

## MARKET-BASED MECHANISM IN PUBLIC SERVICE DELIVERY IN LOCAL GOVERNMENT IN POLAND – A BRIEF OVERVIEW

*DAWID SZEŚCIŁO\**

### INTRODUCTION. CREATING CONDITIONS FOR THE PRIVATE SECTOR'S ENGAGEMENT IN PUBLIC SERVICE DELIVERY IN POLISH LOCAL GOVERNMENT

The reintroduction of local self-government at the level of communes (*gminy*) in 1990 opened the way for an in-depth reform of the local governance framework in Poland<sup>1</sup>. This included not only the legal, organizational and fiscal autonomisation of local communities<sup>2</sup>, but also a variety of innovations that were in line with general international trends connected with transformation of the public sector. Among the core elements of the transformation we may identify the extensive privatization of public service provision schemes. This process affected many areas of local governments' responsibilities, duties that have also expanded over the last two decades. The current catalogue of communal tasks is not limited to typical municipal services (water supply, sewage system maintenance, waste collection, local public transport provision), but also includes the running of primary schools, spatial planning, healthcare provision, the organization of cultural activities and environmental protection.

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\* Assistant Professor in Public Administration, Faculty of Law and Administration, University of Warsaw, [dawid.szescilo@uw.edu.pl](mailto:dawid.szescilo@uw.edu.pl). This article has been prepared within the research project No. 2011/01/N/HS5/05418 funded by National Centre of Science (NCN).

<sup>1</sup> Michał Kulesza, Dawid Sześciło, 'Local Government in Poland' in Angel-Manuel Moreno (ed), *Local government in the Member States of the European Union: a comparative legal perspective* (National Institute of Public Administration 2012).

<sup>2</sup> Aleksandra Wiktorowska, *Prawne determinanty samodzielności gminy. Zagadnienia administracyjnoprawne* (Liber 2002).

In Poland, unlike in a number of western countries, this process was not based on the theoretical background of New Public Management, but was the natural consequence of the rebirth of a market economy with a public sector that was limited in size and the intense development of the private suppliers market. Such trends were, however, compatible with the NPM programme. The expansion of market-based mechanisms in public service delivery is one of its pillars. New Public Management includes two major dimensions to the reform of the public sector: a) the expansion of market-oriented mechanisms in public service delivery; and b) managerialism – the transfer of managerial and organisational techniques and models developed in the private sector to public administration<sup>3</sup>.

This article provides a legal overview of the development of market-based arrangements in public service provision at the most basic level of Polish local government. The analysis focuses primarily on the regulatory framework in place, but also includes some observations on the practical side of this process.

## I. TYPOLOGY OF MARKET-BASED MECHANISMS IN PUBLIC SERVICE DELIVERY

The OECD proposed a basic typology of market-based mechanisms in public delivery, including three major economic and legal arrangements:

- a) outsourcing of public services,
- b) public-private partnerships, and
- c) vouchers<sup>4</sup>.

**Outsourcing (contracting out)** “is the practice whereby governments contract with private sector providers for the provision of services to government ministries and agencies, or directly to citizens on behalf of the government”<sup>5</sup>. In other words, outsourcing is an alternative to the provision of public services by in-house agencies or companies controlled by the government. The cornerstone of outsourcing is an open and competitive procurement process to select the provider. The scope of services that are provided within this scheme is not limited to so-called blue collar support services (cleaning offices, catering) or IT services, but in some countries includes also core government functions (prisons and other services associated with security or defence)<sup>6</sup>. There are a number of potential benefits of contracting out the supply of public services, including

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<sup>3</sup> Christopher Hood, ‘A public management for all seasons?’ (1991) 1 Public Administration 5; Tom Christensen and Per Lægreid, ‘New Public Management: Puzzles of Democracy and the Influence of Citizens’ (2002) 3 Journal of Political Philosophy 270; Mia Vabo, ‘New Public Management. The Neoliberal Way of Governance’ (2009) 3 Rannsóknarritgerðir Working Papers 3.

<sup>4</sup> Organisation for Economic Co-operation and Development, *Modernising Government. The Way Forward* (Paris 2005).

<sup>5</sup> Jon R. Blondal, ‘Market-based Mechanisms and the Provision of Public Services’ (2005) 1 OECD Journal of Budgeting 81.

<sup>6</sup> See (n 4).

the opportunity to reduce costs, increase efficiency and introduce workforce flexibility<sup>7</sup>.

The most extensive definition of **public-private partnerships (PPP)** describes the arrangement as a specific form of private sector involvement in the delivery of public services in infrastructure projects located between traditional public procurement and the full privatization of public tasks<sup>8</sup>. Another element describing the partnership, which is given particular attention in literature, is the transfer (sharing) of the significant risks associated with the project to the private sector, coupled with the preservation of the public sector's responsibility for the delivery of public services to citizens.<sup>9</sup> PPP is an umbrella term covering a wide range of economic and legal arrangements, including in particular:

- Operation – Maintenance (OM). The private contractor is responsible for the operation and maintenance of the facility owned by the public partner.
- Build – Operate – Transfer (BOT). The private partner builds and manages the property for the period specified in the contract. After that time, the ownership of the object is transferred to the public entity. Modifications of this model include: BOOT (Build, Own, Operate, Transfer), BLOT (Build, Lease, Operate, Transfer) and BTO (Build, Transfer, Operate).
- Design, Build, Finance, Operate (DBFO). The private partner designs, builds, finances, owns and operates the facility without the obligation to transfer ownership to the state. Other variants of the model include: BOO (Build, Own, Operate), BDO (Build, Develop, Operate) and DCMF (Design, Build, Manage, Finance).
- Rent – Sale. The private partner designs, builds and finances the facility. After the completion of the facility, a public entity becomes a tenant, paying rent to the private partner.
- Temporary Privatization. Property is transferred to a private entity that carries out its modernization or expansion, and then exploits it for the time necessary to achieve a reasonable rate of return<sup>10</sup>.

The above-listed schemes might be used for a wide range of infrastructure projects. However, they are mainly applied to build and operate roads, bridges and tunnels, light rail networks, airports and air traffic control systems, prisons, water and sanitation plants, hospitals, schools and public building<sup>11</sup>. A study commissioned by the European

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<sup>7</sup> Suzanne Young, 'Outsourcing: Uncovering the Complexity of the Decision' (2007) 3 International Public Management Journal 310.

<sup>8</sup> Organisation for Economic Co-operation and Development, *Public-Private Partnerships. In pursuit of risk sharing and value for money* (2008).

<sup>9</sup> United Nations Economic Commission for Europe, *Guidebook on Promoting Good Governance in Public-Private Partnerships* (2007).

<sup>10</sup> Michał Kulesza, Agata Kozłowska and Michał Bitner, *Ustawa o partnerstwie publicznym. Komentarz* (Dom Wydawniczy ABC 2006); Deloitte, *Closing the Infrastructure Gap: The Role of Public-Private Partnerships* (2006).

<sup>11</sup> International Monetary Fund, *Public-Private Partnerships, Government Guarantees, and Fiscal Risk* (2006).

Parliament provides the following advantages of PPP compared to an in-house delivery scheme:

- reduced life-cycle costs;
- more efficient allocation of risk;
- faster implementation;
- improved service quality; and
- additional revenue<sup>12</sup>.

According to the OECD: “**Vouchers** can take at least three main forms. An explicit voucher is a physical coupon or smart card as described above. The supplier of the services in turn exchanges this for cash from a government body. An implicit voucher takes the form of a qualifying recipient choosing from a number of designated suppliers and, upon registering with one of them, the government pays directly to that provider of the service. The third form is for the government to reimburse the user for expenditure on qualifying services from approved suppliers. This would most often be through the tax system, but can equally take place as a traditional government expenditure programme”<sup>13</sup>. Vouchers are commonly used in healthcare<sup>14</sup>, education<sup>15</sup> or public employment services<sup>16</sup>. The key benefit of vouchers is increased competition between providers and the granting of more freedom to consumers.

At the level of Polish local government only two of the above-described schemes are represented – outsourcing and, to a lesser extent, public-private partnerships. Therefore, the analysis contained hereinafter is focused on presenting the legal framework for their application, without consideration of vouchers.

## II. OUTSOURCING

Polish legislation provides a wide range of opportunities for outsourcing, which in the practice of Polish communes takes the well-known form of contracting public tasks to private entities. In the case of tasks falling within the scope of commune activities, the power to contract them out is expressed by the general clause of Article 3 paragraph 1 of the Act of 20 December 1996 on Municipal Economy<sup>17</sup>: “Local government units may commission the delivery of services in the field of municipal economy to natural persons, legal persons or other organizations without legal personality, by contract based on general principles – taking into

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<sup>12</sup> Andrea Renda and Lorna Schrefler, *Public-Private Partnerships. Models and Trends in the European Union* (European Parliament 2006).

<sup>13</sup> See (n 4).

<sup>14</sup> Lars Nordgren, ‘The Healthcare Voucher: Emergence, Formation and Dissemination’ (2010) 4 *Financial Accountability & Management* 443.

<sup>15</sup> Michael Baggesen Klitgaard, ‘School Vouchers and the New Politics of the Welfare State’ (2008) 4 *Governance: An International Journal of Policy, Administration and Institutions* 479.

<sup>16</sup> Lena Hipp, Mildred E. Warner, ‘Market Forces for the Unemployed? Training Vouchers in Germany and the USA’ (2008) 1 *Social Policy & Administration* 77.

<sup>17</sup> Municipal Economy Act of 20 December 1996 (Journal of Laws 2011, no 45, item 236 as amended).

account the provisions on Public Finances Act and, accordingly, the provisions of the Public-Private Partnership Act, the provisions of the Concession or Services or Construction Works Act, Public Procurement Act, Public Benefit and Volunteering Act and Public Transport Act”.

Municipal services include, in particular, public utility services, whose purpose is to meet the current and ongoing needs of the community via the provision of commonly available services (Article 1 paragraph 2 of the Municipal Economy Act). As a result, the scope of outsourcing might be very broad and includes:

- technical infrastructure, e.g. the supply of water, sewage services, electricity, gas, heating, public transport, cleaning services, maintenance of municipal cemeteries, street lighting, parks;
- social infrastructure e.g. social services, healthcare (particularly primary healthcare), education, public libraries<sup>18</sup>.

Article 3 paragraph 1 of Municipal Economy Act lists a number of regulations which together create a detailed framework for the outsourcing of particular public services. The most important role is played by the legislation on public procurement. The Public Procurement Act of 29 January 2004<sup>19</sup> – in accordance with the EU public procurement legislation – sets out the procedures for contracting out services, supplies or construction works.

A competitive mechanism for outsourcing public functions to *non-profit* organizations (foundations, associations, etc.) is envisaged by the Public Benefit and Volunteering Act of 24 April 2003<sup>20</sup>. This act offers two forms of cooperation between governmental institutions at local, regional and national levels and the “third sector”:

- 1) delegation of the exercise of public tasks (outsourcing) based on funding granted to NGOs by the competent authority that commissioned the specific tasks.
- 2) support for the performance of public tasks by NGOs, including grants for co-financing their activities.

The commissioning of public tasks or the granting of special subsidies for NGO activities has to be preceded by an open tender. The rules for the competition and the evaluation of bids submitted are specified by the Public Benefit and Volunteering Act. Non-governmental organizations may, on their own initiative, submit to the competent authority a tender request for the provision of specific public tasks. A public entity (e.g. a municipality) is obliged to respond to the offer within two months. During this time, this authority must consider the need for commissioning a particular task, taking into account the extent to which the offer meets policy priorities, the extent to which it guarantees the performance of the task in accordance with applicable standards, the resources available for

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<sup>18</sup> Marek Szydło, *Ustawa o gospodarce komunalnej. Komentarz* (Wolters Kluwer Polska 2008).

<sup>19</sup> The Public Procurement Act of 29 January 2004 (Journal of Laws 2010, no 113, item 759 as amended).

<sup>20</sup> Public Benefit and Volunteering Act of 24 April 2003 (Journal of Laws 2010, no 234, item 1536 as amended).

performance of the specific task and the benefits stemming from commissioning it to the interested NGO.

During the performance of the contract, the public entity is required by law to carry out monitoring and evaluation of the task (the state of implementation, efficiency, reliability and quality, the proper use of public funds received)<sup>21</sup>.

Outsourcing of public tasks in the field of social assistance is excluded from the application of the Public Benefit and Volunteering Act. This area is managed by the separate Social Assistance Act of 12 March 2004<sup>22</sup>. According to its provisions, authorities and local government can commission the tasks of social assistance to:

- 1) NGOs active in the field of social welfare;
- 2) legal entities established by the churches.

Along with commissioning the tasks, the competent authority may award grants to finance or co-finance their implementation. As a general rule, the delegation of a social assistance task is preceded by an open tender. The initiator of the commissioning of such tasks may be, however, the same NGO. The administration must respond to the offer within two months. During this time, it must consider the need for commissioning a particular task, taking into account the extent to which the offer meets policy priorities, the extent to which it guarantees the performance of the task in accordance with applicable standards, the resources available for performance of the specific task and benefits stemming from commissioning it to the interested NGO. As in the case of contracting services on the basis of the Public Benefit Activity and Volunteering Act, the public entity is required to carry out monitoring and evaluation of the task (e.g. the state of implementation, efficiency, reliability and quality, the proper use of public funds received for the task, etc.)<sup>23</sup>.

### III. PUBLIC-PRIVATE PARTNERSHIPS

Public-private partnerships in Poland have had quite a complicated history, including the adoption of two acts of law on public-private partnerships over four years and the implementation of several projects based on PPP schemes under other legislation, in particular the Municipal Economy Act. The overall level of development of the PPP market in Poland continues to be assessed as insufficient.

Before the adoption of the first PPP Act in 2005, some possibilities of carrying out public investments using the PPP formula were envisaged in the Polish legislation applicable to the operation of local governments. The two main legal arrangements that could be used before 2005 might be distinguished as follows:

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<sup>21</sup> Jolanta Blicharz and Andrzej Huchla, *Ustawa o działalności pożytku publicznego i wolontariacie. Komentarz* (Wolters Kluwer Polska 2008).

<sup>22</sup> Social Assistance Act of 12 March 2004 (Journal of Laws 2009, no 175, item 1362 as amended).

<sup>23</sup> Iwona Sierpowska, *Ustawa o pomocy społecznej. Komentarz* (Wolters Kluwer Polska 2007).

- 1) implementing projects in accordance with specific laws regulating the principles of cooperation between public and private partners – in particular the Act of 27 October 1994 on Toll Motorways and the National Road Fund;
- 2) using general rules regarding the economic activity of the public sector – in particular implementing investment projects in accordance with the Act of 20 December 1996 on the municipal economy, which allows units of local government to delegate the execution of their tasks to private entities. Such a delegation should comply with the rules laid down in the Civil Code and the Public Procurement Law<sup>24</sup>.

The first Act on Public-Private Partnerships of 28 July 2005<sup>25</sup> was intended to be the milestone in the development of the Polish PPP market<sup>26</sup>. However, not a single PPP contract has been concluded on the basis of this Act. Critics of this Act stated that it provided for an over-regulated procedural framework for PPP projects, including compulsory and comprehensive risk analyses or extensive requirements on reporting and disclosing information about the projects<sup>27</sup>. Among the many other barriers to the development of PPP in Poland, a lack of knowledge about PPP has been identified. In particular, the lack of best practices and pilot projects might have discouraged entities from entering this new, demanding way of financing and implementing infrastructure investments. As argued in the literature, the solution to this problem would be to establish – just as in a number of other countries – government agencies responsible for advisory services and extensive support for the most complex and innovative PPP projects<sup>28</sup>.

Eventually, it was decided to repeal the first law on public-private partnerships by enacting a new law of 19 December 2008 on public-private partnerships<sup>29</sup>. The new law was supposed to deliver a response to the critical assessment of the previous regulation. It has not changed, however, two basic patterns of public investment contained within the PPP formula:

- 1) *by the conclusion of the PPP agreement* – the first stage is the selection of a private partner based on the procedure specified in the Public Procurement Law or in the Act on concessions for construction works and services. The PPP Act does not provide a separate procedure for choosing a private partner, but it does provide some specific criteria to be used in the selection of a private partner. The evaluation of the proposals is based on the following criteria: a)

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<sup>24</sup> Kulesza, Kozłowska, Bitner (n 10).

<sup>25</sup> Public-Private Partnership Act of 28 July 2005 (Journal of Laws 2005, no 169, item 1420 as amended).

<sup>26</sup> Michał Zieniewski and Dawid Sześciło, *Co zmienić, by rozwinąć partnerstwo publiczno-prywatne w Polsce?* (Foundation of Civic Development 2008).

<sup>27</sup> Wojciech Gonet, 'Partnerstwo publiczno-prywatne – kierunki zmian' (2008) 3 Przegląd Legislacyjny 86.

<sup>28</sup> Michał Bitner, 'Finansowanie strukturalne w jednostkach samorządu terytorialnego – skąd przyszło, dokąd zmierza?' in Ewa Balcerowicz (ed), *Obligacje komunalne w Polsce* (2006) 86 Zeszyty BRE Bank –CASE.

<sup>29</sup> Public-Private Partnerships Act of 19 December 2008 (Journal of Laws 2009, no 19, item 100 as amended).

the division of tasks and risks associated with the project between the public and private partners; b) the expected length of the project and the volume of payments or other benefits contributed by the public entity, if any are planned.

Other factors which may be taken into account within the evaluation process include: c) the proportions between the public body's own contribution to the contribution of the private partner; d) criteria relating directly to the subject project, in particular the quality, functionality, technical parameters, the level of technology offered, the cost of maintenance and service. After selecting the private entity, the PPP agreement is concluded. Under this agreement, the private partner undertakes to implement the project for pay and to bear the whole or partial cost of the project. The public entity is committed to cooperate with the private operator, in particular by contributing its own financial or material resources.

- 2) *by the conclusion of the PPP agreement and, subsequently, establishing a special company to which the public institution and private partner are shareholders* – the PPP agreement may provide that, in order to perform the obligations stemming from the agreement, the parties may establish a joint-stock company, limited liability company or even a limited partnership and limited joint-stock company. A public entity may not, however, be a general partner in a limited partnership. Furthermore, the public entity is granted the right of pre-emptive shares as a private partner in the company.

Significant changes compared to the previous PPP legislation were introduced in the regulation for preparing and implementing PPP projects. First, the object of the PPP project was redefined - now the PPP Act can be applied to carry out projects involving the “construction or renovation of a building, provision of services, [and] the execution of the specific works” (Article 2, paragraph 4 of the PPP Act). Second, the obligation to carry out a detailed risk analysis preceding a project has been eliminated. Third, the new PPP Act does not include a detailed catalogue of the elements of the PPP contract. Thus, the participants of the project were granted more freedom in determining the rules for the project and the allocation of rights, responsibilities and risks.

It is too early to fully assess the results of the new PPP Act. However, according to the data collected by the non-governmental PPP Centre, by February 2012 only 28 PPP agreements were concluded<sup>30</sup>. What is more, most of them are based on the Concessions for Services or Construction Works Act, which regulates so-called “small” PPP. (The concessionaire (private operator), under a concession agreement concluded with a public entity, is responsible for implementing the concession project in return for remuneration, which is determined by the type of concession.) The lack of a meaningful impact of the new legislation on the maturity of the PPP market may prove that the major obstacles to developing PPP in Poland lie in non-legal barriers.

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<sup>30</sup> Centrum PPP, *Rynek PPP w Polsce* (2012).

## CONCLUSIONS

From a legal perspective, the Polish legislation provides ample opportunities to engage private providers in the provision of public services at the local level. The general clause contained in the Municipal Economy Act confirms, based on the principle of municipal autonomy, the possibility of contracting out public services falling within the scope of municipal tasks. The Public-Private Partnership Act provides a special legal framework for the PPP projects, yet does not exclude their implementation under the general provisions of the Civil Code and the Municipal Economy Act. Only vouchers are not subject to regulation which results in their absence in the public services delivery mechanism at the local level.

It is difficult to estimate the scale of the use of market mechanisms in the provision of public services at the local level. This issue has not been, as yet, subject to advanced studies covering a significant number of municipalities. We also lack a comprehensive, credible analysis on the effectiveness of market mechanisms, especially comparing it to the system to provide public services within the in-house model.

The dissemination of market-based public service provision schemes, however, is irreversible in a state with a private sector that has a dominant and ever-growing role in the economy. Therefore, there is a pressing need for a comprehensive evaluation of its effectiveness and efficiency. In addition, an *ex-ante* analysis should precede any planned expansion of the scope of market solutions in public service provision. In particular, the potential introduction of vouchers (e.g. in education and social housing) would require a detailed assessment of the benefits and risks, taking into account the quite extensive experience of other countries in this area.