

PROBLEMS OF INDEBTEDNESS OF MUNICIPALITIES IN POLAND

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Abstract: An attempt has been made to find answers to the questions: whether the new rules for the use of debt instruments will be conducive to the development policy of local self-government units in the upcoming programming period of European Union funds, whether it will be a significant barrier that may significantly limit the investment policy of local self-government units, and how the current level of debt of local self-government units will affect the new programming period, is the basic purpose of the considerations undertaken in this article.

Keywords: public debt, local government finances, spending, JST.

1. Introduction

As is well known, local and regional development is a process of change in the economy that must continue. In order for the changes to take place, there is a need for financial resources to spend, as well as for the implementation of investments. Looking at local government units, investment spending is not only for improving the quality and standard of living of communities, but also for local development. To ensure that regions in Poland have the opportunity for systematic and increasingly advanced development, local government units use repayable financial sources [Kozera, 2017, pp. 203].

In Poland, units have the right to take repayable loans and credits, this right is the basic principle of local government finance. In addition to the revenues held by the units, often insufficient for the implementation of tasks, they can incur reimbursable liabilities. However,

given that the debt of local governments makes up the public debt, the state imposes restrictions on units in order to limit their liabilities as much as possible. One can distinguish between several models for limiting the debt of TSUs, by means of which the public debt is depleted. In Poland, the fiscal rule model is used. It is characterized by the fact that the legislator sets specific limits relating to the level of debt, funds provided for servicing public debt, and also determines which expenses can be covered by loans or credits [Miszczuk, 2017, pp. 58].

2. Analysis of the issue

As you know, local and regional development is a process of changes taking place in the economy, which must continue. In order for the changes to take place, it is necessary for this to have financial resources that can be used for spending, as well as for the implementation of investments. Looking at local government units, investment spending is not only for improving the quality and standard of living of communities, but also for local development. To ensure that regions in Poland have the opportunity for systematic and increasingly advanced development, local government units use repayable financial sources [Kozera, 2017, pp. 203].

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"The limitation of local government debt includes formal conditions and quantitative limits established in the laws on public finance, which limit the possibilities for local government units to establish a budget deficit, incur debt and repay it" [5].

The use of credits and loans allows units to maintain expenditures, including investment expenditures at a significant level, even when their investment potential is at a slightly lower level. An important role here is played by the safe level of debt, as well as the proper management of the debt that has occurred. However, the more the units borrow, the greater the threat that arises, manifesting itself in an economic slowdown and deterioration of the financial condition, which is a kind of determinant of the direction of local and regional development.

High indebtedness of local government units reflects not only on their financial condition, but also on the financial condition of the entire public finance sector [Kozera, pp. 203].

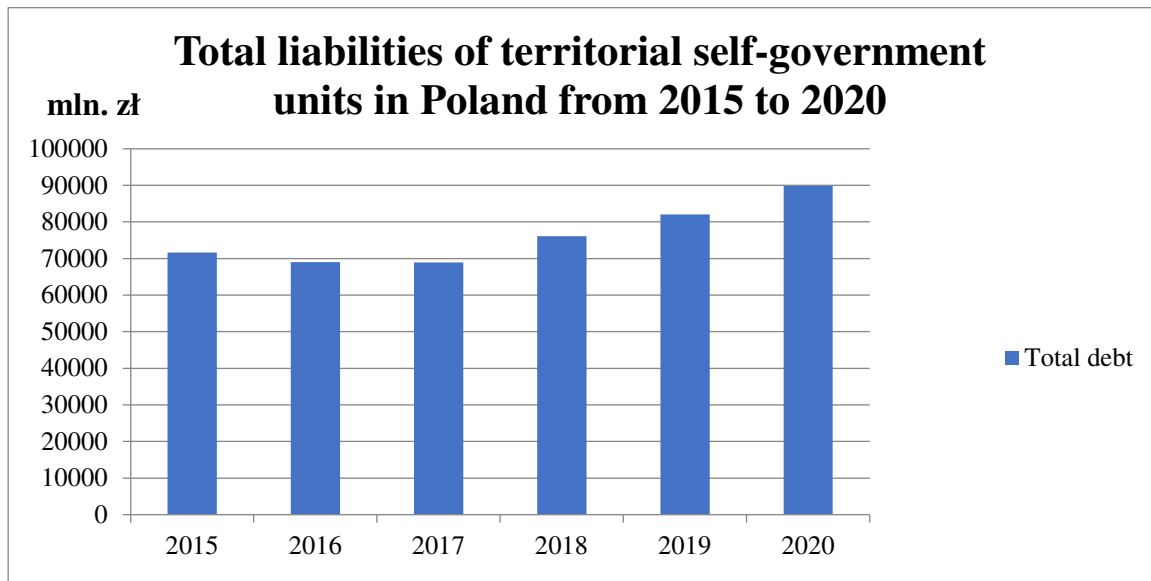


Figure 1. Total liabilities of local government units in Poland in 2015 – 2020

Source: own compilation based on data from the CSO.

As can be seen in the chart above, the debt of local government units has been increasing for the most part. There was a slight decrease in 2016 and 2017, which in turn resulted in a strong increase in the following years. In 2019, the liabilities of local government units exceeded 80 million.

However, it is worth noting that the growing debt of local government units is not always a negative phenomenon. For two types of public debt are recognized: good and bad. With bad debt, units have to deal with a situation where loans are used to cover current expenses, while with good debt in a situation where borrowed funds are used to implement investments. The literature indicates that investment expenditures covered by repayable sources of financing such as a loan is because the benefits of economic development are far greater than the cost of a loan [Kozera, pp. 206].

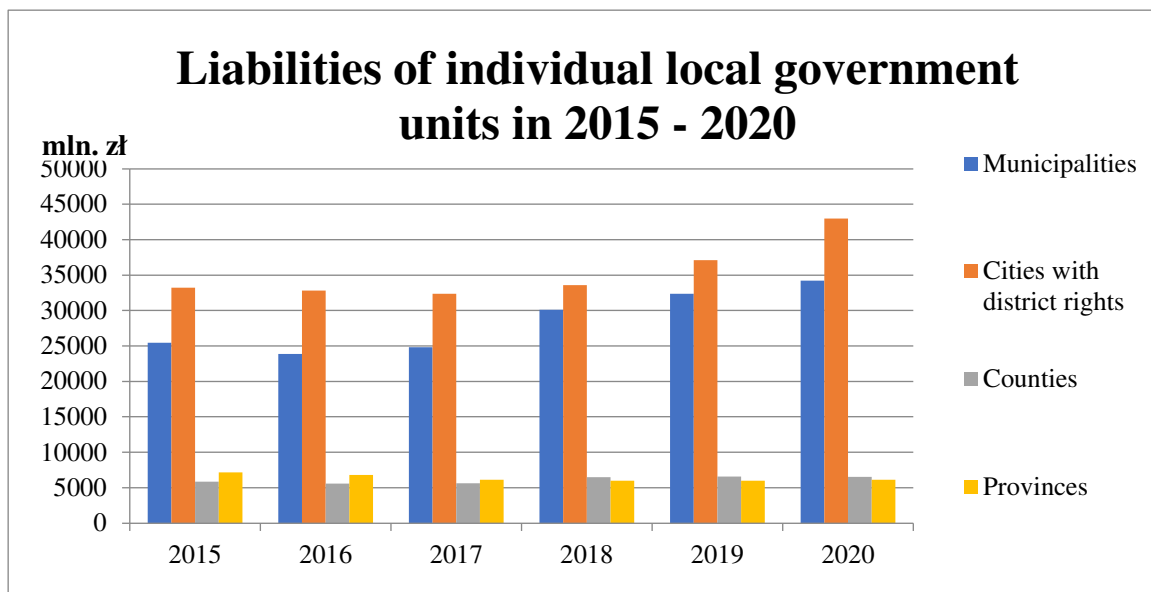


Figure 2. Debt of individual local government units in 2015 – 2019

Source: own compilation based on data from the CSO.

As can be seen, the largest debts were recorded by cities with county rights, followed by municipalities, while provinces and counties remained at similar levels. For all units, year-on-year fluctuations can be seen. The most indebted units showed a steady increase in liabilities, which does not look good. In contrast, for provinces and counties, fluctuations were small and remained at a similar level, and there were no large jumps in liabilities over recent years.

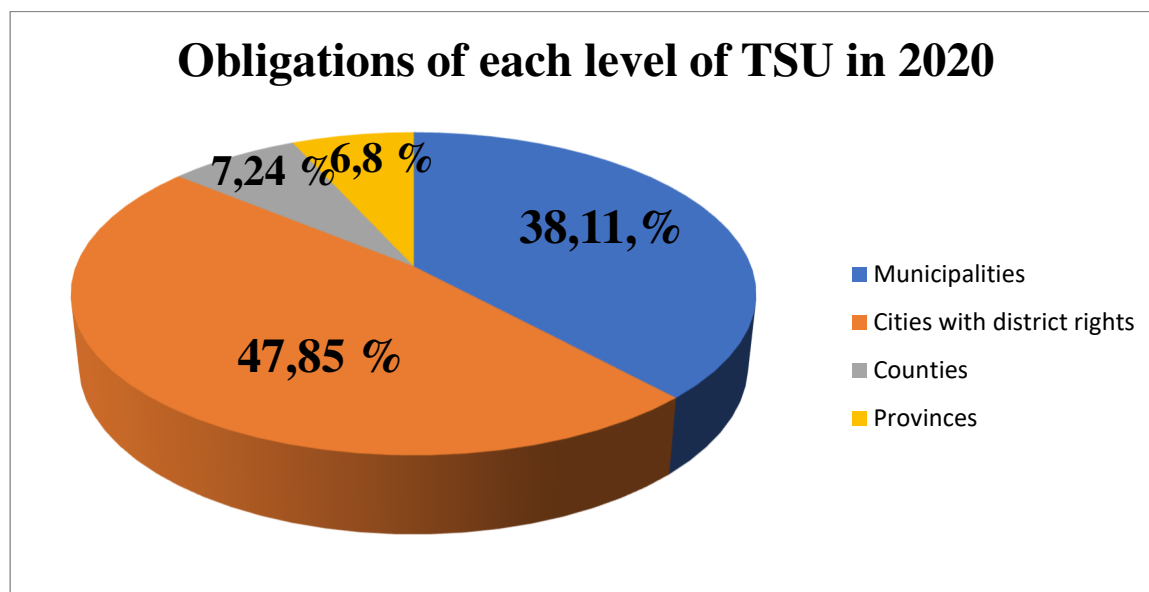


Figure 3. Liabilities of each level of TSU in 2020

Source: own compilation based on data from the Central Statistical Office.

The chart above shows the percentage share of each level of TSU in total liabilities for 2020. The largest percentage went to cities with county rights at almost 48%, the second place went to municipalities at 38%, followed by counties at 7%, and the last was provinces at almost 7%. Thus, it is clear that lower-level units, which are the first to be tasked with responding to the needs of the local community, struggled with the most debt.

It is worth noting that in 2020 and 2021 almost the entire world struggled with the COVID - 19 pandemic, which clearly translated into the financial management of local government units, as well as other local governments. Therefore, the financial situation of local government units for 2020 as well as for 2021 is very specific and differs in many respects from previous years.

In summary, local government units almost every year record an increasing debt, this is associated with the ever-increasing range of tasks provided for local government units, as well as the high cost of their implementation. A large impact on the financial condition of local governments in Poland, also has the economic situation of the country, the European Union, as well as the world as a whole.

3. Debt of local government units, and public debt

When discussing the issue of the indebtedness of TSUs, one cannot fail to mention what public debt is. "The state public debt is understood as the nominal value of the debt of the units of the public finance sector, determined after eliminating mutual obligations between the units of this sector" [Daniłowska, 2008, pp. 107]. Thus, the public debt is a compilation of liabilities incurred through the state treasury, as well as by institutions representing it, such as local governments [Daniłowska, 2008, pp. 107].

The debt includes liabilities for:

- borrowings and loans contracted and outstanding by the state,
- debt securities issued,
- compensation for forced expropriation of property on a payable basis,
- guarantees or sureties,
- indemnity obligations and others [1].

According to the literature, three types of public debt can be distinguished [1, pp. 108]:

- public sector (government administration, public authorities, courts, tribunals),
- local government sector (JST),

- social security sector(Social Security, KRUS).

It is worth mentioning that public debt is also subject to classification in terms of time, and so we can distinguish between short-term and long-term debt. In the literature you can also find a division into domestic and foreign debt [1].

The basic causes of public debt are assumed to be [1, pp. 110]:
budget deficit that persists for several years in a row,

- expenditures for warfare, natural disaster, and economic crisis,
- state interventionism,
- expenses related to political support, of the ruling party.

Table 1. Sovereign public debt at the end of 2021 (in PLN million)

Debt of the public finance sector	1 148 575,8
1. Government sector debt	1 055 787,2
1.1. State treasury	1 053 320,9
1.2. State special purpose funds with legal personality (excluding funds managed by Social Security)	0,0
1.3. State universities	346,5
1.4. Research and development units	0,0
1.5. Independent public health care institutions	1 935,2
1.6. State cultural institutions	1,6
1.7. The Polish Academy of Sciences and organizational units created by the Polish Academy of Sciences	6,0
1.8. Other state legal entities established under separate laws for the purpose of performing public tasks, excluding enterprises, banks and companies under public law	176,9
2. Debt of the local government sector	92 741,9
2.1. Local government units and their unions	87 605,7

2.2. Local government special purpose funds with legal personality	0,0
2.3. Independent public health care institutions	5 066,9
2.4. Local government cultural institutions	63,0
2.5. Other local government legal persons established under separate laws to perform public tasks, excluding enterprises, banks and companies under the law	6,3
3. Debt of the social security sector	46,7
3.1. Social Insurance Institution	0,0
3.2. Funds managed by the Social Insurance Institution	46,7
3.3. The Agricultural Social Insurance Fund	0,0
3.4. National Health Fund	0,0

Source: own compilation based on data from the MF.

In the table above, the value of public debt for 2021 according to the national methodology is shown. It is clear that the highest debt was recorded by the government sector, mainly the Treasury, followed by the local government sector, and the lowest debt was shown by the social security sector.

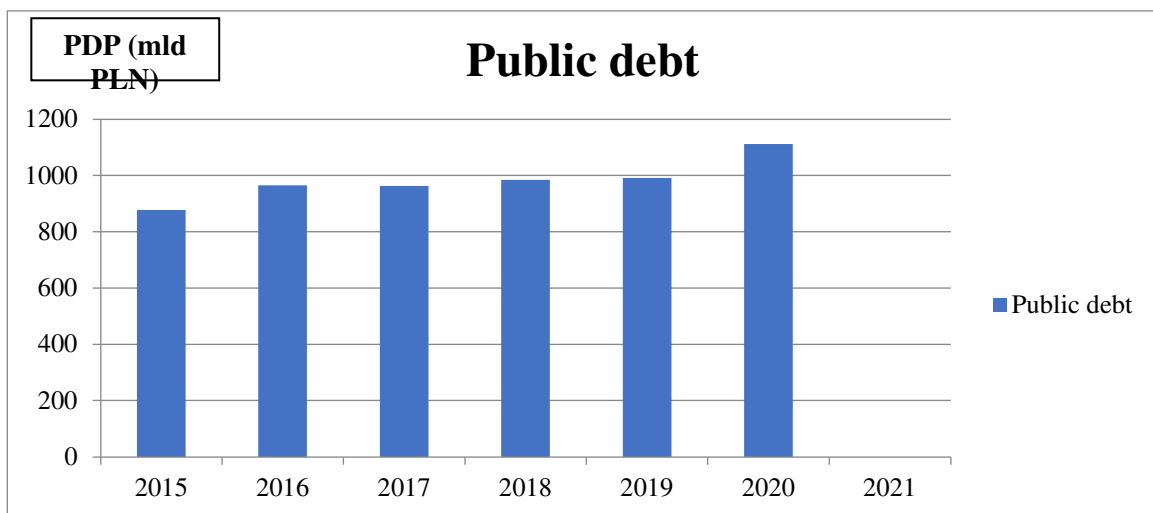


Figure 4. Public debt in Poland from 2015 to 2021

Source: own compilation based on data from the MF.

In the chart shown, one can see an almost constant upward trend in Poland's public debt, over the past few years. A clear increase in debt was recorded in 2020 and 2021. In 2020, the debt increased by 121 billion zlotys, compared to 2019. Such a large increase in the country's debt was caused by the outbreak of the COVID - 19 pandemic, in the first half of 2020, but also many government programs, such as 500+, or the 13th and 14th pensions.

To sum up, the debt of local governments makes up the national public debt. The local government sector, like the other sectors, is experiencing higher and higher debt every year, which translates into the final value of the public debt. As a result, the state public debt is steadily skyrocketing, which affects the financial condition, as well as the economic and economic situation of the country as a whole.

4. Analysis of the causes of the indebtedness of local government units in Poland

Touching on the subject of the indebtedness of local government units, it is undoubtedly worth mentioning the causes and consequences of the indebtedness of local government units. Such information allows a better assessment of the units in terms of their functioning, implementation of investments, as well as financial situation.

As already mentioned in the above part of the work, the primary reason for the indebtedness of local government units **is the insufficient budget** available to the units. The need to carry out public tasks in a situation where the necessary resources are lacking prompts units to incur liabilities. Debt incurred in this situation has a twofold purpose, on the one hand it is a source of income necessary to meet current financial needs, and on the other it is used to finance investments [Poniatowicz a.o., 2021, pp. 148].

The second reason for the indebtedness of the territorial self-government units is „... **the infrastructure gap in public investment that exists in Poland**. It has been influenced by both historical conditions and mistakes made by public decision-makers" [4. Pp. 149].

Admittedly, since Poland's accession to the EU, the area of the gap has been steadily narrowing, but it is still a factor that prompts local governments to go into debt to close the gap. It is worth adding that the local government in Poland is the main public investor, implementing more than 50% of investments in the public area in Poland [4].

The third reason is cited as the nature of investments to be financed through repayable financial sources. The basic features are given as [4]:

- high value of investments,

- long implementation period,
- high risk,
- long waiting period for return of invested funds,
- instability of budget expenditures.

Borrowing credits and loans by local government units, definitely promotes and accelerates investment processes, while reducing their cost and postponing the necessity of tax burden on the residents of the local government community. The use of such sources of investment financing by local government units, significantly relieves the burden on taxpayers. Because financing investments solely through taxes, would involve a significant increase in taxes, which would not find political support, and would have many negative economic, economic and social consequences [4].

The fourth reason is **the idea of intergenerational greatness**. This idea says that investments financed by credit and loans, involve not only expenses, but also benefits in which future generations will share. According to economists, the abandonment of public and local government investments, is far more harmful to future generations than the mere fact that they will be burdened with public debt [4].

The fifth reason is increasing the **access of individuals to the use of funds from the EU budget**. Looking at the indebtedness of units from this perspective, their debt is treated as an instrument conducive to obtaining and using EU funds. This is due to the principle of co-financing, which figures in EU policy and which stipulates that projects must be co-financed by the beneficiary in the form of own contribution. In such a situation, the units, in order to receive funds from the EU budget, must make a commitment in the form of an investment loan [4, pp. 150].

The sixth and final reason is **the identification of local government debt as a tool for stabilizing their financial system**. Economic theories indicate that a high level of public sector indebtedness is an excusable and even necessary phenomenon, as it has a positive effect on stimulating the economy. In this context, debt is regarded as a tool for financing the budget deficit [4].

Having listed above the factors that induce local government units to go into debt, it is worth mentioning the consequences of excessive indebtedness of the local government sector. As is well known, heavy indebtedness always has negative and long-term effects on the local economy as a whole. One of the most basic and very negative effects of excessive local government indebtedness is **loss of liquidity**, which can lead to **insolvency**. Other negative

effects include reduced credibility **and thus creditworthiness**, which in turn has an impact on the rising cost of **debt service**. As a result, local government units do not have the ability to carry out flagship public tasks at an appropriate level. Another negative consequence of local government indebtedness is a **significant increase in local taxes**. It is worth mentioning at this point one more strongly negative effect of local government sector debt, namely that of **private investment**. As a consequence of the high indebtedness of units, **the so-called crowding out** effect can be observed. It is characterized by the fact that local government units are far more attractive customers for banks than private investors, mainly because there is no risk of bankruptcy in the case of local government units, which in turn represents - negligible credit risk. Consequently, banks definitely prefer to give loans or credits to local government units than to ordinary private investors, thus pushing them out of the local market [4, pp. 150].

Undoubtedly, it is worth mentioning that in a situation where the debt crisis affects many units at the same time there is a high risk of upsetting **the financial stability of the entire system of public finances**. Such a phenomenon may even lead to the bankruptcy of local government units. This threat is real, because the units are aware that in a situation of debt repayment difficulties they can count on government support. Consequently, they excessively take out bank loans without fully realizing the consequences of such actions [4, pp. 151].

In conclusion, the indebtedness of local government units is accompanied by many both negative and positive consequences. However, it is worth remembering that the negative consequences are far more numerous and very dangerous, both for the budget of the entity and the financial system as a whole. Therefore, it is important for local government authorities to make rational decisions on large and long-term loans, so that they do not disrupt the basic activities of local government and do not lead to financial imbalance.

5. The impact of economic events on the financial management of local government units

Impact of the COVID 19 pandemic on the finances of local government units

The outbreak of pandemic COVID 19 in early 2020, caused a lot of turbulence in all branches of the economy. Clear turbulence has also been observed in public administration, including local government units. Initially, the impact of the pandemic on the financial situation of TSUs in European Union countries, was estimated through various surveys sent in by local governments. Based on the surveys, the situation of local government units in many countries was considered critical. It was expected that the pandemic would significantly reduce the

income of local government units, as well as significantly increase expenses through anti-crisis measures. Besides, it was assumed that the pandemic would disrupt the process of providing public services. As a result, local governments declared a reduction in current and investment expenditures, to the greatest extent the restrictions were to apply to cities with county rights [Malinowska-Misiąg, 2022, pp. 49].

After obtaining full data for 2020, it was possible to check what actual impact the COVID -19 pandemic had on the financial management of local government units in Poland, and to what extent the assumptions estimated on the basis of surveys proved true. Reduced property expenditures and financial inflows from the Government Local Investment Fund resulted in local government units recording a budget surplus for 2020 of PLN 5.7 billion. It is worth mentioning that as late as the end of 2020, a budget deficit of PLN 21.2 billion was projected. Negative budget balance, showed only 565 units including [2, pp. 57]:

- 489 municipalities,
- 35 cities with county rights,
- 38 counties,
- 3 provinces.

The budget deficit was recorded only by cities with county rights, the total value showed PLN 3.2 billion. The total surplus of local government units at each level, was much higher than expected at the beginning of the year [2].

The situation of local government units after the first year of the pandemic varied widely. The greatest negative impact of the pandemic, was observed among urban municipalities and cities with county rights, while the least in the area of rural municipalities. The recorded budget surplus, was due to a decrease in property expenditures, as well as financial support from the government for investment activities [2, pp. 61]. So, the fears of individuals about the difficult financial situation after the outbreak of pandemic COVID- 19 , did not come true.

Local government units ended 2020 with a budget surplus, mainly due to government support in the form of aid programs.

In 2021, local government units closed the year with a total surplus, at PLN 17.4 billion, while the current surplus amounted to PLN 36.6 billion. According to experts' forecasts, local governments were expected to end the year with a deficit of more than PLN 30 billion. Due to the high budget surplus, local governments were left with more than PLN 50 billion to manage in 2022 and beyond [6].

The impact of inflation on the financial position of local governments

With the increase in inflation, the cost of tasks and investments carried out by the units also went up sharply, which in turn clearly translates into an increase in spending. Therefore, local government units, as announced by the MF, will receive compensation from the government in the form of subsidies. Without such investment support from the government, the financial situation of local governments in Poland would be deeply troubling [7].

The impact of Polish governance on the financial management of local governments

Along with the changes to be introduced in the Polish Order in the middle of this year, the budget of local government units will also change. Reducing the personal income tax (PIT) rate from 17% to 12% will significantly reduce local government revenues. The Finance Ministry announces that local governments can rest assured about this year's PIT revenues, while next year's budgets as well as multi-year financial forecasts remain in question. What right the government proposes a sizable compensation for the units, but it does not equal the value of the lost revenue [8].

The impact of the war in Ukraine on the finances of TSUs

Poland is the country that is most strongly affected by the war in Ukraine, in recent months 3, 416 million war refugees have crossed the Polish-Ukrainian border, they are mainly women and children. In Polish schools and kindergartens, a large number of Ukrainian children have already entered, and with the new school year it is estimated that there will be as many as half a million. As is well known, such a situation involves high costs, which are on the side of local governments, as kindergartens are part of their own tasks. The lack of concrete information about how many Ukrainian children will attend schools and kindergartens in Poland, as well as what the cost will be and what funds local governments will receive for this, causes considerable anxiety among them. Based only on assumptions, there is no way to estimate future expenditures or create financial plans, which further translates into an uncertain and tense situation in local governments [7].

As can be seen, the financial management of local government units, is completely vulnerable to economic events occurring in the country. Every crisis that the country faces takes its toll on the economy, and thus on local government, both in the financial and organizational spheres. However, not every crisis has to end for local government units with debt and budget deficits, there are situations in which units make only minor changes in the budget, and even

those in which they record a budget surplus. However, this does not change the fact that any economic event involving the entire country poses a significant challenge for both the government and local governments. Each crisis requires the introduction of changes, solutions to offset its effects, development of a new plan, reorganization of many issues, which is always associated with high costs. Generally speaking, the budget of local government units, almost always depends on the economic situation of the country, and there is no rule on whether the units in a crisis will increase their debt or perhaps record a budget surplus.

6. Conclusion

In conclusion, the indebtedness of local government units in Poland has been rising steadily for more than a dozen years. Among the most indebted units are cities with county rights and municipalities, as the units that are closest to residents and meet their basic and most important needs. The main determinants of the steady increase in the liabilities of local government units, are the ever-increasing costs of implementing tasks and investments, and a budget that is too low, which consequently encourages local governments to take out loans and credits. Excessive indebtedness results in loss of liquidity and even insolvency, an equally serious consequence is the reduction of credibility and creditworthiness.

Sustained high indebtedness of local government units over a long period of time, can lead to the financial stability of the entire public finance sector. It is worth recalling that local government debt is a component of public debt. So, the higher the debt of local government units, the higher the debt of the country as a whole. Therefore, in order to curb excessive debt among local government units, special regulations have been introduced that set formal conditions and specific limits limiting the possibility of excessive use of repayable financial sources by units.

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