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DIAGNOSIS CONCERNING THE FINANCIAL KNOWLEDGE OF LOCAL GOVERNMENT UNITS (LGUS)

Tomasz Skica¹, Tomasz Wołowiec²

Abstract

Systemic management of a local government unit lacks viewing the LGU as an economic entity which should actively use modern financial knowledge in its activity in order to stimulate active construction of an economic and social potential. It needs to stimulate processes of building in local government structures a financial knowledge based on a modern understanding of LGU finance while considering the new challenges in finance which have been revealed after the subprime crisis, complemented with practical concepts based on New Public Management. Considering the progressing reforms of the national public finance system and the resulting consequences for shaping the financial management of the LGUs, and also globalisation processes and the dynamic development of the financial services' market, it is natural to require managers of the local government subsector of public finance to have thorough financial knowledge – current and interdisciplinary knowledge that would most importantly be reliable and practice-based.

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Introduction

„Financial awareness is a necessary ability to function in modern society and it becomes more and more important in a long-term perspective of a worthy life of an individual and the society” (2009, after: Lyons-Crew, 2008).

Local finance expresses the decentralisation of public finance management. It differs from finance at the central level with its territorial range and the place of concentrating financial resources. The said autonomy is related to the essence of local government, reflected in the fact that public authority is executed using administrative power by entities separate from the state and which have corporate structure regulated by law (Glumińska-Pawlic and Sawicka, 2002). The scale and scope of the local government's power are defined by its tangible assets, hence the financial management of local government units should be viewed from the perspective of all activities connected with collecting and spending financial means that are done by LGU authorities, their organs and the competent organisational units. Also, the financial management of local governments is not limited only to realising the passed budget. LGU income is

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the main source of financing the unit's own tasks, but beside the income, the role is also played by bank credits, loans and financial engineering. Worth mentioning are also hybrid financing, public-private partnerships (PPP), and finally also issuing communal securities (Skica, Kiebała, Rodzinka, Reško and Wołowiec, 2007).

Considering the above, one cannot help but agree that financial knowledge is an extremely important element not only of functioning and development, but more importantly of managing financial processes at local government level. Considering the progressing reforms of the national public finance system and the resulting consequences (legal, financial, as well as managerial) for shaping the financial management of the LGUs³, and also globalisation processes and the dynamic development of the financial services' market, it is natural to require managers of the local government subsector of public finance to have thorough financial knowledge (Ostaszewski, 2010, p. 9-20) – current and interdisciplinary knowledge that would most importantly be reliable and practice-based. Constant changes of regulations, growing demands in budget management, progressing restrictions as concerns LGUs' debt-raising capacity⁴ require not only current, "static" financial knowledge expected when executing statutory tasks, but also "dynamic" knowledge based on strategic planning, i.e. knowledge based on modern financial instruments. New financing forms mean an alternative approach to the issues of gaining external means by the LGUs, and they assume the possibility of financing investments basing on sources outside the "tight" LGU budget. However, a frequent problem is the insufficient financial knowledge of the local government authorities, reflected in their sceptical and very careful approach to new solutions, so far unexplored in most LGUs, concerning financing public tasks.

The practice of managing local government units'

The presented background served to define the aim of the report, which was specified as the assessment of financial knowledge and knowledge of financial instruments in the actual activity of local government units. Achieving such an aim requires forming two hypotheses. The first of them assumes that knowledge is the basic element of shaping the LGUs' competitive edge and building knowledge-based economy. The other hypothesis, in turn, claims that innovative approach to modern financial instruments is the basic determinant of social and economic development of the LGUs, in the context of changes and systemic reforms of public finance in Poland. Such formulation of the aim and the need to verify the research hypotheses have determined the character and structure of this report. As a result, the report diagnoses the financial knowledge as an endogenous source of the LGUs' potential and stable development, and indicates the essence and specific character of financial knowledge in the aspect of factors determining knowledge diffusion in Polish local governments.

In the practice of managing local government units' finance, equally important are both strategic knowledge (based on planning and foreseeing consequences of financial decisions) and

³ See more on the topic in: *Strategy of Debt Management of the Public Finance Sector*, Ministry of Finance, Warszawa 2010; *Decentralisation of Public Finance in the Context of Decentralising Development Processes and the Role of Local Governments in Investing in Regional Development*, expert opinion for the Ministry of Regional Development, Institute for Structural Research (IBS), Warszawa 2010; and in Misiąg, W. (2005). *Changes in the Public Finance System Necessary to Efficiently Implement the National Development Plan for 2007-2013*, Version II – extended, Warszawa: Gdańsk Institute for Market Economics.

⁴ Cf. e.g. Ordinance of the Minister of Finance of 23rd December 2010 on detailed manner of classifying debt titles included in the national public debt, including state treasury debt (Dz. U. 2010, No. 252, item 1692), issued on the basis of art. 72 item 2, specially changed for that purpose, of the act of 27th August 2009 on public finance (Dz. U. 2009, No. 157, item 1240 with later amendments).

operational knowledge, executed at the levels of particular LGU departments, offices and sections. In effect, it is not possible to rank the significance of each of the categories separately, and they should be viewed as components complementing one another. Hence a very important element of managing local government finance is the ability to coordinate operational knowledge with the strategic one based on such criteria as rationality, efficiency and effectiveness, understood as the ability to perform public tasks in the conditions of strong external restrictions. Neither financial knowledge nor the information possessed are given once and for all. Local government units are functioning in a dynamic and turbulent external environment. That fact makes the ability to adapt to changing conditions, and to reach in response to them for ever newer financial solutions, much more significant. The need to shape the financial management of local governments in an adaptative and flexible manner is proved by such phenomena as:

1. the financial crisis, which enforced far-reaching reforms restructuring public finance both in Poland and in other EU countries, as expressed by the reduction of the budget deficit and public debt of the whole public finance sector (PFS), including the LGUs⁵,
2. the unfinished process of financial decentralisation of the LGUs and no reforms of the whole financial system (model) of local governments, including the system of taxing and local fees⁶,
3. the so-far unsolved underfinancing of a range of tasks performed at LGU level as ordered by governmental administration,
4. decentralisation of new public tasks which abstracts from financial decentralisation in the PFS,
5. growing legal and reporting requirements concerning LGU budget management,
6. finally, expiring EU means to support infrastructural investments and in consequence seeking rational ways of financing new investment projects.

The above given factors make it considerably more difficult to manage LGU finance. In response to the said dynamics of changes in the environment, local governments are seeking specialist knowledge as to choosing sources and ways of financing the tasks, implementing a debt management policy, as well as creating relations with capital donors⁷. My research proves that the most desired information in financial knowledge concerns⁸:

⁵ It must be kept in mind that one needs to differentiate the term of “public finance sector” from the term of “budget”. Beside the government’s budget, public finance includes e.g. local government budgets and various non-budgetary funds, the greatest of which is the Social Insurance Fund (Fundusz Ubezpieczeń Społecznych – FUS). Public debt is thus composed of the debt of the government, local government and FUS. Cf. Wołowiec, T., Soboń, J., Malicki, M (2010). Impact of the Financial Crisis on Polish Economy – Reform Directions and Growth Perspectives. [In:] E. Libanowska, I. Michałkow, W. Novikov, Z. Siroic, A. Stiepanov (eds.), *Socioeconomic Problems of Transformation in Central and Eastern Europe*, Poland-East Cooperation Association, Poland-Ukraine Social Association, Maria Skłodowska-Curie Warsaw Academy, Institute for Demography and Social Studies of the National Academy of Sciences of Ukraine, Russian University of Cooperation, Warszawa – Kiev – Moscow, p. 43-67; Skica, T., Rodzinka, J. (2011). Metodologia badania. [In:] Skica T. (ed.) *Wiedza finansowa w praktyce działalności jednostek samorządu terytorialnego. Raport analityczny Vol 1, No 2*. Rzeszów: Wyższa Szkoła Informatyki i Zarządzania, p. 53-55.

⁶ Cf. Wołowiec, T., Soboń, J. (2010). *Decentralisation, Local Development and Financial Management of Local Government Units*. Nowy Sącz: Wyższa Szkoła Biznesu – National-Louis University, and also Wołowiec, T. (2010). Changes in Taxes on Property in 2010 – Threats and Risks for Tourist Health Resort Entities. *Information Bulletin of the Association of Polish Spa-Communities*, No. 3-4, p. 90-100.

⁷ See more on the topic in: Filipiak B., *Financial Strategies of Local Government Units*, PWE, Warszawa 2008.

⁸ Own statutory research, Wołowiec, T. (2009). *Local Government Units' Finances – Financial Departments and New Investment Financing Instruments*. Department of Economics. Nowy Sącz: WSB-NLU. Similar conclusions were reached after the interview with the Head the Association of Polish Spa-Communities, Krynica-Zdrój 2010 (information for the sample of 35 spa communities), and interviews with LGU managerial staff during councils of commune

1. financial engineering and hybrid financing (including: classical and reverse public-private partnership, project finance, venture capital and debt restructuring),
2. unconventional financial instruments (such as sale-and-lease-back of communal property),
3. needs of the LGUs by issuing communal bonds and using that issue to promote the image of the particular local government unit,
4. implementing a professional system of managing LGU debt to diversify sources of financing public tasks, principles of making analyses of LGU financial security, possibilities of alternative financing for the needs of the LGUs and communal companies,
5. identifying determinants for choosing the source and way of financing investment projects,
6. creating LGU financial strategies (including tax strategies at the communal level),
7. instruments allowing to limit the costs of financial transactions (Wołowiec and Górka, 2011).

Local governments seek knowledge that is specialised and reliable, but more importantly – secure. Considering the employment structure in the LGUs, it must be said that local government employees are very diverse as to the criterion of the average work experience in local government structures. The LGUs have both experienced employees who know the provisions of financial and budget law and young clerks who are just starting their work in the LGU. However, regardless of the age structure the issue of financial knowledge does not seem to disappear. The only thing that changes is the focus of the problem. On the one hand a conservative approach to modern financial management is noticeable⁹, supported by employees with longer work experience. On the other, young LGU workers have a strong theoretical foundation in the area of financial knowledge, but unsupported by practical experience. In effect, local government employees are relatively poorly prepared to use the possibilities given to the LGUs by the financial market. In spite of that, the inspection of the financial management of the LGUs conducted last year by the Regional Chambers of Accounts (RIO) gave satisfactory results¹⁰. It proved that the LGUs followed the binding laws while referring to the principles of purposeful and rational expenditure of the public means. This fact confirms the thesis that in their activity, the LGUs refer exclusively to proven and secure instruments of financing public tasks. This evidently proves poor financial knowledge or lack of it in local government structures, and deeply rooted habits related to using external financing sources.

Creating knowledge

Identifying and creating knowledge constitute the beginning of the road that leads to consolidating effects of territorial self-government units operations. Identified but hermetic knowledge does not bring any benefits, it is its transfer and popularization that brings measurable results for an organization. This means that the potential hidden in individuals does not have to translate into the quality of work in the whole office. This explains why often visionary and original ideas of individuals do not bring benefits measures in the whole territorial self-government unit. It should be emphasized that the above statement is not a result of theoretical contemplation, but an empirically identified fact. It proves that closed knowledge (concentrated in competencies of particular officials) does not offer particularly visible benefits. Its significance grows adequately to its increasing availability

heads and mayors in 2010 and 2011; szerzej: Rodzinka, J., Dzyuma U. (2011). *Bariery w pozyskiwaniu wiedzy finansowej przez pracowników JST*. [In:] Skica T. (ed.) *Wiedza finansowa w praktyce działalności jednostek samorządu terytorialnego. Raport analityczny Vol 1, No 2*, Rzeszów: Wyższa Szkoła Informatyki i Zarządzania, p. 68-70.

⁹ Author's own research (interviews with employees of selected communes of the Nowy Sącz, Limanowa and Gorlice districts), Krynica-Zdrój 2011.

¹⁰ Results of the Regional Chambers of Accounts' inspection available at: www.rio.gov.pl as of 28th October 2011.

The indicated regularities lead to another issues, that of knowledge deficit and surplus. Whereas the issue of knowledge deficit has always had negative connotations (its lack may result in faulty administrative decisions being taken), paradoxically, knowledge surplus is also harmful. The cause of this lies in information chaos – excess of information which effectively hampers taking optimal decisions and actions. As a result, in order to accomplish the goals set for a territorial self-government unit concerning strengthening its effectiveness, the process of creating and transferring knowledge should be continuous and selective.

The complexity of the presented issues implies the necessity of indicating those elements which focus our attention as far as knowledge management in an organization is concerned. These elements are: the already mentioned unit, then internal structure and finally external structure (environment). The above issues are the pillars of the potential existing in an organization, the potential consolidated and strengthened by continuous learning, that is expanding the scope of the existing knowledge. Frequently, this potential building boils down to eliminating knowledge gaps demonstrated by particular departments and sections of the office. Of key importance here is the examination of the needs and proper direction of actions concerning expanding knowledge, its supplementation and direction to those sections in the organization structure of a territorial self-government unit which show its deficit. Excessive knowledge is as negative as its deficit. In the concept of knowledge creation (K. E. Sveiby (2005), four stages of this process are indicated. These are: ‘Socialization’, ‘Externalization’, ‘Combination’ and ‘Internationalization’. It is assumed that in order to optimize the process of knowledge management the resources of explicit and tacit knowledge must overlap – both with reference to a single employee and to task teams (groups), and finally to the whole territorial self-government unit. This fact once again confirms that the growth potential of a self-government unit is determined not by individualities but by their sum.

Conclusions

Systemic management of a local government unit lacks viewing the LGU as an economic entity which should actively use modern financial knowledge in its activity in order to stimulate active construction of an economic and social potential. The arguments presented above prove the need to stimulate processes of building in local government structures a financial knowledge based on a modern understanding of LGU finance while considering the new challenges in finance which have been revealed after the subprime crisis, complemented with practical concepts based on *New Public Management*¹¹.

The analyses of source materials showed that in light of the self-government administration experiences so far, we cannot claim that there is a multi-directional knowledge transfer. Therefore, the observed single initiatives in creating and managing knowledge in self-government units are not a result of developed procedures, but are based on circumstances of a particular situation. Therefore we cannot state that we have some worked-out solutions, but rather one-off initiatives referring mostly to rural communes. Also legal regulations are not conducive to developing a uniform approach to creating and managing knowledge, as they limit the real freedom of operation needed by self-government units. Thus we can state that meager results in the area of knowledge management and the attitude of self-government units to obtain knowledge outside

¹¹ New Public Management introduces managerial approach to public sector management. The novelty of the model consists in adapting management methods and techniques used in the private sector to the conditions of public organisation management.

are the consequence of valid regulations and low awareness of officials. As a result, we often observe that self-government units depart from initiating actions which see the potential in the knowledge possessed and created by employees in the organizational structure of an institution.

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