

FINANCIAL DESTABILISATION OF POLISH LOCAL GOVERNMENT UNITS

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Summary: The aim of the study is to indicate the causes destabilising the financial situation of local government units in Poland. Their identification and subsequent verification will allow a diagnosis to be made as to whether it is possible to bring about a stabilisation of the financial situation of these units within a more defined period of time.

Keywords: determinants, finance, stability, vacatio legis (absence of law).

1. Introduction

The problem of the construction of the system of local government finance in Poland has been attracting the attention of economists for many years. Although this topic is discussed in the literature, the solutions applied in practice often come as a surprise to both academics and local government activists. Numerous and frequent changes in the system of local government finance cause that one of the postulates often put forward in the literature is the stabilisation of the basis of finance for local government units (LGU).

2. The concept of financial stability

The growing population, civilisational and economic progress, social and political changes, social doctrines propagated and implemented - these are just a few examples selected from the extensive catalogue of factors that influence the form of local government finances. It suffices to mention here that the progress of civilisation results in a systematic increase in the number of goods and services that can be offered to the public as public goods and services. Today, many of them are not yet recognised because they are yet to be created. It should also be noted that the expectations of local communities are changing not only in terms of the quantity but also the quality of public goods and services offered to them by the local government units. All this means that the local government finance system is evolving. This is a natural phenomenon and results not only from changes in the environment in which these units operate but above all from their striving for their own development.

Assuming that the basic objective of the local government authorities is to create the best possible conditions for the development of the local community, it should be stated that the development is a dynamic process which in effect must lead to quantitative and qualitative changes in the social and economic spheres, technical infrastructure, etc. Undertaking developmental projects, i.e., those that will be implemented over a longer period of time requires certainty that local government units will have sufficient funds to finance them over that period. This is why there are postulates that changes to the local government finance system should not be made too frequently.

The principle of financial stabilisation of local government units is a postulate aimed at ensuring sustainability or relative stability of the basis for the functioning of the financial system of these units. Stability is treated in this case as a state in which the revenue base of local government units is adjusted to their expenditures. The stability of the financial system means that changes in the structure of this system will not be made too often.

The problem of changes in the system of local government finance can be examined from the point of view of their frequency, quantity and quality. Among them, one can identify those of fundamental importance for the scope and structure of functioning of local government units and those of marginal or even "cosmetic" significance for these units, e.g., the unification of applied terminology. Among the changes of a fundamental nature, i.e., those that are a condition for maintaining the state of alignment between the revenue base and the level of expenditures, one may mention changes in:

- construction of power supply sources of LGU,

- the catalogue of tasks performed by LGU,
- application of the principle of non-funding.

The postulate of stabilising the sources of power of LGU is proclaimed by many economists. For example, S. Owsiak states that only a relatively stable financial basis for the activity of local authorities guarantees effective activity of public authorities and effective spending of public funds [Owsiak, 2020, p. 57]. P. Sołtysiak notes that a condition for the proper performance of tasks by local governments is to ensure the sustainability of sources of funding for their activities [Sołtysiak, 2020, p. 349].

This postulate is fully justified; however, it should be added that the inadequacy of the sources of revenues of these units to the tasks performed in the face of the expansion of their catalogue may turn out to be much more significant for local government units.

Changes, especially those that consist in: The main problem for the entities responsible for the implementation of tasks assigned to local governments may be the widespread application of the principle of merging revenues and expenditures of local government units.

For each of the changes made, the local authority must adapt. This requires time first of all. If changes are made too frequently, the local government must of necessity prefer short-term planning of budget revenues and expenditures, it has difficulties in formulating a development strategy, etc.

In general, it can be said that the effects of change are seen in financial, political, social and psychological terms. The frequency of change can undermine local initiative because it influences decision-making, the effects of which can be observed in the long term.

However, it should be recognised that amendments may be necessary for a variety of reasons. If such a situation arises, it is essential that these changes be preceded by a sufficiently long *vacatio legis*, which involves compliance with the annuality of the budget.

It is also important for local authorities to communicate the effects of changes so that adaptation measures can be taken in sufficient time.

3. Determinants of changes in the basis of LGU finance

When attempting to answer the question: under what factors were the foundations of local government units' finances built - it seems justified to refer to the statement by E.

Chojna-Duch, who believes that there are no permanent state and local government tasks, as they are the result of political decisions expressed in legal norms, as well as there are no permanent criteria and proportions of expenditure and revenue distribution among them [Chojny-Duch, 2017, p. 146]. To emphasise this fact, the author quoted above defines local government as follows: "local government exists and acts by the will of the state, within its framework and under its supervision, it bases its existence on the state legal order. By means of laws, the state (its authority) decides on its establishment, forms of local government, levels of governance, the scope of action, functions and powers, and material and financial resources [Chojny-Duch, 2017, p. 151]. If we take this view, it will mean that we consider the political factor to be the basic determinant of establishing the basis for local government finance.

On the assumption that the state decides on the shape of local government, it must also be said that this shape will be determined by the financial situation in which the state finds itself at any given time. Therefore, the financial factor should be considered as another factor that significantly influences the form of local government finances.

S. Owsiak states that „the state authorities, including the central authorities, are very reluctant to give up their powers with regard to taking over public funds”[Owsiak, 2020, p. 29]. To this must be added that this is mainly due to the situation in which the state budget finds itself.

To sum up, the form of local government finance is determined primarily by political and financial factors. Other factors, such as legal or organisational, may also be mentioned, but in our opinion, they are derivative in relation to the above-mentioned ones.

4. Establishing foundations of LGU finances in Poland - legal aspect

When periodising the period of formation of the basis for sources of funds for local government units, two sub-periods may be distinguished, i.e., the years 1990-1998 and the years 1999-2006, i.e., the period in which only one level of local government functioned, i.e., gminas, and the period in which the structure of local government was multi-level.

In the period 1990-1998, among other legal acts, of key importance for gminas were acts which regulated the system of feeding the budgets of these units. These were in particular:

- Act of 8 March 1990 on Municipal Local Government (Journal of Laws of 2020, item 713, as amended),

- Act of 27 August 2009 on public finance (Journal of Laws of 2019, item 869).

The establishment of local government in Poland shortly after the political breakthrough was not reflected in the creation of legal acts providing the basis for stabilising the financial basis of gminas. There were several reasons for this.

Firstly: the necessity to adjust the sources of supply to local government units was enforced by the changes made in various elements of the state financial system, including in particular the tax system. This is because we cannot lose sight of the fact that this was a period of dynamic changes in the tax system, which was being adapted to the conditions of a market economy. New taxes were created at that time, such as personal income tax, value-added tax, excise duty and gaming tax. In turn, other taxes, such as corporate income tax, were modified.

Secondly, there was a lack of a holistic view of the functioning of the newly established local government units. One may risk a statement that the concepts of the functioning of gminas in Poland were built in the course of creating further legal acts concerning their functioning,

Thirdly: the form of the Polish system of local government finance was strongly dependent on the financial situation of the state budget.

The first period of local government, which can be dated back to 1990-1998, can be described as a period of attempts and mistakes. The transitional nature of the legal regulations introduced and the lack of a comprehensive concept of gmina finance were clearly visible. It was not possible to establish a stable basis for the financial management of gminas. S. Owsiak has a different opinion on this issue, claiming that regardless of the changes, a relatively stable system of basic income of gminas was in place throughout the period in question [Owsiak, 2020, p. 43].

Almost 10 years have passed between the introduction of the first stage of local government reform and the introduction of the second stage. The delays that have occurred in the implementation of the next stage of reform are primarily attributable to political factors. Controversy arose mainly over the number of local government units that were to be created. In particular, the number of voivodeships was disputed. In the course of the discussion, different numbers were proposed, ranging from 32 to 15. In the end, 16 were established as a result of a political compromise. There were also doubts about the number of districts.

It was not without significance that, alongside the creation of new tiers of local government, the legal foundations for the functioning of the entire public sector began to be laid. In 1997, the Basic Law was implemented and, in 1999, was implemented the Public

Finance Act. Apart from the aforementioned acts, the legal acts that regulated the sources were of fundamental importance for the local government units.

If we wanted to look for common features of building the foundations of the sources of supply to local government units' budgets in the indicated periods, we would have to state that, apart from significant qualitative changes in the system of supply to local government units, each of the legal acts was a carrier of the message that it would be in force for a short period of time and that it had a transitional character. Laws that were fundamental to the functioning of local government had certain psychological effects. If their effects for local government units turned out to be unfavourable, one could suppose that soon a new legal act will appear, which will bring more favourable solutions. In the meantime, no such act has appeared, and an act that was supposed to be in force for a year or two has been in force for several years.

S. Owsiak quoted this fact by stating: „Experience teaches that amending and adopting of a new law encounters difficulty; it is easier to extend the validity for future years”[Owsiak, 2020, p. 47]. However, the problem cannot be reduced to a technical issue. There were deeper reasons for this state of affairs. This is also mentioned by the author quoted above, who states that it was the crisis of state finances that delayed the building of a more solid basis for gmina finances.

It is characteristic that in the whole period under analysis, the construction of solutions of key importance for local government units, i.e., the system of budget provisioning, was dominated by haste in their elaboration and adoption, by the lack of wide consultations and - first of all - by the lack of a comprehensive analysis of the effects of changes. This is all the more surprising, as works on the form of subsequent laws were commenced already at the moment of enacting the previous ones.

The quality of the law was and unfortunately still is alarmingly low. The statutory introduction of certain terms "lingers" in the literature to this day. For example, in the Act on revenues of gminas and the principles of their subsidising of 1991, the term reversible revenues appeared, which included loans and credits, In the Act on revenues of local government units of 2003, subsidies from special-purpose funds were included in own revenues.

In the book *Theoretical and Practical Aspects of Financial Law. Problems, Concepts, Challenges and Solutions*, the authors draw attention to the multitude of laws regulating the issues of local government [Gorgol, 2020]. They point out that local finances are regulated directly or indirectly by several hundred other laws. These laws, as the authors rightly claim,

come from different years and even eras. A large number of legal regulations which directly or indirectly concern local government also have the disadvantage of using different terminology for the same concepts. It is not our purpose to present in full the qualitative changes included in the legal acts indicated above. However, the attention was drawn to the phenomena which affected LGU in a particular way.

Since the Constitution appeared in 1997, one of the guiding principles that follow from Article 167(4) of that law, was adequacy. In practice, this principle was often violated. Tasks were transferred to local government units without ensuring appropriate funds for their financing. By the way, a question should be raised: how, i.e., according to what method should the amount of these funds be calculated?

The catalogue of exceptions to the principle of non-funding existing in the legal regulations is very broad. It includes not only local government special-purpose funds but also a number of revenues that are related to expenditures. The abolition of special funds has changed little in this respect, as a category of own revenue for budgetary units has emerged.

5. Crisis in public finances or crisis in local government finances?

As S. Owsiak rightly notes „public authorities are [...] a system of interconnected vessels, hence crisis phenomena in government finances must have a negative impact on the state of local finances. The crisis in public finances, as measured by the degree of sustainability of local government budgets, does not appear as obvious as in the case of the state budget”[Owsiak, 2020, p. 68]. It seems that this phenomenon can be traced by analysing the construction of the foundations of local government finance in Poland.

The crisis in state finances first appeared in 1991-1992, i.e., at a time when the foundations of local government finances were being established. The manifestation and also the main symptom of the crisis was the budget deficit. In 1991 the state budget closed with a surplus, which in relation to GDP amounted to 3.8%. In the following years, the budget balance was negative and in relation to GDP it amounted to: in 1992 - 6.0%, 1993 - 2.8%. 1994 – 2,7%, 1995 -3,1%. 1996-2,8%, 1997-2,8%. 1998-2,4%, 1999-2,5%, 2000-2,9% [2].

During this period, the state of government finances and local government finances were radically different. While stipulating that the financial results of municipalities cannot be treated as criteria for assessing their financial condition, it should be noted that this condition was not bad and can hardly be considered a crisis. In 1991, 1993 and 1995 the gmina budgets closed with surpluses. A negative result appeared, however, in 1992, 1994 and

1996-1998. What was worrying, however, was that in the total number of gminas the number of those with a budget deficit was significantly increasing. In 1991 the rate was 2.7%. In 1992 it was 44.7% and in 1998 it reached 68.1%.

However, if we compare the situation of the state budget and LGU in this period, it will not be surprising that the attention of public authorities was primarily focused on reducing the level of the state budget deficit. With this in mind, attempts were made to limit some of the revenues of local government units. An example of this is the unsuccessful attempt to reduce the share in the corporate income tax from 5 to 2%. Another important solution that was applied in connection with the introduction of the Gmina Finance Act in 1993 was the introduction of a horizontal redistribution system. It consisted in the fact that gminas whose tax power exceeded a statutorily defined level were obliged to make payments to a subsidy granted to other gminas.

After a brief period of stabilisation of public finances, symptoms of another crisis emerged between 1996 and 2000. The state budget deficit is starting to widen and other borrowing needs of the state budget are also increasing. The deficit of the state budget relative to GDP in subsequent years of the period in question amounts respectively to: in 2001 - 2.0%, 2002 - 2.2%, 2003 - 3.6%, 2004 - 3.7%, 2005 - 3.7%, 2006 - 3.8%, and in 2007 - 3.9% [3].

The crisis in state finances emerged with full force in 2001-2002. The main reasons for it are the effects of the four major reforms introduced in 1999. One of these was an administrative reform involving the creation of successive tiers of local government. The introduction of this reform was not as significant a burden on the state budget as the effects of other reforms introduced in this period. It is necessary to agree with Elżbieta Malinowska-Misiąg and Wojciech Misiąg that „the state budget did not lose from the establishment of powiats and local governmental voivodeships. No one has gained either, nor can the shape of the new local government units and the financial system offered to them be considered a success” [Malinowska-Misiąg, 2020, p. 34].

However, S. Owsiak emphasises that "the results of the first year of implementation of the systemic reform as regards decentralisation of public finance, an element of which was [...] the Act on revenues of local government units have been critically assessed by the doctrine, as well as by local government activists and organisations [Owsiak, 2020, p. 99]. By the end of 2006, some politicians and local government officials were already talking plainly about a crisis in local finances in Poland.

Since 2000 work on the law on revenues of local government units has been continued uninterruptedly. Out of two submitted drafts (ministerial and governmental) one was passed on 25 August 2001; however, it did not gain the approval of the President, who argued the lack of his signature on the act with the state budget crisis. As a result, work was undertaken on another draft law. The subsequent law on revenues of local government units, as already mentioned, entered into force in 2004.

Therefore, when analysing the financial situation of LGU, two periods should be taken into account, i.e., the years 2009-2013, in which the financial situation of LGU was formed under the influence of the Act of 1998 and the period in which the Act passed in 2013 became effective. If we look at the situation of LGU through the prism of the scale of budget deficits realised by these entities, it can be concluded that most of them recorded a budget deficit between 2014 and 2018. This phenomenon occurred with particular sharpness in the case of powiats, cities with powiat rights and voivodeships. Thus, the share of powiats whose budgets were closed with a deficit in relation to the total number of powiats was respectively: in 2014 - 52.2%, 2015 - 69.5%, 2016 - 77.1%, 2017 - 77.3 and in 2018 - 77.4% [4]. For cities with county rights, the rate was equally high: in 2014 - 89.2%, 2015 - 75.4%, 2016 - 76.9%, 2017 - 73.2, 2018 - 70.8% [4]. It should also be noted the very high share of voivodeships whose budget was closed with a deficit in the total number of voivodeships. This indicator was respectively: in 2014 - 75.0%, 2015 - 68.7%, in 2016 - 71.2%, 2017-2018 - 75.0% [4].

The situation of gminas was slightly different in this respect. In 2014, the share of gminas with a budget deficit in the total number of gminas was very high and amounted to 69.9%. After this period, the situation of gminas is slightly improving nevertheless the ratio of gminas whose budgets closed with a deficit was still high and was respectively: in 2015 - 58.2%, 2016 - 51.3%, 2017 - 54.5, 2018 - 56.3% [4].

It is characteristic that after the implementation of the Law on Local Government Income in 2004, the situation of most of them improved. If we use the indicator presented above, we have to conclude that the share of local government units which were in deficit has significantly decreased. In fact, for the powiats, this indicator was at the following levels: in 2014 - 45.9% and in 2015 - 52.9%. For cities with powiat rights: in 2014 - 53.8%, 2015 - 64.6%. For voivodeships; in 2014-2015 - 12.5%. For gminas it was: in 2014 - 56.7% and in 2015 - 43.6% [4].

The situation of the state budget and the budgets of local government units significantly affects the balance of the entire public sector. In 2015, the deficit of the public finance sector was lower than in 2014, which was mainly due to a decrease in the deficit of

the state budget and extra-budgetary economy, both of the state budget and LGU. There is a surplus in state special-purpose funds, but local government budgets record deficits.

To sum up, the observation of the process of creating the basis for local government finance from the perspective of 2016 leads to the conclusion that the legislator has consistently observed the principle that the construction of sources of supply for local government units should not cause a significant decrease in state budget revenues leading to an increase in the budget deficit or other borrowing needs of the budget. The reasons for this were complex, but the crisis in state finances seems to have played a fundamental role.

6. Conclusion

The creation of multi-annual financial forecasts of local government units takes place in the atmosphere of temporariness. The implementation of subsequent legal acts providing for the revenues of these units has been largely dependent on the financial situation of the state budget, including in particular the crisis of state finances.

While postulating stabilisation of the basis of local government units' finances, we realise that such a postulate is difficult to implement without a thorough reform of the entire public sector. Therefore, recognising that changes in the system of local government units will continue to be introduced, we propose that they be preceded by a sufficiently long *vacatio legis* connected with the observance of the annual budget rule.

Searching for an answer to the question posed in the introduction, whether it is possible to bring about the stabilisation of the financial situation of local government units in a more definite time, it should be stated that until a thorough reform of the whole public sector is carried out and the financial situation of the state budget is stabilised, it is difficult to expect the financial situation of local government units to be stabilised.

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