these purpose in 1999 self-governments invested 62.7 million Lats but received from inhabitants in the form of payments only 8.7 million Lats. In actual fact, housing and public utilities sector is a cost accounting sector where expenses have to be covered by incomes. The present situation shows that the solvency of inhabitants is low, and self-governments cannot collect means necessary for the sector. Taking into consideration that technological facilities of public utilities system are outdated and often are in emergency conditions self-governments invest money in capital repair of systems both when attracting investments and taking credits and channelling means from self-governments budgets in the way of subsidies.

The law On Accounting determines the system and standard of accounting, but nevertheless, there are slight differences between the preparation of accounts in self-governments and enterprises. The law provides that accounting has to be done in the way that third person who is qualified in accounting issues can get a clear impression on the financial situation of an enterprise and its economic activities within a certain time period, as well as detect the beginning of each economic activity and follow its course. The manager is responsible for setting the accounting in enterprise [43].

The chairmen of self-governments (their institutions) and managers of enterprises who permitted violations of the law On Accounting and other normative acts of accounting, malicious misrepresentation of accounting data, not submitted officially determined accounts or loss of accounting documents are called to account according to procedure evoked by laws.

Figure 5.8
Local Government Revenues, 1999

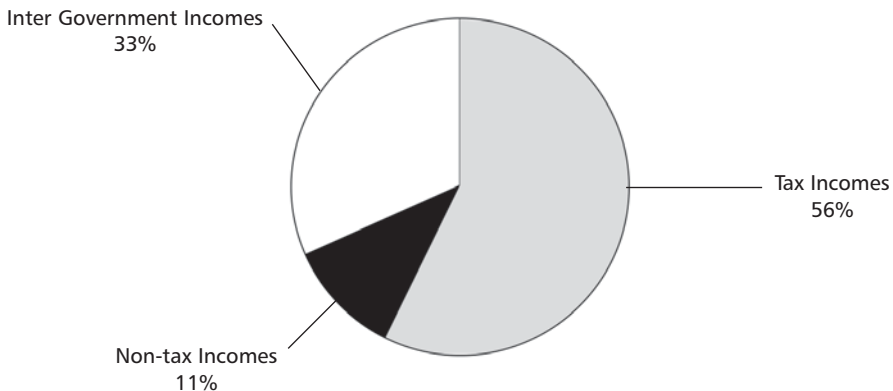
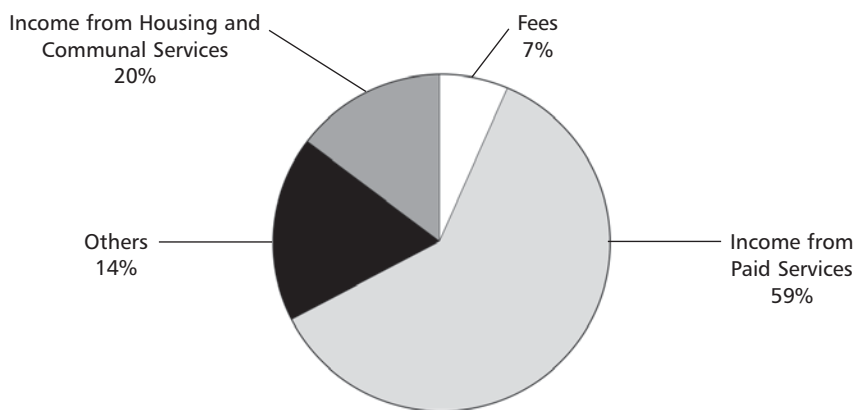


Figure 5.9
Local Non-tax Revenues, 1999



3.1 Property Rights

During the period of Soviet occupation any form of public property was reduced to state property. Therefore, part of the present economically active inhabitants of Latvia still regard self-government property as a form of state property. After the re establishment of the democratic state, since 1990, several principled laws of independent Latvia period (1918–1940) were restored—including the Constitution of 1922 and the Civil law of 1937 [8]. In this law, state property is clearly separated from self-government property.

Article 1404 of Civil law determines: “Juridical persons are declared to be state, self-governments, unions of persons, establishments and community of things what are assigned juridical character.” That opened way to the following formulation of self-government competence in the law “On self-governments” 1]: “When performing local and district (regional) administration, self-governments within the frame determined by self-government law are subject of public rights, but in the sphere of private rights self-governments have rights of juridical person.” This law also determines that property is economic base of self-governments.

Since 1990 self-governments have important role in the privatization process. This process is characterized by several stages:

- *Restitution (denationalization) or the giving back of real estates* to legitimate owners before the soviet occupation in 1940. During this process, real estates (houses and land) first of all came to the self-government property and responsibility of self-governments were to

give back real estates to legitimate owners or their inheritors. The process was basically concluded from 1991 until 1995, but some activities in this sphere still continue.

- *Land privatization* took place according to separate laws in rural areas and towns. This is now mostly complete. There are actions going on with so call compensation lands, which are given in the property of those for whom it was not possible to give land during restitution process because of functional reasons.
- *The privatization of shops, service centres and public catering enterprises:* these enterprises were 'communalized': that is they were transferred from state property to self-government property in 1991. The majority of self-governments privatized all this sphere in 1992–1993. Some self-governments because of prevailing viewpoints there lagged behind for several years. The process is now complete.
- *The privatization of small and medium enterprises:* privatization of these enterprises took place without 'communalization' intermediate, but participation of self-government representatives in privatization commissions was essential. The right of first refusal has its important role—if the ones who privatized tried to buy properties for insubstantially low price, then self-governments could buy these properties with the right of first refusal. The process basically was completed until 1997.
- *The privatization of big enterprises:* This was undertaken independently by national government without the participation of self-governments. The process has been started, but has not been completed. Several enterprises which are essential for economy of Latvia have still not been privatized, such as 'Latvian Railway', energy company 'Latvenergo', navigation company 'Latvian shipping', oil transit company 'Ventspils oil' and others. Big problems arose in the branch, where for 20 years concession was concluded, which established a monopoly in the branch of fixed net telecommunications. EU legislation requires to eliminate monopoly, which can cause big deprivations to the state.
- *The privatisation of health care institutions*—hospitals, polyclinics and doctor service centres. The percentage of privatization is quite high in the sector of self-government health care institutions. The privatization of state health care institutions has stopped And alternative solutions are being sought.
- *The privatization of enterprises of self-government public transport sector,* with regards to heating supply and waste management enterprises. Part of self-governments have accomplished such privatization, others try to keep enterprises in their property. The process is closely linked with the development of methods and institutions of regulation.
- *The privatization of apartments:* according to the law On Privatization of State and Self-Government Privatization[9] apartments of this category are privatized with privatization certificates or money. If those living in the flat require it, then the state or corresponding self-government cannot refuse the privatization of one's own property. The status of apartments privatized in this way, including the procedure of further expropriation, is determined by the law On Apartment Property [10]. In the majority of towns, the

privatization of apartments comes to an end. A certain lagging behind is observed in Riga and Ventspils.

Privatization certificates were introduced as state securities starting from 1993. They are of two types—usual and compensation. According to the law On Privatization Certificates[11] self-government responsibilities in issuing of these certificates were connected mainly with compensation certificates for unreturned property. Self-governments have to accept these certificates as payment means in privatization process of owned properties. Self-governments as subject of private rights are limited in their right ability. They can take actions with their property as far as laws do not limit these actions.

In 2000, the Parliament passed the new Commercial Law [18], although it has yet to come into force. It is linked with putting legislation in order in the sphere of entrepreneurship and resign from such presently existing form as self-government enterprise. The separated property in self-government enterprise is self-government property. But self-government enterprise can deal with this separated property, including alienation. Up until now, self-government enterprises could receive orders when avoiding regulations on public procurement.

3.2 Financing Utility and Communal Services

Any form of public utility has to operate in such a way that its incomes cover management expenses and profit is obtained for investing in development. But the practice in Latvia shows that very many providers of public utilities services work with losses. Since the law On Self-Governments stipulates that the function of self-government is to organise public utilities services to inhabitants, then the task of self-government politicians is to pass a decision on the subsidising of the public utilities sector, or not providing some of services leaving that in charge of inhabitants.

If the provider of public utilities services is a self-government institution or enterprise, then finances for the operation of institution (enterprise) can be formed from:

- a) Incomes from the provided services;
- b) Financing from State Public Investment Programme;
- c) Joint projects with foreign partners;
- d) Loans;
- e) Local subsidies, donations;
- f) Self-government compensation to inhabitants in need.

This latter one is available if the public utilities service provider is a private enterprise.

a) Incomes from the Provided Services

The normative acts determine that revenues from due services are counted in the self-government's basic budget. There is no common procedure on determining charges for services in self-governments. Each self-government elaborates its own separate procedure. The size of due service (tariffs) is determined by the council decision of self-government. When the size of due service is determined, then all necessary expenses for provision of service as well as profit interests which are channelled for investments or repayment of credits.

If the provider of public utilities services is enterprise (self-government or private), then the size of due service (tariffs) is determined by the council decision of self-government and revenues are collected by enterprise.

b) Financing from State Public Investment Program

Financing from the State Public Investment program can be channelled only to institutions of self-government or several self-governments, self-government enterprises and to institutions, enterprises and companies where the sum of shares of self-governments exceeds 65%.

c) Joint Projects with Foreign Partners

One of the most important methods of attracting foreign investments is through the participation in joint projects. Joint projects envisage investments (grants) or credits of foreign partners. In order to participate in a joint project, the council of self-government has to pass the decision the same way as it is when taking credit in the State treasury or Commercial bank. Joint projects are very advantageous because they envisage only small co-financing of Latvian partners—10–20% from the total project budget.

d) Credits

A self-government institution has no rights to borrow finances without the decision of the self-government council. Self-government undertakes credit commitments for the provision of operation of self-government institution.

The service provider is a self-government enterprise or company where the share of corresponding self-government exceeds 50% as well as institutions, enterprises and companies established by several self-governments where the sum of self-government shares exceeds 65%.

Self-governments can give guarantees to these enterprises when passing a decision of self-government council. For institutions, enterprises and companies established by several self-governments, the amount of guarantee in percentage corresponds to a number of shares in corresponding equity capital.

If the service provider is an enterprise or company where the share of corresponding self-government does not exceed 50%, then self-government cannot give guarantees to the mentioned enterprises for taking credits.

e) Subsidies from Self-government Budget, Donations

If the provider of the service is a self-government institution, self-government can assign subsidies for the improvement of technological facilities and the provision of operation for public utilities sector or compensation for people in need. If the service provider is enterprise, then self-government cannot give a subsidy directly to an enterprise. But self-government can determine some leeway to people in need and in the form of compensation transfer the difference of tariffs to an enterprise. The self-government, its institutions and enterprises, as well as companies have rights to receive donations and grants from private and legal persons.

f) Self-government Compensation to People in Need

It is forbidden for self-government and self-government institutions to donate or grant financial means or property. But self-government enterprises and companies where the share of self-government in equity capital separately or in total exceeds 50% can donate or grant financial means or property only to provide assistance in such spheres as culture, art, science, education, sport or health care as well as for social assistance.

In order to increase the ability of inhabitants to make payments for received public utilities services, self-governments give social support to needy inhabitants in the form of apartment benefits. In 1999 self-governments of Latvia have used for these benefits 4 379 000 Lats, which constitutes 32.1% from all financial means used for all types of benefits, 164 400 self-government inhabitants received these benefits. Data from questionnaires shows that from 264 surveyed self-governments, 234 pay apartment benefits.

3.3 Capital Investment Schemes

In the year 2000, the seven years programming period of European Union began. The same as in other candidate countries, Latvia will start to receive so called 'pre-structural funds'—ISPA, SAPARD and Phare. ISPA and Phare concentrate on the viewed public utilities sector.

In 2000, ISPA and Phare programs were formed on different principles. ISPA (environment and transport) projects were planned in a sectoral way, in the Ministries of Environment Protection and Regional Development and Transport. The Phare program was planned with a mixed approach—21 millions EURO were planned in a sectoral way, but 9 millions EURO were assigned for two out of five planning regions of Latvia which have been established by self-governments. It was intended that planning regions will have active preparation for the implementation of future structural funds after EU accession.

The Cabinet of Ministers has already passed the decision to continue this policy, and to divide Phare means of 2001 already, to programs in four regions. Unfortunately the European Commission did not support this intention. Brussels 'pressed' on Latvia to carry out a policy of centralization

of power and finances, when demanding later to do programming and project preparation only in the form of sector policy. If it would be in fact the demand of the officials in Brussels than it would be gross violation of the sovereignty of Latvia (the European Commission cannot give such directions to any of the EU member countries and it is not foreseen by EU legislation). Unfortunately there are well-founded suspicions that local politicians have already agreed with officials in EU Commission on such position.

The difference between the two approaches is as follows:

- In the case with the sectoral approach, the one National Development Plan is elaborated for the whole country as for one region of NUTS II level of European statistical division. This plan during the negotiations with the European Union becomes a single programming document. Activities are planned in a sectoral manner. The measure in the context of Structural Funds is planned for the territory of the whole country on the national level.
- In the case of a regional approach, the development plan is accepted for every planning region. National Development Plans can be made, but it has a subordinate role because it integrates regional development plans. Activities are planned regionally (and so the measure is planned on regional level). Ministries in this case, have a co-ordination function, whilst politicians of the regions have a dominating role.

Unfortunately there was another decision. Therefore the role of regions in the process of formation of capital investments decreases, the process of centralization of finances continues.

But there are also serious problems in the circumstances of centralization conditions. In Latvia the budget is planned for one year and investment programs are indicatively described for three years. It does not allow the rational use of existing financial means, none of the self-governments can be sure that the stated investment project of several years will continue also the next year. Therefore, the Association of Local and Regional Governments of Latvia have already, for several years, invited the government to review the budget preparation process and divide the budgets of all levels into two budgets:

- Medium term development budget with a cycle of 6–7 years;
- Short-term regular budget.

The Association considers the norms of the development budget as obligatory to a regular annual budget.

Another essential problem is to provide local and regional self-governments with sufficient financial resources for co-financing or independent financing of investment projects.

The law On Administration of Budgets and Finances, [6] determines the procedure of elaboration, approval and implementation of state and self-government budget and responsibility in budget process. Regulations of this law concern also financial activities of enterprises in cases if they are

assigned state or self-government budget means, or state or self-government capital share has been invested in these enterprises. The Minister of Finances can, on the behalf of the state, take loans within the frame permitted in the annual state budget law. Equally, only the Minister of Finance can give guarantees on the behalf of the state.

Although the state does not give funds for capital investments to enterprises, it is possible to receive grants through the State Public Investment Program. Now the legislation stimulates that the receiver of financing is the self-government. Since, for the implementation of big projects, self-governments establish self-government institutions and enterprises, it is foreseen to make amendments which allow the mentioned enterprises to receive the financing.

Since 1995, public investments in Latvia have been made within the framework of the Public Investment Program (PIP). The PIP covers infrastructure investment projects financed from financial sources available in the state, i.e. the state budget, guaranteed loans, grants, and own resources of project executors.

The size of PIP has grown every year, and in 1998 the total financial resources of PIP from the central government basic budget, government credits and guaranteed loans and other sources (special budgets, grants, own resources of project executors) amounted to 2.9% of GDP and it is planned that financing from all sources in 1999 will amount to 4.5% of GDP and in 2000— to 5.3% of GDP.

While implementing PIP, the government has retained the priority sectors of the preceding years which is the basic infrastructure of transport, energy and environment protection.

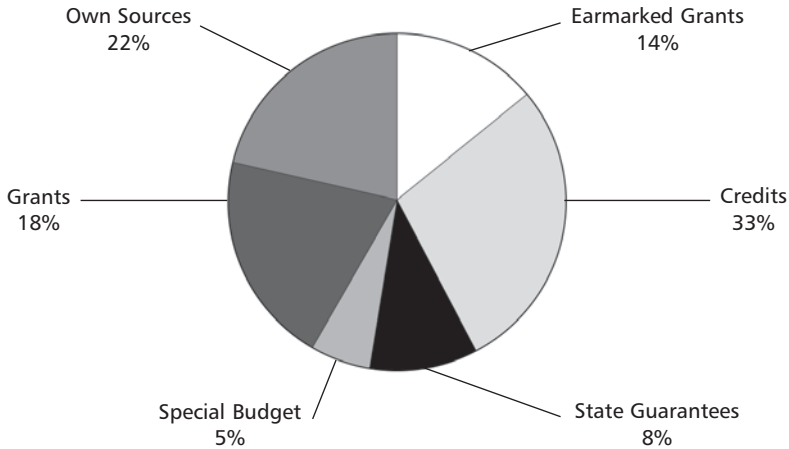
One of the main financing sources of investments is a state earmarked subsidy, which comes through Public Investment Programme (PIP). According to present legislation, the proposals of investments projects of local self-governments have to be submitted to each ministry which is responsible for the concrete sector. But the corresponding ministry determines its investment priorities, and lists at the same time its projects besides self-government projects. The proposals of ministries consisting of both the national and local self-government projects are submitted to the Ministry of Economy. This ministry is responsible for the consideration of proposals submitted by ministries and elaboration of draft PIP, which is further submitted to the Cabinet of Ministers. Before submitting the project proposal, the self-government has to follow the methodology for the preparation of investment project proposals made by the Ministry of Economy.

Although PIP is elaborated every year for a three year period, the finances are known and approved only for the corresponding fiscal year. Last year's state budget comprised of approximately one quarter of PIP financial means—the rest coming from loans, foreign grants and other finance resources (including self-government co-financing part in self-government budgets).

From 1995 to 2000, the structure of invested financial sources of PIP has changed. If in 1995, the proportion of PIP projects financed from state budget was 50% from the total amount of

invested finances, then in 2000 it decreased to 25%, but the use of the resources from loans increased rapidly. (See Figure 5.10)

Figure 5.10
Financing of Self-government Projects in PIP, in 2000

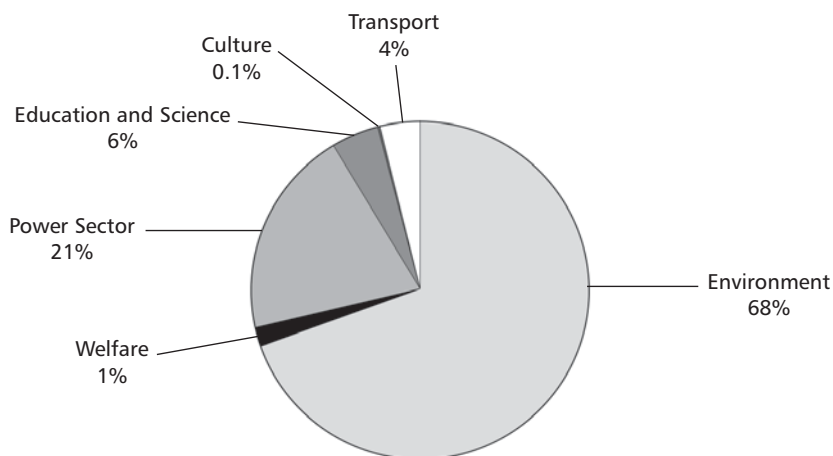


Regarding PIP as sources for financing self-government projects in 2000, we can see that the biggest part is comprised from loans—33 % or 26.4 millions Lats and own financial means, 22% or 26.7 million Lats. Thus in total the investments of self-governments in the implementation of projects is 55%. State earmarked subsidy—14% or 10.8 million Lats, grants 18% or 14.5 million Lats, state guarantees 8% or 6.5 million Lats and finances from special budget 5% or 3.7 million Lats.

When PIP was formed, then the state priorities were determined: power, environment and transport—sectors, where contributions from common state investment resources were the largest. During the last years big changes have taken place, and the priority sectors now are defence, internal affairs and justice. But the mentioned priorities concern state budget institutions.

When analyzing self-government projects in a sector context, then most of the financial means from all financial sources in 2000 were channelled to the implementation of environment projects—68% or 54.2 million Lats, and for the implementation of projects in the energy sector—21% or 16.5 million Lats. 4% or 3.2 million Lats was assigned to the implementation of projects in the transport sector. (See Figure 5.11)

Figure 5.11
Financing of Self-government Projects in PIP from All Financial Sources, in 2000



When analyzing state earmarked subsidies to self-governments by sectors, a similar situation can be found. Most of the finances are channelled to the implementation of environment projects—56% or 6 million Lats, in the power sector 15% or 1.6 million Lats and in the transport sector 11% or 1.2 million Lats [47].

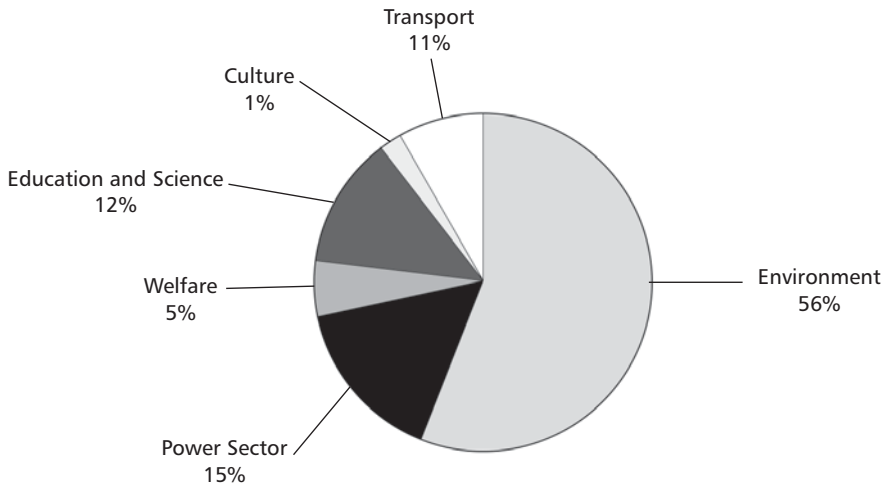
The Union of Local and Regional Governments of Latvia suggests to improve PIP by envisaging to perform the following tasks:

- co-ordination of national development policy with European Union and planning regions;
- improvement of institutional structure of development management;
- reform of budget management;
- financial decentralisation;
- improvement of management procedures of PIP.

3.3.1 On the Stabilization of Self-government Finances

At the beginning and the middle of 1990s, several foreign finance companies gave credits to self-governments with a state guarantee for improving district heating, water supply, and wastewater treatment facilities. In many cases, loans were given on very favorable terms: non-interest, with deferred payments and so on. But now, some self-governments have problems to pay back loans, and then the stabilization process is started. (See Figure 5.12)

Figure 5.12
Financing of Self-government Projects in PIP from State Earmarked Grants



The law On Stabilization of Self-Government Finances Land Supervision of Financial Activities of Self-Governments was passed in May 1998. The initial intention of the law was to use a broad range of financial and administrative measures to prevent a situation of crisis, but the passed law practically envisaged only one type of measure—a state stabilization loan.

The Union of Local and Regional Governments of Latvia asked Parliament members not to support the passing of this law in such wording, because in fact the text of the law did not reflect its title. But the law was passed, and stipulated that the stabilization of self-government finances has to be performed, if at least one of the following indications is stated:

- Self-government debt obligations, which has the term for repayment in the regular fiscal year, together with the debt of the previous year exceeds 20% from total self-government budget of the regular fiscal year;
- Self-government cannot or because of provable conditions will not be able to settle its debt obligations;
- Self-government debts exceeds assets in its property by market value of assets.

The self-government is considered to be the one which cannot, or because of provable conditions, will not be able to settle its debt obligations if the Minister of Finance has approved at least one of above mentioned indications.

In order to start the procedure of stabilization, the application of financial stabilization of the self-government is needed. The council and states approve this application, at least on the question

of stabilization indications, and calculations on the expenses of financial stabilization, and an activity plan is attached to the application. If the decision is passed on beginning of the financial stabilization process of self-government, the Minister of Finance appoints the supervisor of stabilization process.

There are certain problems in Latvia regarding the co-ordination of investments on different levels. Up until now, it was accomplished to achieve sufficient co-ordination neither between sectors, nor between sector policies and regional policy; and further neither between planning regions and national level.

In order to co-ordinate to international financial assistance, the position of the Minister of Special Assignments for Co-operation with International Financial agencies was established. But in order to fulfil requirements of Special Preparatory Programme for the implementation of EU Structural funds, the elaboration of National Development Plan has been started.

3.3.2 Local Borrowing

Self-government rights to take loans and give guarantees to self-government enterprises for the receiving of loans is provided by the law On Self-Government Budgets [5]. But the regulations of the Cabinet of Ministers determine the procedure how self-governments can take credits and divide guarantees [16].

The self-government takes a loan when signing the loan agreement with the State Treasury. The Minister of Finance, when taking into account applications of local governments for implementation of concrete projects, and when evaluating economical development of the state and stability of the finance system, can approve another contractor for a loan. In order to implement the National environment action program of Latvia, self-governments can take loans and give guarantees in the Environment Investment Fund.

Both the taking of loans and the giving of guarantees take place according to a unified procedure, that is self-governments get rights to take loans and give guarantees only after receiving acceptance of the Council of control and supervision of self-government loans and guarantees.

The law determines that self-governments can take loans within the limits and procedure determined by the Cabinet of Ministers, only according to the decision of self-government council. Although the law determines that self-governments can take loans in Latvia or abroad when issuing securities or concluding loan agreements, the above mentioned regulations limit the operation of this law.

Self-governments are not allowed to guarantee loans with properties, which are necessary for the performance of self-government standing functions. In order to implement economic and social programs which need investments, self-governments can take long term loans, such loans cannot be used for the financing of self-government standing (regular) expenses.

Self-governments can take long-term loans and issue guarantees only with the permission of the Ministry of Finance if they have not fulfilled terms of the earlier concluded loan agreement terms on issuing securities.

Self-governments can give guarantees only to those self-government institutions and enterprises where the part of capital of corresponding self-government exceeds 50%, or to institutions, enterprises and companies established by several self-governments, where the sum of self-government shares exceeds 65%.

Self-government enterprises can take loans either in Latvian commercial banks or abroad, but are not allowed to take them from the State Treasury.

In 1997 self-governments took loans and gave guarantees to the amount of 23.4 million Lats, 15.7 million Lats of these were channelled for the improvement of infrastructure and 3.9 million Lats for purchase of fuel. In 1998—18.0 million Lats from which 3.9 million Lats for the purchase of fuel and 12.9 million Lats for the improvement of infrastructure. In 1999 self-governments still take loans and give guarantees for the purchase of fuel as well as invest money in infrastructure development. Regarding credits for purchase of fuel—self-governments buy fuel during the summer months when it is cheaper. In 2000 the total amount of self-government loans was 7 million Lats. But by October 2000 self-governments had already received loans for the amount of 13.4 million Lats. (See Table 5.3.)

Table 5.3
**Self-government Loans and Self-government Requests
for Loans and Guarantees Accepted by the Council of Control
and Supervision of Guarantees for 1999**

| Loans | [Lats] | [%] |
|--------------------------------------|-------------------|------------|
| Administration of Budget and Finance | 345 000 | 2 |
| Purchase of Fuel | 1 713 500 | 9 |
| Power Sector | 4 401 871 | 24 |
| Infrastructure | 7 688 500 | 43 |
| Water Supply | 822 894 | 4 |
| Education | 2 440 367 | 13 |
| Purchase of Transport Means | 238 600 | 1 |
| Others | 664 641 | 4 |
| Total | 12 216 272 | 100 |

| Guarantees | [Lats] | [%] |
|---|-------------------|------------|
| Power Sector | 1 425 000 | 44 |
| Purchase of Fuel | 865 000 | 26 |
| Water Supply | 850 000 | 26 |
| Others | 147 500 | 4 |
| Total | 2 227 600 | 100 |
| Issued Permissions for Loans and Guarantees in Total | 21 802 272 | |

The state receives a credit from international credit institutions and further through either the State treasury or funds channelled to self-government or the state gives guarantee to self-government for receiving a credit.

The credit is assigned to the Latvian Government and is then assigned to self-governments in order to implement infrastructure investment projects. In separate cases it is possible to assign credit directly to self-government enterprise, if repayment of credit is guaranteed by self-government within its budget means. In the both cases self-government is responsible for the repayment of subordinate credit.

At the beginning and middle of 1990s several foreign companies as, for example, Danish Unibank, the National Energy Administration of Sweden, granted credits to self-governments with a state guarantee for the improvement of district heating systems, water supply systems, treatment facilities. In many cases loans were assigned on favorable conditions: interest-free, with deferred payments et cetera. Now some self-governments have problems with repaying, and the stabilization process has begun. It has happened because at the beginning of 1990s there was no experience in the country on the elaboration of an economically based business plan. Along with this, the number of service beneficiaries has decreased in some self-governments (for example local boiler houses have been established).

There are only separate cases when the state gives guarantees to self-government enterprises. Precedent is state guarantees given to port administrations which are self-government enterprises and are also under supervision of the Ministry of Transport.

It was in this manner, in 2000, that the state gave guarantees to a total amount of 101.8 million Lats including:

- Riga port administration 4 million Lats;
- Joint-stock company "Rigas siltums"(heating company) 60 million Lats;

- Ventspils port 7.5 million Lats;
- Jelgava self-government enterprise 'Water supply and sewerage management' 1.5 million Lats;
- Salacgriva port administration 1.1 million Lats.

In the draft state budget for 2001, state guarantees are envisaged at the amount of 28.6 million Lats—3.8 million Lats which are reserved for port reconstruction.

There are also mixed schemes when self-government or enterprise take credit and also receive also grant from the Public Investment Program or other funds. For example, within the frame of the Ministry of Environment's program, the regional development renovation of water supply and wastewater treatment facilities of small towns is being implemented.

The financing scheme of the program:

- Credit from Public Investment Program 30%;
- Grants from Grants Public Investment Programme 30%;
- Grants from Environment Protection Fund 30%;
- Self-government co-financing 10%.

This financing scheme can be differentiated for each of the self-governments. Self-governments can receive an international grant through the Environment Protection Fund.

There are other schemes of how the state and self-governments can support enterprises:

- Subsidies from state or self-government budgets;
- Measures in the sphere of obligatory tax or social insurance payments;
- Subsidising rates of credit interests;
- Complete or partial relinquish of state or self-governments from dividends in the enterprises controlled by them;
- Writing off of debts;
- Determination of preferential tariffs in use of the services provided by state and self-government enterprises;
- Selling of real estates below market value and buying above market value;
- Other measures with the objective to increase competitiveness of enterprise.

The performance of state and self-government support is controlled by the Commission of supervision of state support, which considers the project of state or self-government support provision and makes decision on conformity of project to the law On Control of State and Self-Government Support to Entrepreneurship and other normative acts [26].

According to Commercial law, each stakeholder of free market has an insured possibility to perform economic activities in conditions of free and fair competition. The Competition Council has been established. The agreements between the market stakeholders, the target or consequences of which hindering, limitation or deformation of competition are forbidden and are not valid [20].

3.5 Methods of Setting User Charges

Self-governments, when approving actual tariffs for public services and not providing to insolvent inhabitants the necessary benefits for apartment maintenance, create a situation in which inhabitants are indebted to enterprises. An enterprise has provided services, has invested in the provision of this service, its means, and forecasts that with payments received from inhabitants for service provision will receive back these means. Unfortunately, the actual solvency of inhabitants is low, and the capacity of self-governments to provide social assistance to inhabitants is also low.

All in all, this has created the situation in Latvia that many enterprises become insolvent or they cannot pay back credits taken for the development of enterprise. As a result of which, enterprises stop the provision of public utilities to inhabitants. Such practice is most widespread with regards to the most expensive type of service—heating supply. At first, inhabitants refuse to have such a service as a supply of hot water, or agree with the service provider on a schedule of hot water supply. This schedule can envisage supply of hot water either in fixed hours during the day or in fixed days during the week. In cases when there are very big debts of inhabitants or service provider cannot settle payments to creditors, the heating supply is stopped. That means that inhabitants of big apartment houses have to ensure the heating in their apartments themselves.

When approving lower tariffs for the heating supply than ones calculated by enterprises, self-governments face these enterprises to insolvency. Self-government enterprises have to provide public services, the manager of an enterprise also depends on the self-government because of his or her salary, and the agreement also depends on the self-government as well.

Self-governments of Latvia have possibility with the assistance of the Union of Local and Regional Governments of Latvia to participate in the elaboration of legislation in spheres of self-government interest. When fulfilling these rights the representatives of the Union of Local and Regional Governments participate in working groups on the elaboration of corresponding legal acts. They participate in meetings of corresponding commissions in the Parliament where the draft laws are prepared for reviewing and approval in the Parliament. The representatives of the Union of Local and Regional Governments work in different commissions, councils established by the Cabinet of Ministers and ministries. The most obvious examples of these councils are: the Council of energy-supply and regulation, Central commission on privatisation of apartment houses, and the Council of national economy.

The work of public service enterprises is affected by methodology of tariff calculation approved by the self-government and procedure determined by self-government on the payments of inhabitants for received services.

In the heating supply sector when approving methodology of tariff calculation self-governments can accept one of methodologies of tariff calculation approved by the Regulation council of energy supply. These are the methodologies of unified and divided tariff calculation. The main difference between these methodologies is that when calculating thermo energy tariff according to the methodology of unified tariff, the changing and constant heat production expenses are not separated. Inhabitants pay for received thermo energy only during the heating season.

When calculating the tariff according to the methodology of divided tariff, thermo energy tariff is approved when separating changing and constant expenses. Inhabitants pay for received thermo energy during the heating season, through the determined part of changing tariff and part of constant tariff. But during the summer season only the constant part of the tariff, which is approximately twice smaller than the changing part. It is not determined by the normative act which methodology of tariff calculation has to be used by an enterprise, each municipality determines it. Recently, the divided tariff has become more popular because in the situation when there is low solvency of inhabitants it gives possibility to spread the payment for the heating supply throughout the whole year. Heat production enterprises can also get more stable incomes for supplied thermal energy throughout the whole year, which gives the possibility to these enterprises to prepare the heat supply system for the new heating season.

According to the methodologies of tariff calculation, tariff of thermal energy is calculated as payment for KW in Lats. Only during recent years in Latvia have the producers of thermal energy switched from a unit of measurement Gcal to KW. There are very few heating meters in apartment houses. Due to lack of these meters, and the continued tradition inherited from the Soviet times, the tariff for inhabitants is calculated as payment for one square meter of living space. Table 5.4 shows tariffs approved by self-governments of Latvia for the heating season 1999/2000.

Due to the current situation of no common methodology on calculation tariffs for water supply and sewerage as well as waste management, self-governments have difficulties in motivating inhabitants on approved tariffs. The problem becomes even more urgent because of the wide setting of water consumption meters. At the moment self-governments can determine the price for one cubic meter of used water applying this amount also to sewerage. Inhabitants who do not have these meters pay according to normative for water consumption in 24 hours determined by the self-government. According to the normative consumption of water by one inhabitant per month is calculated and multiplied with the determined price of one cubic meter. These tariffs for year 1999/2000 are shown in Table 5.5.

Table 5.4
Heating Tariffs

| | Unit of Measurement | Heating without Meters | | |
|----------------------------|----------------------|------------------------|---------|---------|
| | | Average | Minimal | Maximal |
| Budget Institutions | | | | |
| Divided tariff | | | | |
| Winter | [Ls/m ²] | 0,29 | 0,15 | 0,43 |
| Summer | [Ls/m ²] | 0,19 | 0,10 | 0,35 |
| Unified tariff | [Ls/m ²] | 0,42 | 0,10 | 0,65 |
| Enterprises | | | | |
| Divided tariff | | | | |
| Winter | [Ls/m ²] | 0,30 | 0,15 | 0,43 |
| Summer | [Ls/m ²] | 0,19 | 0,06 | 0,35 |
| Unified tariff | [Ls/m ²] | 0,47 | 0,20 | 0,78 |
| Inhabitants | | | | |
| Divided tariff | | | | |
| Winter | [Ls/m ²] | 0,30 | 0,15 | 0,46 |
| Summer | [Ls/m ²] | 0,17 | 0,02 | 0,35 |
| Unified tariff | [Ls/m ²] | 0,39 | 0,10 | 0,56 |

The biggest producer of electricity in Latvia is the state share company 'Latvenergo', which deals with the production, distribution and management of electricity and also produces thermal energy. The enterprise has two thermo electro centrals (TEC), three hydro power plants and distribution network of electricity. The Regulation council of energy supply determines the distribution price of electricity of this enterprise. Even here, where there are foreseen tariffs for day and night electricity, they are not applied because there is no corresponding registration of electricity consumption. The negligence of these regulations essentially influence self-governments, because street lighting works only in the darkest period of night

The capacity of electricity production is not sufficient in Latvia to provide the national economy with necessary electricity. Therefore, it is bought from outside, the average purchase price is 1.23 santims per KWh, the prime cost of electricity produced in hydro power plants is 0.8–0.9 santims per KWh. The Regulation council of energy supply has determined the distribution

price for 'Latvenergo' of 3.9 santims per KWh. These different tariffs are equalized with the inter cross subsidies of 'Latvenergo'.

Table 5.5
User Charges in the Water Sector

| | Unit of Measurement | Average | Minimal | Maximal |
|----------------------------|----------------------|---------|---------|---------|
| Budget Institutions | | | | |
| With meters | [Ls/m ³] | 0.25 | 0.08 | 0.66 |
| Without meters | [Ls/m ³] | 0.27 | 0.09 | 0.64 |
| | [Ls/institution] | 20.00 | 10.00 | 30.00 |
| | [Ls/person] | 0.47 | 0.04 | 1.50 |
| Enterprises | | | | |
| With meters | [Ls/m ³] | 0.30 | 0.08 | 1.14 |
| Without meters | [Ls/m ³] | 0.33 | 0.09 | 1.14 |
| | [Ls/enterprise] | 5.95 | 2.50 | 16.00 |
| | [Ls/person] | 0.74 | 0.04 | 2.00 |
| Inhabitants | | | | |
| With meters | [Ls/m ³] | 0.18 | 0.01 | 0.38 |
| Without meters | [Ls/person Min] | 0.24 | 0.08 | 1.90 |
| | [Ls/person Max] | 0.65 | 0.11 | 1.90 |

Natural gas in Latvia is distributed by the share company 'Latvija gas', which is the only supply of natural gas. It has all the distribution networks of 'Latvija gas' and storage of natural gas in Incukalns, which operates as an accumulator of natural gas and where during summer period when the consumption is the lowest, gas is pumped in, which will be used in the winter period. This gas storage can provide the whole of Latvia with the necessary gas for one year.

The Regulation council of energy supply approves the price for natural gas. The heat suppliers of Latvia evaluate critically the present policy of gas prices in Latvia. Practically there is no differentiation in the price for gas depending of the purpose and amount of consumption. There is a situation where producers of thermal energy, which produces heat and supplies it to centralized network of heating supply, are not competitive in the thermal energy market. The expenses for

production of these big enterprises of thermal energy production are much higher than of individual producers. The national programme of power industry approved by the Cabinet of Ministers and state and self-government policy in heating supply as well as the Law on energy provides the administrative protection of the enterprises.

Table 5.6
Sewage Tariffs

| | Unit of Measurement | Average | Minimal | Maximal |
|----------------------------|----------------------|---------|---------|---------|
| Budget Institutions | | | | |
| With meters | [Ls/m ³] | 0.32 | 0.05 | 1.14 |
| Without meters | [Ls/m ³] | 0.42 | 0.08 | 1.20 |
| | [Ls/institution] | 39.67 | 9.00 | 65.00 |
| | [Ls/person] | 0.62 | 0.04 | 1.61 |
| Enterprises | | | | |
| With meters | [Ls/m ³] | 0.38 | 0.05 | 1.29 |
| Without meters | [Ls/m ³] | 0.49 | 0.08 | 2.28 |
| | [Ls/enterprise] | 6.43 | 1.00 | 16.00 |
| | [Ls/person] | 0.72 | 0.04 | 1.61 |
| Inhabitants | | | | |
| With meters | [Ls/m ³] | 0.22 | 0.05 | 0.85 |
| Without meters | [Ls/m ³] | 0.32 | 0.08 | 1.90 |
| | [Ls/person] | 0.74 | 0.13 | 2.15 |

The situation can change in the nearest future because the Parliament in the second reading has approved amendments to the Law on energy which provide:

- 1) that municipalities, when performing the permanent function stipulated by the law, organise the heating supply within their administrative territories as well as provides competition in the heating supply and fuel market.
- 2) connecting or disconnecting to or from the district heating system cannot disturb the process of delivering heat to other consumers. . Connecting or disconnecting to or from a district heating system is determined by the regulations of the Cabinet of Ministers.

At the moment, hard discussions are taking place to make these changes which are put forward by the share company 'Latvija's gas'. 'Latvija's gas' interest is to achieve the increase of consumption of natural gas, the interest of the Parliament members is to create the possibilities of free choice for inhabitants on the methods of heating their flats, including the flats which are in apartment houses.

4. SOCIAL POLICY ASPECTS OF TRANSFORMING LOCAL PUBLIC UTILITIES

The public utilities sphere is on the borderline between the market economy and social tasks of public power. On one hand in the sector, development concepts elaborated by sector ministries and approved by the Cabinet of Ministers have declared the following principles:

- Beneficiaries of services fully cover expenses of services;
- Cross subsidies within sector are forbidden;
- Social assistance applies to a person beneficiary of public utilities) not to enterprise;
- The task of regulators is to promote competition.

On other hand, the norms of social character frequently turn the real development of sector in another direction. The examples of such 'anti-market legislation' are shown in the laws "On Social Security" [21]; On the Rental of Apartments [22] and On Social Apartments and Social Apartment Houses [23].

The state, according to the law [21] has an obligation to provide part of state means for self-government social benefits. Unfortunately, this norm during six years after its approval is not still fulfilled. This method of implementation of this law, rather than its content, lays bare its 'anti-market' character.

Self-government social benefits are:

- Social benefit for families in need;
- Benefit for maintenance of apartment;
- Care benefit;
- Funeral benefit;
- Other benefits according to the view of the self-government.

With these, there is not enough financial means to pay full value benefits for the maintenance of apartments, and self-governments try to decrease the incomes of public utilities providers. This becomes apparent in the economically unfounded decrease of payments for public utilities.

According to the law [22] an allowance is made to include in rent payment:

- 1) expenses necessary for the maintenance of apartment house (tidying-up, regular repair of house, maintenance of service staff);
- 2) expenses for insurance of apartment house;
- 3) real estate tax;
- 4) deductions to cover expenses of house depreciation;
- 5) administrative expenses;
- 6) payment for services that are provided by owner to tenants according to agreement of apartment rent.

Payment for public utilities (heating, water supply, sewerage, gas, electricity and other services) is not included in apartment rent if these public utilities are not provided by lessor.

The structure of payment for rent is stipulated as the possibility of the house-owner to maintain a building but does not envisage having profit. Thus house-owning with the purpose of having profit is changed from legal activity into illegal activity. The rights of the house-owner to turn against non-payers are limited by the separation of payments for rent and public utilities. The tenant has the rights to independently make up accounts with the provider of public utilities for received services according to the procedure set by the Cabinet of Ministers. The provider of public utilities has no rights to stop the provision of public utilities to those tenants who do not have debts for public utilities.

The factor hampering the apartment market is the circumstance that councils of self-governments determine the maximum level of rent in corresponding administrative territory.

The law On Privatization of State and Self-Government Apartment Houses [9] determines that everybody who lives in state or self-government apartment house has rights to privatize his or her flat. Theoretically if all inhabitants would use these possibilities then self-governments will not have dwelling fund at their disposal. In such a situation there are so many variants for the social apartment policy—it would be logical to give subsidies to those needy tenants who cannot pay for apartments. But legislators have chosen another way when setting in the law On Social Apartments and Social Apartment Houses [23]. The task here is for the self-government to maintain social apartments.

The rights to rent social apartment are envisaged for person (family) which is socially needy or socially unprotected and to whom one of the following conditions apply:

- 1) through a court verdict the person/family has been evicted from a property;
- 2) the person/family rents an apartment which is the property of self-government and has expressed wish to rent social flat;
- 3) the person is an orphan and is not provided with an apartment.

A self-government can determine looser terms for admitting a person (or family) to have the right to rent a social apartment. The person (or family) loses the rights to rent a social flat if it does not correspond to the terms of this article. The rent of a social apartment is determined by the corresponding self-government. It has to be at least three times lower than the rent, which is determined to self-government apartments of corresponding category. Self-government can also cover part of the payment for public utilities.

The regions of Latvia are characterized by high disproportions of unemployment rates. If the unemployment rate in Riga does not exceed 2% than in several districts of Latgale region it sometimes exceeds 20% and comes close to 30% of all inhabitants at working age. It causes different attitude towards privatisation.

If social considerations dominate then employment is considered to be the most important social value. Therefore it is very important to keep the existing job places or to create the new ones. According to this philosophy it is more advantageous to hire four people the salary of each of them being 100 Ls than one whose salary is 200 Ls, and the remaining 200 Ls invest each month in progressive technologies.

In several spheres of public utilities, where still there are self-government enterprises or companies where self-government capital dominates, the above mentioned tendency is preserved. That regards management of housing, waste collection and disposal, heating supply, road maintenance. At least for a short period self-governments feel better if they do not have to think about social assistance to people without work.

Since public utility services belong to the regulated ones then no big increases or decreases of price and tariff are observed. Up until now the ceiling of rent, tariffs of heat supply and other public utilities, bus tickets and various other tariffs are approved in self-governments also if private companies provide these services. Special contract prices are observed only in the case with some exclusive services.

In Latvia since 1995 the process of privatisation of state and self-government apartment houses is in the process of implementation, the aim of which is to find the owners for apartment houses built during Soviet times, and involve the inhabitants of these apartment houses in the maintenance of the houses. The concrete apartments and shares of premises of common use are privatized. Such privatization creates such owners who consider the premises of common use in the apartment house, staircases and basements not to be their property and do not want to participate in the maintenance of these premises with their own financial means. The existing legislation determines that the owners of these flats have the rights to come together and establish societies (associations, boards) for the management of the house. But it has been proved in practice that inhabitants are not willing to use these rights and there are several reasons for that:

1. The payment charged to the owners of privatised apartments according to the legislation in force cannot exceed the rent which is determined by the self-government in its territory;

2. Inability or unwillingness of inhabitants to pay for received communal services and to settle rent payments. There are several reasons for this, for example the low solvency of inhabitants and insufficient financial means of self-governments to provide the necessary social assistance and the long lasting procedure of recovering the debts from non-payers, which creates disbelief in the solvent band, who are willing to pay the owners of apartments for the sustainability of established house management societies.
3. In the cases when it is necessary to take credits for renewal of premises of common use, such management societies cannot provide to the banks the asked guarantee for credit. Another case is with renewal of flats where each owner of the flat can receive credit in the bank while pledging as security his flat.

This creates a vicious circle—inhabitants end up paying more for public utilities, especially for the heating supply. If renovation works could be done in the apartment house, it would decrease the payments for public utilities, but in order to do that it is necessary to take the credit and there is no guarantee, and inhabitants, because of their low solvency, do not agree to take credit. At the same time, their payments for rent or the management of a house does not cover the current expenses of the management of apartment house.

5. TENDERING AND CONTRACTING RULES AND PRACTICES

The law On Tendering and Contracting Rules and Practices shall apply to all self-government procurement, whereby goods are supplied, work is performed and services are provided, with payment for them, in part or in full, from the state or local government resources (excluding resources obtained by business activities of the state and local government enterprises or companies).

The conditions of this law regarding tendering procedures (i.e. competitions) shall not be applied to self-government procurement: if the estimated value of the government procurement or the expected amount of state or local government resources in the case of partial financing of the supply of goods or the provision of services (except construction work) is less than 5 000 lati, or for construction work less than 50 000 lati, or for construction design less than 10 000 lati. In such cases, a written contract shall be entered into between the state or local government contracting authority (hereinafter—government contracting authority) and the supplier (i.e. the performer of work).

The self-government has the obligation to verify the qualifications of tenderers in order to determine their suitability for performance of supply or work, or the provision of services.

5.1 Rules and Practices

Assessment of qualifications may be done prior to the submission of tendering procedure (i.e. competition) documents, prior to the acceptance of tenders, or concurrently with the examination of the submitted tenders in the tendering procedure.

All qualification requirements shall be set out beforehand in the tendering procedure regulations or in separate regulations upon the assessment of qualifications (if such are to be prepared); and they shall apply equally to all tenderers.

If the tendering procedure regulations provide that qualification assessment documents are to be examined concurrently with the submitted tenders, then the qualification assessment documents may be submitted later than the tender itself, but not after the deadline specified for the submission of tenders.

The government contracting authority shall announce its decision (acceptance or rejection) to each tenderer individually; tenderers who have been rejected shall, pursuant to their request, also be notified of the reasons for their rejection. The government contracting authority shall, pursuant to a request, notify representatives of the press, or anyone interested, of the list of tenderers accepted (but not those rejected) to further the tendering procedure.

Government procurements shall be awarded independently of the nationality of the tenderer, the place of registration and activities of the enterprise, the type of enterprise or nationality of its ownership, and having adhered to the conditions of paragraphs four to six of this section.

All tenderers shall be provided with equal opportunity to compete for the right to perform self-government procurements. Transparency shall be maintained at all stages of awarding the government contracts. The exchange of information between the government contracting authority [the tendering procedure commission appointed by it] and the tenderers shall be in writing.

The basic method of awarding self-government contracts is by the tendering procedure, but other methods may also be used:

- awarding on the basis of competition;
- awarding by conducting a request for quotations; or
- awarding by examining the tender of only one supplier.

A decision for performing the work or providing the services in-house shall be made by the government contracting authority, taking into consideration cost estimates.

All or part of the work shall be performed in-house if:

- this means of performing the work is less expensive;

- the nature, quality or urgency of the work requires this means of performance; or
- repeated tendering procedures has not provided the results desired.

An invitation to tender with the right to submit in relation to the supply of goods, performance of construction work, construction design or the provision of services, and an invitation for prior assessment of qualifications (if it is provided for) shall be prepared by the government contracting authority and submitted to the Ministry of Finance. The Ministry of Finance, within a period of three working days after the receipt of the invitation, shall examine its content and, if of the invitation conforms to the requirements of this Law, places it on the Internet, as well as sending it to the newspaper '*Latvijas Vēstnesis*'. If the invitation does not conform to the requirements of this law, then the Ministry of Finance shall request explanations or additions, and following the receipt of such place the referred to invitation which conforms to requirements on the Internet web, as well as sending it to the newspaper *Latvijas Vēstnesis*.

Each tenderer, who considers that a government contracting authority has caused it losses or other harm by violating of the conditions of this law in the process of awarding the government procurement, shall have the right to submit a complaint, except in cases mentioned in paragraph three of this section. Complaints may be submitted for administrative review in accordance with the Cabinet regulations on the review of complaints with respect to the awarding of government contracts. The decisions of self-government institutions, regarding examination of complaints submitted for administrative review, may be appealed in accordance with procedures set out by law.

The Cabinet, the State Audit Office, and the respective local governments shall conduct supervision and control regarding the observance of regulatory enactments and the interests of ministries and local governments in the process of awarding government contracts.

If an enterprise makes a procurement for its financial means, it has the right to choose the performer of service, supply or construction insofar as it is not restricted by the law On Construction Work, Supply, Leasing and Services for the Needs of Public Service Undertakings which meets EU requirements.

The law applies to an undertaking (i.e. company)—the undertaking which operates on the basis of exclusive rights provided by the law or other regulatory enactments, or on the basis of a licence issued by a state authority or a local government, which permits one or more such undertakings (companies) to operate in a specified field within a particular administrative territory, or which occupies a natural monopoly position within a particular administrative territory, in one of the following fields:

- a) the energy supply;
- b) the acquisition and supply of drinking water, or the acquisition or supply of drinking water to the drinking water distribution networks of public significance;

- c) its transportation through such networks to the consumer, and the management of such networks;
- d) the construction and management of sewerage networks and purification equipment;
- e) the administration of an airport or a seaport;
- f) the exploration of oil or gas deposits in Latvia or its economic zone;
- g) the maintenance and administration of public telecommunications networks and provision of telecommunications services;
- h) the maintenance and management of the railway infrastructure for public use;
- i) carriage of passengers by buses, trams, and trolley buses.

In the selection of tenderers and the choice of tenders, a public service undertaking shall not discriminate against any performer of construction works, supplier of goods, lessor or provider of services.

If the estimated price without value-added tax in a contract for supply, leasing or the provision of services exceeds 250 000 lats or the price without value-added tax in a contract for construction work exceeds 3 million lats, the public service undertaking shall apply the methods for the selection of tenderers and for the choice of tenders:

- 1) an open competition—when a public service undertaking publicly invites tenderers to submit tenders;
- 2) a restricted competition—when a public service undertaking invites tenderers pursuant to its own choice on the basis of market research; and
- 3) negotiations—when a public service undertaking conducts negotiations (consultations) with one or several tenderers regarding the conditions of a contract.

If a public service undertaking selects tenderers utilising the methods of competition or negotiations, it shall set equal objective requirements for all the tenderers.

A public service undertaking may substantiate the requirement, on the basis of objective needs, to reduce the number of possible tenderers to a level which allows for a balance between the procedures for the selection of tenderers and their nature, with the resources necessary for carrying out such procedures. The selected number of tenderers shall be enough to ensure competition.

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The estimated contract price for supply shall be determined on the basis of the amount of the particular transaction. It shall not be permitted to divide the estimated contract price into parts without good reason, or to utilise special methods for determining it.

A public service undertaking shall choose either the most economically advantageous tender in which such factors as the term for the supply or the performance of the contract, the costs, the effectiveness, the quality of the tender, the aesthetic and functional characteristics, the technical conformity, the exploitation expenditures, the availability of spare parts, the security of supply, the price and other factors have been taken into account, or also the tender with the lowest price. At least once a year, when publishing informative notices in the newspaper *Latvijas Vēstnesis* and in any other periodical press publication, a public service undertaking shall, at all times, inform of:

- 1) in the case of supply contracts—the estimated total contract price in respect of each type of production, if any of the contracts exceed 400 000 lats and their total estimated contract price exceeds 600 000 lats, and such contracts are expected to be entered into within the following 12 months; or
- 2) in the case of construction work contracts—the essential elements of such construction work contracts which the public service undertaking intends to enter into over the following 12 months, if the specified contract price is not less than 4 000 000 lats.

If a public service undertaking has published an informative notice, the invitation to submit tenders regarding specific construction work, supply of goods, leasing or services shall be published not later than within 12 months after the publication of such notice.

A public service undertaking, which has selected tenderers and chosen tenders pursuant to this law shall preserve, for four years from the day of the selection, all the information and documents on the basis of which they have taken decisions.

The supervision of purchase is done by the Purchase Supervision Bureau, which is under the supervision of the Ministry of Finance and acts in accordance with this law, the operations of the Bureau are financed by the state budget.

A tenderer may submit to the Bureau a complaint regarding the activity or a public service undertaking in respect of the selection of tenderers and the choice of proposals, and the decision of the public service undertaking regarding the results of such procedures, and request the review of such activities and decisions, if the referred to tenderer considers the public service undertaking to have violated the law and the interests of the tenderer to have been affected.

The control mechanism in the organization of public services is not precisely defined in Latvia. But during the practice, it has developed that no matter how self-government organizes public services, it can perform the control of these services directly or indirectly.

1. Direct control:

- when performing control on how self-government enterprises observe the norms determined in the law On Construction Work, Supply, Leasing and Services for the Needs of Public Service Undertakings [19] on openness and publicity when choosing constructors, suppliers

and lessors. This law determines the procedure of how the provider of public services has to organize selection of bidders for construction works, supply of goods and services, lease. The methods of choosing the bidders are determined which include closed or open tenders and negotiations.

- with using rights to determine tariffs for public services, for part of public services these rights are determined in the law On self-governments[1], in the heating supply sector they are delegated according to the Energy law [38]. Before tariffs are approved by self-government an enterprise has to prove the validity of calculated tariffs.
- subsidizing public transport services: in Latvia, a the subsidy system is established for passenger transportation with buses. These transportations are subsidized from the state road fund where the procedure of use is regulated by the regulations of the Cabinet of Ministers under "The Procedure on Management and use of State Road Fund" [41].
- with revision commissions in self-governments when implementing financial revisions of self-government enterprises.

2. *Indirect control:*

- Through different (but not self-government) institutions which are directly linked with inhabitants, where these institutions hear out the claims of inhabitants and points of views of interest groups gathered in non governmental organizations and expresses their dissatisfaction mainly with tariffs and quality of services. These institutions are as follows:
- Non-governmental organizations such as associations of tenants, or the associations of protection of consumers' rights, Associations of house owners as well as House maintenance organizations, which can be both the private enterprises as well as non-governmental organizations.
- State institutions—Bureau of protection of consumers' rights which operates according to the law "On Protection of Consumers' Rights" [42].

The provision of control depends on how the services are organized. If the services are organized:

- Self-government service (department) or its institution—in this case the direct control of service provision is done.
- Self-government enterprises—the control is performed when influencing the director of enterprise appointed by self-government through self-government revision commission.
- Companies with limited liability and joint-stock companies—the control is done when following the implementation of the terms of the signed agreement. If self-government has invested in this enterprise then the control is strengthened via person authorized by the self-government.

The situation will change starting in 2001, as amendments were prepared in Parliament on the law On Self-Governments [1], while deleting the chapter on self-government revision commissions

and determining that self-governments for the performance of any revision have to invite independent auditors. The Commercial law also came into force [18] as well as the law on Public Service Regulators [3] and the law will be passed in the Parliament on state and self-government capital shares and share companies. According to these laws, in the future, self-government enterprises will not exist, they will be transformed into share companies, which can be private with or without the participation of self-government capital, or with 100% participation of self-government capital. Self-governments will be able to represent their interests in these enterprises via authorized persons, the rights of whom will be determined in the law, and also in the agreement concluded between self-government and this authorized person. The approval of tariffs for public services will be transferred into the competence of a self-government regulator. In order to control the provision of these public services the law On Public Service Regulation determines, that commercial activity in the provision of public services has to be separated from other commercial activities of an enterprise.

The essential mechanism of controlling public services is the licensing of enterprises and the issuing of licenses for service provision. At the moment, self-governments perform such licensing when issuing licenses to the enterprises of public transport. This procedure will also be retained in the future. Otherwise, it is with other types of public services—heating and water supply, sewerage and waste management—when further implementing the law On Public Service Regulators when these enterprises will continue to be licensed. This licensing will be done by an independent regulator established by a self-government.

The law On Public Service Regulators determines the regulator co-operation with public organizations of the protection of consumer rights. These are established according to the procedure set in the law On Protection of Consumer Rights, which protects the rights of consumers in the regulated sectors, as well as with supervision and in the control of institutions of consumer rights. Representatives from these institutions have the right to participate in the meeting of the regulator in a consultative status, if during the meeting of the regulator the issues are reviewed on rendering, or the provision of public services in the corresponding regulated sector.

When fully implementing the procedures set by the Commercial law, the law on state and self-government capital shares and share companies, as well as the law On Public Service Regulators the competence of self-governments to perform direct control over the provision of public services in its territory will decrease to the minimum and in the future this control can be implemented in the following ways:

- via authorized representatives in share companies where the self-government has capital shares;
- when analyzing annual reports of self-government regulators on its work in the previous year along with a complete finance review checked by certified auditor.
- when performing the control over the implementation of the agreement concluded with an enterprise or issued license.

5.2 Dealing with Monopolies and Large Service Organizations

The Concession law [13] was passed by the parliament in January, 2000. It determines that the concession is the transfer of rights of service provision or the exceptional rights to use the resources of the concession which are given to a certain time period in charge of the concedent and concessionaire, while signing the concession agreement. The resources of concession is state or self-government property, things or community of things which can be given or which are given in charge of concessionaire according to the concession agreement. The corresponding self-government passes the decision on the transfer of concession resources to the concession and approves the terms on assigning the concession. The concessionaire can have, for the period of the concession agreement to secure the concession agreement or some following burdens on real estate, which are the resources of concession in land register. Before assigning the concession, the self-government has to organize either a competition of applicants or an auction. The concession agreement is concluded in a term which does not exceeds 30 years.

The above mentioned conditions, and the conditions provided in the law on the guarantees for implementation of concession agreement and possibilities of breaching the concluded agreement, create the possibility for self-governments to separate part of its property in order to transfer this property to entrepreneurs for providing the public services determined by self-government. Self-governments then get the possibility to decentralize the provision of public services while not establishing self-government enterprises. This possibility is essential for those self-governments which provide public services with the help of its services and institutions.

Another important law, which will have important impact on self-government competence in regulation of public services is the law On Public Service Regulators[3] which determines the general procedure of the regulation of public services and the basic principles of establishment and operation of regulation system. With this law, it is determined that the state establishes the unified regulator, which will regulate the provision of public services as entrepreneurship in the following sectors:

- the power industry except heat supply where during the production electricity is not produced;
- telecommunications;
- post;
- railway transport (including passenger transportation by railway).

But self-governments, when performing one of regular functions determined in the law—, organization of public services to inhabitants, establishes a regulator of public services on its administrative territory, which will regulate the provision of public services as entrepreneurship in the following spheres:

- household waste management except treatment of household wastes;
- water supply and sewerage;
- heating supply where during production process electricity is not produced.

Regarding the heating supply, it is foreseen that according to procedure set in the law On Self-Governments [1] the state authorizes self-governments to implement regulatory function of a centralized heating supply and can authorize self-governments to implement a regulatory function of other public services in sectors regulated by the state if corresponding self-governments are in agreement with that.

The main functions of self-government public service regulator in sectors regulated by self-governments are:

- to determine tariffs;
- to issue licenses for providing of public services;
- to do the preceding review of disputes out of court;
- to facilitate competition in the regulated sectors and supervise the correspondence of public services to the conditions of license, certain quality and environment protection requirements, technical regulations and standards as well as terms of agreement.

According to the law [2] self-governments have to provide the regulation of public services starting with 1 September 2001.

The newly established regulators of public services will be independent. Self-government establishes the regulator with the decision of the council when determining its structure. Self-government appoints the chairman of the regulator and at least two members chosen according to competition for four-year period. The chairman and the members of regulator cannot be dismissed during their authority period.

The legislator has foreseen the possibility for local governments on the base of mutual agreement to establish the common regulator. This possibility is very essential for small self-governments, which because of lack of specialists of proper level can have difficulties to establish the regulator. The problems can arise also with financing of the regulator of small self-governments. The law determines that for the provision of the regulation of public services all providers of public services of regulated sectors pay a state fee for regulation of public services the annual rate of which cannot exceed 0.2% from a net turnover of public services provided by the enterprises in the previous fiscal year.

This condition on the size of the state fee and condition on necessary competence of the members of regulator creates threats to self-governments to implement correctly the functions assigned by this law for the regulation of public services. According to provisional calculations the establishment of the regulator with sufficient financial base is possible only in five regions of the state, when amalgamating approximately 100 local governments. Even the law foresees that with such possibility, it is very difficult imagine how 100 local governments will come to co-ordinated decision on the establishment of a common regulator. It is not possible that the Cabinet of Ministers passes the decision on the establishment of a regional self-government regulator. The division of competences

between the central and local government determines that the Cabinet of Ministers cannot pass the decisions binding for self-governments, if it is not provided in the law. The present schedule that the self-government regulator is established immediately after self-government elections creates doubts that this regulator will be completely independent from self-governments

Even in the law [3], the provision of competition in a regulated sector is mentioned as one of the functions of the regulator. However, the implementation of this function is limited in the same law when determining the regulations on the licensing of public services. The licence in the meaning of this particular law is not only the definition of the terms of regulator regarding the quality and quantity of services provided by the enterprise but also regarding the issuing of guarantees to the enterprise during the time period covered by the licence, when it meets the requirements of the agreement to work in the conditions of monopoly. The features of competition can be observed only in the cases when the enterprises of public services do not fulfil the regulations of the licence and therefore the licence is nullified. In such case, the self-government has a possibility on the basis of competition to offer the service provision to another entrepreneur.

The Parliament when passing the Concession law and the law On Regulators of Public Services[3] has created the possibility to stand apart from direct provision of public services while keeping the possibilities to control the services. At the same time enterprises become more independent - either they will be private or self-government companies or companies with self-government shares. The possibilities to do lobbying in the sphere of public services are decreased to the minimum.

Basically in both of these laws the mechanism for the limitation of competition is elaborated. In the implementation of possibilities set by this law, the important role in retaining competition in public service sector is played by the cCompetition council, the work of which and procedure of establishment, is set in the Competition law [20]. With this law it is determined that the main tasks implemented by the Competition Council are:

- 1) to supervise the observation of the prohibition on malicious use of exceptional status and unfair competition of market actors;
- 2) to pass decision on consolidation of market actors and in these particular cases on regulations, which have to be obligatory, implemented by market actors;
- 3) to review the submitted reports on agreements and consolidation of market actors;
- 4) within the frame of its competence to co-operate with self-governments and provide assistance to them in issues regarding protection, retaining and development of competition.

Thus, the important activities regarding the enterprises, which are in a monopoly situation are in the case with street lightning of self-governments. There is a complicated situation in Latvia regarding this service. The essence of the problem is different forms of 'lighting nets'. Some self-governments own these 'nets'. In this case, the self-government has to organize the maintenance of the nets and pay for the used electricity to the state share company 'Latvenergo'. There are

also self-governments where the existing street lighting nets belong to the state share company 'Latvenergo'. In this case, the self-governments have to cover costs of electricity used for the lighting of streets and expenditure in relation to the operation of the nets.

The problem arises regarding the covering of operation costs. The state share company 'Latvenergo' requires that self-governments cover the costs of these works, but according to the legislation in force, self-governments do not have the rights to make payments for the maintenance of works on someone else's property. 'Latvenergo' base their demand to cover these operation costs in this type of situation. The Council of Energy supply regulation when approving electricity tariffs, did not foresee that in these tariffs would be the payment for expenses of operation of lighting nets. There are also self-governments where there are two owners of the lighting nets: the self-government and 'Latvenergo'.

All this limits self-governments to implement its one functions—the provision of street lighting. The conflict arises as whilst the self-governments are interested in the economic lighting of the streets, 'Latvenergo' is interested in selling more electricity and to receive higher payments for maintenance of nets of street lightning, which are its own property.

It is foreseen that in future the operation of public service enterprises, their consolidation process, which can be linked with the decrease of job places will be influenced by trade unions. But at a moment, trade unions in Latvia are not strong. Their biggest activities are linked with the provision of social guarantees of working and needy inhabitants. The biggest activities performed by the trade unions are with regard to the establishment and improvement of a pension system, and the increase of pensions.

6. PUBLIC ACCESS TO INFORMATION

The law On Information Publicity determines the common procedure on the rights of physical and legal persons to obtain information in institutions of state administration and self-governments, and how to use it. The aim of the law is to insure for society the access to information, which is at the disposal of institutions of state administration and self-governments, for the implementation of functions determined to them in normative acts.

Generally accessible information is given to anybody who requests it, taking into account the equality of persons with access to information. The claimant does not especially have to indicate the motivate in requesting such information, and that cannot be asked.. The regulations of the Cabinet of Ministers regulate the procedure on how the information, which is at the disposal of institutions is given publicity as well as an amount of copies, reproduction, duplicates and extracts

of information from documents and other sources of information. If an information body contains the information of limited access, then the institution issues only that part of such information which is of general access. The information can be requested in written form or orally.

All requirements in written form have to be registered. An institution can determine the procedure as to how to register oral requirements for information and the content of issued information.

The information of general access, which does not have to be additionally processed, is issued free of charge. The charge for issuing of information cannot exceed expenses for the searching of documents or information, additional processing and copying. Any claimant can ask to be exempt from the payment of the service, and the institution can make a decision on lowering or exempting the charge for the issuing of information.

The institution, which has received the request for the information in written form, has an obligation to give an answer within the term determined in the law On Procedure of Considering Petitions, Complaints and Proposals in State and Self-Government Institutions.

The state or self-government institutions, which has received a petition, complaint or proposal has to register it, according to the procedure determined by the regulations of the Cabinet of Ministers and has to pass one of the following decisions:

- within seven days of sending the petition, complaint or proposal to another institution which is competent in the particular issue when informing the claimant on that, if consideration of this petition, the complaint or proposal is not in the competence of this state or self-government institution;
- to give an answer to the claimant if the consideration of petition, complaint or proposal does not need additional check-up or requirement for additional information;
- to give an answer to the claimant if the consideration of petition, complaint or proposal needs additional check-up or requirement for additional information, in such cases the claimant has to be informed on additional check-up.

Heads of state and self-government institutions or their authorized persons periodically, but not less than once in a month have to receive visitors in time convenient for the visitors, and accordingly their competence have to consider a complaint or proposal expressed orally.

The law On Self-Government Budgets determines that the process of preparation and use of self-government budget is open. The information is freely accessible for inhabitants of corresponding self-governments, journalists of any mass media and officials of the state and self-government institutions in corresponding administrative territory [5].

Society can freely obtain information on enterprises (companies). The enterprise 'Register of the Republic of Latvia and Finance Inspection' has to provide documents and information freely

accessible and any person, when having paid state duty, can request it. The mentioned institutions for pay have to give references on documents and information as well as copies and extracts of these documents if the application or request has been received in a written form from the concerned person.

Society can freely obtain the following documentation and information:

- Foundation agreement and statutes.
- Any amendments in foundation agreement and statutes.
- Complete text of agreement and statutes after each change of foundation agreement and statutes.
- At least once in a year-size of registered, announced and paid equity capital.
- Annual account and report and other legal information.

All annual accounts of enterprises and reports of the management are subject to obligatory auditor control.

Enterprise, which in operation amount bring in a net turnover exceeding 2.4 million Lats, total balance is of 1 million Lats and the average number of employees in review year exceeds 250, submit an annual report and copy of auditor conclusion for publishing in official government newspaper.

One of the most efficient ways of informing society, is the involvement of society in processes, which are connected with decision-making in matters essential for society. The involvement of inhabitants includes any process in which the inhabitants influence public decisions, which are connected with their and other inhabitants' life quality. Participation can be active—when inhabitants mutually co-operate with elected officials or when self-government employees influence the political decisions. Either participation can be comparatively passive—when inhabitants simply attend open meetings or receive information on status of self-government programmes as well as participate and vote in elections.

From the point of view of society, involvement of inhabitants in decision-making process in time, especially those one who will be directly affected by this issue or programme can improve understanding, decrease possible conflicts and create favorable conditions for the unanimous decision of wider society. When involving inhabitants in the elaboration of a new policy and program of self-government in time, it is ensured that the thoughts of people are heard and considered, thus guaranteeing better serving to the interests of the whole society. Generally speaking, when involving inhabitants in a decision-making process, self-governments become more open and accessible. If inhabitants consider self-governments as always being open to people, then there is much more possibility that they will understand further, and will obtain more knowledge on self-government issues and, therefore will be more able to assist in solving these issues.

Participation of inhabitants help in decision making, improves understanding, co-operation and positive evaluation on the work done by self-government, reduce conflicts, creates support to implementation of projects or plans of local society and makes self-government more open towards the problems of inhabitants, doubts and questions. For democratic society, the involvement of inhabitants is a basic necessity. [45].

For example, inquiring the view of society and involvement in the process of impact on environment assessment is part of democratic public administration. The topical problem in Latvia is disposal of hazardous wastes. There is a negative attitude in society towards the placing the hazardous wastes treatment facilities on the territory of self-government. Very often this attitude is well founded, but in many cases is based only on emotions because of lack of information.

Inhabitants can obtain information on all issues, which relate to public service sphere in public organizations and self-government enterprises of protection of consumer rights.

Thus, the information is available there on heating supply, energy efficiency, district heating, legislation on protection of energy consumer rights, prices for heating supply services, determination of charges for hot water, its accounting and distribution, as well as quality.

According to the law On Energy, the Council of Energy Regulation has delegated all self-governments to making calculations of thermal energy tariffs according to which self-government approves the prices for thermal energy and linked services. The consumer has the rights to request from the self-government a heating supply enterprise:

- Annual report on results of tariffs approved by the self-government;
 - Calculation of thermal energy tariffs on the base of which self-government decision is based;
 - Expenses of maintenance and repair of inner heating and hot water nets;
- Average expenses of heating per one square meter of heated space in heating season.

When society participates in environment protection issues the chance appears to influence politicians that they take into account the interests of society and to achieve this way introducing of amendments in normative acts.

When involving society in solving problems it should be taken into account:

- Publicity—it has to be said openly to people why and how the problem is solved in concrete case in order they can understand and accept what is happening;
- Co-operation—the main thing, which makes the co-operation with society successful is precise choice of target audience and investigation of the problem;
- Principle of partnership and responsibility;

- Information has to be understandable, simple and easy perceptible. Co-operation with society has to be continuous learning process both from the part of society and the organisers, because this way the experience and ability to evaluate the weak points is obtained.

In Latvia, the procedure on informing society on issues of self-government competence is regulated by the law On Self-Governments. It is stipulated in the law that self-government council meetings are open. In the statutes of self-government, those issues can be pointed out which will be revised at closed meetings. The announcement on place, time and agenda of regular self-government council meeting has to be exposed in a place accessible and seen by everybody in premises of municipal house or near it, and if possible has to be published in the local newspaper [1].

Non governmental organizations play an important role in informing inhabitants on public utilities tariffs. In order to draw the attention of the whole society, any involvement of inhabitants needs to do work with mass media (newspapers, radio and TV). During the initial stage of inhabitant involvement, the mass media gives support when announcing information on a problem, and invites society to co-operate. In the middle of the activities reporting is on the status of initiative, and at the final stage it is on the informing of results and the introduction of tariffs. Sometimes self-governments have to facilitate the work of the mass media in order to include them in inhabitants involvement programs. The most frequent methods used in the self-governments of Latvia, are the announcements to the press and press conferences. These methods allow the mass media to obtain the most important facts with minimal efforts.

At the same time, there is certain competition going on between the mass media and civil servants on creation of negative stories. Nine-tenths of all information on the work of institutions of public power and administration are with negative character. Very rarely are there any news on some progressive reforms or attempts to improve something. The myths are based on the high salaries of civil servants, for example 'total corruption' and other such negative hype. Responding to this pressure, employees of public administration are not willing to give information to journalists.

One of the reasons of this insufficient level of information is that public administration functions are quite often performed by companies established according to private legislation, which refuse to give information on the use of public finances while referring to the commercial secret'. That is one of the reasons why these institutions in future have to be transferred into public agencies. The contradictory rights regarding information distribution also cause the problem. Thus the law On Protection of Data on Physical Persons particularly protects the immunity of private life with regard to personal data processing.

According to the law On Information Publicity, the information of limited access is the information which is meant for a limited circle of people with regards to the implementation of work obligations, and where the loss or handing out of this information, due to its character or content, may burden the work of the institution, creating harm to the legal interests of a person.

The information of limited access is the information:

- if such status of information is determined by the law;
- which is foreseen and determined for inner use of institution;
- on secrets of entrepreneurship;
- on private life of physical person;
- which regards certification, exams, submitted projects, competitions and similar kind of evaluation.

When indicating the motivation foreseen in the law, the author of information or head of institution has the right to determine with its direction the status of information of limited access.

Thus the legal obstacles have been created for free circulation of information in many spheres. What regards to the self-government, then it feels a lack of information. The reasons of this drawback are several:

- centralization policy, which regards the establishment of primary state registers separately from self-governments;
- commercialization policy, which foresees the charge from self-governments for information from state database. Thus, many self-governments cannot receive the information necessary for their work because insufficient financial means;
- policy of information protection, when in the name of basic rights, commercial secret or official secret the information circulation is exaggeratedly limited.

As a result, self-governments do not have enough data on taxpayers, enterprises and owners on self-government territory. This essentially obstructs the elaboration of well-founded development and spatial plans. Therefore the big expectations are linked with the establishment of a self-government information system.

Since 1998, the Public Investment Program has been instigated. This foresees the establishment of a common state and self-government information system. Regarding self-governments it foresees:

- Internet access in each self-government;
- The possibility for each self-government to have information exchange with state basic registers (Population register, Commercial register, Land register, Taxpayers register and others);
- To transfer the processing of primary information of several registers directly to local governments;
- The establishment of a 'One stop agency' in each municipality when providing the necessary exchange of information to their work;
- The establishment of common self-government portal, which would be an instrument for settling relations of any inhabitant with public power.

Unfortunately, this particular system has a very slow development because of an insufficient amount of assigned finances. There are similar plans at the central government level. These processes work in parallel, and are more competitive than co-operation relations.

In relation with public administration reform the expected improvements are unclear. The European Commission promotes the centralization of administration in Latvia which promotes the tendency of a formation of a closed civil servant caste. In many cases as a result of reforms, it is expected that efficiency of administration will actually decrease, as these different administration methods are not characteristic of a modern age. Equally, there are negative aspects to excessive administration, control and regulation tendencies, which creates a favorable environment for corruption.

7. POLICY MAKING PROCESS

The policy of public power is formed on several levels, including the local (rural municipality and towns), district and national levels. The self-government competencies include the preparation of development plans and spatial plans based on development planning. The planning of self-governments at all levels includes the public utilities sector. It also includes the level of planning regions. At the moment, five voluntary established planning regions cover the whole territory of Latvia.

Since the Parliament elections of 1993, there has never been one party government which could implement its pre-election promises. Quite often, the ruling coalition is formed of parties, which have quite different programmatic viewpoints. Therefore there is a tradition that together with the composition of the government, which is submitted by the Prime Minister invited by the President to the Parliament for acceptance, the Declaration on the intended work of the government is also submitted for approval. During the period of one government, the Declaration becomes the guidelines of the government and activity program approved by the Cabinet of Ministers is co-ordinated with this Declaration.

The Declaration is usually the compromise among the programs of several parties. Quite often the compromise is in the way that in the common program there are promises to do such works which no one of parties considers to be good, following 'the principle of lesser harm'. These declarations are also influenced from the heritage of the sector.

In the law on the system of the ministries, policy making is mentioned as one of the tasks of the ministries. Several ministries are responsible on national policy in public utilities sector—Ministry of Economy (power industry), Transport ministry (post, telecommunications, roads, passenger transportation, railway), Ministry of Environment Protection and Regional Development (housing,

waste collection and treatment). This national policy appears in the form of sector development programmes. recently there is attempt to establish integrated National Development Plan.

According to the competence of the Cabinet of Ministers determined in their own Constitution, the Cabinet of Ministers is the one which passes decisions on issues which concern the interrelation of several ministries. The Cabinet of Ministers also reviews sector development programs. Sometimes, the Cabinet of Ministers 'approves' such a program. In the case of approval, it becomes binding to civil servants and other persons who work in public administration, but the policies cannot be the base for administrative acts. In other cases the Cabinet of Ministers 'accepts the information' on the sector programs. In such case the program is not binding even internally, it has the role of the 'intention protocol' of the ministry.

The implementation of state policy is fulfilled in the manner of:

- Normative documents (laws, regulations of the Cabinet of Ministers);
- Establishment of corresponding institutions;
- assigning the financial means for implementation of objectives set in policies.

Self-governments are efficient lobbying institutions both in the preparation of policy and during the stages of implementation.

Already for several years there is a tradition that the representative of ULRGL participate in weekly meetings within state secretaries where the draft normative acts, which are in the preparation in the government are 'announced'. The 'announced' project is sent to sector ministries, State Control and the ULRGL, if it so requires such an opinion. The opinions are summarized and attached to the corrected wording of draft normative act, which are submitted for review to the committees of the Cabinet of Ministers. If the ministry, which is submitting the draft does not agree with opinion of the ULRGL, then its obligation is to prepare disagreement protocol, which is attached to the draft project

The representative of the ULRGL has the rights to participate with consultative rights in the meetings of the committees of the Cabinet of Ministers, and to defend the point of view of self-governments. Civil servants participate in these meetings with the same rights. Further down the line, the government decision is passed in the meeting of the Cabinet of Ministers, where the representative of the ULRGL can be invited by the Head of State Chancellery (according to the decision passed in the meeting of state secretaries) or the Prime Minister.

Regular negotiations take place from spring until autumn. On the first stage (March–April) the agreement is reached with each of ministries on topics of negotiations. On the second stage (May–June) there are negotiations with ministries. During these negotiations its corresponding committee represents the ULRGL, but from the side of ministry there is the management staff

of corresponding department. The negotiations are lead by the chairman (vice-chairman) of the ULRGL from one side and the minister (state secretary) of the sector from another side. Each round of negotiations is concluded with agreement or disagreement protocol.

During bilateral negotiations between the ULRGL and the ministry, the arisen problems are discussed, the points of view on proposed changes in legislation and expenditure of new functions are fixed. The protocols of these negotiations become the base for annual negotiation protocol, which is prepared together with legislative package of budget for submission to the Parliament. The Prime Minister with mandate of the Cabinet of Ministers and the chairman of the ULRGL with mandate of the Council of the ULRGL sign annual protocol.

Special form of negotiations is extended committee meetings of the Cabinet of Ministers, which are foreseen in the regulations on the internal procedures of the Cabinet of Ministers [7]. The members of this committee are persons (ministers) nominated by the Prime Minister and persons (members of the board, heads of committees) nominated by the ULRGL, which discuss most important issues related to self-governments. Annual negotiation protocol and most significant reform issues are discussed I these committees.

The ULRGL participate also in other type of negotiations like as participant in three parties negotiation system between the government, employeers and trade unions. One another form of consultation is Consultative Committee of National Economy established at the Ministry of Economy.

The ULRGL tries to influence the development of draft legislative acts up to the third reading in the Parliament. It is achieved with active participation in the commissions of the Parliament as well as using personal contacts with the Parliament members and fractions. The majority of issues in public utilities sector are reviewed in Commissions of National Economy, Agriculture, Environment and regional policy of the parliament during the meetings of which the point of view of the ULRGL is regularly presented. The ULRGL delegates its experts to working groups formed by both the government and the Parliament.

Many issues important for local inhabitants are solved not on a national but on a local level. It particularly regards the spatial planning and construction. The spatial plan usually foresees a division in zones, when each zone is characterized with certain burdens of private property rights. The change of zoning is caused also by self-government investment activities. When changing the character of the use of territory the obligation of self-government is to organize an opinion poll.

The obligatory character of such an opinion poll is determined in the law On Administratively Territorial Reform, and in the regulations of the Cabinet of Ministers on territorial planning. Each inhabitant of corresponding territory has the rights to express his or her opinion on planning issues. These opinion polls have not yet become usual and general practice, but with every year they take place more and more often and are becoming more and more popular.

In order that the negotiations with government would become more efficient the legal status of them should be precise. Thus, the ULRGL suggests further on to approve the negotiation protocol of the ULRGL and the government in the Parliament.

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NOTE

- ¹ 558 questionnaires were sent out to 77 cities and towns and 481 rural municipalities. 225 rural municipalities (47%) and 39 cities and towns (51%) responded.

Poland

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1. GENERAL TRENDS OF MUNICIPAL ECONOMY IN THE YEARS 1990–2000

1.1 Objectives of Restructuring in Public Services

Following the fall of real socialism in Poland, de-nationalization of a wide array of social and economic life aspects in Poland, including the partial decentralization of public tasks and funds, has been an essential component of changes in Poland's political system. New rules were introduced to grant real powers to the society and a new administrative regime was established. In 1990, the State passed a wide range of public powers and assets to the newly established local authorities ('gminas'). Almost 250 'gminas' were established as new entities of the public law vested them with:

- a legal personality or capacity to act as legal person on its own behalf and responsibility;
- their own assets. A substantial part of state assets until 1990 owned by:
 - (a) local and 'voivodship' (regional local government) administration agencies or
 - (b) State enterprises which were founded by these agencies, was transferred to 'gminas'. In such a way, some state-owned enterprises became municipal enterprises and 'gminas' were given a wide range of powers, including the area of municipal economy;
- own budget with own revenues and transfers from the central budget;
- own municipal staff members.

In a corporation form of municipal enterprises along with management and operation procedures inherited from the era of command economy, which was incompatible with client-orientation and efficiency requirements, forced the newly established local governments to proceed with a restructuring of enterprises, in order for them to have any chance to meet the growing expectations of residents from both new authorities and the local economy.

The introduction of market-oriented principles to the functioning of the municipal economy in 1990 was intended to impose authentic efficiency-oriented changes in this area and in particular was expected to¹:

- improve the quality of municipal services;
- rationalize the consumption of resources by imposing real prices, while eliminating or limiting service subsidies;
- minimize burdens to the central budget;

- separate political from economic decisions;
- attract private investors to the municipal sector;
- protect consumers against monopolist practices;
- eliminate cross-subsidizing;
- create a system of incentives to continuous improvement of cost-efficiency in service delivery.

In order for local authorities to achieve these targets, they have to create conditions that are conducive to competition from different service providers. Natural monopoly sectors require special safeguards against monopoly practices. The local market of municipal services will operate efficiently only if all of the following conditions are met at the same time:

- adequate number of service providers are available in the local market to ensure the competition;
- customers have a sufficient ability to pay for a product or service;
- service providers must have unrestrained access to customers;
- customers should be adequately informed about price, quality and any risks associated with service purchase;
- market operation rules should be regulated by local authorities, although not overly to reflect existing stage of competition development;
- regulations enforcement system must be in place to ensure compliance.²

In accordance with this definition of the local government's objectives and operation principles, they are responsible for ensuring that particular services are provided and available, but local governments themselves are not required to perform these tasks. This understanding of the local government's role has underpinned Poland's legislation over the past ten years.

1.2 The Organization of Local Governments and Public Services

The principle of decentralization and self-governance is one of the key constitutional principles of the third Republic. The Constitution of the Republic of Poland of 1997 contains the so-called 'Corporation Clause' which states that all residents of primary territorial division units form a self government community by virtue of law (Art. 16.1). The territorial system of the Republic of Poland ensures that public governance is decentralized (Art. 15.1 of the Constitution). The laws define primary territorial division of Poland, considering social and economic relationships, and ensure that territorial units are capable of performing their public tasks (Art. 15.2 of the Constitution) on their own behalf and responsibility (Art. 16.2), including decisions on regulation of municipal economy. The 'gmina' is the primary local government unit (Art. 164.1). Other local government and territorial units are subject to separate laws (Art. 164.2.).

Since January 1, 1999, following the enactment of the second stage of administrative reform in Poland and the introduction of a three-tiers administration system, new self-government 'poviats' (regional local government) and 'voivodships' (regional local government) supplemented the 'gminas' (primary local government unit), already in place for nine years. Like *gminas*, new local government units are vested with a legal personality and enjoy legal and property autonomy which is protected by courts (Art. 165 of the Constitution). Their powers and responsibilities are defined by laws on Voivodship and Poviats Self-government, and laws on Powers and Responsibilities of Public Administration Bodies, in relation to the reform of Poland's administrative system (the so-called 'Competence Act'³, 'Minor Competence Act'⁴ and so-called 'Sweeping Act'⁵).

The responsibilities of particular self-government administration levels are without prejudice to the autonomy of other levels. This second stage of administrative reform was based on the principle of abstaining from changes in the governance powers of existing *gminas* and their methods of municipal economy management. Also the scope of the *gmina's* own tasks, as defined by *Gmina Self-government Law*, is unchanged. *Gminas* are responsible for all local government tasks which are not reserved to other local government units (Constitution, Art. 164.3).

The *gmina's* own tasks include in particular:

- water supply, wastewater disposal and treatment;
- maintenance of cleanliness and order;
- rendering municipal waste harmless and landfill operation;
- power, heat and gas supply;
- local public transport;
- a *gmina's* housing construction;
- a *gmina's* green areas and timberland;
- a *gmina's* cemeteries.

Poviats are responsible for public tasks of supra-*gmina* nature, including those regarding transport and public roads, property management, physical planning, water management, environment protection and protection of consumer rights; while self-government *voivodships* perform regional tasks, including: regional physical planning, environment protection, water protection, public roads and transport.

The Municipal Economy Act of 1996 defines general principles governing the functioning of municipal service sectors. The Act regulates such issues as incorporation forms of municipal service providers and general rules governing the operations of municipal utilities and companies with a local authority's share.

The issues of municipal economy are relatively complex. Each municipal service involves a set of different specific issues regarding the management, organization, financing, property, infrastructure

requirements, environment protection, improvements in service standards and accessibility, service provision technology and capital-intensity, privatization/restructuring opportunities, public sensitivity of service provision and adjustment to EU requirements. Each utility sector is subject to separate specific regulations.

The municipal economy is part of the entire Polish economy system which is subject to radical changes. The administrative reform has been implemented jointly with changes in commercial law and the transformation of the public sector (health care, social security, education) that impose new tasks on local governments and utilities and compel them to initiate substantial structural, organizational and financial changes.

1.3 Incorporation Forms of Utilities

At the onset of administrative reform in 1990, approximately 800 utilities operated in Poland under the management of the territorial central government administration and provisions of Law on State Enterprises⁶. In 1990, State-owned assets underwent so-called ‘communalization’. A majority of the enterprises were transferred into the hands of local governments in order to enable *gminas* to implement their statutory public tasks. In fact, it took several years to complete the process of transferring assets, especially the indivisible assets of supra-*gmina* enterprises (for example the water or wastewater utilities). Under existing provisions of law, *gminas* were allowed to accept such assets only upon establishing a special purpose union of *gminas* (i.e. joint authority) or signing an agreement between two or more *gminas*.

Since the reform inception, local governments have been authorized (under provisions of Self-government Law) to choose the incorporation form of their enterprises and approach to business operations in the utility sector. In particular, utilities could be incorporated as budgetary units (under the provisions of the Budgetary Law), municipal enterprises operating under applicable provisions of the Law on State Enterprises, or companies of the commercial code. Additionally, *gminas* were allowed to enter into service delivery contracts with privately-owned entities. The Self-government Law and privatization legislation (of 1990) made it possible to transfer municipal companies, services and assets of existing enterprises into private hands.

1990 saw the beginning of changes in the incorporation form of municipal enterprises, as decided by their self-government owners. According to a survey carried out by the Gdansk Institute of Market Economics from 1992 to 1995 on a representative sample of enterprises, the following incorporation form changes occurred in Poland in the years 1993 and 1994 (see Table 6.1).

Over a period of two years, the number of municipal enterprises tended to decrease in the investigated sample, while the number of budgetary units of the *gminas* and *gmina*-controlled companies of the commercial code had increased. Survey results indicate that the number of privately-owned entities has remained unchanged.

Table 6.1
Forms of Incorporation at Local Governments (1993–1995)

| Incorporation Form | % Share in 1993 | | % Share in 1995 | |
|---|-----------------|----|-----------------|----|
| Municipal enterprise | 19 | | 9 | |
| Budgetary unit | 43 | | 47 | |
| Gmina-controlled company of the commercial code | 22 | | 28 | |
| Privately-owned company of the commercial code | 7 | 16 | 11 | 16 |
| Private partnership or individual | 9 | | 5 | |

Therefore, we may assume that in mid 1990s the following three different groups of utility service providers operated in Poland:

- The first group was composed of disappearing municipal enterprises (and State-owned enterprises that particular *gminas* refused to accept for various reasons, for example due to depreciation of assets, or those providing services to two or more ‘gminas’ which were unable to establish a joint authority for transfer of assets). These enterprises operated under the provisions of the Law on State Enterprises, dated 1982, which did not encourage an efficient management and long-term planning in the conditions of a market-oriented economy.
- The second group is composed of budgetary units and so-called auxiliary units. Budgetary units—as units of a non-budgetary sector—have had their own budgets, but their financial management was subject to Budgetary Law provisions (since 1999, the basic rules of their operations have been regulated by the new Public Finance Law). Operations planning is based on annual financial plans which are connected, to a differing degree, with local authority’s budget and their financial result on operations is accounted for in the framework of the latter. These units are deprived of a legal personality other than that enjoyed by the local authority, they are unable to dispose of the assets (as the management of municipal assets is their only right) and are deprived of the capacity to be a party in civil cases. Since the assets used by a budgetary unit are owned by the local authority, any fees and charges for services provided by the unit do not include the depreciation or assets replacement costs⁷.

Consequently, councilors and sometimes also performance monitoring local councils have difficult access to meaningful information about the operating costs of municipal units. It is now clear that this form of incorporation is unsuitable for any efficiency improvements and rational financial planning.

- The latter group is composed of rapidly growing (albeit this trend is not confirmed by the investigated sample) companies of the commercial code, i.e. limited liability and joint-stock companies, owned by municipalities or with mixed or private ownership of stock and shares. The companies are vested with a legal personality, enjoy decision-making freedom, the capacity to be a party in civil cases, own their assets and operate under accounting principles applicable to business entities. This ensures proper cost and management reporting procedures which are required in a market-oriented economy. This group also includes individuals who run their own businesses or civil code partnerships which are adapted to a market-oriented business environment and contribute to developing competition in the area of various municipal services.

The efficiency of enterprises owned by joint authorities has varied from one enterprise to another and sometimes proved inadequate. Quite often, disparate interests of several 'gminas' has prevented the development of a coherent long-term vision of expansion, although a number of exceptions reported in this context proves that adequate growth-oriented legislative framework has been in place since the beginning of the transformation process (1990).

The trends revealed by the Gdansk Institute's survey have continued in the next 5 years. Following the enactment of the Municipal Economy Law, municipal enterprises, as defined by the Law on State Enterprises, disappeared (from 1 July 1997 this incorporation form is legally unacceptable), while the number of budgetary units has remained stable or (depending on sector), decreased to the benefit of commercial code companies. At the same time, more and more privately-owned businesses enter the market and offer local authorities prices that are competitive to those charged by existing municipal units.

Under existing Polish regulations, public and private entities enjoy equal rights to implement any tasks that are financed from public funds (Art. 25 of Public Finance Law dated 1998) and in terms of public service contracts. Previously, local governments or any other public authorities were able to provide services by their own units, and could reject or refuse to consider any proposal submitted by bidders from the private sector. Today, also due to guidelines and efforts by President of Public Procurement Office, who has an important, legal influence on appeal proceedings, the administrative monopoly which has limited access of privately-owned business to specific markets and tasks financed from public funds (for example green areas and sweeping) is being phased out.

The trend to incorporate municipal utilities as commercial code companies, as reported over the past few years, clearly indicates that local authorities, or at least the most innovative ones, wish to privatize services, companies and municipal assets. From each of the sectors several cases of spectacularly successful privatization or capital projects with a participation of private investors were reported. Following completion of these projects, service prices have increased with the inflation rate (i.e. there was no increase in real terms), along with significant service quality improvement⁸. More importantly, at the same time municipal subsidies had been withdrawn and thus released funds allocated to other pro-development ends.

These examples help to convince more and more self-government decision makers that both privatization and a new approach to utility financing are prospective solutions for this sector. As a necessary first step of privatization, self-government institutions should separate their service delivery management function (responsible for development policies, market creation, contract awards, enforcement of service standard compliance) from service delivery function that may well be contracted out to both municipal and private businesses. Each utility sector has its specific characteristics in this area, as presented in Chapter 2: Sectoral Issues.

Existing trends in service delivery privatization and infrastructure financing by private investors clearly indicate that legal framework established in Poland in 1990 allows for effective pro-efficient ownership changes in the sector of municipal services. This is evidenced by significant improvements in service quality, at a relatively small real-term price increase in the case of well restructured enterprises. It is now clear that the attitude of self-government politicians is main barrier to rapid restructuring and privatization. Other barriers are discussed at the end of this Chapter and in Chapter 3: Recommendations.

1.4 Results of Transformation

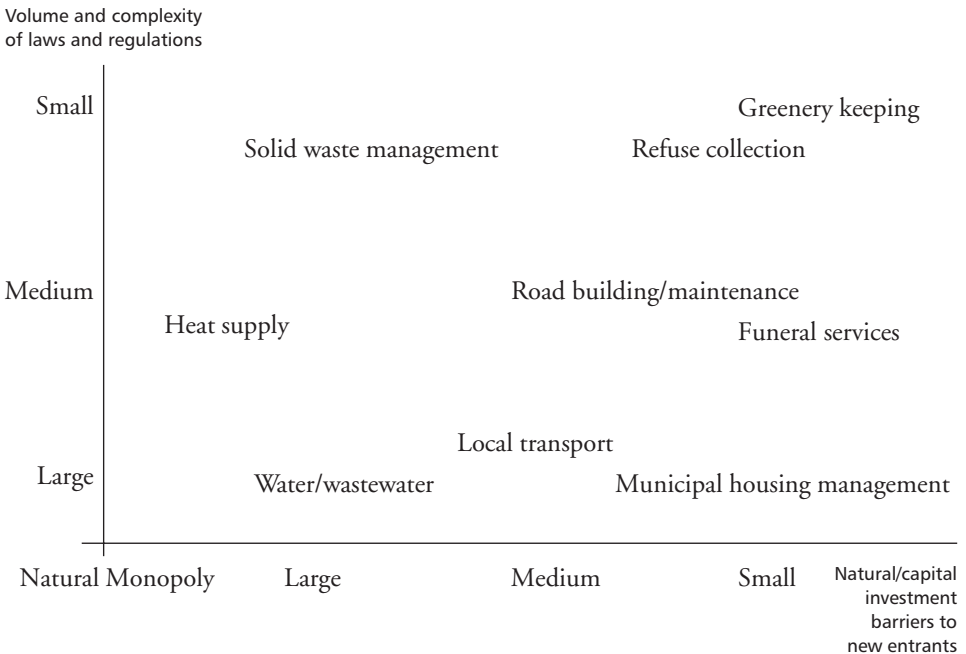
Transformation results are presented here in two aspects: (i) from the viewpoint of competition in a particular sector, and (ii) from the viewpoint of service organization model that a particular local authority may apply within its jurisdiction.

1.4.1 Competition in Particular Sectors

After ten years of transition one may not compare the existing situation to the start point, in terms of service delivery efficiency, quality and incorporation forms. Both pace and scale of changes introduced by local authorities was inversely proportional to the magnitude of barriers faced by competitors entering particular service markets. On the other hand, the more organizational, technological and capital-related barriers potential new entrants faced and the higher level of monopolist service control by single supplier and the more acute lack of proven transformation solutions, the more delayed and prudent, if not conservative, the decisions and actions were. Similarly, a significant positive correlation was reported between generally high professional level of management, in particular municipalities and the introduction of innovative solutions, even in the conditions of monopoly controlled by a single service supplier. This is a very important piece of advice to other local governments, both in Poland and other Central and East Europe countries. The success of any long-term reform depends, among other things, on the introduction of a legal framework that will allow for and promote, by decentralization of tasks, responsibilities and funds, pro-innovative actions initiated by local decision-makers.

In order to give a better picture of the level of competition in a particular sector, a graph will be used to plot competition level by two types of barrier. The horizontal axis depicts specific service susceptibility to privatization (i.e. the presence of natural capital investment barriers to potential new entrants). The vertical axis depicts general volume, complexity and burden of laws and regulations in that sector that affect every player with additional competition barriers. This somewhat arbitrary typology will help to explain the differences between various sectors, as discussed in Chapter 2: Sectoral Issues, and give a more reasonable image of restructuring effects in particular sectors (see Figure 6.1).

Figure 6.1
**Sectors by Complexity of Existing Regulations
 and Natural/Capital Investment Barrier to New Entrants**



In order to understand the exact meaning of this graph it should be remembered that each of these sectors involves three levels of management, of which only some are susceptible to privatization. The three levels are:

- Strategic sector management level (e.g. sector policy), that will always remain the local government’s responsibility;

- Tactical management level (order of and approach to execution of tasks, as required for achieving general policy objectives), that may be either the responsibility of local government or external executive company or organization;
- Service delivery level: Considering efficiency criteria, this should be the service provider's (e.g. privately-owned company's) responsibility.

In each of the aforementioned sectors, including those prone to natural monopoly, it is possible to privatize effectively both tactical management and service delivery functions. Several examples support this statement. The graph depicts sector differences in terms of tactical management and service delivery.

The effects of transformation efforts that have been undertaken during the past ten years will be presented by natural monopoly sectors and those suitable for competition from several business entities.

a) Natural Monopoly Utilities

In water, wastewater, local power and heat supply sectors, the incorporation process started in the late 1990s. More and more budgetary units are being incorporated as commercial code companies to enable a better management of available resources, keep costs under control, apply for loans and float bonds without detriment to the local government's credit capacity. Under favorable conditions, this allows for the separation of management from local politics. However, a major breakthrough in assets privatization and service delivery will require changes in economic regulatory system to protect both investors and consumers.

In practice, this process is almost complete in the heat supply sector. In 1997, the Parliament adopted Energy Law and an Energy Regulatory Office was established pursuant to its provisions. Heat supply enterprises are currently being privatized accordingly⁹.

Some progress was also reported from the water/wastewater sector. In the years 1998-2000, the Office of Housing and Urban Development Urząd prepared, in co-operation with USAID advisors, a draft Water/Wastewater Law, including secondary legislation. Like Energy Law, the draft Water/Wastewater Law provides for a regulatory system which is consistent with EU standards and ensures that water/wastewater prices cover all costs, including capital expenditures, while enabling local authorities to protect customers against excessive price increases, including tariff verification according to standard methods. The Draft Law was approved by the Government and passed to Parliamentary Committees. The Bill will be examined and most probably adopted by the Parliament in the first half of 2001 and will take effect six months thereafter.

The participatory approach to the development of this draft Law, almost unprecedented in Poland, is worth noting. This involved representatives from central government institutions, local governments (owners), organization of water utilities (service providers), professional

organization of utility staff members and the private sector¹⁰. In both heat and water/wastewater sectors, the stabilization or at least prospective pricing stability immediately boosted interest of private, especially international, investors in direct infrastructure investments, insofar as prospects for safe and satisfactory return on investment became apparent. This is an important lesson for other countries in Central and East Europe where, like in Poland, adequate infrastructure development funds are unavailable, especially in the light of pending European Union integration, while assistance from pre-accession and structural funds is unlikely to match existing needs.

b) Sectors suitable for competition

This category includes: solid waste management, municipal housing, local public transport, road maintenance, refuse collection, funeral services and greenery keeping. These sectors are quite diversified, also due to competition conditions, or aforementioned barriers to new market entrants. As a general rule, wherever actual or potential competition from private service providers was available, local governments more willingly incorporated their budgetary units as companies or liquidated them and contracted out the services. However, this rule is not universal and quite a lot depends on policies adopted by particular local authority. Therefore, it is necessary to disseminate knowledge about both the positive and negative experience of local authorities in the restructuring and privatization of utilities.

In these sectors, regulatory systems that protect customers against monopolist practices (service accessibility and pricing) are less important, though this may vary from one sector to another, depending on actual social sensitivity of particular services (e.g. housing). In a number of sectors, market competition is a substitute for this aspect of regulation. Similarly, regulatory systems that protect the interests of potential investors (full cost recovery and reasonable return on investment) are less important, as these are protected by pricing mechanisms. In that case, regulations focus primarily on definition of necessary acceptable service standard and consumer rights.

1.4.2 Utility Organization Models in Polish Municipalities

Generally, there are three parallel models of utility organization in Poland's local authorities [after: M. Szymanowicz¹¹]:

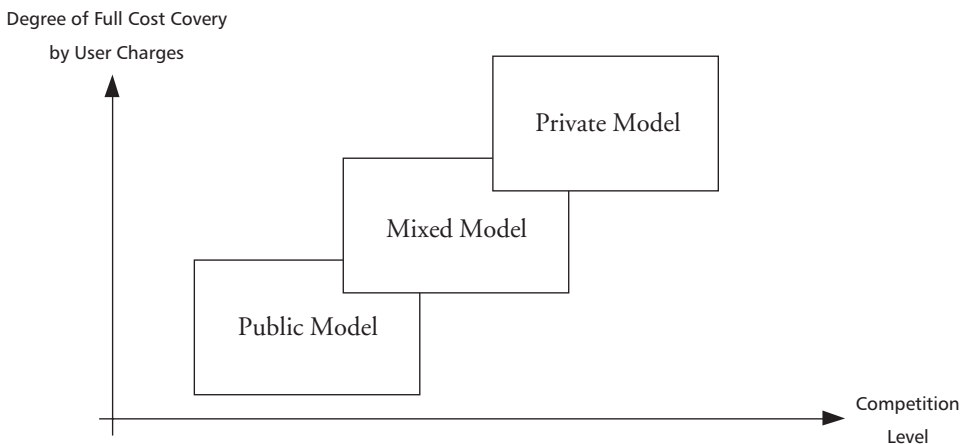
- 1) *Public model*—whereby the *gmina* is at the same time both service organizer and supplier through its budgetary units which provide services in the conditions of *gmina*'s administrative monopoly, insofar as when contracting the services the *gmina* is not subject to the provisions of public procurement law and is interested in keeping its personnel busy. This double role yields a conflict of interests, as on the one hand local authorities are obliged to satisfy the needs of its residents and on the other they are expected to strive for profitability. Since social priorities often outweigh economic ones, utilities are subsidized, resulting in poor management efficiency and additional development barriers.

- 2) *Private model*—whereby municipal services are provided by privately-owned businesses which compete with each other for the market of municipal services. In the conditions of privatized services, the local authority's role is limited to planning responsibilities and enforcement of compliance with service delivery standards. Normally, this requires better management skills than in the case of public model.
- 3) *Mixed model*—whereby elements of both public and private models are present. For example, a *gmina's* company falls into this category. The company is public to the extent it is owned by the local authority, or service organizer. On the other hand it is vested with a legal personality, management and financial autonomy that brings the company closer to market-oriented solutions, so it is typical to the private model.

The financing of costs associated with the expansion and modernization of municipal infrastructure using the funds of various institutions and investment capital sources is another problem. This will be discussed further in this study.

The local authority's decision to adopt a particular service organization model is reflected by the degree of operating costs coverage by fees charged to customers, as illustrated by the Figure 6.2.¹²

Figure 6.2
**The Degree of Cost Coverage by Fees and Charges Depending on
 Utility Organization Model Adopted by Local Authority**



The highest degree of cost coverage (including expansion or capital costs) is typical to the private model, while the lowest degree is associated with the public model, as in addition to operating costs, local authority has to cover network expansion expenditures at the expense of other own tasks.

1.5 Development of Municipal Economy: Key Conceptual Problems

1.5.1 Conflicting Roles of Local Government Units

Dual roles played by local government units are a major weakness of both public and mixed utility organization models and a potential threat to efficient and rational management. On the one hand, local governments create local social policies and, as representation of local communities, may change their elected officials every four years by way of general elections. On the other hand, as owners of municipal enterprises, they have to ensure effective development and delivery of municipal services, long-term capital planning and the good structural and financial condition of municipal enterprises. Adverse effects of this dual role are obvious, for example when making decisions on the pricing of services provided by a municipal enterprise. They face the dilemma: either to choose an economically justified increase in fees and charges (and arouse discontent of residents) or to freeze the prices (which is detrimental to the economy but may please the residents) or introduce any other form of more or less open subsidization. In Poland, political interests most often prevail over economic ones.

This conflict of interest is unlikely to be resolved; it is something we have to live with and try to find shortcuts. Development strategies for particular utility sectors, if any available, may prove helpful to self-government decision-makers. The only real solution to this problem would involve the privatization of municipal utilities and a move towards the private organization model, whereby the local government will investigate and identify existing and future needs, enter into contracts with service providers and regulate the market performance locally. This is the only way to resolve the conflict of interest.

1.5.2 Politicizing Management

The influence itself of local politicians on both directions and methods of municipal utilities' operations is natural and obvious, as local governments own or control the utilities that implement the policies of current local authorities elected in general elections. Similarly, the influence of local authorities on filling managerial posts in municipal utilities is generally understandable. However, the current term of office 1998–2002 saw an unprecedented politicizing of all management positions in local authorities. The parties of the ruling coalitions have directed their activities or supporters to the *gmina's* political positions, but also to medium managerial posts.. Some municipal utilities have not been spared. This applies to supervisory board members, boards of management and even medium management positions in companies. Unfortunately, political criteria are often incompatible with substantive qualifications, with the detriment of management efficiency in the municipal sector. Therefore, it should be condemned as a serious defect and failure of the recent transformation process.

The political impact of local governments on utilities activity areas and methods is natural and appropriate, since local governments are the owners of utilities, and they implement a policy of current authorities elected by general election process. It is also generally understandable that local governments make personal decisions as for the management board of utilities. However, during current tenure (1998–2002) all management posts in local government become highly political without parallel. Local ruling coalitions appoint their activists and supporters not only as political authorities, but also to a middle level of management posts. This process took place in some utilities as well. Political appointees are frequent not only to Supervisory Boards, but also to Executive Boards and middle level of company management. Unfortunately, political criteria often does not correspond with adequate technical skills. This situation does not help to improve the professionalism of utilities management, and should be utterly censurable as pathology and defeat of the last period of transformation..

1.5.3 Provision of Public Services in Co-operation between Municipalities

Local governments have the right to form associations (according to Article 172.1 of the Constitution). This right is confirmed and detailed in local government laws¹³. Municipalities may enter into agreements with each other and form associations in order to provide public services jointly. The same rights were given to poviats and *voivodships*.

In particular, municipalities should exercise this right to provide services in the jurisdictions of two or more municipalities. Service provision to customers in neighboring municipalities takes place typically if the required infrastructure is indivisible and should be aimed at gaining the effect of scale, co-ordination of regional environmental efforts, et cetera.

There are approximately 160 municipal associations in Poland. Some of them have never started their committed activities, the results of co-operation of the others vary from very good to poor. Business practice has shown that municipal association is not the most effective form of management. According to the analysis made by the Gdansk Institute of Market Economics, conflict of interests among municipalities—members of the association is the major problem which frequently affects directly the utility owned by the association. Other functional restriction is that the budgetary law and public finance law apply to financial management of the association. In the conditions of a market-oriented economy, however, establishing companies of which individual municipalities and other entities are shareholders seems to be a more functional option. The relationships amongst shareholders are flexibly governed by provisions of the Commercial Code and Civil Code (in relation to civil agreements between partners or shareholders). The financial management is also subject to general provisions of commercial and accounting laws. Principles and models of municipal co-operation are extremely important because the development of territorial range of services provision in most cases depends rather on decisions of neighboring municipalities than the utility itself.

External financing of municipal infrastructure from the European Union's and budgetary funds, especially in framework of regional development policy, forces municipalities to design joint capital projects. Some EU assistance programs set out minimum budgets for the projects (e.g. ISPA, ≥ 5 Million EURO), effectively extorting from neighboring municipalities the most welcomed co-operation.

1.5.4 Price Setting Methodologies

Principles and methodologies of setting tariffs for municipal services vary from one sector to another:

- a) Energy: tariffs of prices and charges are designed by the utility and approved by President of Energy Regulatory Office (legal basis: the Energy Law),
- b) Water/wastewater sector: the utility designs its tariffs. The final decision on water/wastewater prices and charges or pricing methodology is made by municipal Council or Board (legal basis: the Law on Municipal Economy),
- c) Solid waste collection: the municipal council may set maximum limits of charges imposed by authorized service providers to property owners for solid waste collection and treatment (legal base: the Law on *Gmina* Cleanliness and Order); local government sets principles and fees for disposing solid waste to municipal landfills (legal basis: the Law on Municipal Economy),
- d) Local transport: municipal councils may set official prices for mass transportation and taxis operating within *gmina* jurisdiction, but in most cases they do not do this to allow market competition. The *poviat* Council may set prices for *poviat* transportation. Both central and local governments may introduce free or discounted fares (legal basis: the Law on free or discounted fares by public transport). Generally, local governments generally refund to utilities the costs of free and discounted fares, while the system of central government compensation to those utilities which incur losses due to transportation of people entitled to free and discounted tickets does not work, despite the fact that such compensation is required by the law. Currently, central government compensates such costs only to regional transportation companies.
- e) Maintenance of roads: roads are toll free, except for some express roads. Municipal councils may set parking fees and fees for using the roadway. According to new legislation municipalities may also impose charges for driving into city centers and newly constructed bridges. However, the last two categories have not, so far, been practically tested.
- f) Municipal housing: the municipal council sets the maximum level of regulated rental fee up to 3% of replacement value for municipal houses leased on the basis of the Law on Leasing Houses and Housing Benefits. Councils also decide or have some influence on setting rental fees in Social Housing Associations units (legal basis: the Law on Selected Forms of Housing Support),

- g) Street sweeping, green areas: service prices are specified in contracts between the municipality and utility (legal basis: Civil code),
- h) Funeral services and cemeteries: service prices are specified in contracts between the municipality and utility and between the customer and utility (legal basis: Civil code).

1.5.5 Regulation of Natural Monopolies

All sectors of municipal services are subject to supervision by the Office for Protection of Competition and Consumers. This is a general type of supervision whereby the anti monopoly body reviews whether the utilities are not breaking the principles of competition, do not abuse their monopolist or dominant position and do not set excessively high prices. The anti monopoly body is not a regulator for energy or water/wastewater utilities.

In the energy sector, the central regulatory body—the President of Energy Regulatory Office (URE) was established pursuant to the Energy Law of 1997.

In water/wastewater sector there is neither a regulator nor regulatory system in place.

Details of regulatory issues related to the 'grid' utilities are discussed in chapters on energy and water/wastewater sectors below.

1.5.6 Municipalities Providing Non-public Services

Acceptable level of a local government's business activities (other than provision of public services) has been debated since 1990. Some argue that this allows for generating additional revenues to off-set deficit generated by public services. Others emphasize the fact that municipal institution enjoys a privileged position in the local market and unfairly competes with private businesses. Therefore, the discussion focuses on fundamental principles of the economy. After many years of dispute and several changes in legislative framework, the rules have been set by the Law on Municipal Economy of 1996.

A budgetary unit is not allowed to provide services other than public ones. Commercial services may be provided by the Commercial Code companies if all of the following conditions are met: (1) the local market fails to provide the services; and (2) there is a high unemployment rate in the municipality and other means of market stimulation failed. Other reason for local governments to create or acquire shares of capital companies may be that otherwise the municipal assets would generate material losses. It is worth to note that provisions of law continue to be unclear leaving room for loopholes and abuse by local governments.

In practice in many doubtful cases, local governments may interpret unclear provisions according to their current interests. Furthermore, the above mentioned conditions do not apply to companies providing consulting, promotion, educational and publishing services to local governments and “other companies of importance to the municipal development”. Similar provisions apply to companies owned by *voivodships*.

The authors of this report agree with a common opinion that current legislation needs further amendments in order to limit business activities by municipalities, to avoid unfair competition with private businesses by entities enjoying a politically and regulatory privileged position.

1.5.7 Multi-profile Enterprises

Multi-profile companies and budgetary units prevail in small and middle size towns and rural municipalities. Most frequently they were established as a result of the communalization of utilities existing before 1990. “The reasons why these utilities are multi-profile are that the local market is too small (it is risky to focus on one type of services only); a complicated internal organization structure (common technical equipment); a hope for efficiency improvements (when some types of service are related to each other) and the possibility of cross-subsidizing {...}. The results of a survey of multi-profile enterprises made by the Gdansk Institute of Market Economics prove that a lack of service development vision is the major problem for this group of utilities {...}”¹⁴.

Multi-profile business allows for internal transfers between profitable and deficit areas of activity. In many cases, with this sort of internal financing it is possible to avoid income tax.

Therefore, multi-profile utilities are exposed to the following threats:

1. Difficulties in elaborating a consistent development strategy for the utility and its individual branches, applying half measures and inconsistency resulting from internal and external conflicts of interest within the utility (the impact of the owner’s decisions). The differentiation of utility profiles results from—amongst other things—various organizational requirements of existing laws, different financing conditions and regulatory systems, different scope and organization, capital improvement practice, different financial needs and methods of financing.¹⁵
2. A lack of transparent cash-flow statements, blurred cost-benefit account leading to ineffective and unreasonable business decisions and demoralization of management teams and staff of individual branches (or profiles). Demoralization is especially apparent when profit-making branches subsidize deficit ones: one branch does not want to work for another, the weak branch automatically counts on support from the strong ones.

It is possible that the effect of economizing on a multi-profile status is much smaller than total benefits resulting from rational cost calculation and more reasonable organization and management

of separate and legally independent utilities. Cross-subsidizing of services may also inhibit the development of private service providers.

Existing legal framework allows for establishing legally more complicated forms specified by the Commercial Code meeting more closely economic and other needs of municipalities and private businesses.

The Commercial Code allows for:

- a) merger of companies—one company takes over the assets of another one;
- b) establishing a new company through a merger of existing ones;
- c) establishing a holding company;
- d) establishing a tax holding—a consortium of companies (subject to corporate income tax law).

Any operations under the Commercial Code related to assets managed by budgetary units are allowed after the budgetary unit is liquidated.

Municipalities establishing the complex multi-profile utility of the Commercial Code should also develop new methods of control and supervision, decide on principles and methodologies of development individual profiles within one structure and resolving conflicts among individual companies or units of a holding. Municipality should also hire a team of experts professionally prepared to perform supervisory and regulatory task on owner's behalf. Existing cases of holdings and multi-profile companies in Polish cities do not provide clear answer. Among other, organizational difficulties and costs of holdings are subject to criticism.

1.6 Contribution to Municipal Budgets

Poland's poor budgetary classification system does not allow for a precise distinction of expenditures by sectors, with the exception of roads, heating and green areas. The only unproblematic set of data covers the total expenditures for the provision of municipal services compared to total expenditures of local governments. The second difficulty is that utilities of different organizational forms have different relationships with the municipal budget. Expenditures of budgetary and auxiliary units only are shown in municipal budgets (on both expenditure and revenue sides). Thirdly, the method and scale of financing capital projects by municipalities and utilities (under the Commercial Code) differs and the latter is not shown in municipal budgets.¹⁶

Therefore, it is very difficult to analyze the flow of funds between individual sectors and municipal budgets. The situation will be improved in the year 2001, when a new budgetary classification is to be introduced.

On the other hand, the set of available data allows for analyzing expenditures on municipal services incurred by *gminas*, urban *poviats* and rural *poviats*. According to aggregate data from the Central Statistical Office, in 1999 *gminas* and *poviats* spent 29% of their budgets on municipal services, of which 15.8% and 13.6% was respectively on capital projects.

Rural *poviats* have spent a relatively small amount (7.1%) of their total expenditures on public services: namely on the repair and maintenance of roads, including less than 1% on related capital projects. In comparison, urban *poviats* have spent 8.7% on the same purpose (roads), including 4.7% on capital projects; and *gminas* have spent 6% and 2% respectively.

Hence, expenditures on municipal services are an important, but not dominant item in budgets of the local governments. As a comparison, in 1999, education expenditures amounted to 40% in *gminas*, 38% in urban *poviats* and 42% in rural *poviats*.

1.7 Methods and Sources of Infrastructure Financing

Typically, methods of raising capital funds and financing sources of municipal services and infrastructure projects include most frequently: local governments budgets, utilities revenues (from prices and charges) and external sources such as credits and loans, including soft loans, bonds, subsidies, local, national and international grants and contributions from citizens.

Searching for additional financing sources becomes a must, since year by year the total debt of local governments is growing, and expenditures are increasing as a result of taking new responsibilities (e.g. healthcare and education), inadequate compensation by the State and insufficient revenues from local taxes and fees. According to a statement by Union of Polish Cities made in October during the 20th General Meeting, the success of Polish decentralization reform depends on the availability to local governments of adequate resources required to implement new tasks. Unfortunately, this is still not the case. In 2000, the financial situation of cities and other municipalities once again worsened, along with their ability to finance infrastructure projects (*Rzeczpospolita* National Daily issue no. 241/2000).

Under these circumstances, the financing of infrastructure and assets by the private sector through direct investment, purchase of assets and shares of municipal companies, BOT contracts and leasing will play an increasingly significant role.

Since 1999, the Public Finance Law has significantly influenced the financial management of local governments and municipal infrastructure finance.

The budget resolution by local governments continues to be a financial basis for the purposes of planning infrastructure projects included in the budget.

Enabling *gminas*, *poviats* and *voivodships* to design long-term capital plans as an appendix to the budget resolution (Article 110 of the Public Finance Law) creates an opportunity to accelerate infrastructure development. It is recommended to agree *gminas* long-term capital plans with similar regional programs implemented by *voivodships*.

In accordance with Physical Planning Law, since 1 January 1999 *gminas* are obliged to take into account, in their local land use plans, central and local governments projects resulting from the development strategy, and land use plans of self-government *voivodships* and those resulting from studies and analysis made by *poviats*.

Gminas are frequently the largest local investors, but their structure and annual budget planning procedures, lack of professional and creative staff, insufficient analytical and management tools do not support investments.

As far as capital projects are concerned, *poviat* responsibilities are much more limited than those vested with *gminas*. *Poviats* may participate in regional projects. One of the very few *poviat's* responsibilities is the construction and maintenance of *poviat* roads (Article 2 of the Public Roads Financing Law). There is no detailed legislation on planning capital projects by *poviats* other than Public Finance Law. *Poviat* adopts every year a budget resolution and may design multi-year capital plans.

The *voivodship* has relatively extensive capital planning powers, including municipal projects. The *Voivodship* Assembly adopts development strategies, including the development of technical infrastructure, *voivodship* programs and long-term capital programs. The Assembly adopts also *voivodship* land use plans based on national strategy and the State regional policy. The land use plan is taken into account by *gminas* in their planning process. The *voivodship* self-government has also opinion-making and coordination powers in the area of energy sector.

The Public Finance Law is extending the provisions of the Constitution and introduces significant restrictions on municipal indebtedness. The national public debt includes municipal and other public authorities debts and the state budget debt.

If consolidated national debt reaches the level of three fifths of the annual gross national product, public bodies—including local governments, are not allowed to contract new credits and loans nor extend financial guarantees and collateral. The Public Finance Law includes the safety procedures to follow if the consolidated debt comes close to the limit (50%, 55%) and remedial procedures if the limit of 60% of GNP is exceeded. The same limit applies to each individual local government debt and the same procedures apply accordingly.

Such mechanisms are acceptable from the macro-economic perspective, however, when introduced, municipal debt represented approximately 1% of GNP and the state debt—45% of

GNP. As a consequence of high disproportion in contributing to macro-economic threat and joint and several liability, municipal budgets are penalized for the central government's 'sins'. This may bring to a halt credit financing of municipal projects, causing significant problems for local governments.

Additionally, according to other provisions of the Public Finance Law, a municipal debt service in each individual year needs to be less than 15% of annual revenues or less than 12%, if the national public debt exceeds 55% of GNP.

The total amount of municipal debt at the end of the year shall not exceed 60% of total revenues (the law does not discriminate between the sources of deficit).

If the public debt exceeds 60% of GNP, local governments are not allowed to make any deficit in the next budgetary year.

Local governments may extend specific grants to their budgetary units and auxiliary units. The Commercial Code companies are not allowed to receive any grants from municipal budgets, however according to the Commercial Code, *gmina* as a shareholder may contribute to the equity.

1.8 Municipal Investment Needs in the Context of EU Integration

In order to ensure compliance with environmental provisions of the EU legislation, Poland has to make very significant capital investments. It is likely that some transition periods will be negotiated to allow for the extension of the implementation period. In any case, according to the World Bank estimates¹⁷, capital requirements in the public sector (including water/wastewater sector, solid waste disposal and air pollution control, both central and local governments expenditures) amount to \$22.1 billion or \$42.2 billion, depending on EU requirements (excluding maintenance and repair costs). The required investments in water/wastewater and solid waste sectors amount to \$12.2 and 20.7 billion respectively (approximately 80% for water/wastewater and 20% for solid waste).

The required investments are much higher than Poland's public expenditures on these purposes up to the present. Due to other budget commitments the latter should not be expected to increase significantly in the future. Under these circumstances, even with a significant increase of assistance from the European Union would probably not cover all investment needs. That is why contributions from the private sector and consumers (through prices and fees) is required to finance the construction and maintenance of future infrastructure facilities.

1.9 Accounting Standards of Utilities

Principles and accounting standards vary, depending on the incorporation form of a utility. The Public Finance Law and the budgetary classification apply to budgetary units (e.g. municipal services department in rural *gmina*). Accounting systems of commercial companies are subject to the Accountancy Law.

The amended Accountancy Law, in effect from 1 January 2001, introduces significant changes. The amendments aim at adjusting national standards to the EU directives and international accounting standards. The most important changes for the utilities include¹⁸:

- codification of accounting and reporting procedures applicable to mergers;
- codification of accounting procedures applicable to capital markets transactions (includes also a definition of financial instruments) and reliable valuation of assets and liabilities and related risks in financial reports;
- definitions of financial and operational leasing, agreeing relevant terminology with the Civil Code;
- codification of long-term contracts ensuring correct accounting for resulting costs and revenues;
- codification of terminology and requirements regarding consolidated financial reports of holding companies;
- provisions on deferred tax.

Numerous amendments aim at improving the flexibility and transparency of accounting and reporting systems and reflect the continuous development of structures, management techniques and financial tools. A new financial report format is introduced to ensure full disclosure of actual assets, finances and the revenues of a company. According to the amended Accounting Law, the Accounting Standards Committee will be established.

1.10 Further Transformation Impediments

The process of transformation in the municipal sector has passed a critical point and it seems that nothing can stop a trend of improving the effectiveness and private sector participation. However, this process may be significantly delayed. The most important impediments to transformation and development of municipal services include:

- a) inadequate financing of local budgets, resulting in a lack of resources to stop disrepair of assets and to finance new projects—if the local budgets are to contribute;
- b) politics-driven local government activities related to services development and financing strategy, stimulation and protection of local markets, damaging municipal services sector and utilities;

- c) conservative and dual pricing, tariff and renting policy in water/wastewater, housing and public transport sectors;
- d) passive policy of many local governments in the field of improving the effectiveness of municipal services, restructuring and privatization, independence and self-financing, commercialization market-orientation;
- e) lack of clear economic regulation systems and division of regulatory responsibilities in natural monopoly sectors (particularly water/wastewater sector) resulting from dual roles played by local governments (conflicting roles of utility's owner and consumer's representative). This impediment may be mitigated by a compromise regulation to be adopted in 2001;
- f) Pauperization of many customers groups—a threat on the demand side of services.

2. SECTORAL ISSUES

2.1 Water/Wastewater Services

2.1.1 Basic Information and Data Relating to the Sector

The number of buyers of water/wastewater services has been increasing over the last decade. In cities, on average, some 91% of inhabitants are users of water-pipe networks, and some 82.4% of inhabitants are users of sewerage networks. For small towns, these figures are 70 to 80%, and 40–60%, respectively. On the other hand, however, we should note a fall in tap water consumption by households. In 1998, water consumption fell from 1993 by some 27%—141.0 liters/day per capita. In a vast majority of cities drinking water standards are consistent with WHO guidelines.

The number of wastewater treatment plants in cities has been growing. While in 1993, 319 out of 875 Polish cities had no wastewater treatment plants, in 1998 the number of such cities dropped to 130.

In 1998 untreated wastewater accounted for only 21% of effluents discharged into municipal collecting systems, which means that the share of treated wastewater actually doubled in comparison to 1993.

In rural areas, the water supply and wastewater disposal situation is relatively poor. Some 50% of the rural population has no access to water-pipe networks. The situation in the field of wastewater disposal and treatment in the sewerage network is even worse.

In 1999, the average price of 1 m³ of water for household use was \$0.3.

In view of huge investment needs, estimated at \$12.2 million to \$20.7 million¹⁹, gminas and enterprises must in the future not only maintain, but also intensify their organizational and financial efforts towards the improvement of water supply for households, as well as wastewater disposal and treatment.

2.1.2 Legal Framework and Sector Operation in the Years 1999—2000

The principles of managing the sector and provision of water/wastewater services are set forth by the Water law of 24 October 1974 and by implementing regulations to this law. The regulations relate, inter alia, to water/wastewater quality, ownership of water supply and wastewater disposal facilities, principles of their maintenance and operation as well as the principles of setting prices and charges for water supply and wastewater disposal.

As early as 1990 the law became an obsolete act, inadequate to the changed political, economic and social situation of the country. It not only did not support reforms, but also hampered the implementation of new provisions. The same can be said, more or less, about implementing regulations to this law, including the tariff regulation.

The powers of the central state administration agencies relating to the sector are limited and indirect. They mostly pertain to issues involved with the ownership of waters, commercial use of water resources (water supply and effluent disposal permits), water resource management and its financing, fines and charges for commercial use of water resources and water facilities, as well as water economy and water protection.

Gminas have broader powers in this field. These are ownership powers relating to property or stakes in water/wastewater companies, as well as economic powers (price-setting policy). Nevertheless, there are no detailed rules of exercising these powers in connection with dual roles played by local governments, and to different time frames of making political and economic decisions, which affects the quality of procedures and practices of managing the sector on the local level.

Given the absence of a systemic legal regulation of the sector, there is an urgent need for passing a law water supply and wastewater disposal²⁰.

2.1.3 Management Procedures and Practices

By 1989, there had been some 50 single-profile water/wastewater enterprises, of which 80% operated on a *voivodship* or regional scale. In small towns, not covered by their operation, water/wastewater services were provided within the framework of multi-profile enterprises²¹.

In 1999, in the surveyed 793 towns and cities, relevant operations were conducted by 368 budgetary enterprises, accounting for 46% of the total, 344 capital companies (being a dominating form of incorporation in cities of more than 10,000 inhabitants), accounting for 43% of the total, 19 state-owned enterprises (2%) and 10 budgetary entities (1%). Thirty eight private entities were commissioned, providing services upon the conclusion of appropriate contracts. Twelve contracts of the lease of assets used for rendering water/wastewater services were concluded²².

Relatively few cases of cooperation between public and private entities in the sector can be found in Poland. Bielsko-Biala, Gdańsk, Bydgoszcz, Poznań and Płock are the cities that have implemented or considerably intensified the processes of undertaking such cooperation. Each of these cases has its specific features and would require a separate, detailed description.

In the case of Gdańsk, there are two such agreements. First, the city of Gdańsk and France's SAUR group established a joint-stock company known as SAUR Neptun Gdańsk S.A., in which the French shareholder owns a 51% stake. Secondly, the city of Gdańsk and the company have concluded a contract of lease of assets used for rendering water/wastewater services.

The company is responsible for the maintenance and operation of water/wastewater facilities, for providing services of appropriate quality, and for the collection of charges for the provided services to be contributed to the city's budget. Furthermore, the company acts in the capacity of the city's adviser on investment planning and technological development.

The city exercises supervision and control over the company, specifies investment projects and approves charges. Water/wastewater charges calculation formula is also determined in the agreement, along with limits to growth of these charges.

Agreements of a different kind have been concluded in Bielsko-Biala. AQUA S.A., a municipal company of the city and neighboring *gminas* was established in 1990. The company drew up a long-term investment scheme, and borrowing agreements with the World Bank and the National Environmental Protection Fund were signed in 1996. The agreement with the World Bank includes provisions relating to, inter alia, standards of services and efficiency of equipment, standards of customer service, financial effectiveness, principles and procedure of preparation and approval of tariffs (tariff clauses have been applied), as well as collection of charges.

AQUA S.A. has also implemented a system of joint realization of investment projects with real estate owners who co-finance specific projects up to 30% of costs in exchange for the Company's shares acquired by them at the moment of contributing assets to the Company's equity. Since 1997, the Company's shares have been traded at the CeTO regulated curb market.

The second stage of the Company's privatization started in 1998. Anglo-American International Water Ltd., a company selected by way of offer negotiations, bought 21% of the city's shares. The city itself currently owns a 51% stake.

A different situation has developed in Piaseczno, a medium-sized city in a *gmina* near Warsaw. An agreement was concluded between the city and a private entrepreneur, providing for maintenance and operation of water/wastewater facilities in the city, involving post-damage repairs and network overhauls.

The main differences between the presented cases lie in the scope of responsibility for infrastructure in the sense of commitment to infrastructure development financing.

2.1.4 Principles and Methodologies of Setting and Levying Charges

The existing tariff system can be described as highly unspecified. This issue is regulated by a single provision, i.e. Art. 4 of the Municipal Economy law, under which municipal authorities are equipped with powers to determine the level of prices and charges for providing water/wastewater services, or the procedure of setting them. It is a common rule that the level of charges is proposed by an enterprise for *gmina's* approval.

Price calculation is still based on principles determined in the tariff ordinance of 1996. Under the present economic conditions and in view of capital needs of the sector, these principles are seriously outmoded and do not guarantee raising sufficient funds for development. In accordance with that regulation, the charge is determined on the basis of projected and justified annual costs of maintenance and operation of water/wastewater facilities, with depreciation taken into account, increased by the profit margin calculated by the 'cost plus' method. Maintenance and operation costs do not cover capital acquisition costs, investment costs, costs of building up reserves for receivables and capital reserves. This adversely affects the chances for accumulating capital for development by the enterprise itself, and compels *gminas* to pick up the burden of investment financing.

The levels of charges paid by households and other buyers can vary if there is a documented cost differential, but only with regards to the costs of water/wastewater facilities maintenance. The costs of maintenance and operation of facilities do not cover costs of rainwater draining.

As a rule, quantitative tariff is applied by enterprises which collect charges for water/wastewater services. In Poland, charges for these services are not subject to sharp increases.

2.1.5 Environmental Protection

Regulations relating to the improvement of the quality of water supplied to users, as well as norms relating to the discharge and treatment of municipal wastewater are being regularly amended. The latest legislative change took place in October 2000, with the entry into force of

the regulation of the Minister of Health on standards to be met by drinking, industrial and bathing water, and on the principles of exercising water quality control by Sanitary Inspection agencies. The regulation of the Council of Ministers on conditions of wastewater discharge into municipal collecting systems took effect in 1999. The possible revision of environmental regulations will relate, inter alia, to issues involved with improvement of wastewater treatment standards and with entry of heavy metals or detergents into the environment.

The principles of public access to information about water/wastewater services are determined by regulations of providing services, but this issue is not seen as a particularly important one by local governments, enterprises and buyers of services alike.

Summary

For the sector's future it is most important to work out new systemic principles of its financing and development. Tariff issues and tariff regulation in the sector require many changes in order to provide for actual development of the sector in the field of improvement of standards of provided services, as well as environmental standards.

1. There are no precise rules of exercising of local government entities' powers, including those relating to the sector's regulation by *gminas*, which determines the quality of rules and practices of the sector management and financing at the local level. The way of economic regulation of the sector to date has been highly insufficient. The absence of a regulatory agency independent from *gminas* gives rise to, among other things, the problem dual roles played by local governments (municipal authorities represent the owner of enterprises and, at the same time, consumers and voters). It is especially important in the field of setting user charges for water and wastewater services.
2. The methods of calculation of charges discourage private entities, including investors, from involvement in the sector and, furthermore, they do not motivate utilities to cut operation costs

2.2 Municipal Heating Sector

2.2.1 Basic Information and Data Relating to the Sector

The heating requirements of some 65% of households in Poland are covered by heat generated in centralized heat sources. According to estimates, some 5 million households benefit from this form of heat supply, which corresponds with some 16 million inhabitants.

Centralized urban heat sources consist of:

- professional heating plants and heat-and-power generating plants of total thermal output of some 25 000 MW, including some 10 000 MW of thermal output generated in association with electricity;
- industrial heating plants and heat-and-power generating plants of total thermal output of some 4 000 MW;
- municipal heating plants and boiler plants of thermal output of some 15 000 MW.

'Professional' heating plants and heat-and-power generating plants are the property of state-owned enterprises (power plants), which have recently been undergoing privatization.

Industrial heating plants and heat-and-power generating plants are the property of industrial plants (private or state-owned), selling generated heat or waste heat to satisfy the needs of cities. Municipal heating plants and boiler plants are the property of municipal heating supply enterprises. They are responsible for transmission to buildings (through heat distribution networks) of heat generated in their own sources or purchased from professional and industrial heating plants and heat-and-power generating plants.

Heat output in the above-mentioned centralized heat sources for the needs of residential and public utility buildings, as well as for the needs of industrial plants receiving heat supplies from municipal heating networks amounts to approximately 330 million GJ per year, of which some 260 million GJ per year is required for the needs of residential buildings.

In buildings covered by centralized heat supplies, more than 65% of flats are equipped with hot water supply systems.

The heating requirements of households in cities and in villages remaining outside of the centralized heat supply system are covered by local boiler plants operated by owners or administrators of buildings, or by means of stove heating. In the new buildings constructed in recent years with employment of energy-saving technologies, there is a limited number of cases of using electrical energy for heating purposes.

Thermal efficiency of heating sources depends on the applied heat generation technology. As a result of heat production in association with electrical energy generation, by means of high-performance boilers burning coal dust, thermal efficiency of professional heat-and-power generating plants is the highest and reaches 79–80%.

Heat efficiency of industrial sources shows considerable variations and ranges from 60–65% in heating plants to above 75% in heat-and-power generating plants. Large heating plants operated by heating supply enterprises produce heat at an average efficiency of some 65%, while thermal

efficiency of small, dispersed individual boiler plants is some 55%. The average efficiency of heat transmission grids is estimated at some 90%, and ranges from 85% to 93% in particular cities, depending on the technical condition and grid construction technology.

Frequency of heat distribution network failures declined as a result of repairs carried out in the 1990s. At present, the failure frequency does not exceed 0.1 failure/km per year, compared to 0.2 failure/km per year (1.4 in Warsaw) in previous years.

2.2.2 Legal Framework

Economic activity in the field of heat supply is regulated by provisions of the Energy law.

The law specifies:

- principles of shaping energy policy of the State;
- principles of supplying and using fuels and energy, including provisions which specify, inter alia, the principles of hooking up entities to distribution networks, of covering costs of hooking up, trade in gaseous fuels, electrical energy and heat, provision of transmission services, distribution network traffic and network operation, as well as quality standards of services provided. Detailed regulations in this field, in accordance with the law delegation, are specified by a regulation of the Minister of Economy;
- bodies appropriate for issues concerned with fuels and energy economy (including heat). Central regulatory body—the President of Energy Regulatory Office (later referred to as the URE President) was established. The URE President is appointed by the Chairman of the Council of Ministers, which secures his political independence from local authorities. Among other things, he is empowered to grant and withdraw licenses for economic activity in this field, as well as to approve and control gaseous fuels, electricity and heat tariffs from the point of view of their compatibility with principles specified by the provisions of the law;
- principles of operation of power sector utilities, inter alia, licensing and setting tariffs.

Pursuant to local government laws, *gminas* are answerable to local communities for securing appropriate functioning of heat supplies. The provisions of energy law precisely specify this answerability, imposing on *gminas* an obligation of drawing up plans of supplying heat, gaseous fuels, and electricity.

Pursuant to the law, *gminas* are also responsible for overseeing the development of municipal energy facilities, including heat facilities, by way of the drawing up and approval of energy development plans, and providing for their compatibility with *gminas*' physical planning schemes. Furthermore, *gminas* are obliged to secure heat supplies for residential and public utility buildings being their property.

2.2.3 Management Principles and Practices

In the early 1990s, partly due to the World Bank experts' suggestions, the government of the Republic of Poland declared the undertaking of the following measures relating to the heat supply sector:

- restructuring of organizational schemes;
- departure from the central-level setting (i.e. by the Minister of Finance) of heat prices (so-called official prices), and from subsidizing heat prices paid by tenants;
- modernization of heating supply systems.

Unlike the practices of previous years, when the state was not only the creator of energy policy, but also the owner of the heating supply infrastructure, as well as the organizer and supervisor of services, under present legislation these functions have been split. In the heating supply sector, ownership functions have been separated from the organization and management function and from supervision over prices and quality of services provided.

As a result of the local government system reform, the assets of heating supply enterprises overseen by local state administration agencies, which had been previously owned by the state, became property of *gminas*, which were obliged to provide for management of these assets.

Prior to the undertaking in 1990 of organizational changes, there had been 55 *voivodship*—and regional level—heating supply enterprises operating in Poland. As a result of introduced changes, about six hundred enterprises were established, and their scope of operations corresponded with heat supply infrastructure in particular *gminas*.

Municipal limited liability companies and single- and multi-profile budgetary entities are being further transformed, inter alia, into joint-stock companies and companies with participation of private parties, including foreign parties. These developments are accompanied by the privatization of state-owned heating supply enterprises. Energy Law provisions include uniform legal regulations for all economic entities, irrespective of the form of incorporation.

2.2.4 Principles and Methodologies of Setting Tariffs

In the early 1990s (by the end of the third quarter of 1991) heat producers and distributors were empowered to set the prices of heat generated and supplied to customers on the basis of cost price formula, i.e. with the price being set with the so-called justified costs, verified and taken into account by the Tax Chambers. In October 1991, this system was replaced with a system of setting by the Minister of Finance of maximum conventional price growth indices, and prohibition of increasing conventional heat prices due to higher operation costs dependent on heating supply

enterprises. The above systems of limiting the growth of conventional heating prices were an element of the state policy of equalizing conventional heating prices binding for heat producers and distributors with official prices binding for end-users of heat, i.e. tenants.

The second element of this policy involved increasing the frequency and scale of official rises in heat prices.

As a result of the adopted price policy in 1991–1993, the increase in the conventional prices of heat was similar to the consumer price index (some 250%), while the increase in official heat prices amounted to some 1 700%.

The much faster growth rate of official prices has resulted in their approximation to conventional prices and, by the same token, to cuts in budget subsidies. At the same time, such a situation has led to market-oriented changes in the responses of heat consumers, reflected in the pressure on savings, as well as on a departure for lump-sum payments and their replacement with metered heat supplies.

Equalization of conventional and official heat prices made it possible for the abolishment of budgetary subsidies, for the state's withdrawal from setting heating prices, and for an introduction pursuant to the Energy Law and implementing regulations to this law of the principles of setting heat tariffs calculated on the basis of justified costs.

Through introduction of tariff prices and rates of charges related to units of measures of heat, as well as universal measuring of heating supply to buildings, universal implementation of quantitative settlements was rendered possible. Consequently, heat has become a 'merchandise'. This statement refers, in particular, to buildings in which apartments are equipped with heat control and measuring devices. In such buildings, tenants can take up heat in amounts corresponding with their preferred thermal comfort, or their financial capacity.

Consumer protection against unjustified level of tariff prices and rates of charges has been secured by way of heat tariffs approval by the URE President.

In connection with the liberalization of heat prices, resulting in a high share of expenditure on heating in rental fees (some 60%), it is indispensable to make it possible for the worst-off families to be able to pay heat charges. This will be secured by financial support through the system of housing benefits, being an element of social policy pursued by *gminas*.

Energy Law provisions are assumed to secure self-financing of the activities of heat supply enterprises on the basis of charges collected from customers.

Tariff prices and rates of charges may vary exclusively for justified costs of provision of services. Hence, there is no cross-subsidizing of specific tariff groups of customers, or subsidizing of heating activities with revenues from other kinds of activities.

In accordance with the provisions of the law, tariffs for gaseous fuels, electricity and heat should cover justified operating costs in the field of generation, processing, storage, transmission, distribution or trade in heat, as well as the costs of modernization, development and environmental protection.

Tariffs may take into account the costs of co-funding by enterprises of undertakings and measures aimed at cutting heat consumption by customers.

Enterprises may differentiate tariff prices and rates of charges for various groups of customers exclusively for justified costs related to the performance of services, and are obliged to provide for the share of fixed charges in total charges not to exceed 30%. Profit rate depends on the reasonable investment needs of the enterprise.

Detailed principles (methodology) of tariff setting and calculating are determined by way of a regulation by the Minister of Economy in agreement with a minister appropriate for public finance upon consultation with the URE President. Pursuant to the law, tariffs designed by utilities are subject to approval by the URE President. Decisions made by the URE President can be appealed against to the *Voivodship* Court in Warsaw (the anti-monopoly court).

The URE President can exempt the utility from the obligation of submitting tariffs for approval, if he/she concludes that it operates on a competitive market, or he/she can withdraw the granted exemption.

Within seven days since their approval by the URE President, the tariffs for heating are submitted for promulgation, at the enterprise's expense, in the *Voivodship* Official Gazette appropriate for location.

2.2.5 Investment Financing

Investment projects of heating supply enterprises are drawn up on the basis of their long-term modernization and development schemes, aimed primarily at securing an appropriate quality of services and minimization of heating supply and environmental pollution costs. These projects should be compatible with municipal plans (their provisions) of gaseous fuels, electricity and heat supply, affecting investment activities of enterprises. Financial costs involved with investment outlays which have been made, as well as operating costs associated with completed investment projects are taken into account by heating supply enterprises while designing their tariffs.

In 1991, the government of the Republic of Poland concluded a guarantee agreement with the World Bank, along with bilateral agreements with heating supply enterprises, upon which the World Bank granted loans for financing the most urgent modernization tasks: SPEC Warsaw (\$100 million); OPEC Gdańsk (\$20 million); OPEC Gdynia (\$40 million); MPEC Kraków (\$25 million); PEC Katowice (\$45 million).

Furthermore, a credit line was opened for supporting modernization requirements of further heating systems on the basis of funds provided by the European Bank for Reconstruction and Development, and made available for Wielkopolski Bank Kredytowy.

The World Bank involvement in the financing of the modernization of selected heating systems has also played a role of an incentive stimulating the interest of foreign investors in similar projects in other Polish cities. A market has emerged of consulting services offered by Polish and foreign firms offering preparation of master plans and feasibility studies for heating systems modernization and development undertakings. Building administrations showed an increased interest in fixing heat control and measuring devices, especially heat meters, due to increased heat prices. Undertakings in this field were supported with state budget subsidies.

As a result of modernization investment carried out with support of these funds, as well as enterprises' own funds, large-scale projects involving the replacement of worn-out heat distribution networks have been completed in a number of cities, with application of pre-isolated pipes and state-of-the-art tight fittings. Heat distribution centers have been modernized through providing them with modern, small-size long-life heat exchangers, and with automatic heat control and measuring devices.

Thanks to these actions, the quality of heat supply services has improved. The excessive failure frequency of heating systems has been generally reduced. For example, in Warsaw, where the failure frequency used to be 1.4 failure/km per year, distribution network failures have been reduced to incidental cases.

In a number of cities, modernization of heating supply systems has allowed to significantly cut the costs of routine repairs of these systems, as well as the costs of damage repairs.

The completion in 1999 of the scheme of providing buildings hooked up to municipal heat distribution networks with heat meters, has created conditions for introduction of settlements for the amount of heat supplied to individual buildings, as well as settlements for the amount of heat used in individual apartments.

The law of December 18, 1998 on support for thermomodernization schemes /Journal of Laws No. 162, item 1221/ introduced a system of supporting thermomodernization schemes in buildings on the basis of bank credits repaid by investors (with interest) up to 75%. The remaining part of the credit is repaid to creditor banks from the Thermomodernization Fund supported by the state budget. Unfortunately, towards the end of 2000 credits re-financed pursuant to this law do not enjoy such an interest as was originally assumed.

Pilot projects aimed at the implementation in Poland of European solutions in the field of rationalization of fuels and energy consumption, as well as the utilization of renewable energy sources have been carried out with support of foreign aid funds.

2.2.6 Accounting Principles and Standards

Irrespective of applicable accounting standards, the Energy Law makes power sector enterprises (including those conducting activities in the field of heat supply) obliged to keep, within the framework of company accounts, their books in a way to enable the calculation of their fixed costs, variable costs and revenues, separately for generation, transmission and distribution, as well as a trade in each kind of fuels and energy, also in reference to particular tariff groups.

2.2.7 Supervision and Control

The provision of heating supply services is secured on the basis of a system of granting licenses to entities conducting activities in this field.

Under the Energy Law, licenses are required for economic activity in the field of, inter alia, heat generation except heat generation in sources of power less than 1 MW, and obtained in the technological processes of heat transmission and distribution except heat transmission and distribution to consumers of ordered power being less than 1 MW, as well as trade in heat activities.

Licenses are granted by the URE President to applicants meeting conditions set out in the Law for a period of not less than 10 years.

2.2.8 Public Access to Information

The law provides for an insight of persons and organizational entities into the draft assumptions of the heating supply plan, through making them available for the public for a 21-day period, the notification of which is made in a way customarily acceptable in a given locality.

The local community is also entitled to offer proposals, reservations and remarks to the project. Municipal councils are obliged to examine them upon approval of assumptions.

Heating tariffs are also notified to the public. The URE President is obliged to announce in the *Voivodship Official Gazette* appropriate for location the information about: entities applying for a license, decisions concerning licenses and tariffs, as well as decisions made in litigant cases by the URE President.

2.2.9 Environmental Protection

Pursuant to the Energy Law, municipal plans of heat, electricity and gaseous fuels supply, as well as plans developed by heating supply enterprises cover environmental protection needs. These

needs are determined with the binding environmental protection regulations taken into account (e.g. the ones pertaining to admissible emissions of SO₂, NO_x and particulate matter).

Principle of integrated energy and environment management is observed while carrying out investment projects. In accordance with this principle, environmental protection reasons are taken into consideration at the stage of selection and implementation of heat generation technology. Consequently, causes of environmental damage are eliminated at the stage of carrying out the investment project, instead of liquidating its consequences following the project's completion.

Summary

As a result of the consistently implemented policy of the state, many *gminas* and energy utilities, as well as the entry into force of the Energy Law, systemic principles of organization management, regulation and financing of the sector have been set forth. Institutional and economic foundations for the privatization of power, including heat, distribution enterprises have been created. The privatization of municipal heat distribution enterprises has been accompanying privatization of large state-owned heat-and-power generating plants, in this way contributing to fast ownership changes in the entire sector.

Further systemic changes will result from practical experience of the sector development, technological changes and demand for specific energy sources.

2.3 Solid Waste Management

2.3.1 Basic Information and Data

Waste management is one of the most sensitive issues in environmental and social terms. It is a sector with a complicated organizational and functional structure, as it assumes cooperation of various state-owned, municipal and private entities at different levels of strategic, planning and executionary activities. It is assumed to be a sector of highly integrated methods of waste disposal, as well as multifarious mechanisms and instruments of financing.

The present study is devoted mostly to the part of the waste management system which covers the category of municipal wastes.

Due to specific features of municipal wastes disposal systems, they are 'technically' distinguished in waste management systems all over the world.

In the early 1990s, the condition of the municipal waste management in Poland left much to be desired, in terms of its both technical and environmental aspects. Over the last decade, many arrears have been made up for, especially in the field of organization and techniques of solid waste disposal from urban agglomerations. In this field Poland has already 'caught up' with developed countries. Nevertheless, substantial decade-long delays still exist in the field of organization and techniques of disposal and treatment of municipal wastes.

The underdevelopment of the waste management became more apparent when the growing amount of municipal wastes emerged as the by-product of the economic transformation process. According to the available data, Poland is currently ranked among European leaders in terms of the amount of municipal wastes generated. In 1997, the average amount of wastes per capita amounted to 1 215 m³ (some 316 kg), and almost doubled in 1975²³. In 1998, 133 million tons of wastes were generated in Poland, which was the third-largest figure in Europe to the United Kingdom and Germany.

Landfilling is the basic form of waste disposal in Poland. Only a small percentage of municipal wastes is subject to recycling and composting. According to OBREM data, some 880 municipal landfill sites and some 10 000 unauthorized dumping grounds are registered in Poland. Apart from that, there are some 2 000 small municipal landfill sites established and used without a permit. Only less than 30% of the registered landfill sites have been established in accordance with the requirements of environmental protection services and pose no threat to human health and the environment.

In Poland, the introduction of degassing facilities to municipal landfill sites started only 10 years ago. At present, there are some 13 landfill sites equipped with state-of-the-art passive or active degassing facilities (i.e. burning gas "into the air" or utilizing gas for electricity or heat generation). Approximately 94% of all municipal wastes are deposited in dumping sites. "Provisions of the municipal policy of the State" (1995) envisage that after 2010 the proportions of wastes which are landfilled and processed for further utilization will be reversed.

Some 219 000 tons of solid wastes (1.8% of their total amount) are composted. In Poland there are only several composting plants employing the technology of composting in bioreactors, or proper technology of composting in compost piles. It is assumed that an estimated 20 composting plants will be in operation by the end of 2000. The degree of compost utilization for agricultural purposes is small due to heavy contamination of the product (presence of heavy metals, glass and other inorganic compounds).

The situation in the field of the economic utilization of cullet has improved in comparison to 1990. In 1997, 150 000 tons of broken glass were collected (compared to 2 000 tons in 1991). A more favorable situation continues in the field of metallic raw materials recovery. No major change or even a deterioration is reported in the recovery of paper, textile materials, plastics,

rubber and hazardous wastes. Generally speaking, the degree of secondary materials recovery in Poland still remains unsatisfactory, and under the current conditions economic activity in the field of recycling of wastes is unprofitable²⁴.

As regards to the 'waste' standards of the European Union, given the above description meeting the requirement of non-landfilling wastes without their prior technical, chemical or biological processing seems to be a major problem.

2.3.2 Legal Framework

In Poland, the issues of the disposal of municipal wastes are within the scope of the municipalities' own tasks. *Powiat*- and *voivodship*-level authorities are also entrusted with carrying out public tasks of a supra-*gmina* or *voivodship* (regional) nature in the field of environmental protection, including waste management.

Basic regulations involved with the disposal of municipal wastes are contained in the law on *gmina* cleanliness and order, and in the law on wastes.

The major secondary acts are the regulations issued in 1997–1999:

- on classification of wastes;
- on wastes which should be reused for industrial purposes, and conditions which must be met for their reuse;
- on packaging markings;
- on the detailed rules of disposal, utilization and treatment of wastes;
- on specifying the types of investment projects being particularly hazardous for the environment and human health, or posing a threat of deterioration of the environment condition, as well as requirements to be met by assessments of the environmental impact of these investment projects;
- on fees for waste storage.

Municipal wastes are defined as solid and liquid wastes originating in household, in public utility and public services buildings, as well as in premises used for office or social purposes by the polluter, including liquid wastes accumulated in cesspools, abandoned wrecks of motor vehicles, as well as street refuse, except hazardous wastes.

Pursuant to Art. 19.1 of the law on wastes states that: “*Gminas* carry out tasks involved with rational municipal waste management in accordance with principles set out in regulations on *gmina* cleanliness and order”, and under provisions of par. 3 of this article “*Gminas* implement

tasks involved with rational municipal waste management in accordance with principles of the “*gmina environmental protection program*”, adopted by the municipal council.

Under Art. 3 of the law on *gmina* cleanliness and order, keeping cleanliness and order are among *gminas*’ statutory tasks. *Gminas* secure cleanliness and order on their territory and provide conditions indispensable for their keeping, including, inter alia:

- conditions for performance of works involved with keeping cleanliness and order on the *gmina* territory;
- establishment, maintenance and operation of municipal waste landfills or facilities for the reuse or treatment of these wastes, owned solely or jointly with other *gminas*;
- prevention of streets, squares or open-space areas pollution by means of: liquidation of illegal waste disposal and counteracting such disposal; construction and maintenance of public toilets; placing street dustbins in areas of intensive pedestrian traffic, organization of municipal waste collection from mobile appliances;
- conditions for recycling and storage of reusable wastes, in cooperation with entities and persons undertaking such activities;
- cooperation with appropriate government administration agencies in the field of management of hazardous waste, separated from municipal wastes.

Under Art. 4 of the law, “the municipal council, upon learning the opinion of the state regional sanitary inspector sets, by way of a resolution, detailed principles of *gmina* cleanliness and order, concerning, inter alia:

- requirements in the field of cleanliness and order keeping on the territory of real estate;
- the kind of equipment for collection of municipal wastes on the territory of real estate and public roads, as well as the principles of its distribution;
- frequency, principles and methods of municipal wastes removal from real estate and other areas of public use.

“The laws determine a certain system of managing and financing local waste management, but they do not make up a complete national system of waste management. By passing the law on *gmina* cleanliness and order and the law on wastes the lawmaker vested considerable powers over economic entities with political bodies, not being technically prepared for their execution {...}, he has also put emphasis on reduction of the amount of wastes {...}, without seeing the need for easing the regulations pertaining to the creation of indispensable infrastructure for treatment and deposition of wastes.”²⁵

Inconsistent implementation of the existing regulations is another issue here. (This problem was also dealt with by the Sejm of the Republic of Poland in 1999). For example, only few producers of wastes observe the obligation of consulting the method of sewage treatment with municipal

authorities or the *voivodship*²⁶. By the middle of 1999 as much as 76% of *gminas* had not implemented comprehensive systems of municipal waste management²⁷.

2.3.3 Problems of Managing the Sector

As has been already mentioned, by the mid-1999 as much as 76% of *gminas* had not implemented comprehensive systems of municipal waste management, and only several dozen *gminas* can pride themselves on well-designed and implemented municipal wastes management schemes. The 'island-like' nature of these solutions gives rise to a number of conflicts. Namely, it may happen that due to the high standard of services the adopted solutions are much more expensive than traditional ones. Although the latter are consistent with the law, they do not take into account future requirements. In a number of cases, the choice of cheaper systems did not allow it to achieve the assumed economic parameters. On the one hand, this may be an indication of the shortcomings emerging at the stage of drafting the project and, on the other hand, of the scale of difficulties investors have to reckon with given the binding provisions of the law.

In nation-wide terms, the situation cannot be improved by the waste utilization contests organized by the National Environmental Protection and Water Economy Fund. The third contest announced by the Fund in 1999 was concerned with the undertakings involving supra-local and comprehensive utilization of wastes in rural areas.

Another problem is posed here by unclear competence in the field of supra-local issues of waste management, due to which the issues of hazardous wastes and recycling have been left 'for later'. At present, following the enactment of the second stage of the local government reform, the last significant element of which was the adoption, in the middle of 2000, of regulations concerning regional policy, the management and organization system is being completed, with the final decisions being made about the scope of competence and roles played by particular levels of self-government and government administration in creation of a rational environment for municipal waste management.

Solutions making the municipal waste management an integral part of the nation-wide waste management system have been subject to fine-tuning.

Only a well-organized, coherent system will allow for compatibility of the Polish waste management system with international standards.

At present, the government and Parliament are working on a new package of environmental laws, which will provide for a coherent environmental protection system. Successful implementation of these laws will depend on working out a correlated and effective waste management policy on a nation-wide scale, and on good cooperation between various kinds of administrative and economic entities acting in the environmental protection sector.

New environmental laws will take effect progressively, also in connection with the implementation of all kinds of legal and environmental requirements applicable in EU countries.

2.3.4 Management Practices

The municipal wastes management system reveals a relatively large scale of privatization of activities in the field of waste collection and disposal. This, however, is not the case with more capital-intensive and environmentally, socially and economically sensitive undertakings, such as the establishment and management of landfills and various kinds of waste treatment facilities. Most of such facilities are still owned and managed by *gminas* and municipal utilities.

As can be seen from the data presented in the Report on Municipal Services (*Rzeczpospolita* National Daily Issue No. 178/2000, p. B6), and Central Statistical Office data, more than 1 500 enterprises, most of them privately-owned, including some 600 capital companies, deal with solid and liquid waste disposal in Poland. The market of collection, selection and utilization of wastes is subject to stiff competition. For example, in Warsaw more than 100 firms deal with waste collection, while in Piaseczno, a relatively small town in the Warsaw agglomeration there are 11 such firms, and in Katowice, the main city of the industrial region of Silesia there are 27 of them (of which 14 collect solid wastes).

There is also variation in prices depending on the kind of waste, refuse transportation distance, et cetera. Overall, due to strong market competition, real prices of waste disposal services have been declining.

Competition is also fierce on the landfilling market. For example, some enterprises in Poland find it profitable to transport wastes 200 to 300 km away from the place of their collection.

In the context of prevention of monopolist practices, the principles of organization of the system of collecting, processing and deposition of wastes, have been clearly formulated. The Office for Protection of Competition and Consumers, fosters divisions into utilities dealing with wastes collection and disposal, and utilities dealing with the treatment of wastes, including firms managing municipal landfills. The point here is to prevent enterprises from combining waste collection and landfilling from taking advantage of their monopolist position. Namely, there is a threat and actual cases are reported of eliminating competition from the market by overquoting waste deposition charges, as well as hidden subsidizing of waste collection within one enterprise from landfilling charges levied on competing firms.

On the countrywide scale only several examples can be quoted as handing over the management of municipal landfills to private entities. With regards to investment projects involving the establishment of new landfills, they have been carried out so far exclusively by public entities. The main reasons for that are of a socio-political and economic and financial nature. Local

governments apparently lack experience in the field of preparation of long-term management agreements, and there is conspicuous social resentment to such investment all over Poland, being additionally fuelled by mistrust or reluctance towards such undertakings, carried out by private investors. Due to economies of scale, in the world municipal landfill sites are established for entities not smaller than between 100 000–200 000 inhabitants²⁸. Besides, investment, maintenance and reclamation costs have been growing steadily, also in connection with the requirement to fulfil the more and more stringent EU environmental protection standards (European Union Directive on landfill sites {1999/31/EC}) has been in effect since 1999.

2.3.5 Setting User Charges

The municipal council may determine, by way of a resolution, the upper rates of charges levied on real estate owners for services in the field of disposal and the treatment of municipal wastes, provided by municipal organizational entities, and entities having a proper permit. While setting the rates of charges, the municipal council usually applies lower rates of disposal and treatment of municipal wastes, if these wastes are recycled. Real estate owners are obliged to prove that they are benefiting from services provided by a municipal organizational entity, or from an entity having a proper permit for the provision of services of disposal and treatment of municipal wastes, by presenting the agreement and receipts for payment for services, or presenting on demand of the mayor of receipts for payment for waste deposition at municipal landfill site. If real estate owners do not prove benefiting from services provided by a municipal organizational entity, or an entity having a proper permit, the *gmina* takes over an obligation of disposal and treatment of municipal wastes, collecting an appropriate charge from real estate owners. Rates of these charges and detailed principles of payments for the provided services of municipal wastes disposal and treatment are set by municipal councils.

Summary

- Given the on-going processes of restructuring of the sector, coupled with the local government reform, the present waste management system is not coherent either on the *gmina*, or supra-*gmina* levels, not to mention the national level. This refers to both conceptual coherence, and organization, principles and time schedule of activities conducted in the field of waste management, as well as financing the sector and its particular elements involved with waste utilization. The distribution of powers between specific central state administration agencies, as well as central and local government bodies in the field of both environmental protection and economic activities stimulation has not been completed. Economic instruments of environmental protection relating to waste management, such as eco-funds, grants and preferential credits for environmental projects have not been widely employed for integration of the waste management system. Besides, the adopted

systemic rules and technical requirements for local refuse collection systems have often proved inadequate. For example, in rural areas many facilities have been built (small landfill sites), whose technological and environmental applicability is highly debatable in the context of EU environmental protection regulations.

- Many operating landfill sites do not meet the environmental standards.
- Decade-long underdevelopment relative to advanced economies can be found in the field of organization and technology of municipal wastes disposal and treatment. Programs of 'at the source' recycling, modern waste (including hazardous and processed waste) recycling and treatment plants, as well as state-of-the-art incineration plants, are in short supply. One of the major problems faced by Poland will be that of meeting the EU requirement of not dumping unprocessed wastes.
- So far, no instruments of economic and organizational nature, which motivate or oblige producers and users of wastes, as well as entities supervising waste management systems to rational waste disposal, have been provided, so that minimum quantities of unprocessed wastes were deposited at municipal landfill sites.
- The involvement of private enterprises in managing and investment projects relating to state-of-the-art waste disposal and treatment plants still remains insufficient.

2.4 Public Cleaning, Park Maintenance, Municipal Cemeteries

2.4.1 Basic Information and Data

Particular kinds of services covered by this chapter undoubtedly have their specific features, but due to historical reasons (in the past these services were usually provided by one multi-profile entity) and to some similarities of solutions recommended as final objectives, they are presented in one chapter.

a) Cleaning

Cleaning services can be divided into two basic groups: winter maintenance of urban roads and summer street sweeping. Tasks involved with winter maintenance of urban roads include: fighting winter slipperiness, snow removal, keeping bus stops and pedestrian crossings free of snow and ice. Summer street sweeping means maintaining appropriate sanitary conditions and order in towns and settlements, as well as securing street traffic safety and freedom.

b) Green Areas

The Law on Environmental Issues, 2001 (issued April 2001) defines urban green areas as "plant assemblage in areas which, according to spatial management plans, are to be developed for recreation, health and leisure purposes, in particular: parks, greenstones, street and square green,

isolation green, employee allotment gardens”. In each of the above-mentioned kinds of ‘green’, different kinds of services are provided, which are indispensable in keeping up the functions performed by these areas (for example, completely different tasks are associated with high and low green maintenance).

In this chapter we deal with services involved with the development and maintenance of green in areas owned by local governments, with the largest share of green areas managed by local governments remaining within the powers of *gminas*. These are mostly separated areas (such as gardens or municipal forests), as well as parts of municipal real estate (e.g. municipal estate green), as well as municipal roadside vegetation.

In 1970, the greenery rate in Poland was 12 sq. m/M²⁹. This rate was lower than in many other European states. As a result of a strong urban development pressure, cities like for example Wrocław have lost their ‘green’ city status that they had previously enjoyed.

c) *Municipal Cemeteries*

Two kinds of markets can be distinguished among services associated with the operation of cemeteries³⁰:

- (i) The market of cemetery services involved with managing a cemetery, including its maintenance, which covers, inter alia:
 - the establishment of a cemetery in accordance with physical management plans (setting the areas for burial grounds, graves, alleys, as well as their marking);
 - the construction of a chapel or a funeral home and their operation;
 - providing a water supply and sanitation equipment, and its operation;
 - cleanliness and keeping order (cleaning, waste disposal, etc.);
 - exercising supervision over the use of the cemetery, in particular burial and exhumation of corpses, as well as setting graves in accordance with legal provisions, i.e. pursuant to the law on cemeteries.

- (ii) The market of funeral services provided, as a rule, on individual order of persons entitled to burial of human corpses, covering, inter alia:
 - preparation of the burial place, i.e. digging the earth grave and its possible lining with stone work;
 - preparation and transportation of the corpse;
 - burial of the corpse and sealing of the grave, including activities involved with corpse entombment;
 - tombstone works.

In this chapter, we focus our attention on the first group of services³¹, given the fact that municipal authorities are responsible for the issues involved with municipal cemeteries and the cemetery services market.

Due to the objective of the study, the following legal acts are of major significance:

- *Cleaning*
 - the law on keeping cleanness and order in *gminas*;
- *Urban greenery*
 - the law on environment protection and shaping;
 - regulation of the Minister of Spatial Economy and Construction of 1994 technical conditions to be fulfilled by buildings and their location (Journal of Laws of 1995, No. 10, item 46);
 - the law on public roads;
- *Cemeteries*
 - the law on cemeteries and burial of the dead;
 - regulation of the Minister of Municipal Economy of 1959 on conditions of handing over State-owned land for establishment and extension of cemeteries (Journal of Laws No. 46, item 284);
 - regulation of the Minister of Municipal Economy of 1959 on specifying areas suitable in sanitary terms for establishment of cemeteries (Journal of Laws No. 52, item 315);
 - regulation of the Minister of Local Economy and Environmental Protection, as well as the Minister of Health and Social Welfare of 1972, on establishment of cemeteries, keeping cemetery records and burial of the dead (Journal of Laws No. 47, item 299).

2.4.2 Management Principles and Practices

a) *Cleaning*

The law on cleanliness and order specifies *gminas* tasks and real estate owners' obligations in the field of cleanness and order keeping, as well as the conditions of granting permits to entities providing services in the scope covered by the law.

Cleanliness and keeping order in *gminas* lies within their obligatory tasks. *Gminas* secure cleanliness and order on their area, and provide conditions indispensable for their keeping. These include, inter alia, conditions for performing works involved with cleanliness and keeping order through the establishment of appropriate organizational units. Prevention of streets, squares or open-space areas pollution can be achieved by means of: liquidation of illegal waste disposal and

counteracting such disposal; construction and maintenance of public toilets; placing street dustbins in areas of intensive pedestrian traffic, organization of municipal waste collection from mobile appliances.

Municipal councils, upon learning of the opinion of a local sanitary inspector determine, by way of a resolution, detailed principles of *gmina* cleanliness and keeping order.

Real estate owners' obligations include, above all: snow, ice, mud and other dirt removal from pavements alongside the real estate.

At the building site, the works manager is responsible for performance of these duties, while in the areas associated with local public transport it lies within the responsibilities of entities utilizing areas covered by public transport systems. In areas not mentioned above, road managements are responsible for cleanness and order keeping in reference to public roads, while in other areas these functions lie within *gmina's* scope of duties. Hence, *gmina* performs cleanliness and keeping order duties both in the area of its own real estate, and in the area associated with municipal roads, as well as in all other areas not mentioned by the law.

The law imposes certain obligations on *poviat-* and *voivodship-*level local governments in the field of cleanliness, in keeping in areas associated with their real estate, and with roads managed by them. These areas account for only a small share of the total area subject to cleaning. Consequently, these issues, as only being of marginal significance are not covered by this report, although the poor appearance of these public places often comes under inhabitants' criticism. The major problem faced by *gminas* in terms of the execution of the Law on keeping cleanliness and order in *gminas*, and their internal by-laws with this respect—is lack of effective fiscal instruments against citizens, and institutions who do not obey regulation. On the other hand, one cannot say that *gminas* present sufficient determination in using existing execution and law enforcement mechanisms.

b) *Green Areas*

The environmental protection law states, above all, that: "local spatial management plans and draft provide, in particular, for a comprehensive solution of the problems of development of urban and rural built-up areas, with special reference to, among other things, planning and shaping of green areas".

"Chapter 6 of this law has been devoted entirely to the issues of green areas protection in cities and villages. *Gmina's* bodies and organizational entities secure for urban population access to live nature resources through, first of all, development of urban green areas adjacent, if possible, to forested areas (...). The distribution of urban green areas should secure appropriate health, climatic and recreation conditions indispensable for satisfaction of urban population needs associated with dwelling, work and leisure". {...}

“Chemical agents can be applied only in a way harmless to urban green. The *voivod* determines the kinds of admissible agents and the conditions of their application”.

Removal of trees or shrubs from the real estate area can be authorized by the *gmina* mayor or town president. This body may make the permit conditional on replanting trees or shrubs to a pointed location, or on replacement of trees or shrubs planned for removal with other trees or shrubs.

Under provisions of the regulation on buildings “on building plots destined by the local physical management plan for multi-family housing {...} at least 25% of the area should be reserved for green and leisure”, whereas “a *gmina* body may determine a different share of green areas, if it is indicated by the provisions of the local physical management plan.”

Pursuant to the law on roads, road management is responsible, inter alia, for tree and shrubbery planting, maintenance and removal, and for greenery cultivation in the roadway.

c) *Cemeteries*

Decisions on the establishment, expansion and closure of a municipal cemetery are made by the municipal council (unlike cemeteries in charge of a religious community, where church authorities have the power to decide). A permit issued by the sanitary inspector is indispensable in these matters. The *gmina* board is responsible for exercising the management of municipal cemeteries. In accordance with legal regulations, a cemetery should be organized in every *gmina*. In justified cases one cemetery can be organized for several *gminas*.

The observance of the law on cemeteries and of the implementing regulations to this law is monitored by ‘starosts’, *gmina* mayors (or town presidents), as well as sanitary inspectors appropriate for the place.

Civil law provisions are applicable for setting and collecting the charges for the services provided. Appropriations from municipal environmental protection and water management funds can be made for organization and maintenance of green areas, plantings, shrubs and parks established by the municipal council.

Representatives of municipalities often point out the lack of legal regulations pertaining to green areas as a separate field of infrastructure. It is also proposed to introduce an obligatory spending of several percent of new housing investment costs on green areas development³².

At present, running municipal cemeteries is mostly a loss-making activity. For this reason, the private sector is currently not interested in this market. At the same time, due to its specific features the owners, i.e. *gminas*, come up with no initiatives in this field, either.

The strategy of the local authority often provides for simultaneous provision of funeral services by a cemetery managing body. Such a solution allows the covering of some costs of cemetery

management with revenues from funeral services. Nevertheless, this situation obscures cost calculation, and (as has been already mentioned), gives rise to abuses.

The Ombudsman Office report published in 2000, concerning worship of the dead and implementation of the law on cemeteries and burial of the dead includes information pointing to the emergence of a number of problems including economic ones. Most complaints concerned the applicability and level of charges for extension of the lease of graves, restrictions to the care for them (removal or non-removal of trees planted next to graves) and to sale of plots “for the living”³³, being restrictions to citizens’ rights to graves and worship of the dead, as imposed by individual administrations and managements.

In accordance with opinions voiced by representatives of the cemetery services sector, many shortcomings and errors pointed out in the report result from both the lack of a modern “cemetery and funeral law”, and from ambiguous and inconsistent approaches of local governments towards the cemetery and funeral sector.

2.4.3 Policy Issues

At the beginning of the 1990s, specialized single-profile utilities providing services in particular fields covered by the analysis (e.g. town funeral enterprise, urban greenery enterprise) operated only occasionally in the major cities. In other cases, municipal utilities or, in smaller towns, municipal and housing management utilities were involved. These multi-profile enterprises dealt with municipal housing stock management, cleanliness and order keeping, small architecture management, greenery keeping and maintenance of cemeteries.

Depending on the city size and on local needs, these enterprises operated either as fully specialized utilities (e.g. urban green department, funeral undertaking, town cleaning department), or utilities combining these functions (e.g. town cleaning and greenery department). Sometimes, in a multi-profile enterprise all these activities were performed by a municipal services utility, operating along with a water/wastewater utility, and municipal housing department.

In many cases, waste management utilities were entrusted with cleanliness keeping tasks.

Within the framework of organizational and legal restructuring, most enterprises have been transformed into budgetary units or, to a smaller extent, into limited liability companies. Usually, they still operate as multi-profile enterprises, mostly due to possibility of financial and workforce flows between particular departments. In many cases, due to the stance taken by employees, particular types of activities have not been distinguished either. The process of enterprise restructuring was slow and had no apparent effect on the quality of provided services. At the same time, particular markets showed a fast rise in competition posed by private entities. This could be contributed to the lack of capital barriers to entering the market of these services

(especially in the case of manual sweeping and most greenery keeping services), and to the fact that municipal entities were not monopolists in these fields. Cleanliness keeping or green cultivation services were also found in areas other than municipal economy. There were cemetery and funeral services not associated with the municipal sector, namely those provided in cemeteries being in charge of a religious community. In this situation it was much easier to introduce a market regime (in fact it was just extension of the scope of various already functioning markets, with a simultaneous abolishment of numerous barriers to economic activity).

At present, there has been a considerable local variation in management models. Transformations, especially in big cities, involve, for example, the splitting of the existing utilities into several companies (e.g. employee-owned ones). This process takes place in a way limiting their mutual competition, being the consequence of specialization of individual companies and the field of their activities (e.g. in the field of urban green: one company is specialized in plant nursery, another one in municipal forests management, yet another one in development and maintenance of urban green areas and in small architecture). In many towns tasks are commissioned to private firms in a bidding by auction.

The town area is often divided into sectors in which services are provided by different entities, thus making it possible to compare the cost of services and launching competition mechanisms. Auctions for providing services are organized either by a department functioning within the framework of an office, or by budgetary unit established specially for this purpose.

In the case of the privatization of town cleaning, greenery keeping and funeral services, the costs of investment (especially in specialized equipment) are incurred by private providers.

In the case of maintenance of municipal cemeteries, the costs of necessary repairs and investment are incurred by their owners, i.e. *gminas*.

In accordance with 'State policy in the field of regulations of prices for municipal services'—a program document of the Housing and Urban Development Office—town cleaning, greenery keeping and funeral services, being provided under market economy and intensifying competition conditions, do not require state intervention, but only a creation of a general (mostly sanitary an environmental) framework.

The general supervision over the issues regulated by the law on cemeteries is exercised by appropriate ministers, i.e. the Minister of Internal Affairs and Administration, and the Minister of Health and Social Welfare. The Minister of Internal Affairs and Administration, in agreement with the Minister of Finance, may also determine particular conditions of handing over State-owned land for establishment of new and extension of existing cemeteries.

Monopolist practices applied by municipal utilities, and various irregularities in the commissioning process are often a major barrier to the introduction of market mechanisms. The entry into force

of the public procurement law changed the overall principles but did not eliminate these abuses. Among the analyzed issues the most important ones are associated with cemetery and funeral services. Monopolist practices were usually associated with the fact that economic entities operated on both these markets, attempting to use their monopolist position on one market for winning privileges on the other. If a cemetery manager provides funeral services, he fulfils the criteria of an economic entity, and his competition-limiting actions undertaken in the managerial capacity are subject to an assessment by the Anti-Monopoly Office. It has been assumed that in the examined cases, the Office for Protection of Competition and Consumers does not, as a rule, analyze the share of cemeteries in the local market of the provided funeral services, as the decision about burial largely determines the particular market position of a given cemetery. Therefore, in each case a given cemetery will be regarded as separate local market of funeral services³⁴.

Cases examined by the Office for Protection of Competition and Consumers are primarily concerned with agreements concluded between the *gmina* as cemetery owner, and an enterprise as cemetery manager, which eliminate from the market third parties organizing funeral ceremonies involved with burial on the municipal cemetery.

In accordance with the stance assumed by the Office, it is not justified to claim that under the provisions of the regulation on cemeteries services in this field can only be provided on exclusive terms, so as to secure order. It is possible to formulate agreements in a way allowing two economic entities to fulfil the requirements imposed by this regulations in a non-conflicting way (this relates especially to big cemeteries).

Nevertheless, in accordance with this stance, since the cemetery manager/owner incurs permanent costs of its maintenance and is responsible for its operation and organization, he is entitled to collect appropriate charges from other funeral undertakings.

Also in the field of methodology and principles of setting prices by municipal cemeteries, attempts were made to take advantage of their monopolist position. One of the cases examined by the Office related to introduction by cemetery manager of excessively high charges in order to raise funds for investment financing. The Office concluded that charges for alienation of rights to the grave were actually a local tax levied without a legal foundation.

Sustaining cleanliness improves the condition of the environment in human habitat and protects from threats. Appropriate policy in the field of greenery upkeep improves the quality of life and becomes a significant factor of urban environment development. The amount and condition of urban greenery is of major relevance for air quality in cities.

Services involved with winter maintenance may have an adverse impact on soil pollution and lead to greenery damage. Hence, it is important to apply environmentally safe technologies.

Cemeteries are not mentioned in the regulation on environmentally hazardous investments, but the areas on which cemeteries are situated must meet specified conditions. Their satisfaction is indispensable to minimize the adverse environmental impact.

Summary

1. Town cleaning, greenery keeping and funeral services are regarded by the government as municipal services provided under conditions of market economy and intensifying competition.
2. Monopolist practices applied by municipal utilities, and various irregularities in the commissioning process are a barrier to the introduction of market mechanisms.
3. In the field of competition, the major problems are associated with cemetery and funeral services. Monopolist practices are associated with the fact that economic entities operate on both these markets, attempting to use their monopolist position on one market for winning privileges on the other.
4. Application of many different strategies has led to a considerable local variation in management models. In the case of many centers applying the traditional model (multi-profile budgetary unit) problems emerge with adjustment to market mechanisms and growing competition.
5. In accordance with opinions voiced by representatives of the cemetery services sector, many problems faced by the sector result from both the lack of a modern “cemetery and funeral law”, and from ambiguous and inconsistent approaches of local governments towards the cemetery and funeral sector.
6. Furthermore, in reference to the town cleaning sector there are no effective instruments of enforcement by *gminas* of the observance by citizens and firms of cleanliness and order keeping in accordance with municipal regulations (local law). Irrespective of the operation of municipal enterprises in this field, keeping good appearance of cities is adversely affected, which comes under criticism of local communities.

3. RECOMMENDATIONS

Chapter 3 provides proposals of legislative, regulatory and managerial actions aimed at the improvement of quality and efficiency of municipal services, as well as at overcoming development difficulties and barriers, as mentioned above. At present, some of the analyzed initiatives are already subject to deliberations of government and parliamentary institutions, while other are

proposed by local government officials and experts as support for necessary transformations in this sector, especially in the context of integration with the European Union.

3.1 General Recommendations

3.1.1 Context of Services Organization and Management

Development and protection of the local market of services should be among the major tasks of local government entities. Instruments for the development and protection of this market should be provided by public funds expenditure standards, and upgraded and well-implemented system of public procurement for the provision of municipal services, as well as the privatization and restructuring of municipal enterprises.

The role played by the state and local government entities in economic processes is involved with drafting the strategy of actions, and their planning and carrying out should more and more take into account the subjectivity of economic entities.

The distribution of powers and functions among entities operating in the sector should be based on the principle of entrusting self-governing economic entities, especially capital companies with most issues relating to economic activity and development of local markets of services.

Local government units can interfere with this activity only along the lines resulting from exercising of statutory and assigned public authority powers, especially in the field of one's own or the owner's tasks.

In order to capitalize on the economies of scale of municipal enterprises' activities, local government entities at all levels should work out formalized principles of cooperation. This refers, in particular, to the field of strategy and planning of infrastructure, qualitative, environmental and territorial development of services, also seen from the point of view of organizational and territorial consolidation of small enterprises, development of large enterprises, as well as investment and environmental protection. These are mostly capital-intensive natural monopoly sectors or sectors being environmentally sensitive (e.g. the water/wastewater sector, the power sector, wastes collection and disposal). Self-financing entities should provide, on their own, operational and financial planning, as well as the performance of tasks. The Energy law and the draft law for the water/wastewater sector are a major step in that direction, and create a legal basis for managing municipal services in such a way.

Monitoring and external supervision over the activities of the municipal sector natural monopoly utilities should be exercised by specialized regulatory and judicial bodies, while in other cases by

appropriate departments and budgetary units of local government entities, anti-monopoly bodies, or other specialized inspections and control and supervision institutions.

Local government entities of various levels, particularly *gminas*, should be fully independent in the realization of their municipal economy tasks. On the other hand, the fine tuning of laws on local *gmina- powiat-* and *voivodship-*level governments and the law on the government's support to regional development is indispensable, so as to safeguard the introduction of the methodology and instruments of long-term strategic planning to a common managerial practice of local and regional development on particular administrative levels, as well as the correlation of activities between particular local governments municipal utilities on the supra-local and regional levels. Creation of an effective and rational system of utilization of funds owned by local governments and the state is the main issue here. Therefore, the 'local government laws', the law on public finance. and the law on territorial self-government entities should³⁵:

- a) eliminate conceptual gaps and introduce precise terms defining planning and management instruments, i.e. strategies, policies, programs, including long-term investment programs (e.g. at present it is not known what is the difference between strategy and policy and whether they are interdependent);
- b) correlate the regulations relating to the above-mentioned planning instruments, by supplementing the laws on *gmina-* and *powiat-*level governments with the provisions of the law on *voivodship-*level government. The same concerns secondary regulations to the law on government's support to regional development.

For example, the law on regional development should link the planning of investment in *poviats* with regional programs of central and *voivodship-*level authorities. The law on municipal governments should contain provisions relating to the strategy of *gmina* development and municipal economic programs, including a long-term investment program and, possibly, the principles of applying for subsidies to their realization:

- c) formulate precisely the principles of granting state budget subsidies for individual local government entities in order to secure for all entities equal opportunities for seeking funds for municipal economy development (investment), if the re-distribution of public funds via the state budget continues on the currently applicable principles and on the so-far scale, at the expense of the principle of financial subsidiary (self-reliance) of individual levels of local administration;
- c) social aid provided by the State and local governments should be regularly reduced for the sake of limiting the re-distributive role of public budgets, and should be channeled to precisely defined groups of citizens or individual persons (subsidizing of individuals, not enterprises).

On drafting the instruments of strategy and planning, as well as principles and procedures of their realization, the one-year perspective of investment budget planning should be replaced

with a long-term perspective in all the relevant laws (law on public finance, local government acts, and so on).

Legal and administrative procedures should be less bureaucratic and simplified, and all public issues should be transparent for the society and for individual citizens.

3.1.2 Incorporation Forms of Enterprises

The incorporation form of municipal sector utilities should be further rationalized. Changes should be aimed at covering the possibly largest number of medium-sized and large enterprises with Commercial Code provisions and, subsequently, with restructuring and privatization processes. In the case of multi-profile enterprises, cash-flow analysis should be carried out for individual plants so as to examine whether the branch separation of these enterprises was justified.

Due to the specific features of operation of individual enterprises and various conditions of their functioning, one cannot generalize and point to one totally correct solution for all local government entities and enterprises, as well as optimum institutional models and practical ways of organization, financing and provision and municipal services. The spectrum of cases and solutions is wide³⁶, and the governing criterium should be 'cost versus quality'.

Nevertheless, a general rule should be that commercial law companies, due to their higher cost-effectiveness, shall dominate over budgetary units and firms operated in close relationship with the budgets of local governments.

All capital and organizational operations involved with the establishment, transformation of the incorporation form and mergers of capital companies will soon be facilitated due to modern provisions of a new Commercial Companies Code, which to be enacted in 2001 and to replace the law applicable since 1934.

3.1.3 Financing and Pricing Policies

In most sectors the 'marketization' of charges for municipal services and media is required along with self-financing of all entities providing municipal services. This means most significantly the restoration of economic functions (i.e. the income, information, motivation and stabilization function) of charges. Development of 'municipal' sectors can be hampered not due to technical abilities or service-rendering capacities, but due to the unfavorable cost/benefit ratio and due to not taking investment and capital costs into account. A creation of a system of financing of technical public infrastructure, its replacement and development must be based on covering direct and indirect investment costs, including capital acquisition costs by charges for services.

With such an approach the current proportion of investment financing (some 70% of funds provided by local governments' budgets) should be reversed in connection with, above all, a much larger involvement of the funds from private investors.

Adjacent charges for real estate owners should be introduced on a much larger scale in connection with raising of the 'technical' value of real estate.

With regard to other economic and financial issues, one should:

- consistently reduce or abolish subject-specific subsidies and subsidizing of municipal services. For multi-profile enterprises, where legal separation along branches does not occur, each type of service should have a separate cost-accounting system, so that charges for particular services reflect true costs, and cross-subsidization is avoided. Any subsidy approved by the local government should be entirely transparent, conscious and well documented;
- optimize enterprise operation costs (restructuring, internal costs and investment planning control in the so-called natural monopoly enterprises, in connection with protection of customers' interests under natural monopoly conditions);
- make the charges paid by users of services on the 'quantity' and quality of the services provided (of the offered 'product');
- introduce systems motivating:
 - i) customers to a rational use of resources and media (metering; individual settlements systems);
 - ii) enterprises to improvement of the product and environmental value of services, to increasing investment (capital premium) and efficiency of technical infrastructure systems, as well as competitiveness of payments for services.

3.1.4 Privatization and Creation of Market

Legislative and regulatory activities, as well as managing activities undertaken by the State and local governments in the field of restructuring and privatization of enterprises should:

- consistently extend the scope of cooperation between local governments and enterprises reporting to them in the field of strategy and planning of long-term actions, including infrastructure development;
- aim at a possibly full sovereignty of enterprises and their acquisition of assets they are already working with; and
- implement solutions leading to the self-financing of enterprises, in accordance with principles applicable in a market economy.

Civil law agreements and commercial law agreements should be the main instrument of privatization decisions and decisions extending the powers of economic entities. The scope for BOT (Build-Operate-Transfer) and BOOT (Build-Own-Operate-Transfer) contracts, as well as contracts implying full privatization of enterprises and assets should be growing, with control and regulatory functions to be still performed by public entities.

In the case of entering by local government entities mixed administrative and civil contracts (e.g. BOT contracts), the civil sphere must be very precisely separated from the administrative and legal sphere. The set of agreements between local government entities and private entities should separate agreements and arrangements concluded, in a way, by equal parties and, on the other hand, precisely formulate the principles of cooperation, to be rather examined in the public (administrative) law regime, where the entity being a public administration agency acts as a party.

In municipal services sectors there is no need to introduce licenses. Such an approach is compatible with the state policy of limiting bureaucracy in the economy, including the reduction of powers of state administration agencies in the field of issuing licenses and permits. Besides, this stance is reflected in the new Law on economic activity. It defines, most importantly, the concepts of licenses and permits, and specifies these few fields of economic activity which require licenses.

In the law relating to public procurement and counteracting unfair competition, which is already considered good, methods and procedures of choosing the best providers of services, monitoring and control of services at the local level should be made more precise and flexible by means of auctions, contracting of services, supervision and, above all, methods of measuring the results of services.

3.1.5 Regulation of Natural Monopoly Sectors

In the future, a clear definition of delineation of roles and scopes of competence between regulatory bodies (RBs) and anti-monopoly (competition and consumer protection) bodies (ABs) in the case of the so-called natural monopoly enterprises, should become a rule. Due to some convergence of issues dealt with by anti-monopoly and regulatory bodies, the following should be defined very precisely:

- objectives of ABs and RBs actions should not be identical, but complementary;
- their scope of competence, determined so as to avoid overlapping of tasks and decision-making powers, on the one hand, and 'white spots', on the other hand;
- mutual cooperation principles.

AMs should be mostly interested in a wide spectrum of any enterprises having a monopolist or dominating position on the market, without getting into technical details of their specific

operations, while RBs should rather be interested only in such enterprises which conduct activities of a natural monopoly nature (e.g. transmission grid enterprises).

Assuming that charges for the provided services set by monopolist enterprises are the major subject of regulation, the delineation of competence in this field should be determined as follows:

- AB controls the level of charges (prices) from the point of view of probability of their inappropriate shaping as a result of competition elimination by a specific enterprise, or other violation of competition rules, i.e. AB controls the observance of competition rules, protecting the market and consumers.
- RB controls the level of charges (prices) from the point of view of probability of their inappropriate calculation by a grid transmission enterprise, as a result of conducting by this enterprise economically and technologically justified natural monopoly activities, in a broader context of economic efficiency (charges, costs, investment versus technology). Hence, RB regulates strictly technological and economic aspects of operation of natural monopoly enterprises, and protection of the receiver of services provided by the natural monopolist is of secondary significance.

Anti-monopoly legislation should be generally applicable to any type of monopolist and dominating enterprises, but with one exception. In the particular case of control over activities of natural monopoly enterprises, especially in the field of tariffs, should be subject to regulatory legislation³⁷.

Another option is also possible. Namely, that AB should take over all the issues involved with any kind of monopolist activity, no matter whether ordinary or natural monopoly is the case. Such a solution seems rational and justifiable, as one institution becomes specialized in cases of a common denominator—counteracting monopolist practices. Solutions in the field of organization would involve the creation of two specific task departments within the framework of AB.

Determination, especially for the water/wastewater sector of the final shape of the system and its regulatory authority and the scope of its competence (i.e. whether it is to be broad or limited e.g. to tariff matters) is another significant issue here. If it is to be broad, then given the constitutional tripartite structure of power, why not to transfer most issues concerning disputes in the field of regulation to competence of the judiciary, for example economic courts with specialized departments for monopoly regulation.

The scope of issues subject to regulation should not be too broad and should mostly relate to price setting arrangements so as not to allow a return of the centrally planned economy through the back door.

Basically, devising new solutions in the scope of regulatory institutions should not involve the setting up new bodies if, after some modifications, the operating system (of judiciary, control and regulatory bodies) can cope with new tasks.

3.1.6 Infrastructure Ownership

The share of state treasury ownership in municipal infrastructure should be further reduced, with ownership rights to real property handed over to local government entities, especially to gminas and 'their' municipal enterprises.

Introduction of the cadastral³⁸ real estate system should be conducted with special care for the ultimate determination of ownership rights to a municipal infrastructure in the context of rights to real estate.

In the field of issues relating to infrastructure ownership, the problems of ownership relations or the possible reimbursement of outlays on this part of infrastructure which was not built with funds of enterprises providing municipal services (Art. 49 of the Civil Code, etc.) also require regulation.

For these purposes a detailed analysis of Civil Code regulations as well as sectoral implementing regulations, for example the Energy law, would have to be carried out. This relates to the principles of hooking up the facilities built with private funds to networks operated by power and water/wastewater utilities. These issues are often a subject of cases examined by the Office for Protection of Competition and Consumers (OPCC), and proceedings before the anti-monopoly court, and are especially important in the context of counteracting the consequences of operations of the so-called natural monopoly enterprises. The general rule should be that the builder of facilities is their owner and the transfer of ownership rights takes place by force of a civil law agreement specifying financial principles of the transfer of assets.

3.1.7 Consumer Protection

The methods of counteracting monopolies, and consumer protection (legislation and practices) should take into account objective economic principles and sector financing requirements. Namely, quite often OPCC officials, not knowing these principles and their impact on calculation of charges for municipal services, take rational economic and financial decisions of enterprises for activities conducted to the detriment of buyers of services. Training schemes in this field would have to be introduced.

3.1.8 Lobbying

In the process of legislative works and the changing of the sector operating rules, the hitherto relatively irrelevant role of various institutions (associations, unions, chambers of commerce, and so on) representing local government entities and municipal services utilities is bound to increase. The lobbying role of these institutions will be performed properly, unless they concentrate

exclusively on fostering their narrow, tentative, and selfish-minded political, group or owner interests. The two-year experience of the process of drafting the law on water supply and wastewater disposal, which will have the same revolutionary and sorting out significance for this sector as the Energy law for the heating sector, shows that the cooperation of all these entities can produce good solutions, able to meet European and international standards, at the same time reconciling the interests of all parties (see case study—Annex B).

The role of trade unions should be limited exclusively to issues involved with labor conditions and wages.

Trade unions and consumer organizations cannot decide or influence strategic decisions and decisions concerning the planning of economic actions. These issues should be regulated exclusively by internal authorities and external supervision over enterprises.

3.1.9 Responsibilities of the State³⁹

State agencies should influence activities in municipal services sectors mostly in an indirect way through the working out of strategies and the passing of laws or amending regulations, especially in the field of economic and tax law. This relates, above all, to the accomplishment of such objectives as effective overcoming of bureaucratic restraints on the economy, simplification of the tax system and easing of tax and social burdens (which until now have been a barrier to a generation of appropriate investment capital by enterprises), to market and competition protection, i.e. the creation of proper conditions for the development of free enterprise in the sector, based on stable organization and on stable economic and financial principles, and to securing the balance between providers and buyers of municipal services, wherever market mechanisms fail. Creation of strategy and legal framework in the field of environmental protection and economic pro-ecology actions should be another field of activities of the state.

The legislation pertaining to municipal services sectors should take into account principles and standards applicable in the fields subject to EU standardization, especially as regards to environmental and technological standards.

Voivod's supervision over activities of local government entities exercised in accordance with the law, and the supervision of regional auditing chambers over budgetary management of local governments, are and should be the areas of direct intervention of state administration agencies in the sector's operation. These agencies should check whether the decisions made by *gminas* (e.g. resolutions concerning fees and charges) within the scope of their already existing and new regulatory competence are compatible with the law. Apart from *voivods* and regional auditing chambers, administrative and anti-monopoly courts will play a very significant role. These courts should run professional quasi-regulatory divisions being able to examine disputes quickly and effectively, especially over tariff issues.

3.2 Sectoral Proposals

3.2.1 Water/Wastewater Sector

The consciousness of the required changes able to secure the stabilization of organization, management, regulation and the financing of water/wastewater services, and effective catching up with Western countries in the field of quality of services and environmental standards is shared by both the central government, local governments and professionals working in the sector. It will be more difficult to arrange for the way, methods and instruments of achieving these goals.

The law on central water supply and wastewater disposal was passed by the Parliament in June 2001. Provisions of this law make up a new system of the sector's operation in all the major aspects of management and organization of services, as well as their financing and worth recommending to other Central and Eastern Europe countries.

Among other things, the adoption of projected provisions will fulfil the recommendations of the 7th Congress of the International Water Supply Association (IWSA) held in 1969, confirmed at the 19th Congress (Budapest 1993), and will be consistent with the currently drafted EU Directive on covering all costs of providing water/wastewater services with charges paid by customers.

Major provisions of the law are presented below:

Principles of managing the sector

1. Full cooperation between *gminas* and enterprises of the sector is envisaged in the field of working out the strategy and planning of development of services. The *Gmina*, in cooperation with the enterprise is responsible for providing stable conditions of development and financing of services.
2. Enterprises will be responsible for direct economic activity in the field of water supply, wastewater disposal and treatment, for maintenance, running and modernization of facilities, as well as for investment. The principles of providing services are to be determined by way of internal regulations devised by enterprises and approved by *gmina*, and services will be provided upon an agreement between the enterprise and the buyer of services.

Principles and methodology of setting and application of prices and charges:

1. All expenditures and costs involved with current, investment and financial actions of the enterprise will be covered by means of self-financing of enterprises, especially by customers' payments. The proposed provisions about social reasons in subsidizing the price, the transparency and conscious way in compensating the losses were canceled by the legislators.

2. These charges will be calculated according to new methods, based on methodology of revenue requirements of the enterprise. In accordance with this methodology, the charge would be calculated in an amount corresponding with the sum of:
- current operation costs, especially the running and infrastructure maintenance costs;
 - depreciation, calculated not as the cost for tax purposes (i.e. any officially set depreciation rates) but with real capital expenditures to be incurred for replacement of certain fixed assets;
 - interest on the invested equity or loans for current operation or investment purposes;
 - capital reserves for satisfaction of justified claims resulting from obligations assumed by the enterprise, and justified losses linked to the enterprise operations, e.g. bad loans;
 - the corporate income tax;
 - profit margin or return on invested capital, taking into account the efficiency of its use.

The 'revenue requirements' methodology will allow:

- for reimbursement, in the payment for services, of all rationally determined costs and expenditures involved with the provision of services;
 - for accumulating capital reserves for investment and liabilities arising in the course of economic activity, and;
 - for obtaining return on invested assets, which would be rational and satisfying for their contributors (being only marginal in the case of the local government acting as investor, or an enterprise being its property, and determined entirely by the market in the case of institutional investors and creditors, who otherwise would not be interested).
3. charges calculated this way will be allocated among particular groups of buyers according to proportion of a total costs generated by particular groups, and upon that a price tariff will be determined for each group of buyers. Various cost allocation techniques and methods will be allowed, along with variation in tariffs and their structures (e.g. two-level tariffs).
4. Enterprises are obliged to keep such accounting and management records, which will make it possible for a correct and clear (also for the regulator) justification of the calculation of indispensable revenues and charges. The draft also determines the form of an application for stating proper calculation of tariffs.

The new principles of management and financial activities of enterprises should secure better transparency and the generation of objective and up-to-date information on the situation and price policy of the enterprise. It will be, to a larger extent, possible to compare operation costs of individual enterprises. Cash flows will become more understandable, which will allow, above all, for the elimination of detrimental practices of manipulating with costs, or of hidden cross-subsidizing between plants of an enterprise, or between groups of buyers serviced by that enterprise.

While implementing the processes of price policies restructuring and introducing new price tariffs special attention should be paid to avoidance of sharp price increases so as to avert unwelcome social tensions and disturbances in a timely and effective collection of charges.

According to the originally proposed law, the *gmina*, or a union of *gminas*, would have been a regulatory body competent for approval of tariffs. The point here was to eliminate, first of all, partial, non-economic reasons and pressures exerted by various lobbies. These proposed provisions on confining the *gmina* decisions on non-approval of tariffs by provisions of the law were canceled by the legislators.

The draft also introduced a debatable principle of issuing *gmina* permits for water/wastewater activities. Due to the fact that a central regulatory authority for the sector has not been established so far, the draft law envisaged setting up an Advisory Council for the Chairman of the Council of Ministers. Among other things, its tasks included fine tuning of principles optimizing the system of providing water/wastewater services on the nation-wide scale and giving opinions on typical litigious cases, so as to provide *gminas*, as regulators, a technically rational but formally not binding interpretation of in ambiguous situations, often repeating themselves in many *gminas*. Unfortunately, at the later stage of the legislative process the proposed institution of the Advisory Council was dropped, which will leave *gminas* alone without a comprehensive advice in typical conflict cases. In our opinion this change represent a substantial loss in terms of quality of the systemic regulation of the sector, especially if the 'decentralized regulatory' approach was chosen.

The implementation of provisions of the law on water supply and wastewater disposal is recommended by authors of this report, as it will radically change the system of the sector management and financing, and situation in the field of its privatization, and opportunities for raising private capital for maintenance and development of the water/wastewater sector infrastructure and environmental protection.

The sector will get a proper legal instrument of implementing modern solutions in the field of enterprise management and, in particular, in the field of economic and market principles of conducting operational and investment activity, as well as its financing.

Provisions of this proposed law are consistent with IWSA recommendations and with trends currently found in the EU and are reflected in a new directive which has been currently drafted, introducing a principle of self-financing of (self-reliant) water/wastewater sector utilities, largely on the basis of payments made by buyers of services.

A regulatory system for the sector is a matter still to be settled. Eventually, an institution independent from the local government, such a as a central regulatory authority or a court, should become a regulatory body. Should it not happen, the 'decentralized regulatory' approach, with *gminas* as local regulators—using well defined procedures for verification of pricing requests by enterprises—still represents a major step forward and should be supported by the Parliament.

3.2.2 Energy

Local government laws provide legal foundations for cooperation between local governments, introducing opportunities for setting up municipal agreements and unions.

The Energy law introduces an obligation of giving by the *voivodship* government opinions on *gmina* plans of heat, electricity and gaseous fuels supply, from the point of view of coordination with other *gminas*' plans.

It is estimated that the above-mentioned legal solutions jointly create a legal system contributing to optimization of heat supply solutions thanks to proper inter-*gmina* cooperation.

The strategy of state actions provides for a gradual rise in the role of *gmina*-level governments in energy policy shaping. *Gminas*' powers to draw up and approve plans of heat, electricity and gaseous fuels supply (energy plans) are an important instrument of this policy implementation. These plans determine investment activity of enterprises being obliged to carry out undertakings defined by plans involved, inter alia, with heating supply.

On the other hand, pursuant to the energy law, enterprises are obliged to work out, on their own, long-term modernization and development plans, providing a basis for their investment plans. Investment plans are largely aimed at securing an adequate quality of services and at minimizing costs of heat supply and environmental protection.

Plans prepared by enterprises should be consistent with municipal plans (assumptions to plans) of heat, electricity and gaseous fuels supply.

In the future, to secure effective and optimal implementation of plans drawn up by *gminas* and enterprises (in technical and financial dimension), it is necessary to define more precisely the scope of these entities' powers and the principles of cooperation (including arrangement procedures) between them. This will help to work out a comprehensive and correlated strategy of local energy sector development. This relates mostly to a correlation of municipal planning with similar activity of enterprises themselves, so as counteract making by *gminas* decisions compelling enterprises to carry out infrastructure development tasks being irrational on technical or financial grounds, and incompatible with their plans.

Apart from raising investment funds by way of privatization and drawing credits, there is a need to extend the use of another method of acquiring development funds—by means of issuing bonds, including revenue bonds.

So far, the involvement of leasing and ESCO firms has been insufficient, compared to existing needs and initial indications of demand by *gminas*. Nevertheless, benefiting from this form of

investment capital raising requires emergence, on the domestic market, of reliable firms with appropriate financial assets.

Subsidies have been virtually phased out in the heating supply sector. Low-interest credits from Bank Ochrony Ćerodowska and from the National and *Voivodship* Environmental Protection and Water Management Funds are seen as a limited form of subsidizing.

Abolishment of subsidies and relating the financial management of heating supply enterprises to revenues from charges for heat, reflecting justified costs of providing services, contributes to a better efficiency of the above-mentioned activity.

Low-interest credits, allowing the taking up of environmental protection projects are not always a sufficient instrument of financing reduction of emissions of particulate matter and gasses.

It is necessary to urgently implement to particular heating supply utilities of the principles of bookkeeping in accordance with the provisions of the law on accounting, adjusted to price-setting requirements in the heat supply sector pursuant to the Energy law.

It is required to bring to an end the process of organizing the management of heating supply sector assets in cities, in which the ultimate choice of incorporation form of activity has not been appropriate. It is also recommendable to determine *gminas*' share in the equity of heating supply companies to be privatized in the future. *Gminas*' majority stakes in the equity of these enterprises should be gradually reduced, so that the sovereignty of the decision-making process is not impaired. The government's refusal to approve the proposal, put forward in recent years, of securing *gminas*' participation in the equity of privatized professional heat and power generating plants, should be viewed positively. Otherwise, *gminas* would participate in managing these heat sources.

Traditionally, local municipal heating supply systems are characterized by a considerable centralization of heat generation, transmission and distribution. In some cities, the process of heating supply centralization has not yet been completed. Investment projects which involve linking up to urban heat distribution networks of buildings currently provided with heat, by local boiler plants operated by heat supply companies, or by other users, are under implementation.

Growing competition in the field of heat generation, development of heat sources using renewable energy sources, as well as implementation of third party access to heat distribution networks will contribute to the de-centralization of heat supply systems, being indispensable for emergence of competitive heat markets.

Vertically integrated heating supply enterprises, i.e. utilities dealing with heat generation, transmission and distribution are natural monopolies. Weakening of the monopolist position of these enterprises required separating their particular activities, i.e. heat generation (or purchase), transmission, distribution and sale, as well as assigning costs to particular kinds of activities, providing a basis for setting tariff prices and charges.

The Energy policy of the state focused on development of local heat sources with the utilization of renewable energy sources and third party access to heat distribution networks, are instruments limiting the monopolist position of heat supply enterprises.

Doubts may arise over appropriate performing of regulatory functions by the Energy Regulatory Office (URE), given the considerable dispersion of entities occupied with heat generation, transmission, distribution and sale, and the relatively centralized URE structure (nine branches). It is advisable to carry out regular checks on the performance of regulatory functions by URE in the heating supply sector, in order to introduce possible corrections of the present regulatory system.

It is also necessary to counteract any violations of the URE President sovereignty by State authorities exerting impact on his activity and staffing decisions. This can adversely affect the currently strong interest of private investors, including foreign ones, in investment in modernization of this branch of services.

Public access to heat supply planning information, as well as publication of heat tariffs and URE President decisions in *voivodship* official gazettes, provide heat buyers with information indispensable for evaluation of the operation of enterprises and with opportunities for exerting influence on, inter alia, the heat supply planning process.

The implementation of the Energy law regulations impose on heat supply utilities, an obligation of making the information about the provision of heat supply services available to heat buyers, following the procedure set forth by these regulations.

Further extension of public access to information does not seem to be indicated.

Pursuant to the Energy law, financial costs resulting from investment outlays on environmental protection are justified costs providing a basis for setting heat tariffs.

Furthermore, environmental protection investment is supported with preferential specific purpose credits.

The above-mentioned solutions give an opportunity for taking environmental protection requirements into account at the investment planning stage.

In Poland, the introduction of environmentally friendly fuels (gaseous fuels, heating oil) in the wake of the implementation of modernization investment projects gives rise to numerous cases of increased running costs due to high prices of these fuels. Therefore, in order to keep up the interest of enterprises in environmental protection projects, it is necessary to provide for the re-financing of running costs of boiler plants burning environmentally friendly fuels, the purchase costs of which push up dramatically the costs of generated heat.

An alternative to expensive conventional ecological fuels is use of 'bio-mass' for heating energy generation. This subject requires high attention from both central and local government institutions, not only because of obvious environmental gains, but also due to positive effect on local economic development. Use of locally generated 'bio-mass' as a heating energy fuel, creates income generating opportunities for local producers, which is especially important in the remote rural areas threatened with structural unemployment. The first few complete investments of this sort (municipal heating plants) have been turned into regular use in Poland, for example in 2000 in Jelenia Gora. EU countries are interested in financing such investments based on the agreement that Poland will sell them, in the future some percentage of the 'emissions quota' as per the Kyoto protocol to the Climatic Convention.

For the heat supply sector the implementation of the Energy law provisions established an appropriate legal framework of both the system organization and financing and economic activity of enterprises. It provided real chances for the privatization of many energy sector utilities. In the future they will require fine tuning of the principles of cooperation between particular local government entities and between these entities and sector enterprises in the field of drawing up strategy and development plans will have to be improved.

3.2.3 Waste Management

Due to a specific administrative structure and features of municipal waste management in Poland, many solutions worked out in Western Europe are impossible to apply. After all, there are no universal solutions. Municipal waste management models differ from country to country and are adjusted to conditions resulting from historical, political and economic development of particular states.

Another issue here is the determination of basic principles which have to be fulfilled so that municipal waste management in Poland was found to be consistent with regulations applicable in the EU.

The pace of introducing new legislative solutions and the upgrading of the system in Poland was not adjusted to the speed of changes in the system, especially the rapid increase in amount of municipal wastes.

Hence, so far there had been no proper conditions for the undertaking of comprehensive projects requiring sizable financial outlays. On the other hand, examples can be quoted of places in Poland where the indispensable funds have been raised and undertakings carried out, but at the stage of running the facility serious problems emerge with invested capital return. The solving of problems in the field of infrastructure associated with municipal waste management depends on whether systemic barriers mentioned in part III of the Report can be overcome soon.

The government and Parliament of the Republic of Poland work on a new package of environmental laws, which will make it possible to devise a coherent environmental protection system based on cooperation of various public and private institutions associated with the sector.

At present, intensive work is being carried on creating foundations for such a cooperation. Since the end of 1998, the Ministry of Environmental Protection has been drafting a document known as 'the Second Environmental Policy of the State'. Apart from short-term priorities, it sets forth, inter alia, plans of waste management on the national level and in cooperation with other countries; concepts of creating an integrated network of waste management plants; keeping the average amount of municipal wastes at the level of 300 kg per capita.

Pursuant to a parliamentary resolution, works have also started on 'Poland's Sustainable Development Strategy by the Year 2025'. The Strategy will be an extension of the Second Environmental Policy. Coordination of tasks associated with the balanced development involving all the ministries whose representatives make up the team drafting the strategy is an important element of the current stage of works.

Legislative efforts continue on creation of appropriate regulatory and executive instruments.

The government has prepared and has been successively submitting to the Parliament drafts of the following laws:

- on environmental protection and wastes, with implementing regulations;
- on entrepreneurs obligations in the field of managing certain wastes, on product taxes and deposit charges;
- on packaging and packaging waste;
- the Water law;
- on the environmental impact of assessment procedures, on access to information on the environment and its protection.

For example:

- The Law on environmental protection (more than 400 articles) includes provisions concerning, above all, provisions concerning: integrated permits for economic entities carrying out environmentally sensitive investment projects; principles of setting charges for municipal wastes;
- the Law on entrepreneurial obligations in the field of managing certain wastes, on product taxes and deposit charges introduces new economic solutions for environmental protection financing, and solutions aimed at reduction of the amount of wastes deposited in landfills, at increasing the degree of their sorting and reuse, to be achieved, inter alia, through:
 - making entrepreneurs producing or introducing specific wastes (packagings and goods) obliged to recover and process a specified amount of these wastes, and to pay

finest in case of falling short of the assumed recovery levels (e.g. up to PLN 3 for 1 kg of aluminium packagings);

- setting the rates of recovery of wastes, e.g. 50% of the total amount of packagings introduced to the market in the case of aluminium packagings, and 16% in the case of plastic and multi-layer packaging.

The law sets out methods of allocation of funds made up by product taxes. The National Environmental Protection Fund and *Voivodship* Environmental Protection Funds are responsible for appropriation of these funds. The National Fund will be obliged to co-finance the investment securing the minimization of accumulation of specific wastes, as well as for their recycling and recovery. The tasks of the *Voivodship* Funds will include supporting *gminas* in their environmental policy.

- the Law on packaging an packaging waste is a supplementation to the on product taxes and deposit charges and is aimed at protecting the environment against the stream of packaging waste through:
 - specification of packaging parameters and the principles of dealing with packaging waste, starting from their production, through accumulation, recovery and treatment;
 - specification of obligations and responsibility of producers, exporters and importers of various types of packaging (e.g. product marking, instruction of handling specific wastes), and retail traders (e.g. recycling of wastes);
 - specification of obligations and responsibility of state administration agencies in the field of education and drawing up waste management plans, reporting and creation of databases concerning packaging wastes.
- the Law on environmental impact assessment procedures, on access to information on the environment and its protection, will specify or exert influence on the processes and procedures of the planning and implementation of investment projects, including the principles of cooperation among the investors, state administration agencies and representatives of the society, in order to avoid disputes over environmental and health issues.

These laws are in full conformity with EU Directives and all of them are of great significance for the improvement of functioning of the waste management system and the condition of environmental protection in Poland. All these laws will have an apparent impact on determination of the strategy and further directions of development of the sector, as well as on municipal waste management at all levels of local government entities. Their prompt examination and enactment will allow the stabilization of investment conditions in that sector, along with the upgrading of the standards of pro-ecology actions and of service quality.

The key issues for the new waste management system include: continuation of efforts on working out and consistent implementation of legal, organizational, economic and financial solutions for cooperation between public administration agencies, including supra-gmina ones between local

government entities of various levels (e.g. by means of working out the principles of regional policy), and between these entities, on the one hand, and public and private waste management sector utilities, on the other, within the framework of the so-called public-private partnership. It is also very important in this context to improve the economic efficiency of undertakings by taking advantage of the economies of scale.

Another issue, resulting in a way from implementation of systemic solutions, is securing appropriate financing of activities, especially in the field of investment in waste treatment and recycling, as well as in construction of supra-*gmina* waste treatment plants. This will be rendered possible by securing such conditions of conducting activities in the sector that would be stable and attractive for investors and creditors. Indispensable measures to be undertaken on the enterprise level include:

- broad introduction of the principle of calculating charges for waste management services on the basis of methodology of indispensable revenues of enterprises, providing these services and setting prices on the basis of the principle of self-financing of current operation and investment;
- implementation of instruments of the methodology of internal strengthening of enterprises through introduction of systems of financing and capital planning and state-of-the-art know-how in the field of economics, finance and management.

Infrastructure-related needs of the sector mostly concern the construction of modern waste treatment plants, development of a system of secondary materials recovery, establishment of new landfill sites and construction of new waste incineration plants. One should not forget the costs associated with reclamation or modernization of old waste disposal sites, liquidation of landfill sites not meeting environmental protection requirements, as well as illegal dumping sites and reclamation of environmentally damaged areas.

In the long run, economic activity in the field of waste disposal and treatment should not be conducted by small enterprises. In the case of municipal wastes, profitability of economic activity starts with the level of some 50 000 to 70 000 tons of wastes per year at a price of some PLN 120–150 per ton.

Another very important question is that of what waste disposal techniques should be developed in the future, and which should be abandoned or curtailed. This refers not only to considerations over the engineering side of the process but also to the actual implementation possibilities, estimating the scope of organizational effort, outlays on environmental education, as well as technical, financial and social costs of implementation and operation of specific municipal waste management systems.

Various models are still being discussed by experts. For example waste sorting in Poland does not bring tangible results and, furthermore, it is a very costly method of disposal. It requires professional preparation of objectives and plans, good organization and correlation of actions at

various level of the system, special technological infrastructure, substantial involvement of the population, which also gives rise to specific costs of organization, technological infrastructure, environmental education, and a motivation system needed for shaping the responses of wastes producers.

As regards both to the quantity and kind of municipal waste, composting is not an ideal technology either. It could not be applied on a nationwide scale.

At present, the only alternative to sorting and recycling, as well as the composting of wastes seems to be their disposal by means of thermal methods, with heat energy acquisition and with possible modifications, i.e. their waste-free pre-processing into power raw material (briquettes).

Appropriate conventional and alternative technologies of waste incineration should be developed, taking from other countries' experience and investigating new incineration technologies (e.g. plasm methods). Public discussion on incineration plants, especially with organizations of the 'greens' is indispensable as well, since many stereotypes are perpetuated in this area.

Therefore, regulations pertaining to the construction and running of environmentally safe incineration plants (providing thermal disposal and power recycling of municipal, hazardous and medical wastes) should be drawn up and implemented as soon as possible. Among other things, these regulations will determine the standards of air pollution caused by incineration plants, pollutant concentration in solid products of burning, obligation of effective use of heat generated in the process of thermal recycling of wastes, and depositing of incineration wastes.⁴⁰

Given the above facts, a clear answer should be found as soon as possible on the question of what municipal waste management systems can be applied in Poland on a large scale in both the medium- and long-term perspective.

Poland should implement a principle, at the same time being a EU requirement, of not landfilling unprocessed wastes and, furthermore, a reclamation of land including landfill sites, by means of disposal (removal from soil) of all wastes having a negative impact on the natural environment. The decision is to be made by Poles themselves, as concepts, regulations and practices of waste treatment and disposal techniques are different in different European Union countries.

This process will be facilitated by new environmental protection laws to be successively implemented, also in connection with adoption of various legal and environmental standards applicable in EU countries.

Successful enactment of laws will depend on working out a coherent and effective waste management policy on a nation-wide scale, and on conscious and harmonious cooperation between any administrative and economic entities operating in the environmental protection sector.

Other factors of success in this field include efficiency-oriented restructuring and privatization of enterprises dealing with waste disposal and treatment of wastes, supported by a policy of working out better mechanisms and effective enforcement of requirements determined by local 'waste' regulations, so that the amount of wastes discharged on public areas (in forests, at the roadside) be reduced, and the quality and reliability of the municipal waste collection system, including waste sorting, be improved. This aspect is of basic significance for the assessment of the local government efficiency by inhabitants (for example: whether a *gmina* is tidy or not).

3.2.4 Public Cleaning, Park Maintenance, Municipal Cemeteries

In the analyzed sectors, the hitherto state policy of providing conditions for a full 'marketization' of cleaning and greenery upkeep services should be maintained. The only recommendation to be made here is the consideration of additional regulations contributing to the effectiveness of environmental policy of the state and local governments in the field of the keeping and enlargement of green areas, especially in cities (e.g. investors' commitments to finance certain tasks associated with green areas creation and maintenance, in connection with their undertakings).

The last decade's experience allows the claim to be made that in the analyzed sectors the share of private entities can be effectively increased, and the funds owned by *gminas* should be concentrated on tasks associated with determination of:

- the strategy and standards of the provision of services; and
- monitoring and control principles.

Exchange of experience between particular local governments is an important element of upgrading the municipal services system. It facilitates the creation of standards of provided services, and allows for the establishment of databases on the level of prices for services.

All major economic entities on the local market should get involved in the process of devising the strategy of services provision.

In the case of cemetery services, it is indispensable to adjust the regulations to the present socio-economic conditions. It is necessary to provide precise legal definition, delineation and specification of the scope of competence and tasks associated with cemeteries management and administration, i.e. planning and performance. Due to the competition being suppressed by entities managing and at the same time administering municipalities cemeteries, it seems justified to separate the tasks associated with cemetery management from other kinds of funeral services, so as to counteract monopolization of services. Another disputable matter to be solved here is the separation of powers and obligations between cemeteries' administrators (grave digging lies within the scope of their activities) and funeral homes, organizing funeral ceremonies at these cemeteries and providing inhumation works. This separation also concerns the rights to setting prices and

obtaining revenues from activities.⁴¹ Principles of cemetery services financing should be clearly defined, also including investment tasks.⁴² In the final model, all costs should be covered with charges paid by users (persons entitled to burial of the dead, firms providing funeral services and paying for the use of cemetery infrastructure).

In the future, sorting out the regulations and precise formulation of concepts associated with cemetery services should allow the introduction of new forms of public and private partnership in financing investment associated with the provision of cemetery services.

Another issue here is the determination of a naturalized person's right to have a grave. According to the Ombudsman's Office, the problem of the right to having a grave requires general regulation and lies within the scope of powers of the Minister of Internal Affairs and Administration.

Performance of specific tasks, associated with the carrying out of activities determined by municipal strategy, should be commissioned to private or public entities by way of an auction. Nevertheless, tasks in the field of supervision over the analyzed sectors may be commissioned by *gmina* authorities to budgetary units, or may be performed by a department or a single position in the office structures. For example, such tasks may include carrying out auctions, exercising control over the provision of services in terms of their compliance with specific standards, keeping databases on resources, for example green areas survey data, et cetera.

- The principle of a full 'marketization' of cleaning and greenery upkeep and funeral services should be maintained, with the introduction of indispensable changes in the field of instruments promoting the extension of urban green areas, and adjustment of regulations pertaining to cemeteries to the current socio-economic situation;
- Local governments, by choosing the form of management and organization of the analyzed sector should intensify their restructuring and privatization activities, especially in the field of provision of services.

The authors of this report would like to express hope that its readers will find it to be a reference of an up-to-date, composite and in-depth analysis of the municipal economy in Poland, as well as of success conditions and steps to be taken towards real, sustainable socio-economic development in the national, regional and local scale.

Due to the scope of this report and the variety of addressed issues, and in order to avoid making it too long, the authors have consciously omitted detailed aspects of sector organization, management and financing (almost each of them would have required a vast study), instead, focusing their attention chiefly on these issues and solutions which in their opinion were the most relevant for Poland—its economy, society and natural environment at the end of the year 2000.

Let us also express an opinion that due to the fast pace of changes to economic conditions and to the political and social situation of Poland, the scope of topics covered by the report should be regularly, at least every two years, updated and enlarged.

As a summary of the technical aspect of Part IV and perhaps the entire report, one may say that the progress in terms of providing a better and more cost-efficient municipal services requires equal attention by central and local governments. The central government should improve the legal and regulatory environment to allow for missing private investments in this field and a widest possible competition among service providers, as well as an effective protection of consumers under the natural monopoly situation. On the other hand, local governments should improve management practices and structures, to allow for better efficiency in providing services. To achieve this end local governments should take full advantage of the experience of others in restructuring services and utilizing public-private partnerships. Neither the former did as much as it could, nor the latter fully utilized already existing legal framework. Both carry the same responsibility.

ANNEX

The most important legislative acts of this category are:

- Commercial Code [a new law—the Code of Commercial Companies—will take effect with January 1, 2001],
- Civil Code.

The most important laws enacted from 1990 to 1995 and building the framework of operations in utility sectors are :

- Gmina Self-government Law;
- Secondary legislation to Local Government Law and Self-government Personnel Law, so-called 'Communalization Law';
- The Law on Division of Powers and Responsibilities, as defined by specific laws, between gmina's and central government bodies and amendment of selected laws, so-called 'First Competence Law';
- Constitutional Law on mutual relationships between legislature and executive bodies of the Republic of Poland and on Local Government, so-called 'Minor Constitution';
- The Law on Privatization of State-owned Enterprises;
- The Law on Housing Tenancy and Housing Benefits;
- Housing Ownership Law;
- The Law on Selected Forms of Support to Housing Construction;
- The Law on Counteracting Monopolist Practices and Protection of Consumers' Interests;
- Public Procurement Law;
- The Law on Amendment of Land Management and Expropriation Law;
- The Ordinance of Ministers' Council on secondary acts concerning the transfer of ownership rights in real properties to their existing administrators or users with a legal personality;
- Physical Planning Law;
- Transport Law.

Thoroughly revised laws:

- The Law—the Code of Administrative Proceedings,
- The Law—Labor Code.

During the first half of the 1990s, the foundations of the new self-government administration system were established and, taking advantage of accumulated experience in the management of

municipal utilities, a new phase of the systems reform has been planned and implemented in the years 1996–2000, including a new territorial division and equally important modernization and fine-tuning of legislative framework for the sector of municipal utilities.

The following laws were enacted:

- The Law on Municipal Economy;
- The Law on Commercialization and Privatization of State-owned Enterprises;
- The Law on amendment of specific laws required for the functioning of economy and public administration;
- The Law on Cleanliness and Order Maintenance in Gminas;
- The Law on Amendment of Environment Protection and Shaping and Amendment of Selected Laws;
- The Constitution of the Republic of Poland;
- Solid Waste Law;
- Energy Law;
- The Law on Financing Public Roads;
- Real Estate Management Law;
- The Law on amendment of Building Construction Law, Physical Planning Law and selected Laws;
- Council of Ministers' Ordinance on secondary legislation concerning the transfer of ownership rights in real properties to their existing administrators or users with a legal personality;
- Voivodship Self-government Law;
- Poviats Self-government Law;
- The Law on Introduction of Three-tiers Primary Territorial Division in Poland;
- The Law on amendment of specific laws defining the competencies of public administration bodies, in association with the State systems reform, so-called 'Major Competencies Law';
- The Law on amendment of specific laws in association with implementation of the state systems reform, so-called 'Minor Competencies Law';
- Public Finance Law;
- The Law on Local Governments' Revenues in the Years 1999 and 2000, (in effect also in 2001);
- The Law on Business Operations;
- The Law on amendment of specific laws associated with the functioning of public administration, so-called 'Sweeping Law'.

This already quite extensive body of laws has established firm foundations of the municipal economy business and enabled effective participation of the private sector in delivery of utility services in a manner substantially consistent with the requirements of EU Standards.

Additionally, several new laws have been recently enacted or are impending in the area of economic aspects of municipal services operations, including competition protection, openness in trade, public spending and environmental protection.

The following laws will take effect with 1 January 2001: new Code of Commercial Companies, Law on Business Operations, Law on National Court Register. Other laws affecting business operations are about to be thoroughly revised. A new title on leasing contracts was added to the Civil Code.

These provisions adjust Poland's law to standards prevailing in these areas in European Union countries.

The Civil Law Codification Committee at Minister of Justice is responsible for overseeing the coherence of law-making process, including commercial law. The efforts aimed at amending or codification of the Civil Code, Code of Administrative Proceeding (e.g. in the area of enforcement proceedings) and Bankruptcy Law are about to come to fruition. These changes are primarily intended to simplify, modernize and adjust provisions of law to European standards, while improving trade security.

The Bond Law was amended by introducing new type of revenue bonds that are especially useful in financing infrastructure capital project. Rather than securing the bond debt by claims to specific assets of enterprises or gminas, these bonds are backed by revenues from operation of new assets.

Furthermore, the following laws were amended: the Law on Public Trade in Securities, Accountancy Law, Real Estate Management Law and Tax Law.

In the area of changes in real estate management, the inter-departmental government task force has completed its work on introduction of *cadastral system*—a new market approach to property valuation in Poland—and a new property tax charged on property value rather than its area (the fiscal cadastre is to replace existing tax register maintained by gminas). Property tax reform will be associated with creation of computer data bases with information on real estates. This may well help to make rational privatization decisions and to plan and finance capital projects in the utility sector.

The Codification Committee is developing a new institution of the civil law—the land debt or mortgage which is no associate with particular debt.

The Laws on corporate income tax are being revised, also in the area of depreciation of fixed assets.

Public Procurement Law is considered as a modern legislative act that meets procurement requirements and standards of European countries, including those applicable to services financed from public funds. The Law provides for bidding procedures and paths of appeal against decisions of bidding committees. Law amendments, intended to further modernize its provisions, reflect new mechanisms that help to improve competition and support open and reasonable public spending. Self-government institutions often criticize the Law for inhibiting the flexibility of their operations. It seems, however, that at least some of the criticism is resulting from poor knowledge of instruments available under the Law and inadequate specification of works (TOR).

Competition and Consumer Protection Law (the Antimonopoly Law) is another law thoroughly revised during the past ten years. In fact, it is still being modified in order to ensure compliance with UE requirements and in response to the changing Poland's legal, economic and social environment. At the same time, the efforts of Civil Law Codification Committee have led to amendment of the Code of Civil Proceedings with a view in simplifying, streamlining and expediting the proceedings.

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- ⁶ T. Aziewicz, *op. cit.*, p. 6.
- ⁷ Local governments have to bear both asset replacement and capital costs on a separate basis, irrespective of any subsidies to operating costs of the enterprise.
- ⁸ See: M. Moszoro, *ibid.*, especially in case of Gdansk and Bielsko-Biala Water Utility Companies, as well as in case of Kalisz and Olsztyn city transport companies.
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- ³⁷ "In the field of competition rules the relationship between the Anti-monopoly law and the Energy law is that between *lex generalis* and *lex specialis*. Hence, activities of energy sector enterprises which are allowed by virtue of the Energy law or are subject to administrative regulation by the URE President cannot be regarded illegal by virtue of the Anti-monopoly law," Piotr Jasiński, Współdziałanie organów antytrustowych i regulacyjnych—studium przypadków.
- ³⁸ 'cadastral' is a system of registry of land (i.e. real estate property) necessary for the proper administration of the ad-valorem tax. This system is currently being built.
- ³⁹ *The recommendations presented in section 2.8 are largely convergent with "Średniookresowa strategia działań rządu w latach 1999–2001 w sektorze gospodarki komunalnej"*; a document published by the Office for Housing and Urban Development
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- ⁴² In Anti-monopoly Office rulings examples can be found of financing investments (e.g. crematorium construction) with a surplus obtained as a result of a dramatic rise in charges for some activities.

Romania

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1. GENERAL FEATURES OF THE PUBLIC SECTOR

The basic structure of local government in Romania is defined by the Constitution under which local public administration is to be carried out “{...}in territorial-administrative units{...}based on the principle of local autonomy and decentralization of public services.” These provisions, supplemented by the Law on Local Public administration, provide for the organization of local government on geographically defined administrative subdivisions. These include counties (*‘judet’*), municipalities (*‘municipiiu’*), towns (*‘oras’*), and communes (*‘comuna’*), consisting of one or more villages or hamlets. At present, there are 41 *‘judete’*, 260 *‘municipii’* and *‘orase’* and 2,688 *‘comune’* in Romania. Each administrative unit is constituted as a legal body, having all the rights, duties and obligations assigned to that status by Romanian law.

As the basic units of local government in Romania, municipalities, towns and communes perform both a legislative and executive function. At the municipal, town and communal levels, the legislative function is performed by local councils. The executive operation of local government is carried out by a mayor and a vice mayor. The mayors serves as the principal executive officer of the local government and is accountable to the local councils for the efficient operation of local government.

Local government organization includes 41 *‘judets’* or county-level territorial-administrative units. The function of county government is to “coordinate the activity of Communal and Town Councils, with a view to carry out the public services of county interest”.

The Ministry of Public Works and Territorial Planning (MPWTP)¹ and the Ministry of Public Administration (MPA) are the specialized central administration institutions responsible for developing the overall public service policy and the specific legislation. MPA works on the implementation of the Government strategies and policies in the area of public administration. MPA has links to the local governments through the prefects in each county.

Other ministries, such as MPWTP and the Ministry of Waters, Forests and Environment Protection (MWFEP)² have a specific role as agencies setting the national policies and standards and issuing the environment and construction permits all over the country through their county offices.

MPWTP operates the centrally managed investment program on communal roads and water supply. It applies development strategy and Government policy in territory planning, urbanization, public works and constructions, without interfering with local autonomy.

At a central level, MPWTP has three general divisions, four divisions and a special problems service. At local level there are 42 county inspectorates (specialized in housing, public works, urbanism, and territory planning), and territorial points for buildings statistics.

The Ministry of Finance (MF) has close links with local governments due to the budgetary process and its regulation framework. MF together with the Government issues norms and regulations regarding the revenue sources and expenditure responsibilities of local governments. The budgetary classification for local budgets is established by the Ministry of Finance. MF is also responsible for all the transfers to local governments (equalization grants, subsidies, special funds) through its territorial units (General Directorate of Public Finance and State Financial Control—GDPFSFC). It also monitors the implementation of programs from a financial point of view.

The table below presents the main public service types and the allocation of responsibilities regarding their operation among the public administration tiers.

Table 7.1
Main Public Service Types and Allocation of Responsibilities

| Function | Responsible Authority | | |
|-----------------------------------|-------------------------------|----------------|------------------------------|
| | Central Level | County Level | Local level |
| Telecommunications | x | | |
| Electricity | x | | |
| Gas | x | | x local distribution network |
| Petroleum products pipelines | x | | |
| Postal services | x | | |
| Railway transportation | x | | |
| District heating | | | x |
| Water supply | | x | x |
| Sewerage and wastewater treatment | | x | x |
| Public transportation | | x | x |
| Sanitation | | | x |
| Public roads | x European and national roads | x County roads | x Local roads |
| Public domain administration | | | x |
| Housing | | x | x |
| Public lighting | | | x |

Table 7.1 (continued)
Main Public Service Types and Allocation of Responsibilities

| Function | Responsible Authority | | |
|--|-----------------------|--------------|-------------|
| | Central Level | County Level | Local level |
| Maintenance of parks, cemeteries and green areas | | | x |
| Deposition | | | x |
| Street signs | | | x |
| Street cleaning | | | x |
| Civil status, building permits, etc. | | | x |

1.1 Ownership Regime

Under Art. 135, paragraph (3), of Romania's Constitution, the public property is exclusive, belonging either to the state (public domain of national interest) or the territorial and administrative units. At the same time, the public property is limited since it can only include the assets referred to in paragraph (4) of the same article (underground resources of any kind, communication routes, the air space, waters with a valuable energy potential and those that can be used in the public interest, et cetera).

Consequently, the public property assets are:

- inalienable (cannot be sold freely);
- cannot be subject to any encumbrances;
- not prescribable (cannot be acquired through prescription);
- unseizable (cannot be claimed by creditors).

The inalienability and the unprescribability, being a direct consequence of assigning the assets to a general interest purpose, are applied only as long as the assets remain assigned. Under Law 69/1991 on the Local Public Administration, the Local or County Council is responsible for the administration of the public and private patrimony under its jurisdiction.

The public administration, through an afferent decision, may retire such assets from the purpose for which they were assigned (Article 6 of the Government Ordinance 15/1993). Integrating the public assets in the economic circuit is made through specific methods: administration of public institutions or 'regies autonomes' through concession. Law 69/1996, Article 80 expressly defines the public domain assets of county or local interest, also including the street networks.

The provisions of Civil Code referring to the public domain (Art. 475 paragraph 2; Art. 476; Art. 477; Art. 499; Art. 1310; Art. 1844; and so on) were included in the Code to mark in the general regulation of assets, the assets that are not subject to the common law. However, the private domain of the territorial and administrative units is subject to the provisions of the common law, unless otherwise stipulated in the law. This is a private law regime, when its object involves economic activities, manufacturing facilities which are not public services or land in the private ownership of the state, county, et cetera, which presumes the conclusion of civil or commercial contracts.

The Land Registration Law 18/1991 republished, stipulates the situations when certain land plots will be transferred by law in the ownership of communes, cities or municipalities, as the case may be. Under the provisions of Law 213 of 17/11/1998, on public property and its legal regime, and the provisions of the Romanian Government Decision 548 of 8/7/1999, on approving the Technical Norms for preparing the inventory of the assets included in the public domain of communes, cities, municipalities and counties, the Local or County Councils were bound to nominate the assets belonging to the public domain.

The norm regulating the concession regime for the activities and public services of national or local interest and for the assets in the public or private ownership of the state, county, city or commune, is Law 219/1998, supplemented by the Romanian Government Decision 216 of 25/3/1999 for approving the Framework Methodological Norms for Applying Law 219/1998. The law entered into force on January 23, 1999.

The Romanian Government Decision 216/1999 includes the Methodological Norms establishing the framework content of the concession terms of reference, the guidelines for organizing and conducting the concession procedure, as well as the general framework on the legal regime of the concession contract in applying Law 219/1998.

The concession contract³ is a legal institution with its own distinct characteristics, having a bivalent legal nature—of public, administrative law, and private, civil law. The structure of this contract includes a formal part, dictated by the administrative authority that is subject to a legal regime, and a contractual part comprising clauses that may be negotiated between the parties, and which is governed by the provisions of the Civil Code.

The concession is made, based on a contract whereby a person, called the ‘concessionaire’, transfers for a limited period of time no longer than 49 years to another person, the ‘concessionee’ (this quality may be held by any naturalized or legal person, Romanian or foreign, subject to the private law), acting at its own peril and on its behalf, the right and obligation to exploit a public asset, an activity or a service, in exchange for a royalty.

The assets, activities or services that may become the object of a concession are listed in Art. 2 of Law 219/1998. The activities and services in the private ownership of the state may be concessioned with the approval of the Government, County or Local Council.

The assets in the public or private ownership of the state, county, city, and so on, as well as the activities and public services of national or local interest are transferred directly, by a concession contract, to the companies, national companies or societies established following the reorganization of the 'regies autonomes' (autonomous state-owned enterprises) that administrated such assets, activities or services (Article 40 paragraph 1 of the Law). The contract is concluded by the competent concessionaire authority for a period established through a decision of the Government, County or Local Council on setting up the respective company. In the case of privatizing the companies established following the reorganization of the 'regies autonomes' with a concession contract, the concessionee may require its re negotiation.

The concession is made either by open bid or direct negotiation. In all cases, the concession contract must stipulate the fact that the concessionaire is not allowed to sub-concession, in full or in part, the concession object to another person (Article 28 of the Law). The imperative nature of this provision leads to the fact that the parties are not able to stipulate a contrary clause, under the sanction of absolute nullity.

As it can be noticed, the concession is the most complicated method of entrustment to Romanian or foreign natural or legal persons, since it requires a procedures passing through the County Council, acting as an initiator, the National Privatization Agency, the Ministry of Industry and Trade, and resulting in a Government Decision published in the Official Gazette.

The Romanian Government Ordinance 118/1999, which entered into force on 1 January 2000, establishes the general framework and the procedures for concluding the public procurement contract. The underlying principles of the Ordinance are to promote free competition; the transparency and efficiency of using the public funds; ensuring the conditions enabling every service provider to become a contractor; and giving equal treatment, that is, applying in an indiscriminate manner the criteria for the selection and granting of the public procurement contract.

The Ordinance defines the legal persons subject to the private law, or those that may not act as contracting authorities. They include the legal persons subject to the private law under the influence of the public authority, as having a relevant activity in the provision or exploitation of fixed networks. These networks are aimed at ensuring the public with activities in the field of generation; transport or distribution of drinking water; power; gaseous fuels; heating or hot water; and enjoying special or exclusive rights (in conformity with the provisions of Article 5 and 6, paragraph (1), of the Ordinance).

The public procurement contract may be granted by open bid, limited bid, negotiation or tender. Under Article 93, paragraph (2), once the procurement contract concluded it cannot be modified or annulled, the court being able to grant the plaintiff only the right to compensation payment. This provision may obviously affect the interest of the plaintiff.

The Romanian Government's Decision 755 of 31/8/2000 suspends until November 1. 2000, the application of the norms supplementing the Government Emergency Ordinance 118/1999, therefore until that date, the old legislation on public procurement is applied.

2. PUBLIC UTILITY SERVICES AT LOCAL LEVEL

There are at least three categories of local public services in Romania:

1. General administrative or regulatory services (e.g.: civil status, tutelary authority, building permits, et cetera);
2. Non-exclusive services. The whole community benefits nobody can be excluded from benefiting from such services (e.g.: public lighting, street and sidewalk sweeping, street signs, maintenance of green areas, et cetera);
3. Exclusive services, which are provided to the individual consumers under a contractual arrangement, usually in the form of a subscription contract (e.g.: water supply, district heating, household waste collection and transport).

According to the importance of the service (i.e. meeting the basic needs of the citizens in the jurisdiction), we could list the following main activities within the urban household:

- water supply;
- sewerage and wastewater treatment;
- sanitation;
- heating supply;
- public transport;
- public domain administration;
- other public services;
- housing administration.

The Draft Law on Local Public Services (already passed in the Senate and the Chamber of Deputies) states that the municipal services sector also includes the heating and gas distribution within the municipalities.

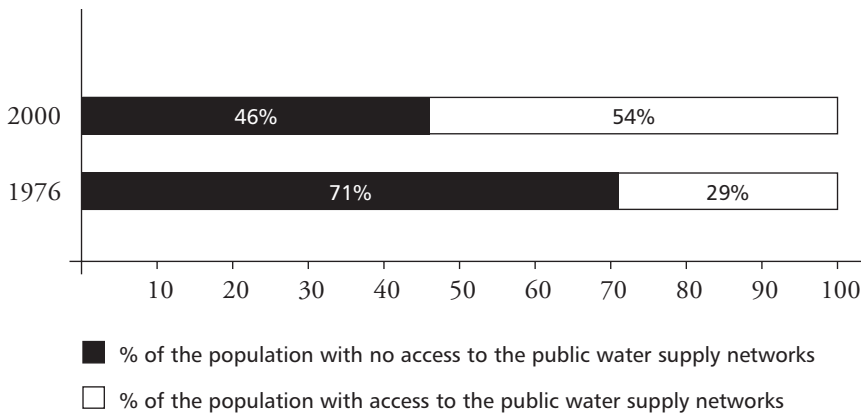
Currently, 2,320 Romanian communities have a centralized drinking water distribution systems, out of which 260 are the municipalities and cities; and 2,060 are rural communities, representing around 16 percent of their total number.

The drinking water distribution networks have a total length of 29,333 km, covering 68% of the total length of streets in the urban areas. The uneven spread of the water resources in the territory, the insufficient degree of flow regularization on the water flows, the significant pollution of some inner rivers, result in the fact that sizeable areas in the country lack sufficient water supply sources, especially in draughty periods or cold winters, when the water supply is cut off for days or the flow is drastically reduced.

Out of a total of about 22.4 million inhabitants, 12.2 million Romanians benefit from the public drinking water network (54%), out of which 10.6 million inhabitants from the urban areas (88%), and 1.6 from the rural areas (16%).

Comparing these data with the figures as of 1976 results in the following evolution:

Figure 7.1
Population with Access to Public Drinking Water Network



The endowment level with centralized drinking water supply systems is clearly unfavorable to the rural areas.

Currently 545 communities have public sewerage networks, which includes:

- 258 municipalities;
- 287 rural communities.

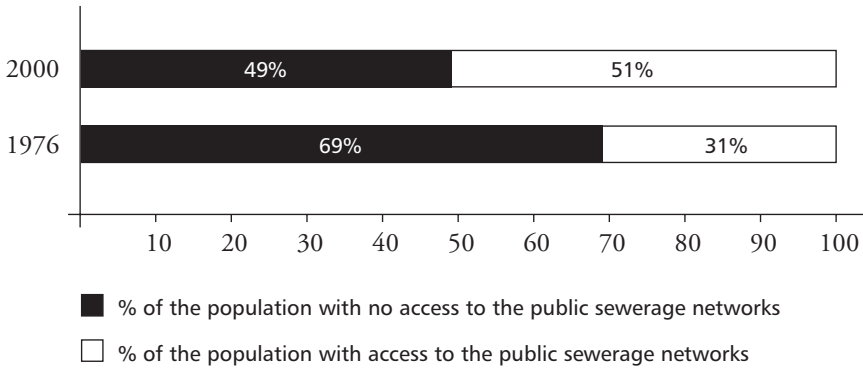
The total length of the public sewerage network is 15 000 km, out of which 14 320 km is located in the urban areas. The length of streets equipped with sewerage pipes is around 10 400 km, covering only 49% of the total length of streets in the urban areas. Only 73% of the streets equipped with water supply pipes also have sewerage networks.

In the 206 wastewater treatment stations existing in Romania, only 64% of the total outflow of the public sewerage networks is treated; 43 urban communities (including Bucharest, Craiova, Drobeta Turnu-Severin, Braila, Galati, and Tulcea), get rid of their wastewater with no prior treatment.

The same as in the case of the drinking water supply, the population benefiting from the public sewerage system is by far more numerous in the urban areas—10.3 million (86 percent)—than in the rural areas—1.15 million (11.2 percent).

As to the situation in 1976, the evolution of this indicator is presented in Figure 7.2.

Figure 7.2
Percentage of Population with Access to a Sewerage Network



Municipal sanitation involves the following responsibilities of the providers of this service: household waste collection and transport, industrial waste collection, sorting and recycling, disposal. Out of the 13 000 existing communities in Romania, only a number of around 2 500 have organized systems for collecting, transporting and disposing the urban waste. The total quantity of urban waste resulted from the communities having sanitation services is about 7.7 million tons per year, out of which 6.2 million tons is household waste and 1.4 million tons street waste.

In Romania there are 1 976 urban waste dumps inventoried, out of which only 15% have sanitary and environmental authorizations. The total area of such dumps exceeds 1 800 hectares. Most of them have an inappropriate location: near inhabited areas; on river banks; on land with low depth ground water; on sandy soils with low stability and with no natural insulation; or in valleys where storm water is accumulated.

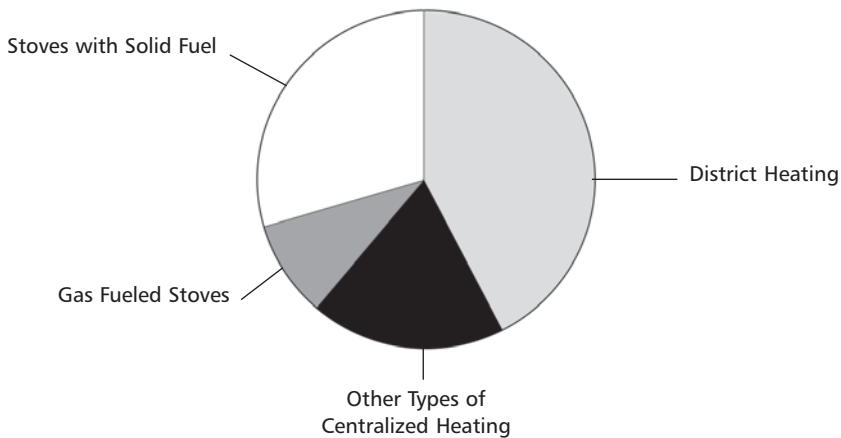
The lack of environmental requirements in organizing the dumpsites as well as the lack of specific equipment for transporting, recovering and recycling result in an inappropriate sanitation apparent in most of the communities in Romania.

In Romania there are public heating and hot water systems in 342 communities, out of which 247 are municipalities and cities, and 95 are rural communities. Through these systems around

36 million Gcal are distributed every year, out of which the household consumption represents 72%. The installations and equipment making up these systems are generally used and obsolete, diminishing significantly the advantages of the generation and distribution of centralized heating. The heating systems used by the population of Romania are mostly centralized in the urban areas (71%), 6.9 million inhabitants being connected to the district heating systems, while 1.7 million are connected to the block or buildings. The individual systems, especially the stoves with solid fuels, are ubiquitous in the rural areas ensuring the heating for 10.1 million inhabitants (98%).

In the year 2000, the split of the population by the type of heating used is as follows (Figure 7.3.).

Figure 7.3
Population Use of Different Types of Heating 2000

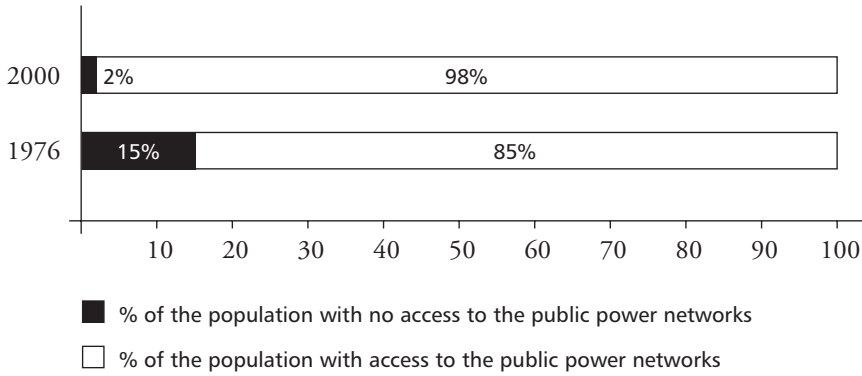


The access to electricity is undoubtedly the most generalized utility for the Romanian communities. Thus, 98% of the communities are connected to the power transport and distribution systems, with the household consumption representing 21 percent of the total.

Currently, the electricity generation and distribution is made by the National Company. The local public authorities have responsibilities only in expanding the low voltage grid for household use and public lighting where such utilities are not available (this is usually a task of the County Council for the communes within that county).

Comparing the situation in the years 1976 and 2000 results in the following chart (Figure 7.4.).

Figure 7.4
Population with Access to Power Networks 1976/2000



The number of communities connected to the national gas transport and distribution system is 528, out of which 152 are municipalities and cities and 376 rural communities. The individual consumption for heating and cooking represents 11% of the total gas volume distributed through the centralized networks.

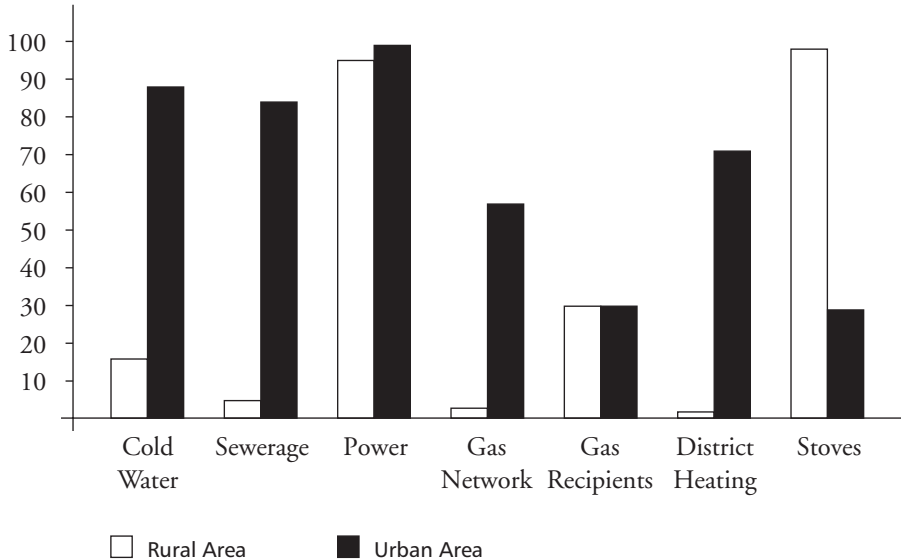
A number of 7.3 million inhabitants benefit from gas supply from the public network, out of which 6.9 million persons are from the urban areas. It should be noticed that another 6.8 million inhabitants use rechargeable gas recipients for cooking, out of which 3.1 million live in rural areas.

Currently, the gas generation and distribution is conducted by the National. The local public authorities have responsibilities only in expanding the low voltage grid where such utilities are not available (this is usually a task of the Local Council).

The existing infrastructure enables the access of the population to the main services presented below in Figure 7.5.

The local authorities also provide a series of important services for their communities including: maintenance and current repairs of streets; street sweeping and snow-ploughing; maintenance of parks and green areas; administration of cemeteries; administration of marketplaces and fairs, dog pounds and so on. These services are generally performed by the own departments of the local public administration, which are frequently named ‘public domain administrations’, and are organized either as budgetary units directly subordinated to the city hall, enjoying or not a financial autonomy, or local business companies or autonomous regies. The share of these services, from the point of view of financing needs, is secondary to the main utilities: drinking water, district heating, household waste collection and disposal, local public transport.

Figure 7.5
Population Access to Main Services



Housing administration includes: administrating the state housing stock; selling the existing housing stock; and building and selling new housing. The city halls own a small number of housing, since in Romania the state owned apartments were sold after 1990 for symbolic prices: fixed prices (from 1990), in 5 year installments and with no interest, since the annual inflation rates between 1990–1993 exceeded 200% and even reached over 300%. Through this mechanism almost everybody acquired their apartments for a low price, under the market value.

This process has had some negative effects, which are now seriously affecting the activity of local administrations. Very low income families purchased their apartments, without being able to maintain them at a normal level, and the installations inside the buildings have deteriorated continuously. In the conditions of Romania, where the heating costs cannot be individualized by apartments (households), this lead to a overall lack of interest for the technical condition of the commonly owned installations (which were indivisible), and the occurrence of very high water or heat losses inside the buildings.

Currently, due to the economic crisis and ongoing transition, most of the families cannot or do not want to repair the installations inside the buildings, and the municipalities are not able to use public funds to maintain private housing units. All these phenomena lead to unjustified consumption and excessive costs with the main utilities per household.

The state or the local administrations have obtained very limited funds from selling the housing stock, which made it almost impossible to build new apartments, since the construction costs have increased at a faster rate than the inflation rate. One of the major social problems in Romania is the scarcity of housing.

3. PUBLIC SERVICE PROVISION

In conformity with the provisions of the Romanian Government Decision no. 106 of 1998, within the Government apparatus was established the Local Public Administration Department⁴. In implementing the Government's policy in the field of local public administration, the Department fulfils amongst others, the task to establish together with the Ministries and the other specialized central public administration bodies, the appropriate measures aiming at solving the local interest matters by the decentralized public services.

In accordance with Article 120, paragraph 2 and Article 121, paragraph 1 of Romania's Constitution, the Local Councils function under the law as autonomous administrative authorities and the County Council is the public administration authority for coordinating the activity of the communal and city councils for performing the public services of county interest.

These provisions are supplemented by the Law 69/1991 on the local public administration, republished in 1996, defining the tasks of the Local and County Councils in respect of the relationship with the companies of local or county interest. Thus, the main tasks of these bodies include:

- administrating the public and private domain of the commune, city, or county and exercising the right provided by law regarding the 'regies autonomes' that were set up by the respective body;
- establishing local companies;
- concessioning/leasing public services or assets;
- participating with equity or assets to companies for performing works or providing services of public interest, in the conditions stipulated by the law;
- appointing and dismissing, under the law, the managers of the local companies and public institutions under their authority;
- establishing specific norms for the local companies and public institutions under their authority whilst observing the general criteria provided by the law;
- organizing effectively and operatively the municipal services, transport, public network services and others, and ensuring their good functioning;

- deciding, under the law, on associating with other local or county public administrations for performing public works or providing public services, as well as collaborating with Romanian or foreign companies for performing activities or works of common interest.

The Local or County Council is authorized to concession and lease the public utility assets and services. It also may establish, organize and ensure the provision of local services either by directly managing them, or by transferring their administration to natural or legal persons based on appropriate contracts⁵.

Public service provision in Romania is carried out at the national, county and municipal levels by ‘regii autonome’ (RA), or autonomous state-owned enterprises. This business form, patterned after the French model, was legally stated in Romania starting in 1990, and serves as the primary mechanism through which local governments “{...}organize public services{...}under conditions of efficiency and operativity, and ensures their proper functioning”⁶.

Under Romanian law, a ‘regia autonoma’ is a legal entity created by the territorial–administrative unit under whose jurisdiction it falls. Local RA can be organized in several sectors of local public utility, network and other services, such as:

- 1) water supply, sewerage and waste water treatment;
- 2) production, transport and distribution of district heat;
- 3) urban public transportation;
- 4) administration and maintenance of housing, markets, fairs, municipal roads, parks;
- 5) construction, maintenance and rehabilitation of county roads and bridges;
- 6) street cleaning and solid waste disposal.

National RAs “{...}are organized and operate within the economy’s strategic branches—armament industry, power industry, mining and natural gas exploitation, mail system, railway transports, as well as in other fields of activity establish by the Government.”

At the local level, a ‘regia’ is a wholly owned operating company, owned by the municipality or the county. The local council appoints boards members. The municipality (county) is financially responsible for the ‘regia’s’ operating results and exercises corporate governance over the region. For providing local services, local governments may establish either public or corporate entities or commercial companies under the commercial code.

3.1 Regies Autonomes

The regies autonomes were defined by Law 15/1990 on the reorganization of the state owned economic entities as legal persons operating based on economic management and financial

autonomy, organized in the strategic sectors of the national economy, as well as other sectors established by the Government, which are set up by a Government Decision (in the case of regies of national interest) or by a decision of the state administration bodies (for the regies of local interest).

The provisions regarding the establishment of regies autonomes stipulated in Law 15/1990 were modified by Law 69/1991 on the local public administration, establishing the competence of the County or Local Councils to set up regies autonomes.

The Ordinance 15/1993 on restructuring the operations of the regies autonomes limits the scope of activity of the regies autonomes requiring the compliance with one of the following criteria:

- being a natural monopoly, in the sense of a manufacturing or service provision activity that due to the need for specific technologies or high capital investment cannot be performed in conditions of normal effectiveness by competitors or entities to become competitors on a short or medium term;
- being of public interest;
- manufacturing goods or providing services that are vital for the national defense and security.

The management of the regie is ensured by an Administration Council appointed by Order of the respective Ministry or by Decision of the Local/County Council. It is compulsory for certain ministries to have representatives in the Administration Councils.

Thus, the regies autonomes administrating public assets and providing public services for capitalizing such assets become legal persons subject to the public law, acting on behalf of the state or the territorial and administrative unit, under its leadership and control. The assets in public property are recorded separately in the patrimony of the regies and in the case of corporatization, such assets cannot become participation to the share capital. Such assets will be concessioned to the resulting business company (under Law 207/1997 for approving the Government Emergency Ordinance 30/1997 on the corporatization of regies autonomes).

Under Law 213/1998 on public assets and its legal regime, the core activities of the local public services such as water and sewerage networks, treatment stations, district heating networks, heating stations and substations, household waste dumps and so on are a part of the public domain of the municipality. This cannot be sold nor can it be used as a collateral, it can only be concessioned to a service operator, either public or private. Thus, the service operator, be it a regie or a business company, either public or private, can only administrate and operate the public domain assets of the municipality based on a concession contract. At the end of the contract period the assets created by new investments by the operator and that are of a public domain nature, enter this domain.

Under the concession law 219/1998, the public authorities may privatize only the operation or administration of a public service and not its assets of a public domain nature.

3.2 Business Companies

Under the provisions of Article 90 of Law 69/1991 on the local public administration, the Local/County Council may set up (with its own share capital or with the participation of other natural or legal persons) business companies, associations, agencies, and may organize other activities for performing local interest works.

Under the Civil Code (Article 1491) the business company is based on a contract by which two or more persons (associates) agree to put together certain assets in order to perform together a certain activity aiming at realizing and sharing the resulting benefits.

Article 3 paragraph (2) of the Government Emergency Ordinance 30/1997 on the reorganization of the regies autonomes approved by Law 207/1997 provides that the resulting companies from the reorganization of the regies autonomes take over the contractual rights and obligations of the legacy RAs, in the limits and conditions established by the individual reorganization administrative norms⁷.

The shares issued by the resulting companies following the reorganization of RAs or the social parts in these companies are owned by the state or the local public administration, as the case may be, and the rights and obligations of the shareholders/associates are exercised by the respective ministries, the local public administration authorities or the State Ownership Fund⁸ depending on the type of the company (Article 5).

In conformity with Article 5 paragraph (2) of the Government Emergency Ordinance 30/1997, 60% of the amounts actually cashed for the shares or social parts sold or concessioned is transferred free of charge to the privatized company and is used preferably for paying the debt and afferent interest and penalties (as the case may be) taken over by the company through the administrative document for reorganizing the respective regie autonome.

The total debt, reviewed and endorsed by the Ministry of Finance for each privatized company, will be written off in total, unless it exceeds 60% of the amounts actually cashed for the shares sold or the social parts concessioned under the provisions of Article 6 paragraph (4) of the Government Emergency Ordinance 30/1997.

The Romanian Government Decision 360 of 2/7/1998 regulates the situation of the local RAs benefiting from external loans taken by the Romanian State from the International Financial Institutions—EBRD, IBRD, EIB, the Social Development Fund of the Council of Europe—that are subject to reorganization, under of the Government Emergency Ordinance 30/97, approved and modified by Law 207/97. Thus, such regies may maintain their current status for their overall operations or, as the case may be, only for the activity or activities financed through external loans.

The RAs maintaining this status following the reorganization will be corporatized within 3 months from the enactment of the regulations on the public property, the concession regime and the local public finance, with the endorsement of the funding bodies regarding the change of their legal status.

The Romanian Government Decision 563 of 20/7/1999, on the national privatization strategy for 1999, stipulates that the sale of company shares owned by the State or local public administration bodies to natural and/or legal, Romanian or foreign, persons may be performed by all the methods regulated under the legal provisions. The provisions regarding the local regies autonomes that have not been corporatized due to the ongoing credit contracts with the International Financial Institutions with sovereign guarantee are maintained.

The Decision lists the main objectives to be envisaged in restructuring this sector (finalizing the transformation process, clarifying the patrimony of local regies, concluding concession contracts between the local public administration and the service providers, establishing a specialized bank financing investments in the field, regional development of the municipal services).

In Romania there are approximately 400 public service operators, organized in regies autonomes, business companies and public services within the structure of Local Councils. They have also organized themselves in non-governmental, employers' and professional structures (the Public Service Employers' Association—PSP, the Romanian Water Association—ARA, the National Committee of Heating Distributors—CNPDETR, the National Committee for Sanitation, Hygiene and Environmental Protection—CNSIPMU, and the National Housing Committee—CLR).

From the perspective of the current regulations, there are three factors playing a major role in the organization, functioning, coordinating and control of the activities included in the urban administration sector: the service providers (regies autonomes, companies, autonomous public services), and the local and central authorities.

Most of the roles and obligations of the service providers are stipulated in the norms adopted prior to 1989, the most specific legal framework being ensured by the Law 4/1981 on Municipal services.

The first post-revolutionary reorganization of the local public service entities was based on the provisions of Law 15/1990 and the Government Decision 1330/1990. This should have been the basis of the reform of this sector, aimed at establishing the adequate framework for the market economy and the rule of law in Romania.

The decentralization of the local public services, continued and applied by the provisions of the Government Decision 595/1992 and Law 135/1995, was characterized by the dereliction of the excessive centralism, the rigid administrative and bureaucratic guardianship of the former state

power bodies in managing this sector. In the light of the local autonomy and public service decentralization principles, the former municipal services enterprises and holdings splintered off, resulting in regies autonomes (RA), companies (SC) and public services within the structure of local or county authorities.

From the enactment of Law 15/1990 until today, the number of local public service providers has increased almost seven times (the current number of service providers is around 400). The structure by types of legal status and the impact in the public service sector is presented in the Appendix.

The central public administration has, in relation with the urban administration activities, merely a guiding and coordination role, for establishing the overall policies for achieving the strategy in the government program.

The passage from the theoretical role of the three factors to the assumed role in the operation of this sector of the social and economic life is a different matter altogether. Thus, the material operations are mainly performed by the economic entities, regies autonomes and companies. The new economic framework in which they are forced to operate makes them difficult to find the balance between their role as service providers, operators of the municipal infrastructure in the public domain on one hand, and business companies, a pawn in the fight for existence of the market economy. This is why, in the case of the regies autonomes and the companies operating in the urban administration sector, we need to take into consideration at least the following three dimensions:

- the degree of dependence to the local public administration authorities in establishing the methods for achieving their operational goals;
- the decision making power on the patrimonial elements they administrate;
- the degree of monopolization of the market determined by the first two dimensions.

The local public administration assumes a different role, on a case by case basis, in monitoring the specific operations of the urban administration and their development. This degree depends mainly on the degree of knowledge, the scope, the political interests and the financial capabilities of each municipality. The increased local autonomy is directly proportional to the evolution of the public service decentralization. The latter is related to the need to make the public action more effective by bringing the administration closer to the citizens. We believe, however, that rather than understanding the administrative decentralization as being absolute, denying the role of the central administration and its specialized bodies, it should be perceived through references to and in correlation with them.

From here the role of the central bodies of the public administration, which should decide the pace of transferring the competencies to the decentralized territorial entities, should develop and monitor the general guidelines regarding the operations of the local service providers.

4. MANAGEMENT PRACTICES OF LOCAL PUBLIC ADMINISTRATION

In the rural areas, the Local Councils usually administrate the communal roads, public lighting and street cleaning. The other public services are quite seldom in the rural areas, they being administrated by county regies or companies. A rural city hall has very few employees, most of the time 7–8 staff, usually with high school education. The main concern of a rural city hall is to persuade the County Council to promote major investment works on its territory, be it the maintenance and upgrading of county roads and their afferent bridges, developing gas or water networks (except for sewerage), which are the main services and utilities concerning the rural Local Councils. On the other hand, the budgets of these communities are extremely low failing to cover in very many cases the city hall's operational expenses. For this reason, they depend to a great extent on the balancing amounts allocated by the County Councils based on certain criteria, most of the times not very transparent.

Most of the utility infrastructure in Romania is concentrated in the urban areas, which results in a much greater involvement of the respective Local Councils. We should analyze separately the situation of the little towns and the cities with over 50 000 inhabitants. We should notice that prior to 1989 at the county level, there was only one municipal services enterprise, which was responsible for all the public services and utilities and had various facilities in different cities within the county. After 1990 these structures have been decentralized within the reform of the local public administration.

In the case of the towns with less than 50 000 inhabitants, the public utilities and municipal services are usually provided by entities subordinated to the city hall, which is called public service under the administration of the city hall. They handle both the district heating system and the drinking water distribution, sewerage, street cleaning and maintaining, household waste transport and disposal. In other cases yet there is one company (or regie) dealing with all these services.

The municipalities with over 50 000 inhabitants and especially the county capital cities have a much better situation. The main explanation is the fact that their economy has coped much better with the transition, which is emphasized by the application of the Local Public Finance Law: there are counties where the capital city represents 70–80% (even more) out of the fiscal capability, while its population represents only 25–40% of the total population.

The public utilities are provided by autonomous entities, organized in the form of regies or business companies, and subordinated to the Local Council. From the organizational point of view there are two types of such structures:

- a single company/regie providing all the public services: water and sewerage, district heating, local public transport, household waste collection, transport and disposal, street maintenance, et cetera;

- specialized companies/regies in providing a certain public service. This form was imposed by the need to separately record the service costs, to avoid the transfer of resources from more profitable activities (water and sewerage), which are not subsidized, to less efficient ones: district heating, local public transport, which are being heavily subsidized.

The Local Councils control the operations of these entities, they appoint the representatives in the General Meeting of the Shareholders (AGA), in the Administration Councils and appoint the commissions to select the manager/administrator. This influences the analysis of the operations of these public utility regies or companies—most of the times the strictly economic criteria are replaced by social criteria: the tariffs should be the lowest possible, even if the profit disappears and the investments are cut to zero, the workplaces are safe (in fact the employees of such entities are a sort of civil servants). This does not improve the social status of the consumers: the tariffs are increasing dramatically, the service quality does not improve, losses are high and are born in one form or another by the consumers.

The Romanian legislation makes no clear distinction between the types of utilities provided by the Local Councils and the County Councils. This is why there is a lot of overlapping, confusion and conflict between the two tiers of the local public administration. Usually, the County Councils deal with the maintenance and upgrading of the county roads and the regional water supply systems. On the other hand, the County Councils also coordinate any infrastructure investments made by the rural Local Councils, thus their influence in this field is higher than it may seem at first glance.

The policy of the local public administrations in the field of public utilities suffers from the lack of a coherent strategy, with clear priorities that can be followed on the medium and long term. Generally speaking, the Romanian local public administration has no local development programs, no set of priorities on the public service provision, because on the one hand the funds for such investments are insufficient, and on the other hand, there is no experience in developing in designing coherent and feasible infrastructure investment programs.

4.1 Local Public Finances

As part of the process of decentralization in Romania that began in 1990, local governments have become increasingly responsible for addressing the needs of the local communities in the country. The reforms to the system of local finances enacted in 1998 reinforced the trend toward greater autonomy. These reforms gave local authorities greater control over their own taxes and fees, as well as direct access to a share of the national wage tax. The reforms also gave the local and county councils full authority to decide how to spend and invest in these resources. These changes have increased the importance of making sound financial decisions at the local level.

In particular, the Law on Local Public Finance (LLPF), adopted in 1998, put local finances and the local budget process on an equal legislative basis with those of the national government. The law also introduced tax revenue sharing in Romania. Under the new arrangement the county and local councils receive a share of the income taxes collected from taxpayers in their geographic area of jurisdiction.

Amendments to the Law on Local Taxes and Fees authorized in 1997 and 1998 greatly expanded local control over their own revenues and authorized local councils to administer their own taxes. These changes are relatively less important for county councils, as virtually all-local taxes are paid to the local councils.

The new legislation also greatly simplified the transfer system. All dedicated transfers for operating subsidies of public service companies and investment subsidies to the local and county councils from the state budget were eliminated. The general transfer was replaced with an ‘equalization grant’ that aims to correct for differences in expenditure responsibilities and fiscal capacity among the county and local councils. The equalization grant is funded through a transfer from that State budget that is allocated directly to the county councils for redistribution by them to local councils in their area of jurisdiction. The state budget also specifies the amount of these equalization grants that the county councils may retain for their own use, within a limit of 25% set in the LLPF. The reforms also reduced the authority of the national government to approve local investment projects to larger projects above certain minimum cost levels, and to those funded partially or fully by the state budget.

4.1.1 Local Government Revenues

Own revenues:

- current revenues: property tax, tax on profit and tax on the net profit of the locally subordinated companies and public institutions, other direct and indirect taxes;
- capital revenues;
- special purpose revenues: special fees, fixed capital depreciation, donations and sponsorships, targeted grants from special state funds: (grants for roads, for housing).

Transfers from the State Budget:

- wage tax share (and starting with 2000, the global income tax share)—this shared revenues are distributed as follows: 40% to the local level, 10% to the county level and 10% represents the equalization fund, at the disposal of the County Council, for the communities with deficit within the county, and 40% to the State Budget. The territorial bodies of the Ministry of Finance make the transfers within the first 5 days of the month for the amounts

collected the month before. This represents the source of revenues for the County Councils and in many cases for communities within the county. The above shares may be modified by the Annual State Budget Law, as it happened in 1999 as well as 2000, when the share of municipalities was lowered to 35% in favor of the equalization funds at county's level, whose share became 15%;

- Shared wage tax amounts (and starting with 2000, shared global income tax amounts)
Out of the shared funds from certain revenues of the state budget annually approved, a part up to 25% shall be assigned to the own budget of the Judet council, and the difference shall be distributed to territorial administrative units by the Judet Council;
- equalization grants, calculated according to a formula established in the Annual State Budget Law;
- targeted grants (for subsidies for heating);
- special purpose grants from the Ministry of Finance, representing the contribution of the Romanian Government in projects funded through external loans (such as the Municipal Utility Development Program, partially funded through EBRD loans).
- public utilities: water, sewerage, water treatment plants, heating, waste collection, transportation and storage, local public transportation and other communal services;
- social housing and housing for youth;
- maintenance, upgrading, investment transportation, infrastructure: streets, communal and county roads, airports;
- social assistance: social aids, heating and transportation subsidies, social assistance for persons with special needs (disabled), social assistance for children in difficulty;
- material and investment expenditures for primary and secondary schools;
- health care institutions;
- wages, material expenses, investments for local cultural institutions: theatres, philharmonic orchestras, museums;
- wages for administrative staff.

The new legislative framework leads to an increased financial autonomy, and made the fiscal decentralization process more effective. A genuine 'revolution' of the budget management was orchestrated, since the local budget revenues are to a greater extent controlled by the local governments, directly reflecting the status of the local economy (for example, the share of own revenues has increased from 25% in 1998 to 51% in 1999), the range of responsibility has widened, and local investments have become decentralized. In addition to this, starting with 1999, the local governments have established their own departments for administration of local taxes and fees.

4.1.2 Local Government Expenditures

In the new context created after 1999, the concerns of the local governments have also dramatically changed. If until then local governments were merely administrators of a budget that was mostly coming from the central level, now local governments have a bigger incentive to manage more effectively and efficiently local resources, focused on boosting the development of the local economy as a basis for increasing their own revenues. This is possible since the local governments have the legislative framework that enables them to develop their own financial policies, targeted on the outcomes and goals they establish.

In fact, one of the major challenges faced by the local governments in Romania is to meet the huge investment need in infrastructure and public services. For example, a municipality with over 100,000 inhabitants needs around 10–15 budgets, as of 1999, for aforementioned extremely urgent investments. Such an investment program cannot be supported from revenues per capita usually varying between USD 30–80, irrespective to the number of projects funded by the Government, the European Union, the EBRD or the World Bank.

Enforcing the new legislative system increased the degree of fiscal decentralization, but also increased the discrepancies between the major municipalities, county capitals in general, whose local economy allowed them to double their total revenues from 1998 to 1999. The small communities (under 30 000 inhabitants), especially those in the rural areas, with no local economic resources, are still highly dependent of transfers, that represent the most important part of their total revenues. For this kind of local governments the new fiscal system brought a dramatic decrease in their revenues, due to cut of received transfers: they shrank from 16.1% of the central government's expenditures in 1996 to only 10% in 1999. Besides the already known horizontal imbalances between the counties, increased disparities were registered among the local governments within the same county due to the gap between the economic strength of the county capital and the other localities (in most of the cases the county's major city mobilizes over 80% of its fiscal capacity).

The quantitative and qualitative indicators of the local budget expenditures for 1999 are presented in Appendices 2 and 3.⁹

Conclusions:

- a) It should be mentioned here, the low level of local budget expenditures per capita for 1999, an expression of a weak economic activities. Thus, the national average is USD 59.8, with a peak for municipalities of USD 80.2 and a very low level for the rural areas—only USD 21.8. The total local budget expenditures per capita for municipalities exceeds the commune expenditures 3.68 times, reflecting the economic public utility infrastructure gap between the urban and rural areas;

- b) It is surprising how close the shares of the capital expenditures in the total local budget expenditures are, between 23.43% and 20.28%. The absolute gaps among municipalities, towns and communes are maintained here, too, the same in the case of total expenditures; for instance, the ratio between municipalities and communes for investment expenditures is 400.75%, while the municipalities make 59.57% of the total investment expenditures made from the local budgets. However, it should be noted that the municipalities, although having budgets per capita almost 4 times higher than the communes, have a very close investment rate: 22.06% and 20.28% respectively;
- c) The review of allocation of expenditures for subsidies by local administration types shows the extreme concentration of public services in the municipalities: they cover 88.12% of the total subsidies paid from the local budgets, and 92.37% of the overall urban areas. For this type of expenditure, the ratio between municipalities and communes, towns and communes, and municipalities and towns is 7,976.38%, 1,615.69% and 493.68% respectively. The communes cover only 1.12% of the total subsidies paid from the local budgets, which represents a closer image to the share of the rural area in the public utility services such as district heating systems or local transport. We should notice that the larger urban communities such as the municipalities (with over 25,000 inhabitants) pay subsidies per capita almost 5 times higher than the smaller towns;
- d) In the case of municipalities we should notice that the share of subsidies in the total budgets exceeds the share of investments: 31.5% and 22.06% respectively, which reflects the huge burden they represent for the urban community finance.

4.2 Tariffs and User Charges

The user charges are in the case of local public services in Romania tariffs or prices established either by the operators or central administrative bodies or the government. In this situation, the revenues made are not part of the local budgets, they are used directly by the operator. The local public administration may establish special taxes to provide a certain public service and the amounts collected from this source may be used only for financing the respective service.

The Law 69/1991 on Local Public Administration and Law 189/1998 on Local Public Finance stipulate that for operating the public services the Local or County Councils may establish special taxes. Their rate is established on a yearly basis depending on the invested amounts and the current expenses for maintaining and operating such service. The public services of local interest performing economic activities are bound to calculate, record and recover the wear-and-tear and obsolescence of the afferent assets to such operations through tariffs or fees (Article 47 of Law 189/1998). The amounts resulting from depreciation are used as financing sources for the investments in the respective field and are recorded separately in the investment program.

The establishment of fees and tariffs charged for providing public services is regulated by Law 21/1996 on competition, whose provisions are supplemented by the norms issued for regulating the activities in the field of water, heating, power, et cetera.

The fees and tariffs charged by the regies autonomes as well as those charged for the activities with the natural monopolies are established with the endorsement of the Competition Office, under the provisions of Article 4 of the Competition Law 21/1996. Such provisions are supplemented by the Government Emergency Ordinance 7/1998 of fees and tariffs for the performed products and provided services domestically within activities with the character of a natural monopoly, approved by Law 88/1999, and the norms issued for regulating the activities in the field of water, heating, power, et cetera.

The Government Emergency Ordinance 162/1999 Article2 (1) stipulates that the national reference price for the heating supplied to the population through centralized systems will be established by Government Decision, upon the proposal of ANRE (the National Energy Regulatory Authority), with the endorsement of the Competition Office. An example in this respect is the Romanian Government Decision 879/1999 establishing the national reference price for the heating supplied to the population through centralized systems.

Law 143/1999 on state aid, which entered into force on 1 January 2000, regulated the methods of the authorizing, granting, giving and monitoring of state aid. The state aid includes among others the price cuts afferent to the services provided by the public authorities or other bodies administrating state resources.

The billing of local public services to the subscribers is usually made on a monthly basis. Determining the billed consumption is based on reading the meters, around 30% in the case of district heating, while the rest is determined on a lump sum basis. There are some municipalities that have finalized the installation of individual meters, so that the entire water quantity is billed based on reading the meters. Significant progress has also been made by some municipalities in the case of district heating. There is an increased trend of installing meters at the door of an apartment. The continuous deterioration of the purchasing power of citizens has had a negative influence on the payment for such services, such as the average delay of outstanding debts, which is around 140 days. The financial blocking affecting the industrial consumers results in a similar situation at this category of consumers.

Introducing the Value Added Tax starting 1 April 2000, resulted in increasing the value of bills charged to the population by 19%. The payment system of the VAT to the State Budget, corroborated with the delays in paying the bills, produces a negative cash-flow in the treasury of the service providers, with a major negative impact on their financial results.

The tariff system for these services is still subject to the centralized control. The local public service expenses represent 24% of the minimum basket, according to the National Indexation

Commission, as of July 2000. The tariffs are established based on the historical data principle, through a mechanism discouraging the efficiency measures. The hyperinflationary environment, the delays in approving the tariff increases also diminish, to a significant degree, the financial profitability of the service providers. An encouraging breach was made by introducing in the EBRD loan agreement a clear formula for adjusting the tariffs to the inflation for the cities included in the MUDP Project, and a long term mechanism in the concession contract for Bucharest.

Delayed payment of bills, especially for the heating and drinking water distribution is a problem. Arrears hinder the mobilization of funds from the depreciation of the fixed capital. It should be noted that there are municipalities where the average collection period exceeds 200 days, which at the 40% inflation rate per year could mean a 25% devaluation between issuing an invoice and its collection. This blocking has several causes: the impossibility to individualize the costs by each family; cutting the bad payers off the system; and the high cost of the services provided. The exaggerated production costs generated by the bad technical condition of most networks and installations, inefficiency of big centralized systems, the monopoly situation characterizing both at the national and local level such public services also influence user charges. For instance, for the current prices for heating, hot water and drinking water, the costs for such services will amount in a winter month for a 4-person family with two average salaries living in a 3-room apartment, approximately 25% of their incomes. If we add up the power, telephone and other important bills, all these costs exceeds 30% of the monthly incomes, which is relatively high.

The possibilities of the local public administration to have an autonomous social policy, complementary to the public utility policies, are rather limited in Romania. The establishment of prices for drinking water, the reference price for heating, the levels and thresholds for granting the heating aid are the responsibility of central authorities. In this situation, the local authorities only fund the costs of a social policy established at the national level. The most important implementation mechanism of a social policy in the field of public utilities is the financial aid for heating granted to disfavored families. This system creates a very significant discrimination from the beginning: only the families whose housing units are connected to the district heating systems benefit from this aid, thus implicitly recognizing the exaggerated costs and ineffectiveness of this public service. Consequently, wide population categories cannot benefit from any support from the local authorities (practically all the inhabitants of the rural areas or those living in individual houses with own heating systems in the urban areas).

This financial aid system stipulates that depending on certain income thresholds, of income per family member, the local budgets will cover a part of the heating costs every year between November and March. The income thresholds and the level of the aid per family are established annually through a government decision. The families who may benefit from this support will only pay the difference between the actual heating cost in a month and the aid level, rather than receiving money, and the municipalities will disburse the heating supplier. The system functions quite hard and supposes the co-operation of the city hall with the owners' associations, since the families who may benefit from this aid must fill in special applications with their net incomes. It

is almost impossible for the city halls to control the accuracy of these statements. This system has been functioning since 1997, with an interruption in 1998. For the months November 2000 to March 2001, the income thresholds and the level of the financial aid were first established in October 2000 and amended in January 2001 as follows:

Table 7.2
Social Assistance by Level of Income

| October 2000 | |
|--|-----------------|
| Net Income by Family Member [USD] ROL/USD Rate = 26,454 ROL = 1 USD | Aid Level [USD] |
| -22.7 | 17.0 |
| 22.7-28.4 | 9.8 |
| 28.4-37.8 | 4.9 |
| January 2001 | |
| Net Income by Family Member [USD] ROL/USD Rate = 26,454 ROL = 1 USD | Aid Level [USD] |
| -26.5 | 19.3 |
| 26.5-32.1 | 11.3 |
| 32.1-41.6 | 5.7 |

These values need to be correlated with the average monthly net salary in Romania, which is around USD 90, and the level of maintenance costs for a winter months, which may reach over USD 40 for a family of 4 persons living in a 3-room apartment. Depending on the economic condition of the urban areas, around 40–60% of the families living in apartment blocks benefit from the system.

The above mentioned system has certain advantages:

- the financial support is punctual and aims at disadvantaged families;
- a rather high share of the urban population benefit from the system and the aid covers over 50% of the maintenance costs in the winter months for the poorest families.

Disadvantages are:

- the system is rather complicated and difficult to control;
- the municipalities cannot adapt the system to the local economic conditions;
- the local budget burden is significant (it can reach 10% or more of the total expenditures) as well as difficult to predict; as we mentioned, the government modifies the income

thresholds and the aid level when and how it wishes, without providing additional financial sources to the local authorities;

- over half of the population of the country does not benefit from this system, especially the very poor categories from the rural areas.

5. ECONOMIC PROFILE OF THE PUBLIC UTILITY SECTOR

The economic and financial profile of the local public service sector in Romania is not fundamentally different from the overall economy. The fluctuations recorded by the Romanian economy between 1990-2000 have also influenced the financial status of this sector. Although there is no national system centralizing the financial statements of the local public service providers, from the statistical data at hand we may draw the following conclusions:

The sector's turnover is around ROL 50 000 billion (USD 2 000 million). The financial results of the service providers are very different from one city to the other. Very few of them make reasonable profits (5–10%), most of them have a profitability of +/-2%, yet there also some companies in extremely difficult financial situations, when the loss represent 10–20% of the turnover.

The calculation of the depreciation, mostly from the perspective of the changes to appear following the transfer of water, sewerage, district heating, public transport, and such like systems to public ownership, considerably reduces the development funds of the service operators.

Different forms of financing are used for current operations and capital investments. Services fully financed by allocations from the local budgets (no matter whether these are municipalities or counties) are: maintaining and upgrading streets, communal roads, county roads, street cleaning, park maintainance. It has been ascertained that these are services with a high degree of externalization, this being the main reason for which they are fully funded from the local budgets. Such services are provided either by regies/companies subordinated to the local public administration or by services established within the local councils.

Services fully financed by fees or tariffs paid by consumers are: drinking water distribution, wastewater collection and treatment, household waste collection, transport and disposal. The tariffs for these services have different regimes: while the tariff for waste collection, transport and disposal is fully liberalized, the tariff for drinking water and sewerage is controlled by the Competition Office. The companies or regies providing such services may adjust these tariffs depending on the evolution of the inflation rate, and based on a historical structure of the production costs. This methodology hampers the funding of major investments in the drinking water, sewerage and wastewater treatment sector in Romania.

In the urban areas, these services are provided by regies or companies and rarely by services within the city halls. The prices for such services are controlled and may be adjusted only upon the agreement of the Competition Office or the National Energy Regulatory Authority (ANRE), following the negotiation between the service providers and the local councils. Since the two services differ from this point of view, we need to analyze them separately.

The district heating tariffs paid by the population are determined by the policy of the major public utilities: CONEL (Termoelectrica), ROMGAZ and PETROM, which recommend the basic tariffs for the steam generated in heating plants and used in the district heating systems, for gas and light fuel. These tariffs are endorsed by ANRE and approved by a Government Decision. At the same time, the Government establishes a national reference price (maximum price) by Gcal for the population connected to the centralized heating distribution systems.

It has been noticed that the leverage of the local companies or regies is extremely limited, since the local tariffs, which are also approved by ANRE, are strongly influenced by the prices established at the national level (usually to a degree of 65–70%). Moreover, if the local tariff exceeds the national reference price, the difference is born from the local budget through a subsidy granted to the producer, which represents in many municipalities an additional burden to the local budget of 25–30% or even more.

Subsidized services are district heating and local public transport. In the case of the district heating distribution there are two types of subsidies:

- a) subsidy to the producer, calculated as the difference between the local and national reference price (that is the one paid by the consumers). This subsidy is paid out of the local budget, either from own resources or from equalization grants from the State Budget. This subsidy raises a series of issues:
 - a uniform social protection for all individual consumers, irrespective of their income, which leads to extremely high costs;
 - the burden for the local budget is very heavy, since in many cases this subsidy exceeds 25-30% of the expenses, especially in the smaller towns or those using light fuel for heating. The balancing amounts allocated from the State Budget for this purpose (similar to the social protection transfers prior to 1999) are insufficient and delayed;
 - the subsidy level, thus the level of the local budget resources allocated for this purpose is determined in a decisive manner by the decisions made by the national companies—CONEL, ROMGAZ and PETROM—which has a negative influence on the capability of the local public administration to follow a coherent financial policy in this sector.
- b) the financial aid granted to the low income families during November-March for heating. Such aid is in fact a subsidy to the most affected categories by the price increase. It is granted according to the net incomes of a family, and even if its practical argumentation is not

perfect, this system is more effective than the subsidy to the producer. Granting such a subsidy contributes to the diminishing of the financial blocking. (see Chapter 4.2 below)

The national reference heating price has a double function:

- to establishes the maximum price that the population can pay, in case the local price exceeds the reference price. If the local price is smaller than the reference price, the population pays the local price;
- to establish the manufacturer subsidy paid from the local budget in the case when the local price is higher than the reference price. The subsidy equals the difference between the local price and the reference price and is paid directly by the local administration to the heat supplier.

There are cases when light fuel is used for heating when the reference price does not present more than 30–35% of the local price, leading to blockages in the public service provision, taking also into account the fact the inability of the local councils to cover in full, and in due time the subsidy to the producer. Except for the drinking water and heat price, the price of all local public services are established either by the local operators (household waste collection) or the local administration (local public transport).

The subsidy for the local public transport is regulated by the Government Emergency Ordinance 97/1999, modified by the Government Emergency Ordinance 148/2000, and is paid out of the local budget. The prices are approved by the Competition Office for the companies benefiting from subsidies from the State Budget, and by local administrations in cases where they have established (defined and regulated the routes and other operation conditions) the public transport service.

If the local public transport is not provided under a regulation by which the local administration had defined the public transport service, and no subsidies are granted, than the operator (company/regie) is free to establish the price. In general, the Competition Office accepts the adjustment based on the inflation rate, based on a methodology privileging the situation and historical structure of the tariffs in the field. This makes it extremely difficult for finance projects to upgrade the vehicles, which are quite obsolete.

We should notice that the new regulation provides, through the amendments brought in by the Government Emergency Ordinance 97/1999 and the Government Emergency Ordinance 148/2000, a decentralization of the decision making process and provides the local authorities, who have defined and regulated the local public transport service, also with the necessary economic leverage to develop a coherent policy in the field. This example should be expanded to other public services with controlled prices.

The calculation method of the subsidy takes into consideration the difference between the estimated number of users and the actual number, and the difference between the tariff established

in commercial condition and the imposed tariff. The subsidy volume varies depending on the size of the municipality, the number of users and the existence of competitive transport systems: taxis or maxi-taxis. This is due to the fact that in a municipality there are both profitable and less profitable routes, which need to be covered in full since this is a public service. The taxi and maxi-taxi activities focus on the most profitable routes, diminishing to a significant extent the number of users of the local transport company. Moreover, many taxi and maxi-taxi companies evade taxes and benefit from the lack of clear regulations from the local council regarding the public transport activity (for example: tendering for the maxi-taxi routes, combining very profitable with less profitable routes, et cetera.). Consequently, mostly in the smaller towns with less than 200 000 inhabitants, subsidizing the local transport also means a resource transfer to the private taxi or maxi-taxi private companies.

Modernization of the existing local utility capacities and developing new ones is today an indisputable priority. This major and lengthy operation supposes important financial resources. Thus, a recent EU-funded study showed that for aligning Romania to the European standards in the field of drinking water supply, sewerage and wastewater treatment, Romania needs around EUR 4 310 million in the short term, and EUR 10 130 million on the long term in a coherent investment program for rehabilitating the existing systems and developing those systems in the rural areas. Such capital expenses are divided as follows: water supply—35%, sewerage—20%, wastewater treatment—45%.

For the other public services the following figures were available:

- Heating generation, transport and distribution USD 6 000 million
- Sanitation and urban environment protection USD 2 500 million
- Street and green area maintenance USD 1 250 million
- Public lighting USD 900 million

Financing the necessary investments to these major services is usually made from the local budgets or through subsidies from the State Budget. The operators, be it companies or regies autonomes, have very limited financial resources, which is mainly caused by very low profit rate (if any) and the high level of arrears.

Loans are financing methods that have been little used in the public service investments. Until 1999 the Local Councils could not take investment loans unless the Government approved it (through expressed provisions in the annual budget laws). The most frequent financing methods of major investment works performed through loans were EBRD, PHARE and the World Bank, yet all were guaranteed by the government and were mostly taken by utilities from major cities. The most significant achievements in financing the public investments through loans with sovereign guarantee are: MUDP I (Municipal Utility Development Project) (loan value—USD 28 million), Jiu Valley (loan value—USD 25 million), MUDP II (loan value—USD 75 million),

the EBRD Program for rehabilitating the district heating systems in 5 cities, the EIB Program for rehabilitating the district heating systems in Bucharest and Cluj, and the World Bank Program for rehabilitating the Bucharest water supply system.

With the enactment of the Local Public Finance Law (189/1998), the local public authorities are able to take loans with no direct governmental guarantee. After 1999, EBRD started to consider the possibility of financing certain infrastructure and public service projects in the field of drinking water and district heating through loans with no governmental guarantee (the so-called private EBRD loans) to local public administrations. Several cities were selected (all county capital cities): Bistrita, Tirgu-Mures, and Rimnicu-Vilcea, and the Bank decided to finance technical and economic studies identifying the optimum technical and economic solutions for implementing the proposed projects.

A number of municipalities attempt to finance certain investment projects in infrastructure through loans taken from the domestic or external market.

Unfortunately, there are some obstacles hampering the municipalities to take such loans:

- a) Incomplete legislation—especially the fact that the local public administrations are not allowed to hold accounts in commercial banks¹⁰
- b) Economic and legislative instability—especially the very high inflation rate and the instability. These phenomena also explain the high risk of inefficiency attached to foreign investments in and loans to Romania, representing additional costs for the borrowers.
- c) A high volume of loans is required for the performance of the investments as to the possibilities of the local budgets. For the most prosperous municipalities in Romania, the level of the local budget does not exceed USD 100 per capita, while in the Czech Republic it is between USD 500–700 per capita and in Poland between USD 300–500 per capita.
- d) The reluctance of the banking sector to grant loans to the local public administration, based on a number of causes including the following:
 - It is much more effective and safer to finance the state budget deficit by buying Treasury Bills issued by the Ministry of Finance, through the so-called eviction effect
 - A lack of familiarity with the specificity of the local public finance and financing public infrastructure investments, and lack of specialized staff in these fields. This leads to the analysis of the projects proposed by Local Councils based on the same criteria as those used for business companies, which is directly reflected in the analysis of the appropriateness of such projects;
 - The local public administrations cannot generally offer material guarantees, since their private domain is very limited.
- e) The reluctance of the local public administrations to take loans, considering that the interest rates are too high as to the evolution of the budget incomes. In the last few years, except

for 1999, the incomes to the local budgets in real terms have decreased, a phenomenon discouraging the development of the credit market for the local authorities.

- f) The reduced capacity of the local public administrations and public service providers (regies/companies) to propose financially viable projects, to draft investment programs with clear priorities and well defined objectives, to review the financing variants and opportunities for such projects, and so on. In general, only very short term investments are financed, the local public administrations initiate simultaneously several investments with a very slow development pace, and they do not take into consideration the advantages of finalizing rapidly a major investment when analyzing the adequacy of a loan.
- g) A lack of trained staff in project management in the local public administrations and public service providers.

6. POLICIES FOR IMPROVING LOCAL PUBLIC UTILITIES

6.1 National Development Strategy

The strategy should include objectives, priorities, implementation methods, funding sources and responsibilities for the two main actors: the central and the local level. The strategy should also be corroborated with the programs funded by the European Union and the World Bank and should comply with the criteria to be achieved by Romania for the European Union accession. The strategy should be realized following an interactive process involving both the local level through the associations of local public administrations.

The strategy should include at least the following elements:

- *performance indicators*: both qualitative and quantitative, specific to the public services and their infrastructure, to be achieved on a short, medium and long term;
- *the responsibilities of the central and local administrations*: including the separate approach of the rural infrastructure;
- *funding sources and methods*: allowing a medium term budgetary planning. The strategy should include clear criteria, formulas and priorities in allocating the funds from the State Budget to the local budgets for investments in the field;
- *methods and procedures*: for involving the three main actors in developing the strategy—the government, and the local administration and the associations of public service operators. Thus a Working Committee should be established, consisting of the representatives of the respective ministries, the associations of local public administrations and public service

operators. The Committee should convene twice a year and review the measures to be taken, the implementation procedures, the funding sources and methods and endorsing the legislative proposals of the Government affecting this sector.

The local public administrations, especially the county and municipal councils, should adopt medium and long-term *infrastructure modernization programs* with clear objectives and priorities, reflected in the preparation of the annual budgets and correlated with the national strategy in the field.

The local infrastructure upgrading programs need to be an integrate part of the local development programs established in the medium and long term by city halls or county councils. The access to government funding should be conditioned by the existence of such viable programs at the local level.

We should not omit the development of an upgrading program of the public service infrastructure in the rural areas, where the situation is the most dramatic and the investment need is the highest. This program is very important since the economic development in the rural areas is closely linked to the modernization of the infrastructure in this area.

The local administrations need to make *clear decisions*, with a long term impact, providing the answer to a series of fundamental questions such as:

- centralized or decentralized housing heating systems?
- regional or local water distribution systems?
- waste dumps for each community or for groups of neighboring communities?
- what would be the future of the public transport in cities with 100 000–150 000 inhabitants?

The answers to these questions should be fully debated from the technical, economic and environmental points of view. Unfortunately, there are currently a series of contradictory trends, a spontaneous expression of the crisis faced by the public service sector in Romania.

The best example in this respect is the district heating: due to the very high prices the consumers tend to disconnect from the centralized systems, using instead either improvisations or individual heating systems (gas fuelled apartment micro-plants). The phenomenon is also emphasized by the impossibility of individualizing the consumption in this sector due to the current technical conditions of the Romanian blocks of flats. There are local councils that have initiated major investment programs for upgrading the heating plants or micro-plants and the distribution networks without taking into consideration the consumers disconnecting from the centralized systems. There are municipalities where the heating provider has lost almost 90% of the customers. In these conditions, any upgrading of the centralized systems is economically inefficient and leads to very high prices per Giga calorie, even if the losses are completely eliminated.

The programs for upgrading the infrastructure and the public services should be accompanied by very clear *norms regulating this field* and allowing the monitoring of the operators in the sector. For instance, a detailed regulation should be developed for the metering of drinking water, hot water and heating, or a regulation for the taxi and maxi taxi activities.

For making the public services more efficient *alternative provision methods* should be introduced. To this purpose, a clear separation should be made between the service provider and the producer, and the development of intermediary service providers groups should be stimulated. The local public administrations will play a very important role in quantifying the consumers' demand for various types of public services or utilities and making this demand known to the providers.

The local public administration needs to develop, based on the legislation in force, clear procedures for the public service bidding and contracting, including the establishment of specialized departments in the field. In addition to that, the local public administration needs to set up high performance legal departments, especially in the context of concluding investment or concession/service contracts with foreign banks and specialized companies, working with different standards and legal systems.

6.2 Reorganization of Public Service Companies

Involvement of the private capital in the public service sector should be expanded in the future. It should include mainly the energy related services (power and heating, public lighting, gas), due to the higher internal recovery rates that may be obtained in this sector. The regulation of the public services by independent authorities is however necessary before a significant involvement of the private capital. There are already such bodies in the energy field, but not in the water supply, local public transport and waste management. The establishment of such bodies is thus a priority.

The privatization of the public utility services is a very important and sensitive aspect from at least two points of view: the majority status as natural monopoly; and the level of prices and tariffs that would make the sector interesting for investors. In this context, the following aspects are essential:

- The local public administration should take for granted the quality of regulatory and quality control authority for these services, and should establish clear and simple procedures to be applied in an intransigent manner. The sector needs to be regulated prior to the privatization so that the involved actors know the rules.
- The local public administration needs to maintain a certain control over the prices and the investment level for the privatized services constituting a natural monopoly.
- The evolution of prices and tariffs should not exceed the evolution of real income of a family, so that the share of the utility expenses in its budget to go down¹¹. This is very

difficult in the conditions of a very low profitability in the public service sector and the existing financial blocking. Two very important aspects need to be taken into consideration in the moment of privatizing the public services representing a natural monopoly: the level of prices and tariffs charged and the level of infrastructure upgrading investments. In both matters, the local public administration should maintain a certain level of control through the service concession contracts. Thus the price and tariff level should be negotiated and endorsed on an annual basis by the local councils, so that they are bearable from the social point of view and allow the established investment level. In addition to this, the local councils should also annually endorse the upgrading investments committed by the operator. It is obvious that the total investment level committed by the operator is provided in the concession contract, yet it is advisable that the local administration should endorse each year the capital expense volume so that there is a guarantee of the contract performance.

- The public service privatization policy should be corroborated with the subsidy policy, so that the investments are stimulated, reducing thus the losses and costs. The subsidy should go down, at least in its share of the local budget, reducing the financial blocking resulted from the bill payment delays, reducing the share of utility expenses in the household budgets.
- The individualization level of the costs of these services for the consumers should increase as much as possible, otherwise we will face a specific type of negative externalities that will block the system.
- A detailed analysis of the competition's impact on the quality and costs of certain services—it is not always that a higher number of competitors leads to an increased quality and lower prices.

Increasing the role of the private companies in the public service sector depends on a series of important factors:

- ensuring a clear and stable legislative framework;
- the existence of independent regulatory authorities;
- economic sizing of the scope of the service providers;
- ensuring a transparent competition in the service delegation process;
- recognition by the local authorities of the principle of reasonably capitalizing the invested capital.

Most of the local public administrations are now aware of the need to ensure these preparatory conditions and are open to initiate the preparatory process of long term public-private partnerships. Training courses will, however, be necessary for the management teams of the service providers, the civil servants and even some elected councilors. In addition to this, the central authorities will need to support this process mainly through the guarantee systems required by the strategic investors.

Unfortunately, the tendencies characterizing the period between 1990-1992, when the provisions of Law 15/1990 on the reorganization of state enterprises into regies autonomes and business companies were applied, resulted in over 250 entities (regies autonomes and companies) splitting off the 40 county municipal service providing groups.

It would be desirable that this period of trials and experiments could come to an end, and a natural process of consolidating the viable entities to begin, including mergers, takeovers and acquisitions. The starting point of this process is the corporatization of the regies autonomes, transforming them into business companies and expanding the scope of the sound entities from the financial and operational viewpoint to economic dimensions. It would be preferable if the process was 'fuelled' by economic arguments (profitability, economic efficiency) and not by administrative criteria. A fiscal incentive could stimulate the initiation and continuation of this process.

For the regulations envisaging natural monopolies, the consumers should be consulted in advance, that is, the owners' associations and the operators' associations. The functioning of such consultative councils should be regulated by local council decisions and a stabile and clear functioning framework.

6.3 Improving Service Quality

The determination of the quality standards (optimum, necessary, possible, and that which can be financially bearable for the beneficiary) should be made by consulting all the parties involved rather than unilaterally. Periodic studies should be performed on the efficiency of all public services and their compliance with the proposed quality standards.

The analysis of the public service quality should be based on mathematical models, developed in such manner that they should review:

- the efficiency of costs (through indicators such as: economies in the production costs, efficiency in providing the service, the way in which the service is provided, et cetera);
- alternative methods for increasing service quality (through indicators such as: what financial effort is necessary for a certain quality increase, what additional cost can the beneficiary bear for such increase, how much is he willing to pay, et cetera);
- efficiency of the public service provision process (inputs, outputs, procedures, outcomes, etc);

The local public administration should establish departments and procedures for monitoring the quality level of the public services, the compliance with the set of indicators provided in the concession contracts for the provision of these public services. The monitoring should be based on clear, precise and detailed regulations and the obtained information should be publicized.

It is necessary to *introduce performance indicators* for measuring the public service quality. The performance indicator system should include at least the following:

- a) cost indicators (measuring the output of a public service system depending on the input values);
- b) quality indicators:
 - indicators measuring the compliance of the result with proposed outcome,
 - consistency indicators, minimizing the effects of performance losses,
 - customer satisfaction indicators (that is, the correlation between the price the consumers are willing to pay for ensuring a certain quality).

In more detail, we suggest the introduction of the following performance indicators in the public service sector:

- a) indicators reflecting the quality standards of public services and protecting the consumers: quality of drinking water, hot water and steam temperature, number of hours of heating, hot water and drinking water, frequency of public transport by hours and routes, frequency of household waste collection in a certain area, the cleanliness of waste sites. These indicators should be part of the concession contracts for the public services and the service contracts with the consumers;
- b) indicators reflecting the technical efficiency of the public service infrastructure: the technical efficiency of the heat supplying installations, the volume of drinking water supplied per capita, the level of losses in the drinking water and heating networks, the quantity and quality of treated water in the treatment stations, the technical condition of public transport vehicles, the endowments with specialized vehicles for waste collection , et cetera;
- c) indicators of the public service operational costs: cost of a cubic meter of drinking or hot water, cost of one Giga calorie, average public transport cost, cost of collecting, transporting and disposing a cubic meter of household waste;
- d) indicators of the real level (eliminating the inflation influence) of prices and tariffs, especially their evolution in time, and the share of utility expenses in the household budgets;
- e) indicators of the investment level realized by the public service operators in modernizing their infrastructure.

The associations of local public administration should maintain a permanent dialogue with the government, the ministries involved, the professional associations of operator in all the performance measurement matters, quality standards, legal procedures and regulations, so that there is the possibility of comparing various concrete situations.

In achieving quality objectives we should take into consideration the EU standards. The main difference between Romania and the European Union in the public service sector lies mostly in

the heritage from the former regime, resulting from a policy that was not correlated with the current sustainable development concerns.

The low efficiency in using the energy resources, encouraged by the low tariffs for the public services, represents a major cause of the current status of the infrastructure. At the same time, the low investment level, both in quantitative and qualitative terms in the infrastructure field, and mostly the permissive regime in applying the regulations imposed by the domestic legislation, resulted in a further widening of this gap.

The preliminary results of the projects financed by the European Commission evaluating the law enforcement progress have shown that the full transposition of the legislation cannot end by the year 2005. Implementing the 'acquis communautaire' will need significant investment, so that the implementation framework will depend to a great extent on Romania's overall economic development.

The investments should lead to a gradual achievement of the standards required by the provisions of the European Union Directives. These are mostly the task of the public sector (especially the local authorities) and will represent a heavy burden on the public finance.

The most costly directives (in respect of their implementation) are listed in Table 7.3.

Table 7.3
The most costly directives (in respect of their implementation)

| Directive | Transposition | Implementation |
|--|---------------|----------------|
| Drinking water (98/83/EEC) | 2000 | 2015 |
| Urban wastewater (91/272/EEC) | 2000 | 2030 |
| Surface water for drinking water (74/440/EEC) | 2000 | 2015 |
| Hazardous polluting factors in underground water (80/68/CEE) | 2001 | 2015 |
| Hazardous polluting factors in surface water (76/464/CEE) | 2000 | 2030 |
| Framework Directive on Waste (75/442/CEE) | 2000 | 2002 |
| Storing PCB/PCT (96/59/CE) | 2000 | 2015 |
| Framework Directive on Air Quality (96/62/CE) | 2000 | 2010 |
| Public access to environmental information (90/313/CEE) | 2000 | 2002 |
| Directive on environmental impact with subsequent implications (85/337/CE) | 2000 | 2002 |

6.4 Financing Utility Service

A price policy for the service companies needs to be established, so that:

- the consumers should pay the real service cost where it can be clearly determined;
- crossed subsidies should be eliminated (as it is currently the case in the case of electricity);
- services should be provided at prices under the cost where the price reduction may stimulate the consumption;
- clear and transparent consumption-based methods for establishing the tariffs should be established based on consumption.

The methodology of determining controlled tariffs and prices needs to be decentralized and liberalized based on the following principle: the authority paying the subsidy should also decide upon the price level. The local public administrations should play a major role in the process of determining the public service tariffs and prices, the more that the development strategy of the local infrastructure, its methodologies and implementation pace are also their responsibilities. The systems for determining the prices and tariffs should be conceived in such manner as to encourage the investments in the service and the public utility infrastructure.

The main problem to be solved by the Government is the ever increasing prices of the public utilities provided by the major national companies holding monopolies in the field of activity. The drinking water price is not subsidized by the local administration, yet it is controlled by the Office of Competition based on a methodology starting from the historical prices. This hampers the operator in mobilizing sufficient financial resources for the investments needed. Another very important aspect is the very different local conditions in providing the water supply: there are free fall water collecting systems with very low operation costs, and there are water collecting systems needing water pumping where the costs are very high. What is common to all the Romanian municipalities with water supply systems is the very precarious condition of their distribution systems needing major investment. In this context various types of measures should be taken:

- a) developing regional distribution systems of the drinking water, by associating all the local councils involved and giving up to the current system provided in the Public Property Law (213/1998), by which such systems are part of the public domain of the county councils and are administrated exclusively by them. The beneficiary local councils should become involved since they are the closest administration tier to the direct beneficiaries of the respective service;
- b) the approval of the drinking water prices should be the exclusive responsibility of the local administration involved. In the case of a regional system, a price approval procedure needs to be established, which should be able on the one hand to protect the interest of every municipality (be it large or small) and on the other hand to enable the privatization of the respective public service, i.e., the public-private partnership.

The public service subsidy system should be modified. Before making any decision influencing the prices of the public utilities subsidized from the local budgets, the Government should consult with the associations of local public administrations and the associations of service operators. The current level of the subsidies to the producer is completely outside the control of the local administrations that needs to pay them. The share of these subsidies in the local budgets has increased significantly in the last year, diminishing mostly the funds for investments.

The current system of subsidizing the low-income families could be expanded, combining the income criteria with those referring to the difference between the national reference price and the local production price. Thus, the higher the difference between the local price and the national reference price, the higher the income thresholds for receiving various subsidy levels as well as their rate. The national reference price would remain solely a social protection indicator and the individual consumers who would not comply with the subsidy criteria pay the local price, irrespective to its level. Hence, the subsidy would concentrate on those who really need it and the costs for the local public administration would be much lower, thus freeing investment funds.

The subsidy granting system should thus be modified and made more efficient, taking into consideration the following aspects:

- a) The subsidy system should also include the consumers with individual heating systems, since an exponential increase of disconnections from the centralized district heating system has been noted recently. For this purpose, the local authorities could issue tokens to the disadvantaged families, for the payment of the gas, light fuel or wood, partially covering the heating costs, at the same level as in the case of the centralized systems;
- b) If for the public transport, due to the high degree of externality, it is practically impossible to give up to the general subsidy (the subsidizing system for the local public transport was regulated accordingly by the Government Emergency Ordinances 97/1999 and 148/2000, giving the local authorities sufficient freedom to establish the most appropriate policy in this field), in the case of district heating distribution the subsidy granted to the producer should be eliminated;
- c) The subsidy system should be correlated to the average period of collecting the utility bills from the population and its payment delays. A major problem is at this moment the impossibility of billing the heating or drinking water costs for each apartment.

The system of allocating the equalization grants to local budgets should also be modified to satisfy a number of conditions, as follows:

- ensuring sufficient financial resources to the small and medium sized municipalities facing an acute lack of budget incomes due to the prolonged economic crisis (in general, the economy of the large cities, the county capital cities, has done better than the economy of the small and medium sized towns and the rural communities);

- the system should be predictable, allowing the medium term planning (3-5 years) of capital expenses of the local public administration. This supposes the definition of clear, stable and quantifiable allocation criteria within a formula;
- encouraging the infrastructure investments. This could be achieved very effectively by introducing in the allocation formula of the balancing amounts indicators measuring the realized investments, their share in the local budget, et cetera.

For covering the high infrastructure investment needs, both the local public administrations and the public service operators need to have access to *loans*, because:

- a loan imposes economic efficiency and involves financial discipline. This investment funding method also imposes the compliance with the deadlines for finalizing the investment. The failure to observe such deadlines is a critical problem of the Romanian local administrations which has resulted in a series of negative phenomena: exaggerated costs for the ongoing investments, reducing the expected positive effects of such projects;
- the current funding sources do not allow a high investment level in this sector, where there are huge requirements taking into consideration the condition of the public services in Romania;
- a loan allows for spreading the burden of urgent infrastructure investments (generating long term benefits) on several generations of future beneficiaries. From this point of view funding major investment projects through loans is more equitable than from the current financial sources.

The past experiences in this respect with the loans from the European Bank for Reconstruction and Development, the World Bank and the European Investment Bank, have proven the viability of this approach. Continuing the development and implementation of such projects especially for small and medium sized towns is one of the priorities of this sector.

6.5 Increase in Capital Investments

Encouraging the partnerships among the local authorities, the public service providers and the private investors, could be a solution to the high investment needs in the sector. It is unlikely that the local public administration will be able to fully finance, from own resources, through loans, international grants, the major infrastructure investments. In this case, the private direct investments of domestic or foreign capital are extremely important. The most difficult problem is the profitability of such businesses, seriously affected now both by the financial blocking and the low level of individual incomes.

The partnerships and collaboration between municipalities should also be encouraged. It is obvious that there are public services for which the economies of scale compensate the additional costs due to the large or even very large size—of the drinking water distribution systems. In such cases, as well as others (building ecological waste sites), the cooperation among local councils

should be encouraged by creating stock companies where all the interested parties should invest, including the county councils.

In order to protect the fundamental interests of all shareholders, the strategic on the price and tariff policy or the investment policy should be made with a high majority (two thirds or three quarters). The current regulation in Law 213/1998 considering the infrastructure of such investments as the public domain of the county council, does not encourage such partnerships and associations. This is a negative aspect, since not always the interests of the municipalities match those of the county councils.

An urgent change of the management is required both at the level of the local public administrations and the regies/companies providing public services. The local authorities need to train their staff to be able to prepare viable projects to be financed by foreign investors. In today's global competition, the access to capital is difficult and it supposes the assimilation of the internationally recognized standards. In this respect, the associations of local public administrations should develop staff training programs, especially in project management, investment planning and local economic development.

The management of the public service providing companies must have management contracts with precise indicators (derived from the performance criteria provided in the concession contract) to be achieved every year. It is absolutely necessary for the management of the local companies and regies to be familiarized with the project management in order to be able to achieve their objectives and to have access to the internationally funded projects.

Currently all the internationally financed programs (EU-PHARE, EBRD, the World Bank, etc.) function in this manner, which is less familiar both to the municipal staff and the employees of the local companies and regies providing public services.

6.6 Legislative Changes

Since the local public administration needs to have access to the capital market and bank loans, urgent legislative measures are necessary:

- a) *Annulling the interdiction to hold accounts in commercial banks.* A possible solution would be to allow the local authorities to open accounts only in the banks specially authorized by the National Bank of Romania reflecting the solidity of the respective institutions (a similar system was applied when the currency market was liberalized, the approval to function as a dealer or broker was differentiated and was granted depending on the applicant's performance). Thus the local authorities could manage much better their cash flows, could obtain additional incomes and the banks would not be reluctant in granting loans.

- b) *Modifying the norms of the National Bank of Romania for evaluating the credit risk.* Currently, the loans guaranteed with future loans are rated with a 100% credit risk since the investment credit analysis norms of the Romanian banks refer only to business companies, with no relevance for the local public administration. This type of loan (guaranteed with future incomes) is the only one that a local administration can now contract, and in this case, the future incomes are not hypothetical amounts obtained from the sale of products, but taxes and duties collected with a high degree of certainty. This situation reflects a generalized state of facts in the Romanian banking system: lack of knowledge on the functioning of the local public administration and its income sources.
- c) *Stimulating the Romanian banks to lend to the local administration* for financing feasible investment projects in the field of infrastructure. A grant system from the State Budget could be created, subsidizing a part of the bank interest, or co-financing together with a loan a public service project
- d) *Stabilizing the capital market for stimulating the bond issuing.* Now it is too early to launch a bond issue on the capital market to finance an infrastructure investment project. There are several reasons for this, including: the chronic crisis of the Romanian capital market (in fact its underdevelopment); the lack of trust from the population in such securities following the numerous crises faced by a series of commercial banks and investment funds; macroeconomic instability and especially the high inflation rate; the lack of institutionalized investors on the market. However, in 2–3 years time, bonds may be issued for the major Romanian municipalities, which may ask strong investment banks to intermediate the issue and which have sufficient budget resources to guarantee such bonds.

The involvement of the private capital in financing the public services must first be stimulated through legislative measures. The evolution of the concession contractual arrangements in the fields of water, heating, sanitation, public lighting, and so on, will have to be rigorously evaluated, so that the good experiences and lessons are disseminated and the bad experiences avoided.

Legislative measures both at the level of the local public administrations and the public service operators should introduce requirements for using modern management methods and techniques (such as program budgeting or budgets oriented on performance, quality analysis, introducing performance indicators, et cetera).

The legislation in force should be revised for introducing the market mechanism in the public service sector, by correlating the legislation in the field, to allow the financing of public services (where possible) through user charges. Expanding the user charges system would create a better correlation between the demand/supply/quality for the public services financed through this method. This system will also enable the allocation of resources in conformity with the citizens' preferences and the necessities and will avoid the losses and overproduction. And last but not least, the 'exposure' of the public services to competition and a market system will increase the efficiency of the service provision and of the involved costs.

APPENDIX

Legal Organization Forms of The Romanian Public Services In Romania

The situation of the municipal service operators

| | |
|--|------|
| <i>Local public service operators (around 400)</i> | 100% |
| regies autonomes | 35% |
| companies | 35% |
| public services in the executive structure of municipalities | 30% |
| | |
| <i>The population services by:</i> | 100% |
| regies autonomes | 70% |
| companies | 24% |
| public services | 6% |
| | |
| <i>Operation volumes:</i> | 100% |
| regies autonomes | 69% |
| companies | 28% |
| public services | 3% |
| | |
| <i>Number of employees:</i> | 100% |
| regies autonomes | 66% |
| companies | 30% |
| public services | 4% |

NOTES

- ¹ Starting with December 2000, the Ministry of Public Works, Transportation and Housing.
- ² Starting with December 2000, the Ministry of Waters and Environment Protection.
- ³ In respect of the concessioning of the land and assets in the public domain in relationship with the power and heating sectors, under the Government Emergency Ordinance 63/1998 on power and heating, besides the general criteria for approving the concession the specific criteria for the respective activity provided in point 7, Art. 60 of the Ordinance will be also applied. In addition to that, the natural or legal persons interested to participate to the bid for obtaining a concession must get a temporary authorization from the competent authority for performing the concessioned activity. Following the adjudication of the concession, the temporary authorization of the bid winner will be transformed into a final authorization.
- ⁴ At present, under the Ministry of Public Administration.
- ⁵ The contract to which at least one of the parties is a public person is an administrative contract and its main feature is that it aims at fulfilling directly a general interest (public service) and is subject to a legal regime pertaining to the public law. When the public interest requests it or when the service providing company fails to perform its contract obligations or when the performance becomes a burden to the company, the public administration authority may unilaterally modify or terminate the contract.
- Under the provisions of Law 4/1981 on the municipal services (still in force), the Local Councils must ensure the drinking water supply, the development of new sources and and the water distribution and sewerage networks, as part of their responsibilities regarding the municipal services (such as public transport, street lighting, district heating and hot water supply).
- ⁶ Law 189/1998.
- ⁷ Corporatisation of regies autonomes—Legal ground:
- Government Emergency Ordinance 30/16.06.1997 on the reorganisation of regies autonomes, published in the Official Gazette no. 125/19.06.1997.
 - Government Emergency Ordinance 53/24.09.1997, for modifying and supplementing the Government Emergency Ordinance 30/97, published in the Official Gazette no. 253/25.09.1997.
 - Law 207/12.12.1997 for approving the Government Emergency Ordinance 30/1997 with its subsequent amendments, published in the Official Gazette no. 366/18.12.1997.
 - Law 99/1999 on measures for accelerating the economic reform, modifying and supplementing the Government Emergency Ordinance 88/1997 on the privatisation of business companies, with its subsequent amendments.

- ⁸ In present, ‘The Authority for Privatization and Administration of State Allotments’, under the Government .
- ⁹ From the data presented by the Ministry of Finance we cannot precisely establish the level of investment made by the local authorities in the field of public utilities. However, taking into account the relatively low level of investment in education or culture, the overall level of capital expenditures represents a relevant indicator of the financial effort made by the local administration especially in the field reviewed in this report. The qualitative indicators presented in Annex 3 are less relevant for the county councils, especially when it is about the expenditures per capita for investments and subsidies. The capital expenditures made directly by the county councils are primarily focused on the rural communities, taking into consideration the scarcity of their local budgets. On the other hand, the county councils administrate in very few cases the public services benefiting from subsidies, which explains their very low share in the respective budgets.
- ¹⁰ The regies and business companies providing local public services have a higher flexibility in using the bank accounts than the local administration. The problem is that they administrate public domain assets, which cannot be used as a collateral. Their own patrimony, which could be used as a collateral, is limited in comparison with the size of the loans that should be taken for public utility investments. For this reason the loans should be taken by the local administrations, which can guarantee with future revenues (which are significant in the case of large cities with over 100 000 inhabitants). The ban of local administrations to work through bank accounts makes the credit development process very difficult for investments in the public utility infrastructure and the banks are very reluctant to borrow to clients that cannot unfold the loans through their accounts;
- ¹¹ One of the current problems of the drinking water public utility services—sewerage, hot water and district heating—is the high level of debts of the population to the suppliers. This phenomenon has two explanations:
- the technical system of constructing apartment blocks for the last 40 years makes it impossible to individualising the drinking water and heating costs for each apartment—in the best case scenario the physical consumption could be measured by groups of apartments (10–20 apartments or even more), and the bad payers cannot be disconnected individually. In this situation the so called ‘harsh budgetary restriction’ does not function—services are still provided to those who fail to pay since they cannot be disconnected without also affecting the good payers;
 - the level of costs for such services during the cold season is very high, it can reach 20–25% of the income of a family with two employed persons receiving the average net salary (around US\$ 90 per month). In the case of poor families or retired persons the share of these expenditures may exceed 50% in the cold season. This leads to the failure to pay the bills, the occurrence of debts and financial blockage. That is why it is so important for the prices of such utilities in Romania to grow to a slower pace than the population incomes so that the share of maintenance expenditures in the household budget to decrease.

Slovakia

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1. LOCAL COMMUNAL AND UTILITY SECTOR

Slovak Republic has an area of 49 035 km² and a population of 5.4 million. The average density of population is 109.9 inhabitants per km². Administratively, and for the purposes of state bodies, jurisdiction in Slovakia is divided into 8 regions and 79 districts.

The basic local government units are municipalities of which there are 2 883 in Slovakia. Within these there are 136 towns and cities where almost 60% of population is concentrated. The largest city is the capital Bratislava, with 452 000 inhabitants. The status of cities with a population exceeding 200 000 inhabitants is set by separate legislation. The local government of Bratislava is divided into 17 municipal wards with their own self-government bodies. The city of Košice is divided into 22 municipal wards with their own self-government bodies.

On the other hand, there are many hundreds of small municipalities—68% of municipalities have a population of below 1 000. Table 8.1. below shows the size and population of municipalities at the end of 2000:

Table 8.1
Breakdown of Municipalities by Size

| Municipalities by Size (Population) | Number of Municipalities | | | Number of Inhabitants | | |
|--|-----------------------------|-------|----------------|--------------------------|-------|--------------------|
| | | % | of this cities | | % | % accumu- lated |
| –499 | 1 194 | 41.4 | — | 325 923 | 6.0 | |
| 500–999 | 779 | 27.0 | — | 553 810 | 10.2 | 16.3 |
| 1 000–4 999 | 786 | 27.3 | 21 | 1 491 617 | 27.7 | 43.9 |
| 5 000–9 999 | 52 | 1.8 | 43 | 364 347 | 6.7 | 50.6 |
| 10 000–19 999 | 30 | 1.0 | 30 | 424 153 | 7.9 | 58.5 |
| 20 000–49 999 | 31 | 1.1 | 31 | 902 458 | 16.7 | 75.2 |
| 50 000–99 999 | 9 | 0.3 | 9 | 65 0 814 | 12.0 | 87.2 |
| 100 000 and more | 2 | 0.1 | 2 | 689 425 | 12.8 | 100.0 |
| SR total | 2883 | 100.0 | 136 | 5 402 547 | 100.0 | |

SOURCE: Statistical Office of Slovak Republic

In July 2001, the Act on higher territorial units¹ established a second tier of local government in 8 regions.

The status of the territorial self-government is set in the Constitution of Slovak Republic, which defines a municipality as the basis of a territorial self-government. Municipality and region are independent territorial and administrative units that associate individuals with permanent residents in its area. The municipality and the region are legal entities, which independently manage their own property and financial funds.

1.1 Major Service Responsibilities

The fundamental law, which defines local government responsibilities in local communal services and utilities provision, is the Local Government Act 369/1990 as later amended and followed by a range of other laws. The Local Government Act states that the municipality administers its internal issue, mainly in the preparation and approval of the municipal budget and its closing account.

It provides public services, it performs its own investment activities and business activities in the interest of providing for the needs of the inhabitants of the municipality, and for the development of the municipality, and it establishes and inspects municipal enterprises and other legal entities

This act (besides other regulations) assigns municipalities to execute construction, maintenance and operation of:

- local roads;
- public areas;
- local cemeteries;
- market places;
- culture, sport and other municipal facilities.

The Local Government Act also sets down the obligation to provide ‘public-welfare services’, such as:

- the collection and disposal of municipal waste;
- public cleaning;
- operation and maintenance of public greenery;
- operation and maintenance of public lighting;
- water provision;
- sewage treatment;
- public transport.

The municipal responsibilities in the communal and utility sector also include own investment and business activities in order to provide for the needs of the citizens and for the development of the municipality. Municipalities are also responsible for completion of complex housing constructions and a supplementary infrastructure, for initiation and co-ordination of the new housing construction.

The responsibilities mentioned above are obligatory, and the municipalities are due to provide them either by their own or by other firms and bodies. The scope of provision usually depends on the size of the municipality and its financial base. To provide these services, cities and larger municipalities have established their own organizations and businesses, but they also use the option of contracting services out to the private sector.

1.2 Legislation on Communal and Utility Services

Legislation regulating the provision of local communal and utility services is fragmented into a great many acts, ordinances and decrees. Our aim is not to enumerate all of them here. Many of them have been amended several times, and new amendments are still occurring. As mentioned above, the most important Act is the Act no. 369/1990 on Local Government, and the corresponding act Act no.138/1991 on Municipal Property (both in later amendments).

1.2.1 The Act on Local Government

This Act was approved of in 1990, and in this year it also came into power. The process of establishing a local government in Slovakia became on the basis of this Act. The previous system of local public administration was based on three level systems of national committee's bodies while municipal functions had been significantly limited by the state power. After 1989, mainly by the ratification of the Act on Local Government, the role of municipalities (which are represented by towns and villages), has changed significantly. Also their powers and duties were strengthened which also means that new responsibilities for certain matters, including the responsibility for communal and utility services, had been transferred to them.

The Act defines the position of towns and villages as 'municipal territory units', and sets out the rights and duties of their citizens, functions and execution of municipal activities, municipal bodies and so on.

According to this Act, local government issues ordinances that are binding for all individuals and corporate bodies within their jurisdiction. Such 'generally binding ordinances' may be superseded or invalidated only by parliamentary acts. 'Generally binding ordinances' are legal

norms through which the municipality regulates social relations and directs behaviour of individuals and corporate bodies. Municipality issues two types of 'generally binding ordinances':

- 1) Generally binding ordinances carry out municipal tasks, or as required by law.
- 2) Generally binding ordinances in those matters where the municipality fulfils tasks of the state administration.

Generally binding ordinances must not be in contradiction with the Constitution or other Acts. In some cases, generally binding ordinances are required by the law—in this case they take a role of executive regulation that is lawful on the territory of the municipality. An example of this would be the generally binding ordinance on communal waste management.

Besides this basic legal norm, the provision of communal and utility services is also regulated by other generally valid legal norms of which we will mention the most important ones:

1. The Act on Budgetary Rules²
2. The Act on Consumer's Protection,
3. The Act on Protection of Economic Competition
4. The Act on Prices,
5. The Act on Regulation in Network Sectors
6. The Act on Public Procurement.

A brief description of legal norms is summarized in the Annex.

1.3 Forms of Service Delivery

To provide communal services and local public utilities, municipalities have established various forms of organizations including business companies. However, direct service provision through a municipality or organization owned by a municipality is just one of many options. There is a range of relations with private bodies (business or non-profit), which can be used for local public services delivery. The most frequent case is the contracting out via public tender. The contracts take various forms, which are described in more details in the section 1.4.

Various types of organizations, which are used for local service delivery, can be grouped into following forms:

- municipal organizations (such as local authority departments, budgetary organizations, contributory organization);
- commercial companies;
- non-profits.

The legal framework for these forms is continuously adjusted. In following text we will describe broader characteristics which are more likely not to be considerably changed.

1.3.1 Municipal Organizations

Local *authority departments* are not legal entities. This form is used mainly in small municipalities. They are managed directly by a mayor (or city manager). Their incomes and expenses are a part of municipal budget. The central legislation and local conditions for local government staff include qualification requirements for those who deliver services and regulate the staffing.

The budgetary and contributory organizations (budget funded and subsidy funded) have a rather long tradition dating back prior to year 1990. These organizations have their budgets tied to the budgets of their founders. The founders then guarantee and control their operations and take appropriate measures if shortcomings are traced. Budgetary and contributory organizations are established to perform key public functions or public works that are fully or partially funded by the municipal budget according to specific regulations or decisions taken by appropriate authorities.

The status of the budgetary organization is most frequently granted to institutions covering only a small proportion of their expenses by a direct income. Budgetary organization is a municipality founded legal entity tied to a municipal budget by its cost and expenses. This means that their incomes and costs are fully incorporated into the municipal budget revenue and expenditure. *Budgetary organizations* have their own bank accounts. They manage their funds independently, according to an approved budget allocated by the municipality within its budget. They do not depreciate fixed assets.

If the municipal department delivers the services, the municipality is clearly responsible for all aspects of ownership, investments, and financial operation. The same responsibility has a municipality if the service providing was transferred to a budgetary organization.

Contributory organization is a municipality founded legal entity tied to municipal budget via contributions or consignments. It is governed by financial principles specified by the municipality within its municipal budget. Municipality may:

- provide contribution for operational or capital costs
- request the consignment of a part of operating incomes to its budget or set the consignment of depreciation.

Contributory organizations are characterized by a higher level of autonomy, and they are evidently more motivated to effective service delivery as they:

- bear the operation costs costs;
- have higher discretion in remuneration;
- can keep half of the operating surplus which was planned in budget.

Contributory organizations can use the operating surplus for the renovation of facilities and equipment. Besides their main activities, they may have business activities and use the resources from these activities for the improvement of main services.

Contributory organizations are usually made responsible for those services where the large proportion of cost is covered by charges for provision of these services. Quite often these organizations are also responsible for other services, that are not generating a lot of income (e.g. public green maintenance) but the cost of which reduces their tax basis.

Contributory organizations are dependent on the municipality because they utilize its property.

As an alternative option to budget-funded and subsidy-funded companies, local governments may vest the function of asset management and public work and service delivery to business companies established in accordance with the Business Code³. Many local governments established such business companies and transferred to them activities previously provided by the existing budgetary or contributory organisations. This process is frequently referred to as privatisation, even if the municipality owns such a business company.

There is no specific regulation limiting the equity participation or interest of municipalities in business companies. A municipality may be:

- a 100% owner;
- a majority owner, while the minority owners are other municipalities or private companies;
- a minority owner while other municipalities or private companies may own the other equity shares.

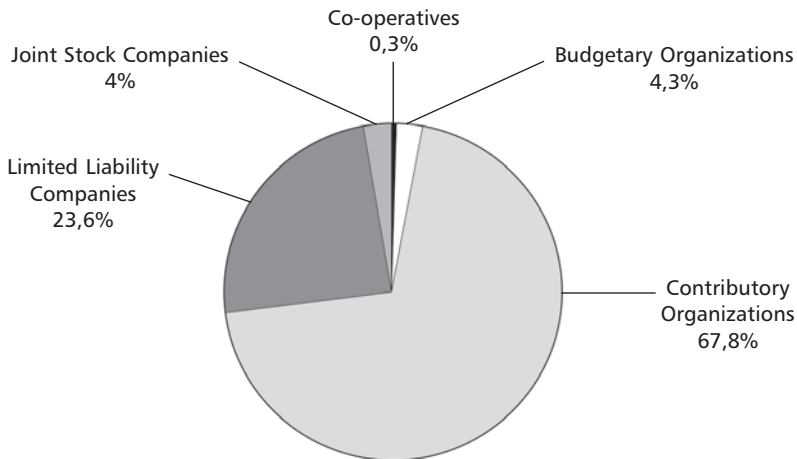
1.3.2 Local Public Enterprises

In 1998, the Institute for the Municipal and Regional Development (IROMAR) conducted a questionnaire survey in all the Slovak municipalities with more than 2 000 inhabitants (more than 70% of the population of Slovakia live in municipalities of more than 2 000 inhabitants). The survey was focused on the organization and legal forms of local public enterprises, the number of employees, services provided, as well as on the provision of local public services by private sector. Due to the high (63%) return rate of the questionnaires this survey can be considered sufficiently representative and its results reflect the structure of local public companies in Slovakia. The following section presents some of the results (see Figure 8.1).

The survey showed that 75% of municipalities have established at least one organization or company (municipal enterprise) to provide local public services of which they have exclusive (100%) ownership. Besides this, 44% of municipalities are equity holders in suchlike companies (i.e. where they have less than 100% ownership).

The enterprises that have 100% ownership by municipalities are mainly subsidy-funded organizations, and this apply to all size categories of the municipalities. Almost one quarter of the enterprises are limited liability companies, this being the second most frequent form of local public enterprises.

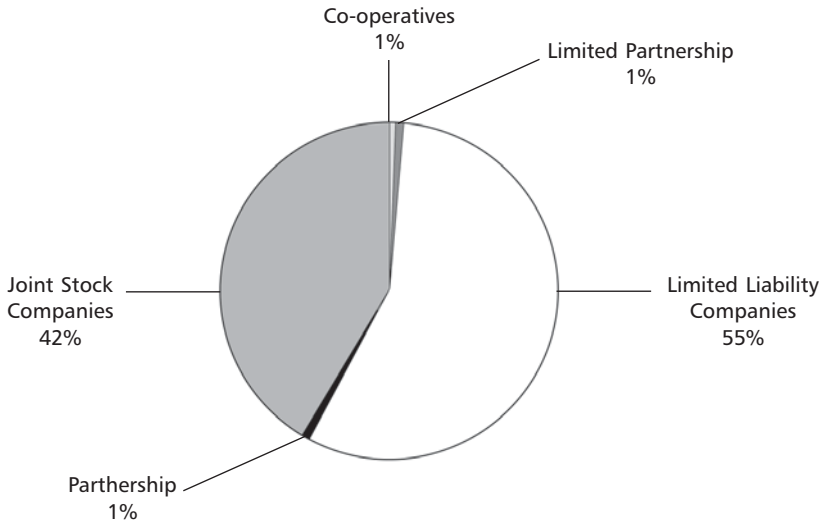
Figure 8.1
Enterprises in 100% Municipal Ownership



This means that out of the total number of enterprises in total municipal ownership, almost three-quarters (72%) are directly linked to municipal budgets. In the business company group, the most frequent legal form used is a 'limited liability company', while the form of a 'joint-stock company' is used with a substantially smaller frequency. Here, we must add, that in large municipalities (with a population of more than fifty thousand inhabitants) this proportion has changed. Although the budgetary and contributory organization still represents more than half of the total number (57%), the proportion of business companies has increased: 27% represent limited liability companies and 16% joint-stock companies.

As already mentioned, a municipality may provide services using the companies owned jointly with other municipalities or private firms (having the majority or minority share). The survey showed that in this case, limited liability companies and joint-stock companies prevail.

Figure 8.2
Enterprises in Less than 100% Municipal Ownership



Within this form of ownership, 17% of municipalities have their interest in a company jointly owned with other municipalities. The bigger the size of a municipality, the higher the proportion of municipalities who have an interest in companies owned by other municipalities.

1.3.3 Contracting Out

Although the majority of municipalities provide local services via their own organizations, most of them (75%) make use of contracting some local services out to private sector companies. Similar to the previous issue, the same principle applies, i.e. the bigger size of the municipality, the higher proportion of municipalities contracting some of the services out (See Table 8.2).

The most frequently stated reasons leading to the decision to contract service delivery out to the private sector were: lower costs, higher flexibility and the existence of a private sector provider for the given service. Private sector companies provide all types of communal services for which the local government is responsible. In large cities, it is a quite common feature that services of the same kind are delivered both via a contributory organization, and via a contracted private firm.

Table 8.2
Municipalities contracting out service delivery

| Size of Municipality | Proportion of Municipalities Contracting Service Delivery Out to Private Sector |
|-------------------------------|---|
| Population less than 5000 | 72.6% |
| Population of 5001–20 000 | 72.7% |
| Population of 20 001–50 000 | 79.2% |
| Population of 50 000 and more | 100% |
| All municipalities | 75% |

1.4 Local Government Management Practices

To provide communal and utility services there are several types of arrangements. The type of arrangement determines the ownership, financing operation, maintenance and investment, scope of direct intervention, and so on.

To decide the type of arrangement for a particular service is in the competence of the local government. In the following section we list the basic types of arrangements used in Slovakia to provide communal and utility services. They might be modified or combined as well. Unfortunately, there is no national statistics or survey on the proportion of particular arrangements.

1.4.1 Direct Service Delivery

If the services are delivered by the municipal departments, municipality is clearly responsible for all aspects of ownership, investments, and the financial operation. The same responsibility has a municipality if the service providing was transferred to a budgetary organization.

If the contributory organization delivers services, the municipality remains the owner of the property. It is also responsible for investment costs, and the reproduction and expanding of services although the contributory organization makes amortization in its accounts. Municipality sets the charges, and then the municipality is responsible for financial liabilities if the contributory organization find itself in insolvency

1.4.2 Arrangements with Business Companies

As mentioned above, local public services can also be delivered by businesses owned by municipalities or by businesses where all shares are owned by private subjects. There are several kinds of arrangements which municipalities use to provide services via business companies. The most important are described below.

1.4.3 Contract for the Service Delivery

The municipality can entrust the service delivery to an external organization (also the business company which is owned by the municipality can be included in this). The contract can be concluded for the provision of the service as the whole (i.e. the administration of housing fund), or for a secondary activity, as for example the reading of meters or maintenance of vehicle fleet.

The municipality remains the owner of the property, which is used by this service, although an operator is responsible for repairs and maintenance and usually for the replacement of equipment with a short lifetime. Operational yields are regulated and obtained by the municipality. The supplier of the service is compensated for the provision of the service, usually according to the contractual price. There does exist some options of reimbursement for provided services, including the following:

1. Total annual amount;
2. Amount of actual costs plus fixed percent portion;
3. Amount of the fixed unit costs (for instance per hour or according to the conditions of the meters);
4. Percent portion from collected revenue.

Usually the municipality is directly accountable for the service to the users.

1.4.4 Contract for the Service Operation

There are two types of contract for the service operation—with or without a share on profit.

a) Without a Share on Profit

The municipality is an owner of the property and invests in the construction and expansion of the property. It will determine the level of fees for users. It is accountable for the service to users and bears financial risks.

Contractual supplier operates the service for a fixed amount (usually determined by the public tender). Operational and maintenance costs are reimbursed from the revenue and potential balance goes to the municipal budget, i.e. the municipality either gets operational surplus or pays operational deficit.

b) With a Share on Profit

The same conditions apply, although:

- A supplier has a right to charge fees for the service;
- In addition to a fixed contractual price, the supplier receives a fixed percent portion from operational surplus.

Operation of the service with a share on profit is usually applied to those services which are expected to function without an operational subsidy (water supply system or waste collection). But it may also be used for the provision of services such as public swimming pools, which have significant yields, but despite this they get a municipal subsidy, usually for the provision of services which are the subject of concession for certain groups of inhabitants (children, the elderly). In this case, a supplier shares an operational surplus with the municipality after being paid a fixed subsidy.

1.4.5 Lease

Municipal property can be leased to an external organization for a lease fee (municipality can, but also need not be the owner of the organization). Leaseholder is accountable for the provision of the service directly to its users, i.e., they are consumers of a leaseholder but not of the municipality. The leaseholder bears financial risk.

The municipality is the owner of the property and is responsible for investment and payment of financial obligations. The leaseholder is responsible for the operation, repairing, maintenance and replacement of equipment with a short life. The leaseholder must return all leased means in good condition to the municipality at the end of the lease.

The leaseholder receives operational yields—even if the municipality can regulate the level of a charge for the service—and pays operational costs. The leaseholder will pay to the municipality the following: lease fees; or a percent portion from the yields; or both (i.e. a smaller fixed fee as compensation to the municipality for the depreciation of the property and share on yields according to actual need).

These conditions usually come out of the public tender. Lease contracts are usually concluded for a middle term period, i.e. for 10 years with a possibility to renew them.

1.4.6 Concession⁴

The concessionaire is given an exclusive right to provide the service for the stated period, in return for capital investment into inevitable infrastructure. The concessionaire bears all the costs—investment, operational, for repairs and maintenance, and is directly accountable to users who become his clients. He also bears financial risks.

The municipality on the basis of public tender usually assigns concession. The concession document may determine a range of provided services, and the highest level of fees. It is usual that the level of fees is regularly reviewed and can also be based on inflation.

Level of fees, and the period for concession is calculated to cover operational costs, full amortisation of investment capital and adequate return of investment. The concessions are assigned for a longer period, typically from fifteen up to thirty years, when compared to the lease contracts, or contracts for the provision of services. The reason for this is a requirement of obligatory capital investment. At the end of the period of concession the premises must be transferred to the municipality.

Municipality can subsidize initial investments, either by existing property or by cash. In this case, it is usual that it has valid claims for a fixed percent portion on operational yields. Another solution might be that the municipality will pay an operational subsidy to the concessionaire, in order to decrease a level of fees. It can also be in the form of total subsidy for decreasing the level of fees in general, and for the support of use of the service (for example in the case of public transport). Another option is targeted subsidy to decrease the level of fees for certain groups of users (i.e. reduce the fare for children at a pre-school age).

1.4.7 Financial Agreement

Municipalities can conclude contracts with non-profit making organizations, in order to provide grants for the reimbursement of costs related to concrete social, sports and cultural activities. The organization is responsible for each investment and operational costs. It owns the means which are used (if they are not rented from the municipality) and bears financial risks.

Agreement on financing is usually related to a certain program of activities, not to an operation of the whole organization. The agreement is related to the whole program range and will determine quality level, which must be kept to by the organization. Financial reimbursement from the grant depends on complying with the quality level, and regular activity checks take place on activities provided by the organization.

1.4.8 Provision of Services without Legal Relations

The public service might be provided for by an organization without legal relations with the municipality. In this case, the municipal legal rules concerning the construction of a facility, sale of services, employment relationship, protection of the environment, health and safety at work rules and so on must be kept to. The organization can also be a subject of national or municipal inspections, but only under the same conditions as those applied to commercial activities.

1.5 Local Significance of the Communal and Public Utility Sector

Local budget revenue consists of five revenue groups as prescribed by budgetary classification which is compulsory to follow for municipalities:

- Tax revenue;
- Non-tax revenue;
- Grants and transfers;
- Revenue from repayment of credits and loans and from sales of shares;
- Credits.

Table 8.3
Structure of Local Government Revenue

| Revenue Group | 1997 | | 1998 | | 1999 | | 2000 | |
|--|-----------------|--------------|-----------------|--------------|-----------------|--------------|-----------------|--------------|
| | [million Sk] | [% of Total] | [million Sk] | [% of Total] | [million Sk] | [% of Total] | [million Sk] | [% of Total] |
| Tax revenue | 10 596.4 | 36.7 | 11 402.2 | 39.5 | 11 608.4 | 42.5 | 12 799.2 | 38.0 |
| Non-tax revenue | 10 294.8 | 35.8 | 10 646.6 | 36.9 | 9 116.5 | 33.3 | 10 691.6 | 31.8 |
| Grants and transfers | 5 026.3 | 17.5 | 3 784.6 | 13.1 | 3 362.3 | 12.3 | 3 739.4 | 11.1 |
| Revenue from repayment of credits and loans and from sales of shares | 161.9 | 0.5 | 96.5 | 0.3 | 93.4 | 0.3 | 124.3 | 0.4 |
| Credits | 2 733.1 | 9.5 | 2 942.7 | 10.2 | 3 162.9 | 11.6 | 6 302.8 | 18.7 |
| Total | 28 785.5 | 100.0 | 28 872.6 | 100.0 | 27 343.5 | 100.0 | 33 657.4 | 100.0 |

SOURCE: Accounting reports Úč RO 2-04 for 1997-2000, Ministry of Finance

The tax revenue has obviously the most important position in the municipal revenue structure. Revenue from the communal and public utility sector is incorporated in the non-tax revenue group, which carries nearly the same importance as the tax revenue.

The basic expenditure classification divides operating and capital expenditure. Operating expenditure involve also debt payments.

Table 8.4
Basic Structure of Local Government Expenditure

| | 1997 | | 1998 | | 1999 | | 2000 | |
|--------------|-----------------|--------------|-----------------|--------------|-----------------|--------------|-----------------|--------------|
| | [million Sk] | [% of Total] | [million Sk] | [% of Total] | [million Sk] | [% of Total] | [million Sk] | [% of Total] |
| Operating* | 16 607.8 | 62.4 | 17 700.2 | 64.5 | 19 064.1 | 73.1 | 24 243.3 | 76.7 |
| Capital | 10 017.4 | 37.6 | 9 735.4 | 35.5 | 7 019.8 | 26.9 | 7 366.4 | 23.3 |
| Total | 26 625.2 | 100 | 27 435.6 | 100 | 26 083.9 | 100 | 31 609.7 | 100 |

* Operating expenditure includes repayment of loan principles and equities
SOURCE: Accounting reports Úč RO 2-04 for 1997–2000, Ministry of Finance

As mentioned in the section ‘Local Government Management Practices’, separating the three functions: owner, client, and policy maker, the amount of revenue from communal and public utility sector depends on what kind of organization provides services and which kind of contract has been signed with contracting out services.

In the following part we briefly deal with the significance of different services in the municipal budget’s revenue and expenditure.

Communal services are included mainly in two sections of the budgetary sector classification of public budgets in Slovakia:

- local economy services;
- environmental services.

These two sections together comprise up to 16.5% of total municipal expenditures.

The section on ‘Local Economy Services’ consists of five paragraphs:

- public lighting;
- burial services;
- public welfare services;

- other local economy services (such as local markets, public toilets, etc);
- organizations of local production and services (financial relations to organizations which are not included in any other paragraph of this section).

Table 8.5

Local Government Revenue and Expenditure for Local Economy Services [millions Sk]

| | | Revenue | % of Total Revenue | Expenditure | % of Total Expenditure | Capital Expenditure | % of Capital Expenditure |
|------------------------|------|---------|--------------------|-------------|------------------------|---------------------|--------------------------|
| Local economy services | 1997 | 159.3 | 0.6 | 2 209.4 | 8.3 | 246.6 | 2.5 |
| | 1998 | 113.0 | 0.4 | 2 208.0 | 8.0 | 364.6 | 3.7 |
| | 1999 | 93.2 | 0.3 | 2 118.1 | 8.1 | 341.5 | 4.9 |
| | 2000 | 123.0 | 0.4 | 3 071.6 | 9.7 | 639.2 | 8.7 |

SOURCE: Accounting reports Úč RO 2-04 for 1997–2000, Ministry of Finance

As mentioned above, the section on 'Local Public Services' includes data on public lighting, burial services (construction, operation and maintenance of cemeteries, crematoria, funeral hall, etc) and public welfare services (facilities). The following table (Table 8.6) provides more detailed information on a share of these services in total local government revenues and expenditures as well as a share in local government capital expenditure.

Table 8.6

Local expenditures by communal service areas

| | | Revenue | % of Total Revenue | Expenditure | % of Total Expenditure | Capital Expenditure | % of Capital Expenditure |
|-----------------|------|---------|--------------------|-------------|------------------------|---------------------|--------------------------|
| Public Lighting | 1997 | 3.1 | 0.01 | 642.9 | 2.4 | 67.4 | 0.7 |
| | 1998 | 2.5 | 0.01 | 837.5 | 3.0 | 166.1 | 1.7 |
| | 1999 | 2.2 | 0.01 | 909.1 | 3.5 | 208.2 | 3.0 |
| | 2000 | 1.6 | — | 1 325.7 | 4.2 | 522.3 | 7.1 |
| Burial Services | 1997 | 17.2 | 0.06 | 148.5 | 0.6 | 60.2 | 0.6 |
| | 1998 | 18 | 0.06 | 167.2 | 0.6 | 74.7 | 0.8 |
| | 1999 | 20.1 | 0.07 | 165.6 | 0.6 | 73.0 | 1.0 |
| | 2000 | 24.5 | 0.07 | 180.9 | 0.6 | 56.0 | 0.8 |

Table 8.6 (continued)
Local expenditures by communal service areas

| | | Revenue | % of Total Revenue | Expenditure | % of Total Expenditure | Capital Expenditure | % of Capital Expenditure |
|-------------------------|------|---------|--------------------|-------------|------------------------|---------------------|--------------------------|
| Public Welfare Services | 1997 | 57.9 | 0.2 | 925.7 | 3.5 | 58.7 | 0.6 |
| | 1998 | 33.3 | 0.1 | 735.8 | 2.7 | 52.9 | 0.5 |
| | 1999 | 15.4 | 0.06 | 626.9 | 2.4 | 16.5 | 0.2 |
| | 2000 | 32.7 | 0.1 | 920.4 | 2.9 | 18.2 | 0.2 |

Section Environmental services involves five paragraphs:

- nature protection (protected areas, botanical gardens, zoological gardens, etc);
- public green (construction and maintenance);
- cleaning and winter treatment of local roads;
- waste collection and disposal;
- other environmental activities.

Table 8.7
Local Government Revenue and Expenditure for Environmental Services [million Sk]

| | | Revenue | % of Total Revenue | Expenditure | % of Total Expenditure | Capital Expenditure | % of Capital Expenditure |
|------------------------|------|---------|--------------------|-------------|------------------------|---------------------|--------------------------|
| Environmental Services | 1997 | 241.6 | 0.8 | 1 628.7 | 6.1 | 191.5 | 1.9 |
| | 1998 | 208.7 | 0.7 | 1 583.1 | 5.8 | 162.3 | 1.7 |
| | 1999 | 232.3 | 0.8 | 1 713.5 | 6.6 | 84.4 | 1.2 |
| | 2000 | 276.7 | 0.8 | 2 161.3 | 6.8 | 116.9 | 1.6 |

SOURCE: Accounting reports Úč RO 2-04 for 1997–2000, Ministry of Finance

The revenue and expenditure of this section are dominated by communal waste collection and disposal. Table 8.8 provides more detailed information on a share of specific services (public green, cleaning and winter treatment of local roads as well as communal waste collection and disposal) in total local government revenues and expenditures as well as a share in local government capital expenditure.

Most of the water and wastewater services have, up until now, been provided by five regional water companies which were owned fully by the state government. Municipalities have been

given the legal responsibility to provide adequate drinking water and waste water treatment services. However, only a very small part of water and wastewater infrastructure has been transferred to the municipal authorities. Otherwise, municipal authorities have so far little control over investments in the water sector, if even the municipal authorities have financed a fairly large proportions of the investments in the water sector. This issue is described in more details in section 3 'Water Supply and Sewage Systems'.

Table 8.8
Local Expenditures by Environmental Service Areas

| | | Revenue | % of Total Revenue | Expenditure | % of Total Expenditure | Capital Expenditure | % of Capital Expenditure |
|--|-------|---------|--------------------|-------------|------------------------|---------------------|--------------------------|
| Public | 1997 | 5 | — | 438.4 | 1.6 | 60.6 | 0.6 |
| | Green | | | | | | |
| | 1998 | 2.6 | — | 440.3 | 1.6 | 37.9 | 0.4 |
| | 1999 | 3.4 | — | 460.7 | 1.8 | 22.2 | 0.3 |
| | 2000 | 2.9 | — | 585.1 | 1.8 | 24.5 | 0.3 |
| Cleaning & Winter Treatment of Local Roads | 1997 | 0.8 | — | 500.2 | 1.9 | 6.9 | 0.07 |
| | 1998 | 0.3 | — | 426.1 | 1.6 | 4.7 | 0.05 |
| | 1999 | 1.4 | — | 545.2 | 2.1 | 1.2 | 0.02 |
| | 2000 | 1.2 | — | 773.3 | 2.4 | 4.8 | 0.06 |
| Commu- nal Waste Collec- tion and Disposal | 1997 | 227.9 | 0.8 | 619.7 | 2.3 | 90.4 | 0.9 |
| | 1998 | 200 | 0.7 | 685.5 | 2.5 | 109.6 | 1.1 |
| | 1999 | 225.6 | 0.8 | 664.6 | 2.5 | 56.7 | 0.8 |
| | 2000 | 256.3 | 0.8 | 748.0 | 2.4 | 79.4 | 1.1 |

There are a very small percentage of municipalities which operate their own water supply and sewage system as to the share of supplied inhabitants. In 1998, municipalities administered 533 (491 in 1997) municipal water supply systems and a water-piping network of 846 km (550 km in 1997) of the total length. These systems supplied 5% of inhabitants. Similarly, the proportion of municipalities administering sewer and wastewater treatment systems is rather low. The network of sewer pipelines administered by municipalities was 549 km in 1997. There lived just 2.3% of inhabitants in houses with connections to municipal sewage systems. Municipalities administered 108 wastewater treatment plants in 1997.

Incomes from the operation of these systems comprises less than 0.3% of the total municipal revenues cca 2.5% of total municipal expenditure. 80% of expenses are tied to construction of water and sewer systems and treatment plants. They comprise 6–8% of total local government capital expenditure.

Table 8.9
Local Government Revenue and Expenditure for Water Supply and Sewage Systems
[million Sk]

| Year | Revenue | % of Total Revenue | Expenditure | % of Total Expenditure | Capital Expenditure | % of Capital Expenditure |
|------|---------|--------------------|-------------|------------------------|---------------------|--------------------------|
| 1997 | 44.5 | 0.15 | 718.1 | 2.7 | 618.8 | 6.2 |
| 1998 | 52.5 | 0.18 | 673.6 | 2.5 | 542.2 | 5.6 |
| 1999 | 60.3 | 0.22 | 546.2 | 2.1 | 428.5 | 6.1 |
| 2000 | 89.8 | 0.27 | 772.4 | 2.4 | 620.2 | 8.4 |

SOURCE: Accounting reports Úč RO 2-04 for 1997–2000, Ministry of Finance

2. COMMUNAL SERVICES

The term ‘communal services’ in Slovakia has traditionally been related to the following activities:

- a) collection, transport and disposal of communal waste;
- b) cleaning, construction and maintenance of local communications;
- c) care for public green and cemeteries;
- d) operation of public lighting.

Local companies ‘technical services’ established by national committees usually provided these activities before 1990. The size of these companies, their technical equipment, efficiency and level of management differed from company to company, mainly dependent on the abilities and skills of those people who were in the top management and elected bodies. In smaller municipalities, the companies from adjacent towns and villages provided these services, and permanent or temporary divisions were set up and paid for by the executive apparatus of the national committees.

2.1 Current State of Communal Services⁵

The Act on Local Government and the Act on Municipal Property in 1990 passed a responsibility for these services on municipalities, which then became owners or founders of these ‘technical service’

companies. Small municipalities faced the decision of how to provide these services —either to provide them in full range from own funds and in that case to provide investment, or to carry them out only partially, or not to carry them out at all and have them contracted from the closest provider.

The previous technical service companies with their management system and organization came under the jurisdiction of mayors and councils. New municipal organs started to gradually change the system of management in these companies, or they were making decisions about their transformation into other organizational forms. Mistakes occurred in the process of their transition, restructuring and privatizing. Decisions were influenced by a political structure of municipality. They also depended on the abilities of management, on fierce competition of local and foreign entrepreneurs, on group, political or individual interests, on lobbying and so on.

The process of transformation took place mainly in the period of 1990–1995. In some cases, these companies remained in their original form with the same range of activities, i.e. in the form of budgetary organization. However, the majority took the form of a contributory organization set up by municipalities.

The original organizations, which provided a whole spectrum of services, were quite often split into more legal entities with a specific focus, which either remained under direct management of municipalities, or new commercial entities were set up with partial or full share of private capital.

In municipalities, which decided to entrust these services to the private sector, the whole or part of the companies was privatized, and new independent private entities were established. These started to provide the communal services for the municipality on the basis of a contract. Privatization was usually used one of the three models modified to certain conditions:

- Sale of the company as one unit to a commercial company with a take-over of rights and duties, financial liabilities and receivables. Usually the sale was related only to movables and annual installments were agreed (5–10 years).
- A lease of immovables (buildings, sites, land, so on). for a longer period, e.g. for 10 years with a condition of free of charge maintenance and a possibility for a mutually agreed investment, funded by a leaseholder, and a lessor reimburses the investment and the end of the lease. The price of the lease was usually agreed lower than the current prices in order to help the new entity stabilize its economy and maintain employment, upgrade technology and keep the leased property in good conditions and so on. For instance in Bratislava where the original technical services were split into independent companies for: collection and waste disposal; maintenance and cleaning of communications; and public lighting, was the price for a lease of immovables set only in the amount of depreciation
- The municipality has committed to order public services in certain amount from the privatized company. The amount of works could be equal, for example up to 30% out of the funds from the budget for these particular activities in present year. The buyer could compete with other suppliers for the rest of the works in a tender.

These models were applied with some modifications in several Slovak towns. Differences were mainly in the level of privatization. Newly established companies based on this model have been either with a 100% share of the municipality, or with a partial private share usually owned by members of the management or purely independent private entities. In some towns, foreign investors established themselves and became joint owners with a majority or minority share, mainly in the area of communal waste disposal /Brantner, Marius-Pedersen, Lobbe and so on. The most intensive process of the companies' transformation was in the period 1992–1995, but it has been still going on by the transforming and privatizing of contributory organizations to some of the forms of commercial companies.

On the other hand, in several municipalities, a discussion has started on the disadvantages and problems concerning the public services provided by private companies. Some of the municipalities have established small units, which should help to get them a bit out of such a dependent position in relation to the provision of public services. For example, some municipal parts of Bratislava have already set up their own organizations for communal services, even though the original technical services—now privatized—have the required capacities to cover these activities in the whole city. Some of the municipalities even consider a backward transformation of the commercial company (at which they have majority share) into a contributory organization. Technical services limited 'Ziar nad Hronom', who was transformed into a 100% private company, was rebought by the municipality, who gained 100% ownership.

As it has already been mentioned, the communal services are provided either through the companies that provide all the services, or through those ones that provide only individual services, and even through the municipal department. In the following part, we will describe the situation in more detail using as an example public lighting.

2.2 Public Lighting

The data and information from the Slovak Public Works Association⁶ were used to describe the current state of public lighting. With regard to the fact that member organizations provide public services in approximately 70% of Slovak territory, we can consider them as sufficiently representative.

In 1856 gas, and then in 1884 electricity, were used as energy for systems of the public lighting, i.e. lighting for communications, town squares, and public spaces. The public lighting maintenance had initially been provided by a gas works company, and then by an electricity company, and municipalities had their shares in both. According to the present legislation, responsibility for the public lighting is fully in the competence of municipalities. A basis for the current state was the establishment of national energetic companies in 1950–1960, and then the transfer of responsibility for the public lighting to national committees and their organizations. Basically, the public lighting is classified as a public goods indirectly paid by taxes.

Surveys of the current state of the public lighting in Slovakia conducted by the Slovak electricity company showed that there is a proportion between the number of lights and number of inhabitants, which approximately means a ratio of 10 inhabitants to 1 light of the public lighting. Another important survey results, shows the lamp structure of the public lighting (see the following diagram), with approximately half a share of natrium lamps, and an average electricity consumption for the public lighting including lighting costs:

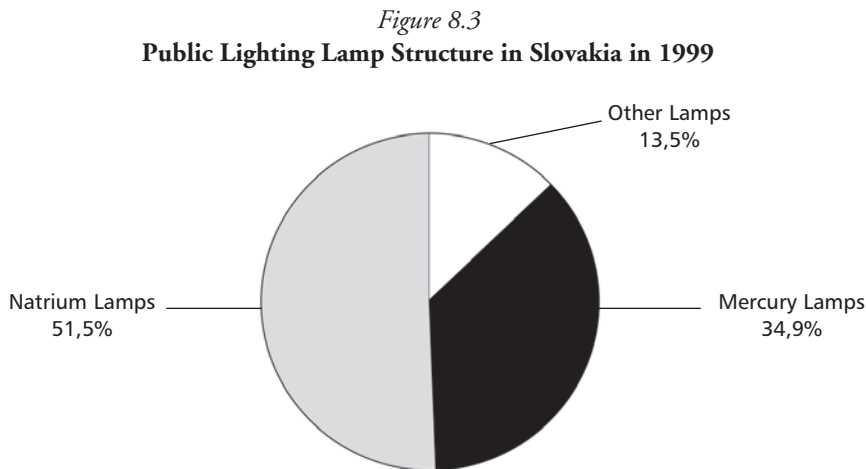


Table 8.10
Total Electricity Consumption and Electricity Costs for the Public Lighting in Slovakia, in 1999

| | |
|--|--------------------|
| Total electricity consumption per year | 342 151 GWh/year |
| Total costs for electricity | 864.3 million SK |
| Total maintenance costs | 257.8 million SK |
| Total costs per year | 1 123.7 million SK |

SOURCE: Documents of Slovak Electricity Company

Municipalities follow their own generally binding ordinances issued for the development, construction and operation of the public lighting when they carry out activities related to the area of the public lighting. From the point of view of works, maintenance, and construction,

there are valid national norms: STN 360400, STN 360410, STN 360411 for low voltage facilities, and operational rules since the public lighting is an electric facility. In the process, preparation for the reconstruction, upgrading and rationalization of the public lighting municipalities often use documents approved and issued in the socialism period, for examples: Views on Operation and Maintenance of Public Lighting 1972; Methodology for the Creation of Conceptions and Reconstruction Planning 1975; Rules for Lighting on Streets, Roads and Highways 1971 and so on.

The norm STN 360400 on public lighting, states partial requirements for energy saving operation and maintenance of the public lighting facilities. Limits on the energy consumption in relation to the size of municipalities, the so called ‘figures of consumption’ and output from the past lost their effect by a transfer to the market economy. The only limit for quality and quantity of the public lighting operation are operational costs, which are limited by an amount allocated from the budget for these purposes.

The public lighting facility is in the ownership of the municipality, and the management of this municipal property could be transferred to:

- professional departments of municipalities;
- specialized budgetary or contributory organizations of the municipality;
- commercial organizations—businesses which provide public lighting for an agreed price on the basis of mandatory contract.

The maintenance, reconstruction, and renewal of the public lighting facilities is carried out on the basis of the selection in a tender: they might be provided for either by the municipal employees, or by municipal budgetary or contributory organizations or by commercial companies.

The transformation of budgetary and contributory organizations responsible for the public lighting was implemented also through public tenders in order to select an entity, which was interested in privatization of the company ‘Technické služby’. A successful applicant would usually get also a contract for the following activities:

- maintenance and service;
- maintenance, service and operation;
- maintenance, service, operation and rationalization;
- maintenance, service, operation, rationalization and reconstruction including supplies of material.

In long-term contracts, the period of validity is connected to the return period of rationalization project investment. Sometimes municipalities announce tenders for the supply of individual components of the facility (lamps, lampposts) and the installations are done by the municipal organizations.

A natural part of the public lighting services delivery is the rationalization of maintenance and consumption of electric energy. This requires a significant amount of investment. The following ways are used to obtain it :

- supplier credit—even from foreign sources (e.g. Bratislava-Siemens);
- specific grants focused on rationalization of energetics, e.g. from PHARE;
- direct bank loans for municipal programs—e.g. PKB Žilina;
- emission of municipal bonds for approved project of communal strategy.

In the public lighting services, the regulated price is the price for electricity consumption in public lighting. There has been a huge price increase of about 80% in recent years. Costs for electricity consumption for the public lighting represent of about 0.6-9% of municipal budget expenditure (in the price level of 1999) as it was found out from the data of 55 respondents. A supplier of electricity for the public lighting is a network of state energy companies, which have not, as yet, been transformed. They are in a monopoly position and they do not provide price advantages for the public lighting sufficiently. The remaining cost items in the public lighting are market based. As for the costs of maintenance and operation of the public lighting, there is a demand for a general assessment and approximate determination of technical-economic indicators. These could make the basis for determination of costs of the public lighting used in contracts.

2.3 Construction and Maintenance of Local Roads

The state owns and provides construction, maintenance, and administration of the following types of the ground communications (besides local ones): motorways, roads of standard grades I, II and III . The Act no. 135/1961 on Ground Communications (the Road Act /with later rules states the conditions of the traffic and administration for each type of road including local communications. The state owns approximately 3,070 km of roads of grade I; 3 920 km roads of grade II and 17 650 km roads of grade III. The construction and maintenance of all types of roads owned by the state are provided by the organization Slovak Administration of Roads. Its budget consists of 70% share on the road tax, contributions from the state budget and National Property Fund and loans.

The Act on Ground Communications (Road Act) states that the municipality performs local state administration for ground communications. The municipality is a road administrative organ for local and other communications in its territory. The municipality, as the owner of local communications, must maintain them in the conditions they were designed for. The cities Bratislava and Košice own roads of I and II grade located in their territory and perform their administration. the municipality as an authorized road administrative organ can fine either an individual or legal entity up to 1 million Sk if the rules of the act are violated on local communications.

The Act no. 315/1996 on Traffic on Ground Communications declares the municipality as a road administrative organ on local communications 'LC'. The municipality administer local communications, issues decision about closing 'LC', the bypass and digging up of 'LC'.

According to the Act on Local Government and later rules, municipalities become administrators (§4 article (3) letter e—municipality performs construction, maintenance and administration of local communications, public space, ...) and in accordance with the Act on Municipal Property municipalities became owners of local communications. Municipalities administer local communications either directly through its own budgetary or contributory organisation, or through another company on the basis of contract.

Table 8.11
**Local Communications (LC), Level Crossings, Crossroads
with Traffic Lights and Bridges**

| Indicator | SR | Region | | | | | | | |
|--------------------------------------|----------|---------|---------|---------|---------|---------|---------|---------|---------|
| | | BA | TT | TN | NR | •A | BB | PR | KE |
| LC [km] | 24 978.7 | 1 373.1 | 2 420.9 | 3 258.9 | 3 410.9 | 4 018.8 | 4 547.8 | 2 944.1 | 3 004.2 |
| Bridges [num- ber] | 9 080 | 228 | 440 | 1 202 | 754 | 1 658 | 1 732 | 1 928 | 1 138 |
| Level crossings | 1 094 | 81 | 71 | 127 | 193 | 165 | 236 | 118 | 103 |
| Cross- roads traffic lights | 258 | 77 | 17 | 19 | 27 | 36 | 13 | 27 | 42 |

SOURCE: Documents of Ministry of transport, post and telecommunication SR

A 30% share, out of the road tax yield was allotted to municipalities for the construction, administration and maintenance of local communications until 2000. Trends of municipal revenue from this shared tax is shown in Table 8.12.

Since 2001, the share of road tax yield for municipalities has increased from 30% to 40%, and for cities Bratislava and Košice even to 60%.

The distribution of the road tax yield is applied to municipalities from the tax yield of each tax district, according to the number of inhabitants. Therefore, the tax yield per inhabitant differs

from one tax district to the next, in relation to the development of business activities and tax collection. It is clear from the table that tax yield steadily grows and is stable. However, in general, the tax yield is not sufficient. It does not fully cover the costs of road administration and maintenance. Mainly winter maintenance has to be funded from a municipal's own sources.

Table 8.12
Municipal Revenue from the Shared Road Tax

| Year | 1994 | 1995 | 1996 | 1997 | 1998 | 1999 | 2000 |
|-----------------------|-------|-------|-------|-------|-------|-------|-------|
| Revenue [thousand Sk] | 389.1 | 411.8 | 432.0 | 461.1 | 490.6 | 515.4 | 629.1 |
| % of total revenue | 1.9 | 1.8 | 1.7 | 1.6 | 1.7 | 1.9 | 1.9 |

SOURCE: Accounting reports Úč RO 2-04 for 1997–2000, Ministry of Finance

Cleaning and maintenance of local communication is classified as a public goods generally funded from municipal budgets. Complementary income source to cover cleaning and maintenance costs of local communications may be an income from parking fees. Parking fees have not been regulated until recently by central law. Municipalities set parking fees in their own generally obligatory ordinances. These were in some cases contested by the district public prosecutor's offices. The Association of Slovak Municipalities has prepared a proposal on a legal amendment of parking fees, and submitted it to Parliament. The Slovak Parliament approved a law which including a parking fee in the system of local fees.

To provide these services, municipalities use similar models as described in the public lighting section. In any case, to provide cleaning and maintenance of public communication they more often use budgetary or contributory organizations of municipalities. Financial resources from the housing support funds are often used by municipalities for the construction of local communications.

2.4 Public Parks and Cemeteries

The municipality is responsible for the administration of public spaces, municipal cemeteries according to the Act 369/1990 on Local Government.

The decree issued by Ministry of Health Care 46/1985 on the procedures surrounding death and funeral sets the municipal competency to establish and administer cemeteries, columbariums, crematoriums, and so on. It also gives the municipality power to entrust the administration of these facilities to other organizations. Conditions for the establishment of cemeteries are also set up in the Construction Act, and are related to ordinances of environment protection.

Basically, the care for public greenery and cemeteries has been classified as an ‘indirectly paid for’ service, through taxes. Complementary income to cover the costs are fees for the use of the public spaces or burial site. Municipalities use similar models as described in the section on public lighting to provide these services, but generally this is done by the budgetary or contributory organizations of municipalities.

2.5 Solid Waste Management

The main strategy of waste management in Slovakia is integrated protection, which is based upon the following principles:

- a reduction of the waste production;
- a decreasing of toxic material contents in waste;
the material utilization of waste;
- a thermal modification of waste if there is no possibility to use it, with the purpose to get energy, reducing a cubage and weight of waste along with a reduction of the contents of harmful material in waste;
- the dumping of waste at a minimum rate.

In next few years it will be needed to continue, not only in building of a whole infrastructure of waste management, but to focus especially on the decreasing of waste production at the source, and an increase in the exploitation of waste.

A database of the waste production in Slovakia is maintained by the Regional Waste Information, which covers data collection from waste generators. The data is elaborated on by the Slovak Environmental Agency. According to this database, 19.8 million tons of waste were produced in 1998, of which communal waste was 1.7 million tons. Per capita, waste production counts currently for 330 kg.

According to the Act on Local Government, municipalities are responsible for the removal and disposal of communal waste. This responsibility was also carried out in the provisions of Act 238/1991 on Waste, which was applicable until June 2001. It was a fundamental law on waste, from which are derived other legislative regulations.

The Act on Waste clarifies, in its provisions, the main concepts of waste management, licenses and responsibilities for respective institutions of public administration, legal and physical entities, responsibilities of transport operators for waste transfer, collection, repurchase and modification of waste, and the responsibilities of the operators for disposing facilities. The Act defines charges for the waste disposal for legal and physical entities, defines the penalty assessment of legal and

naturalized persons for breaking the law and its amount. Penalties for breaking the act are set by state administration and they are the revenue of the state environmental fund.

In addition to the Act on Waste mentioned above, the Ministry of Environment issued a public notice (number 19/95), which determinates the categorization of waste and waste catalogue. Waste, according to this regulations is defined in Slovakia into the following categories:

- A) hazardous waste;
- B) specific waste;
- C) other waste.

Waste is arranged according to its generator, hazardous waste is arranged according to its attributes or malignance contents.

The law, which is connected to the basic Act on Waste, is Act 309/1992, on charges for waste disposal. this sets the charges for the waste producer; defines sorts and altitude of charges; prepayment and conscription; detection of quantity; categories; and types of waste and validation.

Another legal norm is the government regulation 605/1992 on waste evidence. The purpose of these regulations is the administration of the evidence of waste according to its categorization. Regulations determine who is obliged to administer evidence; the responsibility to report production and disposal of special and hazardous waste; the responsibility for the transfer of hazardous waste, and to execute a transmittal letter, and produce the evidence. Regulations also assign to the operator of a landfill to administer a registration sheet of dump, a component of which is also a list of an individual type of waste, which is permitted to be disposed of in the dump.

The legislation, which modifies the conditions of waste management is government regulations 606/1992. The regulation determines the responsibilities of waste producers to accumulate, separate, adjust, treat and utilise the waste. It also determines the specific conditions required for dealing with hazardous waste, and the methods of waste disposal.

Municipalities are responsible for the provision of public services including the waste collection and disposal. For details of these regular responsibilities, refer also to the Act on Waste § 2 ('Dealing with Communal Waste Produced on the Territory of the Municipality), which regards the municipality as a waste producer. This means that citizens who in fact produce the waste, are not seen as waste producers.

Municipalities as waste producers are obliged to:

1. Prepare a program of waste management and submit it to a competent public administration body for approval;
2. Collect produced waste separated according to the sort of waste;

3. Exploit of accrued waste as a source of secondary raw material especially at their activity;
4. Provide for the disposal of waste;
5. Register sort and quantity waste and their disposal.

Municipalities as producer of communal waste were responsible for following waste:

- households waste
- waste similar to household waste (public services, micro-businesses, transport, recreation, agencies)
- separated household waste with harmful contents ('household' including the family house, communal economy, leisure facilities, and offices)

Most of the municipalities set these regular responsibilities in more details by the municipal generally binding ordinances approved by the council. Hazardous waste is not a part of communal waste and is therefore not in the responsibility of municipalities.

The fact that municipalities were considered to be communal waste producers, brought big problems to municipalities. Charges to be paid by citizens for waste collection, separation, removal and disposal have often not been paid. The ordinances on waste management were often advanced by a public prosecutor as unlawful because, in accordance with the law, the producer of communal waste was a municipality and not a citizen. Hereafter the principle of 'polluter pays' was broken.

The Slovak Republic is characterized by a large number of small municipalities. They are not always able to perform their responsibility because of economic reasons. It concerns mainly the responsibility to provide the collection, removal and liquidation of communal waste. The technical issues such as garbage bins, vehicle for waste collection, land fill construction also create problems for small municipalities. Therefore, the small municipalities solve waste management problems in collaboration with other (often bigger) municipalities by forming Waste Management Associations. These associations are established at the base of a Civil Code, or Business Code, as commercial companies.

The association of municipalities or commercial companies, (whose shareholders or stockholders are municipalities), are established in order to manage the waste, but also to build and operate landfill for solid communal waste.⁷

The shares of individual municipalities are in association, and are set up usually according to the amount of their financial inputs or property inputs. The association has its own name, statutes, bodies, and area of activities to perform, and their own account. The aim of the association is not to create a profit, but to provide services. The length of the association existence is not legally set. The association can be abolished by the decision of the assembly.

In this way, municipalities join their financial resources to finance waste management, to get a loan from a financial institution, or to get a financial subsidy from the Environmental State Fund or from the EU structural funds.

The landfill construction for solid communal waste is rather limited because of a large land protection policy of state. Therefore, landfills are located into various gorges and on soil with low contents of mould (a bad qualitative class of soil).

Waste collection and disposal at the landfill for small municipalities is often provided by the municipal enterprises of bigger municipalities on the basis of contractual relations. But the private sector is getting to be predominantly involved in the provision of such services.

Communal waste management services are largely provided for in the Slovak Republic by the private sector, or by a company in private-communal ownership. Private companies in the system of communal waste management, are focusing on the separation and removal, and also especially on the construction and operation of landfills.

If municipalities lack the sufficient funds, the private sector takes a role as a business partner. In this case, joint-stock or limited liability companies are established. Their aim is to provide complex waste management services, and to achieve the return of financial investments as well as profit. These companies are established by municipalities and private firms with the usual majority of private sector

The input of foreign private companies into this area is also very intensive. (A.S.A, LOBBE, PEDERSEN companies are most frequent). Foreign companies form common commercial companies with individual municipalities (as joint-stock companies, or limited liability companies). The stake of municipalities is usually land for landfill construction. The stake of private companies is financial capital and expertise. Private or communal companies mostly provide a comprehensive, complex program of communal waste management services through contract arrangements.

As municipalities are responsible for communal waste and its disposal, companies conclude contracts on waste collection and disposal. The price is not regulated, and it is set according to costs, plus profit. If the price gets over the 'acceptable burden level' to citizens (the 'acceptable burden level' is decided by the local council), the costs are subsidized from the municipal budget.

The method of waste management is set in a municipal's 'Binding Ordinances', in which the altitude of charges for the collection, removal and disposal of waste is also determined. As mentioned above, payment for charges is often a problem. Due to difficulties in setting the charges, municipalities often get payments from inhabitants through rental of the garbage can. In any case, these payments cover just a small amount of waste management costs, and the spare amount is covered from a municipal budget.

The waste management financial indicators used by municipalities (under the validity of Act on Waste applicable until June 2001) included:

- cost of municipalities incurred by collection and transfer, separation and exploitation of waste as a secondary source raw material;
- basic charges paid by municipalities for waste disposal at landfill;
- penalties imposed to municipalities by an executive agency gives to commune for breaking the rules set in law;
- municipal incomes from legal and physical entities for waste management;
- basic charges acquired by municipalities for disposal of communal waste on landfills, which are in its cadaster;
- sources acquired for separated collection (grants from state funds, other sources).

A previous law on waste was effective from the year 1991. There was a general agreement that relatively big change was needed from the view of development, and taking over principles and regulation established in EU states.

The first step has been an adoption of a new Act on Waste. The next legal step will be the adoption of law about packing, and waste from packing, which take over provisions from EU regulations

In the frames of new law preparation, municipalities tried to achieve three main changes in communal waste management, which could be stated as follows:

- the disposal with communal waste produced on the territory of municipalities is determined on base of law by general binding ordinance;
- the penalties for breaking the rules for communal waste management are in the revenue of the communal budget;
- the waste producer is the body whose activity produces a waste and the producers also pay for waste producing.

These proposals had been accepted and they are incorporated in the provisions of the new Act on Waste.

The new Act on Waste⁸ becomes effective as from July 2001. The new act has been made to mostly harmonize with directives and regulations of the EU. The law has adopted provisions from the general directive for waste; from directives on hazardous waste; from regulation directing delivery; exportation and transit of waste; from the regulation about batteries; and from the regulation about the disposal of oil waste.

The new act in its introductory provision counts as a waste producer, any person or body producing waste, which also includes citizens. Municipalities regulate in 'generally binding ordinances' a

method of waste collection, transport, disposal, way of separated collection, and way of handling construction waste.

Collection, transport and the disposal of waste are a municipal service, which is funded from the local fees for waste. The municipality imposes the fee on waste producers. The law sets a minimum and maximum limits of this fee, but the municipality determines the final amount. The revenue from these fees can be used only for waste management purposes.

To service of waste collection and disposal in the municipality can deliver only that company which has a contract with the local government (if the local government does not deliver this service itself).

The act is assigned to municipalities who have the power to act on the contravention of the law. The municipality can impose a penalty for contravention, which becomes an income of local budget.

The new Act on Waste has established a so-called recycling fund. It is a non-state fund which has its own bodies including a managing board and a supervisory board. Producers and importers of specific products, such as car, paper, tyres, plastics, pet bottles, luminescent tubes, etc, pay the contributions to a fund. Producers and importers are also members of managing and supervisory board. In this managing board, which consists of 15 members, are the municipalities who are represented by 3 members. The money from the fund can be used only to support waste collection, revaluation and processing. Municipalities can apply for the money if they provide a separate collection of defined commodities.

2.6 Heating Supply

The heat management in the communal sphere represents a significant part in the Slovak energy sector. Transformation of the original planned economy to a market one has had an impact on all spheres of the national economy, so it also has affected the heat management, i.e. the supply of heat to citizens. The supply of heat has its own specifics; thus we can not say there is a free competition on its market in the right sense. The heat management in the communal sphere is a sector which is outside the state property. It is owned either by municipalities or private or state companies also with a part of housing fund (this is specified in section 4).

In many cases, the producer of the heat and the purchaser is the same organization, which certainly does not create a good economic environment. This is caused by the monopoly position of the heat producer that at the same time is also a housing management company. But in each town the situation varies, and is being changed during the course of time. Regulation in this monopoly environment of the heating sector is not at a sufficient level to create a market environment. The consequence of this is that a final customer— citizens—can not exercise their choice

of heat supplier according to quality and price, as they are very often supplied by heat from the direct purchaser (the housing management company). Thus, the final customer who actually uses the heat is not a full participant of the market and has little chance to influence the heating supply as a product.

Heat producers are the decisive participants in the heating market—they are the license holders that manage municipal property. At present, there are 768 heat producers in the market. Suppliers of heat are in many cases also housing management organizations and as a direct purchaser of heat they calculate the cost of it on the final customers or sell it to other direct customers. On the heat market there are also customers that use the heat for industry purposes or in the sector of services (e.g. schools, hospitals, etc.).

Figure 8.4
Heat Market Scheme

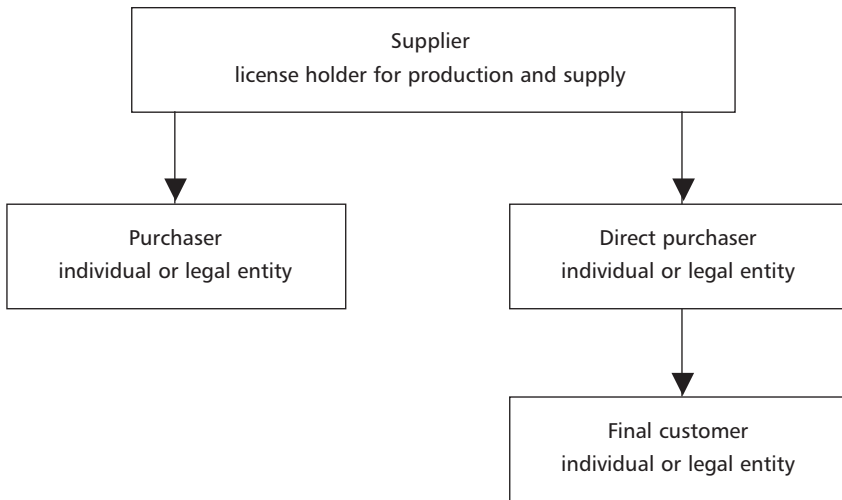


Table 8.13
Heat Supply from Centralized Heat Systems

| Share of energy sources | [PJ/year] | [%] |
|--------------------------|-----------|-----|
| Public energy sector | 17 | 46 |
| Industrial energy sector | 6 | 16 |
| Heating units | 14 | 38 |
| Energy sources total | 37 | 100 |

SOURCE: Documents of Slovak Energetic Agency

The above table gives an overview about the composition of the energy sources of centralized heating supply systems, which participate in the heating supply for heating and hot water in the communal sphere. These were usually built up within the complex municipal housing construction. Towns and villages have a dominant share in the heat production and supply in communal housing sphere.

The Act no. 369/1990 on Local Governments (in § 21) states the following: “municipalities can create temporary or permanent national, regional associations in order to carry out corporate tasks or to represent their interests and needs or from other reasons.” The rules for associating of legal entities are dealt with in the Civil Code (§ 20). The Commercial Code enables municipalities to set up commercial companies and co-operatives, and the Act on Budgetary Rules enables them to establish budgetary and contributory organizations. In principle, municipalities can use all these forms to provide the management of the heating facilities, but in real practice only the following forms are being used:

1. Organizational unit without any legal power, i.e. directly managed by the municipality;
2. Budgetary or contributory organization connected to municipal budget;
3. Commercial company set up by municipality or with a share owned by municipality (limited, or joint-stock company);
4. Contracting out to commercial company totally independent from a municipality.

Each operating organization of the heating facilities must comply with rules stated in the Act no. 70/1998 on Energy, and on the amendment of the Act no. 455/1991 on Entrepreneurship. In practice, half of the municipalities use the form of contributory organizations and the other half use their own commercial companies or independent ones on a contractual basis—a lease.

Basic legislation rules for the energy sector, which take into account changed social–economic conditions are determined by the Act no. 70/1998 on Energy and on the change of the Act no. 455/1991 (further only the Act on Energy). The Acts were valid until 1998, and were based on the principles of a planned economy, and they did not allow for competition in the energy sector. Now the Act on Energy enables competition also in this sector, which due to the method of supplying of its ‘product’ has a monopoly character. According to this Act, the Ministry of Finance (MF) can regulate the prices and tariffs to a certain level, and the Ministry of Economy (ME) can regulate the conditions in the area of entrepreneurship. According to the Act on Energy, an individual or legal entity can start a business in this field, but only if it is able to obtain a license, which is assigned by ME. Furthermore, the Act orders a license holder to assign a responsible representative (or employee), stating the conditions which must be fulfilled in order to obtain an authorization for the position of the responsible representative, conditions for entrepreneurship in electric energy, heat energy and gas energy sectors and duties and rights of suppliers and customers buying electricity, gas and heat.

The license would be allocated by ME to every individual or legal entity, which fulfils the act conditions separately for each activity in the energy sector, i.e. for the production and transit and

the purchase of electricity and gas. The license has to also be allocated in the heat energy sector. Each applicant for the license in the heat energy sector must fulfil the administrative and personnel requirements, and has to prove sufficient economical and technical means. Economical means are proved by the document or title, or by a lease contract for the operation of the heating facility (in this case with the municipality), and technical means by the document about the functioning and safety of the equipment. That means that the license holder can only use the heating facilities, which are stated in the supplement to the license.

ME carries out regulation of entrepreneurship in the heat energy sector by defining the place and scope of business and at distribution by defining the territory in which a license holder must provide heat. In such defined territory the license holder has practically a dominant position, which enables a long-term development of the energy management with a focus on effective distribution of heat to customers.

Apart from stating conditions for entrepreneurship in the energy sector the Act on Energy also arranges relations between a license holder and the customers. It defines the conditions under which the license holder must supply heat (the heat supply contract), and the cases when the holder can restrict or stop the supply of heat. An important part of this Act, is a duty to measure consumed heat at a place, which must be agreed with a customer, and which usually is at the property boundary of contractual parties. When there is an absence of the Act concerning the effective utilization of energy, then §36 of the Act on Energy becomes an important tool as it determines the technical conditions for provision of an effective supply of heat:

- provision of automatic control of heat supply in dependence on climatic conditions of the heating system;
- to maintain hydraulically controlled systems of the heating facilities up to the place of consumer;
- to check the effectiveness of the heating facilities operation up to the place of consumer once a year at least.

The other regulation tool within the sense of the Act on Prices—the price regulation of heat, is within the powers of the Ministry of Finance. The Ministry of Finance performs the regulation of the price of heating by the regulation based on the principle of allowable costs included in the price at a producer and by determining the ceiling(i.e. maximum) price of heat for the final consumer. This principle has been applied since 1991.

After 1993, the price difference between the production price and the ceiling price has been compensated by subsidies from the state budget according to the Act on Budgetary Rules, the Act on Prices and directives of Ministry of Finance. The Ministry of Finance decrees has arranged the price market of heat. A change took place in 1993 when owners and organizations managing housing funds became the recipients of subsidies instead of producers. The table below shows an amount of subsidies spent by the state for these purposes.

Table 8.14
Heating Price Subsidies

| Year | 1993 | 1994 | 1995 | 1996 | 1997 | 1998 | 1999 | 2000 |
|----------------------|------|------|------|------|------|------|------|------|
| Subsidy [billion Sk] | 2.6 | 3.2 | 3.6 | 4.3 | 4.3 | 3.6 | 1.6 | 0.2 |

SOURCE: Documents of Slovak Energetic Agency

In the second half of 1997, the Ministry of Finance reduced the subsidies for heat of about 30% of the previous year's subsidies, which was followed by a problem in the heating market.

On 1 January 1998, the price regulation of heat was given into the competence of district offices, which according to the Act on Prices can carry out the price regulation only by determining the ceiling price. In many cases, the prices which were determined by the district offices did not enable the subsidies to cover the price difference between the production and selling price, thus creating tense relations between producers and purchasers. Mainly housing co-operatives and condominiums did not pay the full amount according to the ceiling price determined by the district offices, but only a household price i.e. up to the amount with a provided subsidy. Thus, the producers were not paid the full price of covering the costs of production and distribution. Even so, from 1 January 2000, according to the Part I, Letter B, Item 1. measure of MF SR no. R-10/1999, the ceiling price of heat for the heating and hot water for households and other use will be determined by organs of the state administration (i.e. the district offices).

There is an overview of the average prices of heat for suppliers and citizens in the following table since 1993. It is clear from the table that the price growth for citizens significantly lags behind the price growth for suppliers. A claim for subsidy rose from 65 Sk/GJ in 1993 to 109 Sk/GJ in 1997.

Table 8.15
Heating Price Development

| Price of Heat [Sk/GJ] | 1993 | 1994 | 1995 | 1996 | 1997 | 1998 | 1999 | 2000 |
|-----------------------------|------|------|------|------|------|------|------|------|
| Price from supplier [Sk/GJ] | 185 | 216 | 232 | 240 | 254 | 267 | 288 | — |
| Price for citizens | 120 | 130 | 140 | 140 | 145 | 165 | 245 | 350 |

SOURCE: Documents of Slovak Energetic Agency

Decree of MF no. 17172/1997/54 which states the conditions for subsidies to prices of the heat energy for households, along with the method their application, significantly changed the established

rules for the application of subsidies to the price of the heat energy for the whole of 1997. Just a few weeks before the end of 1997, it created the foundations for non systematic measures to take place in 1998 and 1999.

During 1997, 1998, 1999 and even now, the state still regulates the production price at producers and suppliers, and at the same time it determines the ceiling price for citizens through the district offices. The ceiling price determined by the state was usually lower than the production price, which is also determined by the state. In reality, this meant that the owner of the block of flats was selling heat for a cheaper price than he actually paid for it. Thus, the price difference occurred for the owners of flat units, i.e. condominiums, housing co-operatives, town's organizations managing communal flats. The owners were fully compensated for this price difference by subsidies from the state budget, up to 1997.

In 1997, 1998 and 1999 this price difference—a loss caused by the state organ decisions—was not compensated in full by the state, thus creating a financial loss for the owners of the housing fund. After meetings and discussions with MF, the Council of Economic and Social Agreement the government and the state decided to compensate part of the loss and to decrease the financial loss of the owners. Owing to the fact that this has become a long term problem and the poor financial position of the owners' debts brought about by not compensating the price difference, have also been passed on other participants in this commercial chain as distributors, producers of heat and further on the suppliers of fuels and energy. Some suppliers started to exercise an application of penalization, which made financial obligations more complicated and increased outstanding debts. There were some cases of temporary cut-offs in the supply of heat and hot water. Moreover, institutions tied to the state budget (schools, hospitals) were also unable to pay for the supply of heating and increasing number of individuals who ceased to pay for this service got the owner of the housing fund into an even worse position of loss. Very tense relations arose in the whole chain, beginning at production then distribution, but also including suppliers of fuel and energy creating a threat for the provision of a permanent supply of heat for almost 45% of citizens, schools, health facilities and others in the period 2000–2001.

MF maintained an opinion that there was no legal claim for subsidies, and considered issues connected to an application of subsidies for 1997 and 1998 as definitely settled. The owners of the block of flats did not agree with this and, after negotiations in the Council of Economic and Social Agreement, the state committed to pay the subsidies.

New problems in this area can bring wrong and mutually unbalanced decisions about a price change of gas and a price of heat caused by growing prices of natural gas at the world market, and by the devaluation of Slovak crown against the US dollar.

The gas is the basic raw material for the heat production supplied to the greater number of households, and poses the biggest item in its price. A possible increase in the price of natural gas will make the price of heat growth, and in many cases the production price will be higher than

420 Sk/GJ, which is the ceiling price determined by MF for citizens. The owners of the housing fund and producers of heat are the first to be hit by the impact of the price change. Other negative facts are the time gap between an increased price, and the increasing of installment payments for heat, and last but not least, citizens dissatisfaction presented by them stopping their payments for consumed heat. All these reasons may cause an uncontrolled decline of the owners; administrators of housing fund and companies producing heat and thus endangering the heating supply for citizens. In order to solve this problem, a systematic solution should be searched for a whole Slovak economy with a focus on the social conscience. The government, ME, and the Slovak Gasworks state company should all together try to solve this problem in systematic and complex way with regard to the whole chain of production, and distribution of heat, and not least for the living standards of the citizens.

The most transparent view on the reduction of consumption—rationalization of production and consumption is given a specific consumption of heat for heating purposes—consumption per 1m² of the area of a flat. Climatic conditions in individual years will have to be taken into account, in order to have an objective view on the specific consumption development. The course of the day—degrees (°D) which represents the climatic conditions in individual years is illustrated by following: a number of day-degrees since 1994, when there was an average 3313 °D, was increasing until 1996 when it reached 4082 °D. Since 1997, winters have become milder, and until 1999 the number of the day-degrees has downward tendency.

Local producers and foreign investors also influence the rationalization. The company Steirische Fernfarwärme GmbH is an important investor in 9 towns (Banská Bystrica, Krupina, Levoča, Prievidza, Revúca, Rimavská Sobota, Rožňava, Veľký Krtíš a Zvolen). Investment into the rationalization in these towns was seriously affected by the reduction of subsidies in 1997, 1998 and 1999, and endangered foreign investment.

Each business activity, which is to develop and provide at least a minimum standard service, needs an environment, which supports it, or at least which does not create obstacles. Due to its character, an entrepreneurship in the energy sector has a monopoly position, therefore it is submitted to a certain state regulation and control. The regulation is inevitable, but the rules must be clear and stable. A recent year's experience of the heat suppliers and other participants in the market is not very positive. The development of the heating energy sector has not occurred.

The problems in the market with heat can be split into three chief areas, all of which are interconnected:

a) The License Holder

The Act on Energy must clearly state the basic conditions of entrepreneurship in the heat energy sector, and determines the rules and duties for both the suppliers of heat and customers. The validity of the license and exclusiveness in a given territory should ensure the license holder's long-term sustainability of competitive technical conditions and the development of the heating

facilities systems and their modernization. A potential change of an operating company on the leased facilities can result in limiting investment into the modernization of the heating facilities, which reduces consumption.

The license holder has a duty to supply heat in the defined territory, in case of violating this duty the license can be taken from her or him by the Ministry. In the case of violations which are not of significant consequences, the Ministry or the State Energy Inspection may fine him. But the duties stated in the license are not well balanced by legal rights for the operation of the heating facilities. For instance, a license holder can not stop the supply of heat because of technical reasons when he/she has outstanding debts with a direct purchaser, if the final consumer pays installment payments. This can bring about his/her bankruptcy. Similarly, legislation should deal with the conditions of disconnecting customers, which is causing a problem for the heat suppliers, of costs being stuck in the central sources of heat, into which investment means were poured in order to provide supply of heat for these customers.

b) The Price of Fuel

To make the actual costs of an obtaining, transport and distribution objective, the system of cross subsidies at network suppliers of fuel and energy should be abandoned and thus make price equalization of the installation of individual heat sources. To create relations in the market with heat, similarly as they are arranged in the electricity or gas markets, i.e. a supply of heat and hot water should be based on a contract between the supplier and final consumer. A long-term valid structure of economically justified costs and adequate profit at the calculation of price for heat with maximal values for individual cost items should be introduced. In the process of the calculation of projected costs for fuel norms of heating, equipment for the testing of the heating facilities systems should be used. The prices should be valid from 1 January each year. This will help to hasten the process of contract conclusions with customers. Establishment of a double item price should be promoted, where one item would be the stable payment for the connection to the heating system (depreciation, salaries, maintenance, repairs) and the other item would be of variable payment for the supplied heat (fuel, water, electricity). The stable payment gives an opportunity for the purchaser to have a different share on the fixed costs according to the consumed heat. This provides a wider scope for the purchaser to rationalize his or her heating management.

c) Technical Measures

The Act on Energy and relevant decrees state rules concerning the technical measures to increase the effectiveness of production and distribution of heat. The problem is how to measure supplied heat. The act defines the place and entity responsible for the installation of measuring equipment. It does not specify the place of measuring, it leaves this issue up to the partners to agree. The act does not deal with a potential situation when the agreement is not reached. Location of the measuring element is a subject of contract. A cut in the supply of heat may be a result of not concluding a contract. This gives a supplier a possibility for abuse of his/her monopoly position. This, and in the case that the agreement is not concluded, may lead to a direct supply cut off.

The Act on Energy defines duties for the direct purchaser, and if the duties are not fulfilled, a fine can be imposed. On the other hand, other acts restrict access to the private property of individuals, therefore preventing them from carrying out technical measures. This is mainly related to the installation of automatic control elements on each thermal equipment, and elements for measuring the final consumption of hot water for moving consumers. This duty should be included into the duties of the owners of flats and flat management companies at the first installation of control equipment in blocks of flats.

As mentioned in section 1, the Parliament of the Slovak Republic approved the Act on Regulation in Network sectors in July 2001. The Act is changing, in principle, the current legal status, especially in the granting of licenses and price regulation. These will be transferred to an independent body, and price regulation will become gradually free from political influence.

2.7 Other Issues

Apart from the predominant issues mentioned above, there are some others that should be taken into account:

The provision of communal services by an external organization puts requirements on employees of municipality and its councilors, which only a few municipalities are able to fulfil :

1. The municipal council should decide about the level and standard of the services which are expected to be provided. It is a political decision, and elected representatives should consider all options.
2. Employees of the municipalities should have the required skills, in order to know what is expected from the service providers, and should be able to control their activity. At the moment, this is a bit complicated since the skills and abilities are just in organizations providing the services.

There is an absence of general indicators which could be the basis for determining the objective costs for the services and that creates a problem for the conclusion of contracts with external organizations or determining level of funds for contributory organizations. The result of this is that prices in different municipalities significantly differ and in comparable conditions they are much higher.

The member of the Slovak Public Works Association identified together with their partner associations in the V4 countries at the conference in Nitra in October 2000 the following issues and problems they are facing:

- frequent tensions, conflict and mutual distrust between public works company managers and local government staff, mayors, councils and councilors;

- small municipalities can often afford to spend less money for public services, but require the same quality and quantity of services;
- not honoring existing agreements and not paying for completed services;
- ineffective management of public works companies owned by towns and villages. There is a need to increase motivation and qualifications of top management and their staff;
- lack of political will or direction;
- lack of qualified and objective analysis of the need for privatization of public works activities;
- municipalities are frequently in a disadvantage situation while negotiating service contracts, mainly with private companies owned by foreign capital. These contracts often unduly burden municipal budgets and additional costs are transmitted to citizens.

Currently, many Slovak municipalities are reviewing the structure and forms of local service provision. In order to take best option of the form of organization, it is necessary to summarize not only the pros and cons of individual forms from the aspect of service to be provided, but also from the aspect of economic efficiency and budgetary implications, ownership structure, capital investment funding, a need of service fee regulation, et cetera.

As a principle, it is an effort to find the balance in the trade off of an economic efficiency and effective control and management of local communal services.

3. WATER SUPPLIES AND SEWAGE SYSTEMS

The water supply provided to municipalities is one of the most important activities of the water management, and a number of inhabitants connected to the public water supply systems and specific water consumption characterizes living standard and housing hygiene. 4, 447 800 million inhabitants, which represents 82.4 % out of the total number of inhabitants of the SR (Slovak Republic), were connected to the public water supply system in 1999.

Table 8.16
Share of Inhabitants Supplied from Public Water Systems

| 1995 | 1996 | 1997 | 1998 | 1999 |
|--------|--------|--------|--------|--------|
| 79.4 % | 79.8 % | 80.8 % | 81.8 % | 82.4 % |

SOURCE: Report on water economy in SR 2000

Improvement of hydrogeological conditions in 1985 stopped the decreasing of water resources. Since 1985, the specific water consumption was stabilized at the same level and in 1990 a sharper growth was recorded (195.5 liters per inhabitant per day). Since 1990, the specific water consumption has been decreasing, mainly due to an increase of its price, and in 1999 it represented the value of 126.9 liters per inhabitant per day .

Table 8.17
Household Water Consumption

| 1997 | 1998 | 1999 | 2000 (Expected Development) | 2001 (Expected Development) |
|-------|-------|-------|-----------------------------------|-----------------------------------|
| 131.9 | 131.4 | 126.9 | 124.8 | 124.7 |

SOURCE: Report on Water Economy in SR 2000

The construction of the water supply systems, also meant an increase in the number of technical facilities. The total length of the water supply piping has been gradually increased. This length was 21 017 km in 1999, out of which 20 116 km is under the management of the state waterworks and sewerage companies, whilst the remaining 901 km is in the management of private and municipal companies.

Table 8.18
Length of Water Supply Networks [km]

| 1997 | 1998 | 1999 |
|--------|--------|--------|
| 20 484 | 20 612 | 21 017 |

SOURCE: Report on Water Economy in SR 2000

There was a sharp increase in the percentage of losses in piping in 1990, which was also influenced by a more precise accounting of water. This increase stopped in 1992, and then there was a slight decline in 1993 and 1994, although in 1995 it rose again.

There is a need for a gradual reconstruction of existing water supply piping in order to reduce losses in it, and to comply with the European standards.

The expansion of production and increase of living standards proportionally increases the pollution of waste waters, so an issue of waste water collection and treatment reaches a new level of the national interests.

One of the characteristics of Slovakia is the large number of small villages. The total number of municipalities is 2 883, out of which 461 municipalities has a sewerage system. This represents 16% out of the total number of municipalities. The number of inhabitants living in houses that are connected to the sewerage has been increasing, and in 1999, it reached a number of 2 929.9 of inhabitants, which represents 54.3 % out of the total number of inhabitants of the SR⁹

3.1 Current Situation of Service Provision

Until recently, there was a notion that water resources can not be exhausted which led to wasting within it. Similar tendencies characterized the development of water supply and sewerage systems.

Development of waterworks and sewerage began with the towns, industrial and housing development in the period after the war. It became impossible to provide a sufficient amount of drinking water within the territory of the district, so it was necessary to accept a conception of creation of waterworks systems with a group water supply piping. Development of water supply and sewerage systems as well as water flows, have created preconditions for the organizational structure of this sector.

After 1960, the activities were moved onto districts, not only in production activity but also in the administrative one. Each district established a waterworks administration (OVHS) in the form of a budgetary organization. Such an organization provided waterworks and sewerage services, administration of flows and small investment construction. In 1966, the state companies of waterworks and sewerage were established, which still exist today.

Their main goal was to provide a sufficient amount of water of suitable quality for inhabitants, industry and agriculture, then provide sewerage to municipalities and solve the problem of water flow pollution.

A negative part was played here by supplier's capacities, both the construction and technological ones, which were also caused by their monopoly position. Construction and technological capacities were not sufficient for healthy-waterworks constructions. The construction industry and mechanical technology were not prepared for this kind of construction.

A similar situation was at the construction of sewerage and wastewater treatment plants (WWTP). Only a few WWTPs were built in accordance with a time schedule. The construction period was prolonged for 5 years and more, which brought about the fact that at the time of their introduction into operation, some of them were overburdened. At present they are overburdened whether from the point of hydraulics or substances.

In addition to the above problems, there was a lack of financial means, which used be to solved by the construction of small waste water treatment plants. At present this is shown in practice when some small WWTPs are built without sewerage systems, with an ‘unsolved’ final step of sludge treatment and so on. Lack of finances causes, in many cases, the construction to be divided into stages, which are incapable of operation.

Another problem is the obsolete equipment. For the repair of basic assets—when compared with their value—was allocated only a small amount of finances, up to recently not exceeding 1%. In 1990 it was the coefficient 1.28%.

On the other hand, a low price for drinking water and also small charges for the collection of waste water caused that waterworks and sewerage, which are mainly managed by the state companies, to generate losses and become dependant on the state subsidies for operation and development. A paradox is that waterworks and sewerage, which are not, the generators of wastewater, pay heavy fines for water flow pollution that contributes to the generation of their losses.

3.2 Water and Sewage Systems Operation

Five state waterworks and sewerage companies, two private companies and two communal companies provide the water supply and wastewater collection in Slovakia.

Smaller municipalities, which in recent years built up their own municipal water supply, and sewerage systems provide their operation themselves or have it under the administration of the state companies on the basis of contracts.

The following five companies provide water supply and the collection of waste water:

1. Vodárne a kanalizácie Bratislava (Waterworks and sewerage Bratislava)
2. Západoslovenské vodárne a kanalizácie Bratislava (Western Slovak waterworks and sewerage Bratislava)
3. Stredoslovenské vodárne a kanalizácie Banská Bystrica (Central Slovak waterworks and sewerage Banská Bystrica)
4. Severoslovenské vodárne a kanalizácie Žilina (Northern Slovak waterworks and sewerage Žilina)
5. Východoslovenské vodárne a kanalizácie Košice (Eastern Slovak waterworks and sewerage Košice).

The state companies of waterworks and sewerage have the biggest share on the number of inhabitants supplied by water in the SR. In 1999, they provided the supply to 4, 140 400 million inhabitants. However, their share has started to decline. This state should be completely changed by the ‘transformation’ of these companies from the state, to the municipal.

Table 8.19

A Decline in the Share of Inhabitants Supplied by the State Companies

| 1997 | 1998 | 1999 |
|-------|--------|-------|
| 95.5% | 95.0 % | 90.2% |

Individual state companies consist of branches of waterworks and sewerage, which provide a supply on the territories of the former districts according to the previous territory division . The property of these companies is owned by the state. The state companies are operators and administrators of the property.

The Slovak Government approved the concept of state waterworks and sewerage companies transformation in 1966. In this concept the assets of state waterworks and sewerage companies was divided into three parts:

- principal systems (intake facilities at the sources, preparation plants, long-distance pipes) which should have stayed in the state property
- operation property, (such as buildings, machinery, equipment, laboratories), which should have been privatized by private companies
- Infrastructural property (such as pipes, pumping stations, hydrants, treatment plants) which are located in built territory of municipalities and serve to supply water and to collect waste water. Municipalities could voluntary apply for this property. In such a property, mainly municipalities were interested, which were not joined to the principal systems. In most cases, they wanted to also receive operation property which was not open to them.
- group waterworks and sewerage systems which provided water supply and waste water collection for several municipalities including intake facilities. These should have remained in the state property, but a group of municipalities in the territory covered by systems could apply for them.

The regions of Trenčín, Komárno and Hlohovec succeeded in their privatization effort and were handed over the property and also registered in the Land Register. In total 736 municipalities entered the privatization process during 1997 and 1998.

In 1999 this form of privatization was abolished by the government resolution, thus the rest of the municipalities could not complete their privatization effort. The reason for abolition of the

former conception was a change of privatization to transformation, which considers a transfer of the whole state property of waterworks and sewerage to municipalities. The infrastructural property should be transformed (including operational property, even long-distance pipelines, collection and water conditioning facilities).

3.3 Current Legislation and Legal Norms

The very basic legal norm is the Act no. 138/1973 on Waters, the so-called Water Act and decree of the Ministry of Forest and Water Management no. 154/1978 on Public Water Supply and Sewerage Systems.

The Act no. 50/1976 on Land Planning and Construction Order deals with construction permissions for water constructions.

Slovak technical norms (STN) deals with inner sewerage, sewer network and sewer connections, inner water supply system, terms, monitoring of drinking water quality, fire water systems, monitoring of waste water, limits on effluents.

The new Act no. 264/1999 on Technical Requirements On Products takes into account European norms and gradually all EN norms should be worked in into Slovak STN.

The Act no. 369/1990 on Local Government, gives a responsibility for water supply and wastewater collection to municipalities. At present, municipalities de facto can not provide this legal duty since the owner of the water supply and sewerage systems is the state, which operates them through its companies.

3.4 Price Control

The main revenue of the waterworks companies (state, private and municipal) are receipts for the supply of drinking water and for the collection and treatment of wastewater. So their prosperity or loss is influenced by the level of prices (fees) for the provision of water supply, collection and treatment of wastewater. The prices for these services in the SR are determined (and regulated) by the Act no. 18/1996 on Prices and its decree no. 87/96.

On the basis of these legal norms, the state determines the price level (fee) for the supply of water for households and price level (fee) for the collection of wastewater from households.

The prices for other customers are not regulated so there are price contracts concluded 'contractual prices'.

Due to cross subsidizing, the difference between the prices for households and other customers, the operators can make only minimal profit or non profit (mainly state companies) which does not enable them to carry out investment development.

After a completion of the 'transformation process' and the establishment of regional waterworks companies (the following part gives a detailed description of this), this price regulation should be exchanged by a factual price regulation. That means that there will be different prices of water in individual regions. The prices for households and other customers will be equalized, and will be determined on the basis of economically justifiable costs and adequate profit.

The price level will be determined by the Regulation Office each year. The Regulation Office will determine the price for each waterworks company.

The Constitution of the SR says that surface and underground waters belong to state property. That means that in the SR waters are not defined as 'public waters'. On the basis of this the state, owner of surface and underground waters, has determined the prices for it.

Price for surface water is regulated and its maximum is 2 00 Sk (Slovak crown) for 1m³ including VAT. Receipts for the supply of surface water become receipts of the state Slovak water management company Banská Štiavnica, which administer Slovak water flows. Price for underground water is 1 00 Sk for 1m³. Receipts for underground water are revenues of the state water management fund.

In 1996, in accordance with the Act on Prices and decree of the Ministry of Finance, which determines a scope of the item with regulated price, there was a price of drinking water for household determined at the level of 8.00 Sk including 6% VAT. The price for collection of wastewater was determined at 4.00 SK including 6% VAT. In 1999, the rate of VAT for services was increased from 6% to 10%. Therefore, the prices were increased to 8.30 Sk including VAT for drinking water and to 4.30 Sk including VAT for wastewater.

At this point, it needs to be said that VAT increase did not influence the revenue of waterworks companies, it was shown in the revenues of the state budget.

On 1 February 2000, the Ministry of Finance increased the maximal prices to 9.40 Sk for drinking water and 6.40 Sk for wastewater for households.

As it can be seen from the tables, this development of regulated prices was significantly lower than the actual average economically justifiable costs.

Table 8.20
Trends of Drinking Water Prices

| | 1996 | 1997 | 1998 | 1999 |
|---|-------|-------|-------|-------|
| Price for household Regulated (without VAT) [Sk/m ³] | 4.71 | 4.99 | 5.66 | 7.26 |
| Price for other customers not regulated, average (without VAT) [Sk/m ³] | 11.42 | 14.70 | 15.98 | 16.26 |
| Average price for all customers (without VAT) [Sk/m ³] | 7.09 | 8.65 | 9.40 | 10.44 |
| Average economically justifiable costs [Sk/m ³] | 7.77 | 9.76 | 10.45 | 10.80 |

SOURCE: The report on the water management in SR 2000

Table 8.21
Trends of Sewage Water Prices

| | 1996 | 1997 | 1998 | 1999 |
|--|------|-------|-------|-------|
| Price for household Regulated (without VAT) [Sk/m ³] | 2.83 | 3.14 | 3.77 | 3.77 |
| Price for other customers not regulated (without VAT) [Sk/m ³] | 9.13 | 10.53 | 11.36 | 13.19 |
| Average price for all customers (without VAT) [Sk/m ³] | 6.07 | 6.85 | 7.46 | 7.85 |
| Average economically justifiable costs [Sk/m ³] | 5.21 | 5.84 | 6.44 | 7.49 |

SOURCE: The report on the Water Management in SR 2000

Cross subsidizing of the prices for drinking and wastewater in the state companies can be seen from the above tables.

A similar system of price cross subsidizing is used at private and municipal companies. (We could not obtain their price overviews).

These price deformations should be removed by actualizing the prices for drinking and wastewater (making them 'real').

3.5 Private Companies

At present, the share on the operation of the waterworks and sewerage systems by private companies is very low. In reality only 2 systems, Trenčín regional waterworks and sewerage system and the municipal waterworks and sewerage system of the town Hlohovec are operated by private companies. The municipal company operates group water supply system in the town Komárno.

A bigger share of private companies in the operation of water supply and sewerage systems is anticipated after completion of the whole transformation process of the state companies and establishment of the regional waterworks companies. Shareholders of these companies will be municipalities, which then will be deciding about the way of their operation.

There is an assumption that the regional waterworks companies will be gradually split into 2 companies, while one will be property company, and the other will be an operational one. Operational company through an operational contract can be leased by operational companies for a longer period (15–20 years), or water supply and sewerage systems can be operated by the municipal's own management, or they may conclude the managerial contract with a management company. The establishment of the regional waterworks companies will be in accordance with the Commercial Code.

3.6 Social Aspect of Water Services

At present, there is, in accordance with the Act no 18/1996 on Prices and its decree no. 87/96, a factually regulated price of drinking and collection of wastewater for household. These prices are under the level of economically justifiable costs and contractual relations with other customers are used to equal the price difference.

Such state policy does not prepare the conditions for the transformation of the state waterworks and sewerage companies, and it will be needed to change such regulated price to a factually regulated price which will take into account economically justifiable costs and adequate profit in individual regional waterworks companies.

This change in the factual system of the regulation of drinking and wastewater will bring about different price moves in individual regions. There is an assumption of price growth in certain regions after transformation stage. This will be determined by the basic economical inputs as resources, conditioning and distribution of water, cleaning costs and so on. It will be needed to remove price deformations of drinking and wastewater arising from loss of equalization.

One of the limiting factors of the transformation within the proposal of the new regional waterworks companies is also the economical efficiency of each company. There is an effort to eliminate price difference as much as possible in individual proposed companies.

It is intended that property will be handed over to municipal companies, shareholders of which will be municipalities. That means that the decision making process will be in the hands of representatives of municipalities who were elected by inhabitants. They can make a decision about the implementation of tariff zones in accordance with the consumption or other criteria. They will conclude operational contracts with private operators, in which they will decide the level of fees for supply and treatment of water. As they are the closest to inhabitants, they will directly feel the pressure from them for fair price creation in the waterworks companies.

3.7 Need for Change

Issues of property transformation and the operation of water supply and sewerage systems were the subject of intensive, and many times conflicting, debates between the representatives of municipalities and government going on for some years. Only in 1997 some results were accepted, which created conditions for realization of transformation of the state waterworks a sewerage companies.

Today, there is a political will to give the whole property of waterworks and sewerage to municipalities. That also includes property of group water supply and sewerage systems, long distance water pipes, which provide water supply to several regions, facilities for water conditioning, and facilities which serve for the operation of whole systems.

Due to the reason that it is intended to also transfer water supply supra systems, the Ministry of Agriculture (the guarantor of the transformation) approved the decision that it is not possible to transfer concrete property located within the territory of a municipality to individual municipality, but the property of the whole system (in most cases it covers the territory of several regions) to be transferred to the municipal waterworks company established by municipalities.

Thus the municipalities will become new owners of waterworks and sewerage property in their region in the form of shares. Act no. 369/1990 on Local Government and its provisions (§4 part {f}) will then be fulfilled, since the municipalities will be enabled to take the responsibility for the water supply and wastewater collection.

At present, there is still a discussion going on about the best way to transform the state companies of waterworks and sewerage, while the basic point is economic criterions—quality, quantity at adequate fees.

Recently, discussion was mainly focused on whether the transport of a division of water from a spring (or reservoir) to a consumer should have a strategic role, or whether water should be considered as industrially important mineral. The assumptions are coming out of the fact that despite all of the forecasts, Central Europe has a lack of water. Although Slovakia has encountered

an improvement of its hydrogeological conditions after 1990, its position is still in need of attention.

The basic aim of the transformation of the state companies of waterworks and sewerage in Slovakia is to :

- establish conditions for multi-source financing, joining foreign capital;
- maintain technologic and operational functioning of waterworks and sewerage systems;
- transfer the professional staff of current companies to new ones;
- enable the participation of all municipalities in the process of transition if even there are no water supply or sewage systems in their area;
- transfer directly shares of waterworks and sewerage companies to municipalities.

The transfer of the state property to municipalities has been guided by the following principles set by Slovak Government in January 2001:

- respecting the inhabitants right for water as the basic requirement of human life;
- respecting the inhabitants right for a clean environment (i.e. the collection and treatment of waste water);
- the subject of transformation is concerned with the whole state property administered by state waterworks and sewerage companies;
- water flows and ground water remain as state property;
- the basic unit of territorial self-government is the municipality, which is obliged to provide water supply and waste water collection.

At present, there exists so-called superior water supply systems', which create united systems for the whole regions in water supply. Then there are groups of water supply systems and sewerage, which supply water and collect wastewater on smaller territorial units. Several municipalities, but not exceeding the territory of the district, often create such a territorial unit. The last structure is the local water supply and sewerage systems, which provide services to one, or only a few adjacent municipalities.

The superior water supply system, and also the group water supply and sewerage systems create one unit and from the operational and technological point of view that it would not be economical to split it into more outputs. That is why a rule has been accepted that these units will be a pillar of the new regional waterworks companies and the following limiting conditions have been stipulated;

Limiting conditions for establishment of the regional waterworks companies:

- a) Retention of technological—operational functioning of water supply systems.

At present, basic operational units are branches of waterworks and sewerage companies which provide operation, i.e. water supply, collection of waste water, its treatment on the territories of the former districts according to the previous territorial division.

Technological—operational functioning means not separating the property and retention of the system from the source and conditioning of water and its transport to consumers and collection of waste water, its treatment and its discharge to recipient, water course and so on.

- b) The inevitability to implement a factually regulated price for drinking and collected waste water. This is a basic and inevitable condition of economic efficiency of operation of the waterworks companies. Factually regulated price will bring about price differences in individual regional waterworks companies.
- c) Even those municipalities in a region which at present do not have a water supply and sewerage systems on their territories can take part in the establishing of the new waterworks companies and transformation of the state property.
- d) Whole state property, which is under the administration of the state companies of waterworks and sewerage, located in the territory of competence of the newly set up waterworks companies will be transferred to municipalities.

These limiting conditions for the transfer of the state property to municipalities were submitted by the Ministry of Agriculture of the SR, which is the guarantor of this process.

The form of the company will be the joint stock company, of which the only shareholders will be municipalities located on the territory of the waterworks company. Number of shares for each shareholder (municipality) will be proportional to the number of inhabitants.

Establishing of the companies will be in accordance with the Commercial Code.

Based on these conditions Slovak Government approved six communal waterworks companies in June 2001:

1. *Bratislava* waterworks company which includes districts Bratislava, Pezinok, Senec, Malacky, Senica, Myjava, Skalica, Trnava, Hlohovec, Piešťany
2. *Nitra* waterwork company which includes districts Dunajská Streda, Galanta, Šal'a, Nitra, Nové zámky, Topolčani, Levice, Zlaté Moravce, Partizánske, Bánovce nad. Bebr.
3. *Žilina* waterwork company which includes districts Púchov, Ilava, Považská Bystrica, Žilina, Bytča, Čadca, Kysucké N. Mesto, Martin, Turčianske Teplice, Ružomberok, Liptovský Mikuláš, Dolný Kubín, Námestovo, Tvrdošín.
4. *Banská Bystrica* waterwork company which includes districts Banská Bystrica, Prievidza, banská Štiavnica, Brezno, Detva, Krupina, Lučenec, Poltár, Zvolen, Zarnovica, Žiar nad Hronom, Veľký Krtíš, Rimavská Sobota

5. *Košice* waterwork company which includes districts Revúca, Rožňava, Košice, Košice okolie, Humenné, Snina, Medzilaborce, Bardejov, Stropkov, Svidník, Sabinov, Vranov nad Topľou, Michalovce, Prešov, Sobrance, Trebinov
6. *Poprad* waterwork company which includes districts Poprad, Stará Ľubovňa, Kežmarok, Levoča, Spišská Nová Ves, Gelnica

ANNEX

A summary of the further relevant legal regulation

1. The Act on Budgetary Rules

This Act regulates a position, function and composing of the state budget, final state account and position of municipal budgets and also the use of finances from the state and municipal budgets. It sets up the rules for the management of budgetary means, inspection of their keeping and financial relations of the state budget towards individuals and corporate bodies.

The Act on Budgetary Rules in relation to municipalities, lays down the structure of revenue and expenditure of municipal budgets, management of budgetary finance including provisional budgets, establishment and management of off-budget funds.

This Act also sets out the conditions and principles for the establishment and management of budgetary organizations and contributory organizations. According to this Act, municipalities can establish budgetary or contributory organizations, (which are fully or partially funded from their budgets) for the purpose of carrying out the basic municipal functions or public works. The municipality issues an establishment charter of such an organization in which the basic public activities or functions, for which the organization is established, are stated.

The Act on Budgetary Rules lays rights and obligations for budgetary and contributory organizations and sets the rules of their management.

2. The Act on Consumer Protection

The Act on Consumer Protection¹⁰ sets out some conditions for conducting businesses which are important for the consumer protection, a role of public administration in the area of consumer protection, competence of consumer and of the Consumer Association or other corporate bodies established for the purpose of consumer protection. This Act defines legal terms for the consumer, entrepreneur—as well as the seller, product and service. According to this Act, a legal entity (or corporate entity) can also be in the role of a consumer. This means that this Act is also applicable to Slovak municipalities as well as to consumers, since the Act on Local Government and the Slovak Constitution defines them as legal entities. On the other hand, municipalities, especially businesses established by the municipalities to provide local services are in the position of a seller so all regulations relate to them

All the public administration bodies (which include both the state administration and the local government) are due to take all measures (within their powers) to restrict launching and setting hazardous products on the market. Responsible bodies have a duty to inform without any delay about a presence of a hazardous product in the market. This should mainly be done through the mass media.

In case that a supply of essential products has been endangered, municipalities declare the time-regulated sale of products.

Municipalities supervise the keeping of duties which are required by the law on market places. Municipalities also issue regulatory order for market places.

3. The Act on Protection of Economic Competition

The purpose of The Act on Protection of Economic Competition No.136/2001¹¹ is a protection of economic competition on the markets of products, outputs, works and service against its limitation as well as creating conditions for further development of competition with a goal to support economic development in favor of consumers. This Act also concerns institutions of the state administration and local government, if they are involved in activities which are related to the economic competition.

The main forms of economic competition limitation are regarded as:

- agreements limiting the competition;
- exploitation of the dominant position at the market including dominant position resulting from the ownership or management of unique facilities (inclusive of infrastructure).

The central supervisory body is the Anti Monopoly Office.

The Act states that institutions of the state administration and local government must not privilege certain businesses by the apparent support or limit of economic competition by other means. In the case of violating the Act by the municipality, a remedy may be required by the Anti Monopoly Office.

4. The Act on Prices

The Act on Prices¹² sets out the rules of bargaining, regulating and controlling prices of products, work, services, leases and real estates. Further, the Act deals with competence of the state administration bodies in the area of prices and goods for domestic market including prices of

imported goods and of goods for export. The Act also sets forth rights and duties of individuals and corporate bodies and of the state administration bodies at the enforcement of this Act.

Price regulation means setting the price or directing the price bargains by the price organs that is the Ministry of Finance but also district offices or other organs of the state administration appointed by a special legal rule (e.g. the Act on Telecommunications). The Act allows for more ways of the price regulation:

- Authoritative price setting, which means that the organ of the state administration will set the maximal, minimal or fixed price, which must not be altered;
- Subject price directing by the state organ which means setting maximal range of price increase, minimal range of price decrease, stating the portion at which an increase of price inputs of the price can be taken into account and determining obligatory procedure for price creation or its calculation;
- Time price directing which presents stating a minimal advance period for announcing intended price increase, minimal period after which an announced increase can take place and also a time limited ban on repeated price increase;
- Time moratorium is a time limited ban on price increase against the price level before the moratorium has come into power. The Government of SR on the period of the maximal length of 6 months can declare this moratorium.

According to this Act, municipalities have no authority to influence the process of price setting. They are legal entities, which have to keep the rules of this, and other acts related to the goods, or products that are produced or provided by the municipality to its citizens.

Price organs regulate the prices when the market is endangered by insufficiently developed market environment or if it is of public interest, consumers and market protection in case of natural monopolies.

In case of public services and natural monopolies mainly in production, transfer of energy, heat, gas, telecommunication services, water management, and other regulated activities (e.g. public transport, cable television) according to individual rules are prices regulated in the following form:

- a) setting a price, tariffs and tariff conditions;
- b) determining obligatory production conditions, supplies and purchase;
- c) setting economically justified costs and adequate profit including investment, which can be included into the prices and tariffs.

Scope of the price regulation is decided by the Ministry of Finance or other body of the state administration through its decision about the price regulation. Apart from the Ministry, other organs of the state administration, Office of Financial Control, Slovak Trade Inspection also district offices play an important role in the area of prices. They implement a price regulation of

some services within a scope specified by the decision about the price regulation. They can also carry out a price control in accordance with the rules, and can take action if they find out the violation of the price discipline or decisions concerning the price regulation.

District offices determine maximal prices for goods of local importance within the range determined by the Ministry of Finance after consultation with the municipality. They also may reduce the maximal prices set by Ministry of Finance for goods of local importance after consultation with the municipality

From the point of view of the subject of this study district offices determine the maximal prices for the following services

- heating and supply of hot water for a household;
- local public transport.

5. The Act on Regulation in Network Sectors

The Act on Regulation in Network Sectors (which becomes effective as from August 2001) sets conditions of state regulation in network sectors and the conditions of realizing regulated activities. Network sectors regulated by this act are the:

- production, purchasing, transit and distribution of electricity;
- production, purchasing, transit and distribution of gas;
- production, purchasing and distribution of heat.

The state regulation in network sectors includes

- issuing licenses for realizing regulated activities;
- price regulation;
- deciding on business terms in realizing regulated activities;
- approving construction, reconstruction or abolition of facilities for realising regulated activities;
- deciding on access to networks;
- state supervision of business activities.

The state regulation in network sectors will be implemented by Office for Network Sector Regulation (Regulation Office).

According to this law regulated activities can be realized only on the basis and within the scope of the permission granted by the Office. The office will decide on business terms in realizing

regulated activities and to approve the construction, reconstruction or abolition of facilities for providing regulated services. Since 2003, the Office will also regulate prices in these sector, i.e. set maximum prices or tariffs, and price calculation formula.

6. The Act on Public Procurement

The Act on Public Procurement sets out procedures at the process of procuring goods, works and services paid from public funds. It states procedures and methods of public procurement, which are used in contracts. Municipalities must follow these procedures even in a case of a chosen contractual partner that will be providing services for which they are responsible. Basic method is a tender open for unlimited number of applicants.

Every municipal budgetary or contributory organization as well as corporate body in which municipality has a decisive influence must also follow rules of the public procurement. These are corporate bodies that carry out activities using the municipal property based on a lease or administration. These include also companies whose majority share is owned by the municipality or where more than a half of board members are appointed by the municipality.

Another legislation which regulates provision of local public services are incorporated in sectoral legislation. These are mainly:

- collection and disposal of communal waste, the Act on Waste¹³;
- town public transport, The Act on Road Transport¹⁴;
- local housing management, The Act on Ownership of Flats and other Rooms¹⁵;
- construction, maintenance and administration of local communications, The Act on Ground Communication¹⁶ (Road act);
- administration and maintenance of public greenery, The Act on Nature And Landscape Protection¹⁷; along with other legislation norms.

NOTES

- ¹ Act. 302/2001 on Higher territorial unit self-government (Act on Regional Government).
- ² The Act of SR (Slovak Republic) no. 303/1995 about Budgetary Rules.
- ³ The Business Code provides for the following types of legal entities: a limited liability company; a joint-stock company; a partnership; a limited partnership; and a co-operative company.
- ⁴ The Act on Concession procurement defines specific rules of the concession process.
- ⁵ The data and information from the Slovak Public Works Association were used in this part and in the part on public lighting. With regard to the fact that member organizations provide communal services in approximately 70% of Slovak territory, we can consider them as sufficiently representative.
- ⁶ The Slovak Public Works Association (SPWA) has been in place in the Slovak Republic since 1990. It is an association of bodies that provide public works services or take part in its delivery. The major activities of 90% of SPWA membership focus on communal waste management, road cleaning and maintenance, public lighting, landscaping and public green maintenance, funeral and cemetery services. Only in some cases do these subjects provide central heating services and maintenance. 10% of the members are manufacturers, supply and service organizations for equipment and know-how in public works.

At the present SPWA has got 67 members that operate in cca 1800 communities in the Slovak Republic. 50% of the members are contributory organizations set up by towns or communities, among other members there are business companies owned by communities (joint-stock companies and limited liability companies) companies with partial private shares but also purely private companies. SPWA gains its financial means through annual membership fees and through incomes from advertisement and presentation of supplier companies. SPWA does not include Sewer and Water supply facilities, companies for local transportation and subjects set up to build, maintain and heat houses and flats.
- ⁷ When constructing landfill, the municipality where the landfill is located takes an important role in the decision making process and in the process of environmental impact assessment.
- ⁸ Act 223/2001 on Waste.
- ⁹ The report on the water management in SR 2000.
- ¹⁰ The Act of SR no. 637/1992 on Customer's Protection.
- ¹¹ This act is an amendment of a previous Act on Protection of Economic Competition from 1994.
- ¹² The Act SR no. 18/1996 About Prices.
- ¹³ The Act SR no. 606/1992 on Waste.

- ¹⁴ The Act SR no. 168/1996 on Road Transport.
- ¹⁵ The Act SR no. 182/1993 on Flat And Rooms Ownership.
- ¹⁶ The Act SR no. 160/1966 on Ground Communications.
- ¹⁷ The Act SR no.287/1994 on Nature And Landscape Protection.