

FINANCIAL AUTONOMY OF LOCAL GOVERNMENT

Pr. dr. Jacek Stasiak¹

¹„Herbrand” Centrum Medyczne NZOZ w Aleksandrowie Łódzkim,
e-mail: jacek_stasiak@interia.pl

Summary: The transfer of financial authority to other public entities, including local government, means a limitation of the state's authority. The essence of the financial independence of local government units lies in the possibility for the state to share certain attributes of financial power with other public entities, legally and organisationally distinct from the state, including local government units.

Keywords: state budget, budgets of local government units, financial sovereignty.

1. Introduction

The basic principle with regard to the functioning of local government is the principle of autonomy. It underpins the idea of decentralisation. Article 15 of the Polish Constitution contains an order to organise public administration in such a way that decentralisation can be adequately ensured. This provides a legal basis and a guarantee of the highest constitutional rank: moreover, it determines that at least part of public authority will be decentralised, i.e., transferred to local government. However, this does not provide grounds for placing the local government in a position of independence from the state legal order and complete independence from state authorities. Neither on the theoretical grounds nor in the practice of functioning of public administration in modern states does one postulate total sovereignty,

also financial, of local government units. Thus, the concept of local government cannot be understood simplistically as an expression of not being subject to anyone's authority and „getting around” without anyone's help. The state, through its central authorities, must have the possibility of intervening in the sphere of the performance of public tasks by the local government. One of the instruments of this influence is financial instruments with the help of which the state supports certain activities of the local government in selected areas, at the same time stimulating it to undertake them. These instruments have to be located in the area of the distributive role of the central budget and partly also of other public resources (funds).

2. State budget and budgets of local government units

The concepts of autonomy in general and financial autonomy of local government are not defined unambiguously either in the existing legal norms or in the literature. There are attempts in the literature to define these concepts as separate from the concept of autonomy, which means the right to establish, independently of central authorities, its own rules of operation, including in the financial sphere. At the same time, it is underlined that this kind of autonomy of local governing authorities is not acceptable for the model of a unitary state. Local government is an element of the structure of the state, enjoys statutorily defined powers and remains under the control of certain state bodies [Wołowiec, Cienkowski, 2015].

Many authors have attempted to theoretically present the concept and scope of the financial independence of local government. It has been pointed out that it has several aspects, and its scope is determined by such factors as the size of the monetary resources placed at its independent disposal (measured in relation to the size of the state's monetary resources), the extent of freedom in the formation of expenditure, the extent of freedom in the spending of funds, and the extent of freedom in the organisation of local government budgets, budget planning and budget implementation. It was also pointed out that the essence of financial independence should be seen in providing local government units with revenues allowing them to perform the public tasks assigned to them, leaving them the freedom to decide on expenditure and creating appropriate formal and procedural guarantees.

The concept of the financial independence of local government is understood as the right expressed in the law to have sufficient resources to carry out its tasks, including the obligation for the state to provide local government with sufficient resources to carry out its tasks, among which own revenues should prevail.

The independence of local government cannot be understood in isolation from other state structures. The government and local government administrations are elements of public administration in its broadest sense, with the local government administration being a form of decentralised administration of public tasks, as discussed in the earlier considerations. Thus, local government finance is an element of public finance, and financial independence is an effect of the processes of decentralisation of public finance within the public sector, which does not mean the creation of complete financial independence of the local government sector from the state financial system.

The extent of the local authority's independence within the scope of its functions is derived from the functions performed by the public authority and the manner and proportion of their distribution between the central and local authorities. Decentralisation of the implementation of individual functions attributed to public finance is not and cannot be done to the same extent.

These functions are classified differently in the theory of public finance. For example, a division into allocation, redistribution and stabilisation functions is proposed. With such a division it is believed that the allocative function should be realisable by local authorities, while the realisation of the redistributive and stabilising functions should be primarily linked to the responsibility of the central level.

A different approach to the functions of public finance and their division into fiscal, redistributive, stimulatory and accounting and control functions, as presented in the literature, allow for a more detailed analysis of their division between the central and local levels, where each of the functions may be fulfilled to a different extent.

The implementation of fiscal, redistributive and allocative functions at different levels of local government is primarily related to the size of funds that are collected and distributed by local and regional budgets, and the extent of decision-making autonomy as to how to carry out the distribution of funds accumulated in these budgets. In local budgets (gmina, powiat), the importance of the subject, object and time criteria of redistribution, related to decisions on the allocation of resources to individual tasks is increasing; in regional budgets, the role of territorial criteria of allocation of resources between individual local government units included in the regional territorial structure of the country's division is increasing.

The relationship between local government units and the central budget results from constitutional regulations and guarantees contained in the European Charter of Local Government and the European Charter of Regional Government, as well as from laws determining the principles of transferring financial transfers from the resources of the state budget to the budgets of local government units of particular levels.

The Constitution [1] grants the following rights to local government units, thus determining the extent of their financial autonomy:

- the right to legal personality (art. 165(1)),
- ownership and other property rights (art. 165(1)),
- the right to have public funds adequate for the tasks (art. 167(1) and (4)),
- the right to determine the sources of revenue by law (art. 167(3)),
- the power to set rates of local taxes and charges, within the limits laid down by law (art. 168),
- the right to supply local government budgets with funds from three types of sources: own revenue, general subsidies and targeted subsidies from the state budget (art. 16(2)),
- and defining the principles and criteria for the supervision and control of the financial activities of the local government (art. 171(1.2)).

The subjective rights of local government units also result from the European Charter of Local Government by ratification, which currently has the force of universally binding law of supra-statutory rank, which grants local government also other rights, not included in the binding constitutional regulations [Owsiak, 2020, p. 209]. It is the right to:

- the free disposal of financial resources in the exercise of their powers (art. 9(1) and (7)), levies and local taxes (art. 9(3)),
- a diversified and flexible system of financial provision (art. 9(4)),
- receiving compensatory payments in view of either an unequal distribution of income sources or unequal distribution of the burden of fulfilling public tasks (art. 9(5)),
- to express opinions on the design of the financial resources system, on access to the national capital market within the limits set by law.

Additional standards for regional government result from the European Charter of Regional Government adopted at the Fourth Session of the Congress of Local and Regional Authorities of Europe in Strasbourg. The Charter is not yet a binding act of international law, but its entry into force is expected to be soon, so the question of the extent to which its provisions have been implemented should already be considered in the light of the problem of Poland's ratification of the Charter and future measures to bring the system of regional finance in Poland up to European standards. They consist of:

- enabling regions to pursue their own social, economic and financial policies,
- that the regions base their financial resources on their own financial resources, including their own taxes and charges, the rates of which they may set within the limits laid down by law (the Charter also considers the regions' share of general, the so-called state taxes to be their own resources); where regions are unable to levy their own regional taxes, they should be authorised to set regional supplements to these taxes,
- stipulating that transfers of public funds to the regions should be primarily of a general subsidy nature and based on legally defined principles, determined by a small number of objective criteria related to the actual needs of the regions,
- not limiting the region's financial autonomy through statutory requirements for compliance with budgetary law and the standard settlement system,
- establishing that the management of regional taxation, with a view to rationalising, increasing efficiency and coordinating it, may be the responsibility of more than just a regional authority.

The most relevant provisions of these acts therefore determine the relationship with the state budget as follows:

- define two basic forms of central budget support, i.e., general subsidies and specific grants, and make them obligatory for each local government unit,
- assign a predominant role to transfers as general financial support not focused on the implementation of specific tasks,
- create the need for transfers to be designed in such a way that part of them is compensatory in character, either from the point of view of uneven distribution of revenue or in terms of the burden of having to carry out increased public tasks,
- transfers should be based on objectivised criteria for their calculation,
- the size of transfers from the central budget must be linked to the implementation of

the principle of the adequacy of resources to the tasks.

The need for local government budgets to be supplied with revenues other than its own revenues is due to the following reasons:

- the most efficient or high-growth taxes feed into the central budget. This applies to taxes such as value-added tax and excise duties,
- revenues from local taxes on local authority property and capital revenues are not sufficient in any country to fully fund the public tasks delegated to local authorities [Owsiak, 2020, p. 256],
- there are significant disproportions in the number of revenues obtained by local government units from own sources of income granted to them, which results in the necessity for the state to intervene in the sphere of allocating public revenues [5],
- there is a need for the state to pursue a general policy towards the activities of local and regional authorities. The possibility for the state to pursue such a policy in selected areas (e.g., education, social care) should not be in conflict with the need to decentralise public administration. The point is to support the local government in the implementation of those tasks which the state situates in the area of general social policy.

The relationship between the state budget and local government budgets involves various types of financial transfers. They are an expression of financial aid granted by the state to local and regional unions, but they have different functions and therefore different legal character.

In 1950-1990 the relationship between the central budget and the budgets of local authorities (national councils) was very close. The Sejm passed a collective amount of income and expenditure for the budgets, which was an expression of a uniform state budget management. It was a strictly centralised system, with territorial budgets being an element of the state budget system (although territorial units measured their own budgets), and the basic form of financial relations - a subsidy transferred from the state budget, the amount of which was calculated annually in a discretionary manner.

Since the reactivation of local government in Poland by way of the Act of 8 March 1990 amending the Constitution of the Republic of Poland, and then the so-called Small Constitution - the Act of 17 October 1992 and the Act of 8 March 1990 on local government (now the Act on gmina local government), initially only to the extent limited to the primary

level, i.e. gmina level, there was a need to define in a new way the relationship between the state budget and the budgets of gmina local governments. Local government budgets have become separate budgets created independently by authorised gmina bodies [Rogalska, Bury, Dziakański, 2010].

Legal regulations concerning financial transfers from the state budget are currently regulated in two basic legal acts, i.e., the Public Finance Act and the Act on revenues of local government units. They constitute a development of constitutional regulations relating to the financial system of the state and local government (mainly Article 167(1,213) of the Constitution of the Republic of Poland), although it should also be stressed that these regulations are not properly harmonised with each other. In fact, the Constitution only mentions subsidies and specific grants from the state budget as transfers, while, as is clear from the other two laws, there are more forms of transfers.

The relationship between state and local government budgets can be divided into the following types:

- 1) support of a general nature for local government budgets (taking the form of the so-called general subvention),
- 2) providing local governments with shares in state taxes (CIT and PIT). The local government has been demanding for a long time that it be provided with a share of revenues from the goods and services tax, but these demands have not been met so far; instead, all levels of local government participate in revenues from two income taxes, i.e., from natural persons and legal persons,
- 3) support in well-defined areas to achieve well-defined objectives: this may take the form of:
 - the definitive transfer of funds (the so-called target-based subsidies),
 - loans for specific purposes (e.g., pre-financing related to the acquisition of EU funds for local authorities);
- 4) support of an incidental nature, assistance in the situation of specific financial difficulties occurring in particular local government units (recovery proceedings),
- 5) refunding lost income, connected with system changes in the sources of income - local government, most often due to statutory reductions and exemptions in local taxes (once these are subsidies, once they are grants).

The financial links between state and local government budgets perform different functions, thus they should be considered and assessed primarily in terms of their effectiveness.

In addition, funding is provided from the state budget, this mechanism can be described as the so-called indirect support. These are funds that the state budget transfers to BGK (National Economy Bank) in order to create separate funds to support the implementation of local government investments. These are the Municipal Investment Development Fund, created by the Law of 12 December 2003, and the EU Guarantee Fund, created by the Law of 16 April 2004). Funds from the state budget are only one of the sources of financing for these funds, whose task is to provide preferential loans (Municipal Investment Development Fund, in Polish: FRIK) and guarantees (European Union Guarantee Fund, in Polish: FPU) to access credit and support municipal bond issues.

Participations of local government units in taxes constitute a special legal construction of the division of income flowing from one tax source, common for local government budgets and the state budget. In the solutions applied in different countries, there are various methods and legal forms of such division. The structure adopted in the Polish budgetary system consists in the fact that the amount of shares in revenues from the two types of income taxes operating in the Polish tax law (i.e., from natural persons and legal persons) is defined in percentage terms in the Act (previously in the Act on financing gminas, now in the Act on revenues of local government units). The amount of revenue to gmina budgets from tax shares is therefore dependent on the revenue that these taxes bring to the state budget in each subsequent financial year.

Local government shares in taxes collected by the state budget are a form of systemic redistribution of centrally collected revenue. I do not believe that it is appropriate to describe this form of financing as a share of State budget revenue, since all of the revenue from a particular tax is shared between the State budget and the budgets of local and regional authorities, and therefore only a specific part of the revenue from this tax is State budget revenue and part is revenue for local and regional authorities.

The design of shares means that they are shares in the proceeds of taxes that are also income to the state budget, rather than shares in the taxes themselves (i.e., the proceeds of a legal tax title) [Wołowiec, Cienkowski, 2015]. This indicates that they are transferred in accordance with the legal situation prevailing during the financial year. In the event of a

change in the legal status, the entitlement to the shares settled after the end of the financial year shall lapse taking into account the period of the transitional settlement after the end of the financial year.

At the same time, it should be stressed that due to the fact that the share structure makes the amount of revenue in local government budgets dependent on the current economic and social policy pursued by the state at the central level, in particular the tax policy, the influence of local government bodies on the elements of the tax structure as a whole, e.g., with regard to reliefs and exemptions provided for a specific tax, is limited.

The current method, adopted by the current law, of calculating the size of the shares of the different levels, especially in personal income tax, is complicated and unclear.

The amount of the gminas' share is set in the Law on Income of Local Government Units in Article 4(2), at 35.72%, but in combination with the rule expressed in Article 89, it is reduced each year by the number of percentage points corresponding to the product of 3.81 percentage points and the ratio relating to the residents admitted to social welfare homes (for 2019, this ratio was given by the legislator - 0.95%). This way of calculating the shares does not make it possible to calculate them on the basis of the Act alone, but requires obtaining data on the number of residents of social welfare homes nationwide, while the Act does not specify which authority is to carry out the determination and on the basis of which reports.

The rate of participation in this tax is to be increased every year by amounts that are currently unknown until the target rate is reached. The target figure will only be reached when there is no longer a single resident admitted to social welfare homes by the end of 2003.

According to a different principle, the participation of the gmina in the corporate income tax was regulated. In the light of Article 4(3) of the Act, the amount of the share in the corporate income tax from taxpayers having their seat on the gmina's territory amounts to 6.71% (the so-called gmina CIT) as from 1 January 2019. The aforementioned part of the income tax is transferred by the tax offices to the account of entitled gminas, i.e., gminas on the territory of which the registered office or branch of the legal person is located.

It is reasonable for an establishment (branch) of a legal entity to contribute an appropriate share of corporate income tax to the gmina in which it is located. This solution is supported by the fact that the gmina should be financially interested in the location of an establishment (branch) of a legal person on its territory, and also by the fact that an

establishment (branch) drawing up a balance sheet or not drawing up a balance sheet, generating a loss or income, uses gmina facilities (e.g., roads, water supply systems, heating systems) and should therefore participate - through tax payments - in financing these facilities. Legal entities or other organisational units, their establishments or branches can contribute to the creation of new jobs, the economic revival in the gmina and thus can increase tax revenues.

There is a negative opinion of including, moreover purely formal, shares in state taxes as own income, although improving the statistics on the structure of income of local government units, but not increasing their financial independence, as this source of income still does not constitute an effective, direct instrument of the financial policy of individual local government units, and its efficiency depends on the policy of the central government.

It should also be pointed out that the formal attribution of shares in state income tax revenues to gmina own revenues does not result in them becoming own revenues in the sense of the non-legal material, e.g., these shares do not have the constituent characteristics of own revenues. These are transferable revenues, which are not affected by the local government's fiscal performance. It is also beyond the competence of local authorities to decide on individual reliefs set out in the provisions of general tax law. These allowances are therefore still an institution of budgetary law, not tax law [Kukołowicz, Modzelewska, Siechowicz, Wiśniewska, 2016].

The increase in the percentage ratio of local government shares in income taxes in subsequent statutory regulations is connected with a proportional decrease in those funds transferred from the state budget to local government units.

The need to supplement the local government's own revenues with external transfers results from the fact that the latter are not efficient enough to ensure the implementation of the public tasks imposed on the local government. It should also be noted that under the current system, local governments (gminas) are granted, inter alia, such levies whose financial importance is low (e.g., forest tax) and difficult to predict (tax on dog ownership), and whose enforcement also poses many problems.

In Poland, as in all EU countries, local governments receive funds in the form of transfers - their types are different, which results in greater or lesser freedom in their use. The implemented models of various countries reflect a mixed model, combining sources of own

revenues with transfer revenues transferred to the local government in the form of subsidies or grants from the central budget, but the proportions of the share of transfers in the overall structure of local government budgets are very different.

In some countries, the size of such transfers exceeds 50% of total government revenue. These countries include: Greece (60%), Italy (65%), the Netherlands (62%) and Spain (59%). Countries, where this type of revenue exceeds 30%, are: Belgium (46%), Ireland (47%), Luxembourg (37%), Portugal (49%). The countries in which such income represents the smallest part of total income are: Finland (23%), Denmark (18%) and Sweden (13%) [5].

It is generally accepted that the size of grants and subsidies decided by local authorities is one of the elements constituting the scope of their autonomy. The proportions between such grants and subsidies and targeted transfer funds for specific projects or services decided at central level vary across the European Union. Countries in which *specific grants* account for less than 25% of the total amount of transferred funds include, for example, France and Denmark. There are, however, some EU countries where specific grants account for a larger share of the total transfers. These include Portugal, Belgium, Greece, the Netherlands (67%) and Ireland (where this share is the highest - 80%).

At the same time, it should be noted that under conditions of crisis in public finances, the significance of funds transferred from the central budget increases, as the economic rationale for allocating public funds between different public budgets then plays an important role. In such situations, the need to stabilise the financial situation of the local government also increases, and such stabilisation is ensured primarily by guaranteed funds, i.e., subsidies. This is because subsidies are the only guarantee of their 100% implementation in the course of the year, and so they are the only fully reliable source of income. In such a situation, basing budgets on subsidies increases the sense of certainty and financial stability in the local government. On the other hand, basing budgets to a greater extent on own revenues increases the effectiveness of the local government in obtaining them, while the need to formulate a more long-term financial policy arises, thus increasing the responsibility of the local government for the definition and implementation of such a policy. A properly formulated and implemented financial policy should lead to an increase in budget revenues in the future, but achieving the objectives set in this respect is always subject to certain risks, due to the fact that financial instruments are only one of the factors for implementing the set policy and,

moreover, they are mostly only of indirect significance. It is, therefore, necessary to properly balance the proportions between transferred revenues, especially in the form of subsidies, and own revenues, which guarantees the implementation of the principle of stability and certainty of the sources of revenues of local government budgets. It should be noted here that the Constitution of the Republic of Poland, in article 167(2), guarantees that the local government will provide its budget with its own revenues, as well as with subsidies and grants from the state budget, but it does not prejudge the share of each of the three types of revenues in the overall structure of revenues of local government budgets. The structure varies from one unit to another and the assessment of the form of the structure is not unequivocal, although the view of inadequate endowment, especially of the supra-gmina levels, with own revenue is commonly expressed.

Transfers should also reflect the principle of linking the level of revenues of local government units with the dynamics of economic growth, and thus with the revenue situation of the state budget. It is a matter of creating such forms of transfer of funds which respond appropriately to changes in the economic situation and the social situation. This is not ensured by the current transfers, e.g., the education subsidy.

The need for balancing measures is confirmed by data concerning the level of own income per 1 inhabitant of a given community in particular local government units. They show a significant and deepening in recent years variation in their own revenues. It is not possible to construct such a set of sources of income that would ensure their ideal territorial distribution. Thus, the principle of minimising discrepancies in the level of revenue emerges. The literature emphasises that the need for external transfers, including subsidies, as a form of supplying local government budgets results from three basic premises: the need to equalise the level of revenues, the need to take into account differentiated spending needs and the need to equalise differentiated unit costs of performed services [Owsiak, 2020, p. 294].

The need for balancing measures may be increased under the conditions of the proposed reforms concerning local taxes, especially the property tax, as the reform will further diversify the revenues of gmina budgets, as the property value tax will mainly increase the revenues of those gminas where higher value properties are located.

Balancing measures must be connected with such forms of transferring financial resources which do not restrict the local government in the manner of spending them (so forms of transfer in the form of subsidies rather than targeted grants should prevail). This

does not mean, of course, that the legislator may not restrict the local government in the scope of spending on specific tasks (either by introducing generally binding standards of service provision or by limiting spending in another way).

The necessity to undertake balancing measures on the part of the state also means strengthening the equalising function of transfers transferred to local governments, and this function should become dominant over other functions, such as the task-oriented function or the stimulus function. In the current system of transfers, the task function still dominates.

It is widely postulated in the literature that funds transferred to the local government should take the form of general-purpose transfers. The same postulate is contained in Article 9 of the European Charter of Local Government. Thus, the basic system assumption for reforming the revenues of local government units was to reduce the scope of earmarked subsidies in the general structure of revenues and replace them with increased shares in income taxes. The role of the general subsidy in the general structure of revenues was also reduced due to the liquidation of some of its parts (the so-called compensation part and the road part for powiats and voivodeships). Still, the role of the general subsidy remains significant, as more than 70% is a subsidy calculated on the basis of tasks (the so-called education subsidy), and the relevant tasks constitute the dominant item in the budget expenditures of local government units [Owsiak, 2020, p. 309].

The main drawbacks of the subsidy are that it stimulates a specific "passive" attitude of local governments, discouraging them from taking independent measures to increase their revenues and focusing their activity on obtaining the largest possible subsidy. Under these conditions, the subsidy becomes the most desirable form of budget funding - stable, secure, guaranteed, with the possibility of free management of the successively transferred funds, relieving the local government of the concern about raising own revenues to a fuller extent. The subsidy causes a specific „claimant” attitude of the local government towards the state budget, creating a conflict between the interests of the state, which with a rational financial policy should not be interested in increasing its expenditure, and the interests of the local government, which is interested in increasing the pool of state budget expenditure on the general subsidy.

It seems expedient that at the next stage of the reform of the income system of local government units a new model of financing educational tasks should be developed, based on

income regarded in the Polish model as own income, while the subsidy should focus mainly on compensatory functions.

Many criticisms may also be levelled at the institution of targeted subsidies for local government units. The current system is characterised by a high degree of discretion, lack of transparent procedures for their allocation, and at the same time is a sign of centralisation of the system of public finance. It is also a sign of centralisation of the public finance system. This weakens the possibility of budget planning, which is an important barrier hindering the introduction of long-term planning.

3. Conclusion

The scope of independence of the local government is the result of the functions carried out by the public authorities and powers divided between the central government and the local government. The relations between particular local government and the central budget are based on the constitutional regulation and the guarantees included in The European Charter of Local Government. The relations between the central budget and the budgets of particular local government are based on transfers which have various functions and express financial support of the central government for the local and regional authorities. However, the equal opportunities function of transfers is fundamental. The present system favours a task-oriented function of transfers, which should be strongly criticised, and recommendations should be made concerning the reshaping of the transfers. Their main role is to equalise the chances that particular local government have to carry out their tasks.

Bibliography

1. Konstytucja RP z dnia 2 kwietnia 1997 r. (Dz. U. Nr 78, poz. 483).
2. Kukołowicz T., Modzelewska M., Siechowicz P., Wiśniewska A., *Rola samorządu terytorialnego w finansowaniu polityki kulturalnej w Polsce w latach 1990-2015*. „Studia Biura Analiz Sejmowych Kancelarii Sejmu” 2(46) /2016.
3. Owsiak S. (red. naukowa), *Wydatki publiczne*, PWE, Warszawa 2020.
4. Rogalska J., Bury P., Dziekański P., *Samodzielność wydatkowa gmin województwa*

świętokrzyskiego. „Biblioteka Regionalisty” 10/2010.

5. Samorząd terytorialny, Nr 12/2019.
6. Wołowiec T., Cienkowski M., *Income taxation, fiscal policy and economic growth (selected theoretical and practice problems)*, “VEDECKÝ OBZOR - SCIENTIFIC HORIZON” No 1/2015.
7. Wołowiec T., Cienkowski M., *Podatek dochodowy a równość i sprawiedliwość opodatkowania*, „Zeszyty Naukowe Uczelni Warszawskiej im. Marii Skłodowskiej-Curie” Nr 3 /2015.