ARL ACADEMY FOR TERRITORIAL DEVELOPMENT IN THE LEIBNIZ ASSOCIATION

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Municipal economy

URN: 0156-559910848

This is a translation of the following entry:

Oebbecke, Janbernd (2018): Kommunalwirtschaft.
In: ARL – Akademie für Raumforschung und Landesplanung (Hrsg.):
Handwörterbuch der Stadt- und Raumentwicklung. Hannover, 1171-1175.

The original version can be accessed here:
urn:nbn:de:0156-55991084

Typesetting and layout: ProLinguo GmbH
Translation and proofreading: ProLinguo GmbH

Recommended citation:
Oebbecke, Janbernd (2018): Municipal economy.
https://nbn-resolving.org/urn:nbn:de:0156-559910848.

Leibniz Association

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The municipal economy is the activity of local authorities in economic competition with other entities. This includes, for example, energy and water supply, local public transport, savings banks, and house-building companies. The municipal economy is still of considerable importance. From a legal point of view, it is regulated by sectoral laws and the municipal laws of the German federal states.

1 Term and definition

The term *municipal economy* is vague, like the related term ▷ *Provision of public services*, and is not used consistently. In legal terms, it refers to economic activity, namely the production, supply or distribution of goods and services, which may also be provided by private companies for a profit (cf. Oebbecke 2011: 62 et seq.). It involves activities on the market in which the municipal provider of the goods or services is at least potentially exposed to competition from other providers. The term has a different meaning in the context of municipal policy. For example, the German Association of Local Public Utilities of municipally determined infrastructure undertakings and economic enterprises *(Verband kommunaler Unternehmen, VKU),* which, according to the preamble to its articles of association, considers itself 'lobbyists for the local economy', mainly organises the public utilities of electricity, gas, water, district heating, broadband, as well as waste and sewage disposal or street cleaning companies, which are statutory municipal duties. From a legal point of view, companies in the housing sector, savings banks, transport companies, trade fair companies, forest holdings, or tutoring companies are part of the municipal economy. It is not clear what makes these types of company municipal. The spectrum ranges from the local authorities' and districts' own activities, owner-operated municipal enterprises, establishments and associations with legal capacity right through to municipal companies of the local authorities and mixed enterprises. The German Association of Local Public Utilities of municipally determined infrastructure undertakings and economic enterprises can also include companies that perform municipal tasks and whose decisions are sufficiently influenced by local authorities in ways other than shareholding (cf. VKU 2013: section 3(1c)).

The economic importance of the municipal economy is considerable. Precise details are problematic because of the aforementioned ambiguities. The figures below are therefore only guidelines. At the end of 2013, the German Association of Local Public Utilities of municipally determined infrastructure undertakings and economic enterprises consisted of 1,432 companies with EUR 110 billion in generated revenue and EUR 8.5 billion in investments (cf. VKU 2014). The roughly 740 municipal and public housing associations had approximately 2.5 million homes as of 31 January 2012 (cf. Federal Association of German Housing and Real Estate Companies *[Bundesverband deutscher Wohnungs-und Immobilienunternehmen e. V., GdW]* 2012). At the end of 2014, the savings banks had a market share of 37.7% in investments by private individuals and 42.6% in corporate loans (excluding housing development) (cf. Savings Banks Finance Group *[Deutscher Sparkassen- und Giroverband, DSGV]* 2014).

2 Development

While towns began operating water supplies and organising markets in antiquity, the history of the modern municipal economy dates back to the 19th century. Whilst early predecessors of municipal savings banks appeared as initiatives on the part of civil society and local territorial rulers in the 18th century, they can properly be traced back to the first decades of the 19th century (cf. Hoffmann 1959: 744 et seq.). The second third of the 19th century saw waterworks, gasworks, and electricity stations spring up, initially in cities – and often privately owned (cf. Ronellenfitsch/ Ronellenfitsch 2012: 8 et seq.; Hofmann 1984: 587). Street lighting and local public transport were

operated at a municipal level. The local authorities only allowed private companies to use the streets to lay supply lines in return for concession levies. By the 20th century at the latest, many of these activities had been taken over by the local authorities and combined into enterprises usually referred to as *public utilities* in order to avail of the associated economic benefits. This development benefited from tax arrangements which, for example, allowed profits from power companies to be used to cover shortfalls in local public transport. Electricity and gas production and the supra-local distribution of electricity, gas, and even water, were linked regionally and supra-regionally. With the advantage of being grid-based and secured by demarcation agreements for concessions for street use, and exempt from the ban on cartels, local energy supply was organised as a monopoly and run by municipal public utility companies until the end of the 20th century. Public utilities are now managed as semi-independent owner-operated companies and increasingly as GmbHs (limited liability companies) or AGs (public limited companies). It was only when efforts were made to create a European single market that deregulation of the energy markets began – particularly of the electricity market (cf. Pielow 2011: 558 et seq.). The two decades around 2000 were marked, on the one hand, by the sale of profitable sections of the municipal economy (▷ *Privatisation*) and on the other by the attempt to make up for the fields of activity lost through the deregulation of the energy supply with telecommunications or broadband coverage. Recently, there has been significant 'remunicipalisation', whereby local authorities participate in tenders for the networks with their own companies (cf. Ronellenfitsch 2012: 16 et seq.; Schmidt 2014: 357 et seq.).

3 Legal framework

The right of the local authorities to be economically active is protected by the constitutional guarantee of self-government in the Basic Law *(Grundgesetz, GG)* (article 28(2) sentence 1 of the Basic Law) and the state constitutions (for example, article 78(1,2) of the Constitution for the State of North Rhine Westphalia) (▷ *Local self-government*). This constitutional protection, however, is not unlimited. In the interest of the common good (▷ *Common good*), restrictions are permissible if they comply with the requirements associated with the prohibition of excessiveness – in other words, if they are appropriate for achieving the objective of the common good – and there is no other less restrictive but equally appropriate means (necessity), and the advantages of the restriction outweigh the associated disadvantages (reasonableness).

Apart from special sectoral laws for individual fields of activity (for example, the Energy Industry Act *(Energiewirtschaftsgesetz, EnWG),* the Carriage of Passengers Act *(Personenbeförderungsgesetz, PBefG),* the Regionalisation Act *(Regionalisierungsgesetz, RegG),* local public transport laws of the federal states, banking law *(Kreditwesengesetz, KWG),* and the savings bank laws of the federal states), there are general restrictions on the economic activity of local authorities in the municipal law of the federal states. These provisions are based on sections 67 et seq. of the German local government code *(Gemeindeordnung)* of 1935. The provisions on the permissibility of economic activity aimed to restrict such activity in order to protect the local authorities from the associated financial risks and to ensure that they did not neglect their other duties. Likewise, the intended protection of private competition against (public) competition secured financially by tax revenue tends to be achieved today by the ban on subsidies. Today, consumer protection law and the antitrust prohibition of a monopolistic position serve to protect against municipal companies

abusing their strong market position. The restriction of economic activities to protect the local authorities and their other duties is still hugely important today.

The provisions of the federal states (for example, section 107 of the local government code of North Rhine-Westphalia *(GO NRW))* more or less exclude from their scope of application extensive fields of activity, in particular education, social, sport, and health policy. Economic activity in the other fields is usually only permitted on three conditions, which must be met cumulatively: (1) It must serve a public purpose, whereby making a profit does not constitute such a purpose. (2) It must be proportionate to the local authority's economic capacity as well as to the anticipated demand in most federal states. (3) Finally, the purpose must not be served just as well – in other federal states: not better – by other means. When determining whether the conditions are met, courts widely go by the scope for decision-making in local policy. Economic activity, as a local function, must also respect the spatial boundaries of the local authority's remit (cf. Oebbecke 2000: 375 et seq.). In the absence of statutory rules to the contrary, supplying non-resident consumers outside of a local authority's own area is in any case prohibited. Exceptions also apply in this respect to the local energy industry (▷ *Energy industry*) (cf. Oebbecke 2011: 59 et seq.). Whether private competition can seek legal remedies against municipal economic activity is contested and is judged differently by the case law in the federal states (cf. Wendt 2011: 75 et seq.).

The municipal laws of the federal states also include provisions about whether and how the local authorities are allowed to use organisational forms under private company law – most notably GmbH and AG. The permission to do so is essentially protected in the constitution. The legal restrictions aim to ensure that the company is aligned with its public purpose, that administrative effort is concentrated on the core tasks of the local authorities, that elected municipal politicians do not improperly influence the companies, and that financial losses are avoided. The statutory provisions, therefore, more or less decidedly prioritise the local authority's own enterprises over AGs and include various stipulations for structuring them under corporate law. These statutory provisions must be in line with federal company law. They are thus pushed to their limits in particular when the establishment and activities of subsidiaries of municipal companies are to be regulated (cf. Oebbecke 2012: 215 et seq.).

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Last update of the references: March 2017