

Selected issues of the local finance system in Poland

The decentralization of public finances in Poland has resulted in the division of tasks between State and Local Government Units (LGUs): municipalities/communes, counties and provinces. Together with the division of tasks, sources of income have been divided. Unfortunately, own incomes granted to local units are not sufficient for the carrying out of those tasks. Since 2014, EU membership has opened up new opportunities for Polish local government funding, especially for investment projects. Also legal acts that create the framework for the public finance system ensure additional sources of income such as non-earmarked transfers and earmarked grants. The aim of this article is to present the system of local finance in Poland. Analysis covers the years 2009–2013. Necessary data was acquired from the Ministry of Finance and Polish Statistical Office websites.

Decentralization of public administration and public finance in Poland

The processes of decentralization strongly influence the economic and social effectiveness of the sector of public finances. Depending on the degree of decentralization, the means and effects of the realization of elementary functions of public finance will differ, i. e., the functions of stabilization, redistribution and allocation. Theory and business practice does not provide clear opinion on the role of decentralization in the execution of the functions of public finance. Views on the subject are varied and undergo constant change.

Decentralization is a theoretical concept conceived both by theory and legal norms. The concept of decentralization has many descriptions, but a general definition identifies three issues (Gajl 1993: 12):

- Delegating public tasks to be implemented at the local level,
- Using local authorities and their powers and assets to ensure independence and the ability to decide on public affairs,
- Having adequate financial resources for the implementation of its policies.

1 University of Natural Sciences and Humanities in Siedlce; e-mail cím: annaswirska@gmail.com.

2 University of Natural Sciences and Humanities in Siedlce; e-mail cím: anamk@interia.pl.

Decentralization is linked to the existence of an organized system of public administration, which apart from the main centre, is characterized by the existence of other entities that are to some extent independent of the national central site.

E. Ruśkowski (www.nik.gov.pl) distinguishes three types of decentralization: constitutional (or political, equipping LGUs with democratically elected representatives as well as the status of public law that ensures political independence from the state); administrative (granting to LGUs tasks and administrative tools for the implementation of those tasks appropriate to the nature and level of the individual units of local government), financial (transferring to LGUs the appropriate public financial resources and the power to dispose of them).

A decentralization initiative is closely linked to the existence and development of local self-government institutions. Confirmation of this thesis is the long-standing practice of well-developed countries, as well as over twenty years of operational experience of local governmental institutions in Poland. Development of local self-government institutions is carried out to (White 2011: 3–4):

- optimize social and economic tasks,
- limit the size of central level of public sector,
- limit conflict and protect minority rights,
- response citizens' preferences and expectations.

Levels of public administration in Poland

Poland is one of the largest countries in Eastern Europe, comparable in terms of area of Italy or Germany. The population is estimated about 39 million. On the basis of the Constitution of the Republic of Poland (1997) it is a parliamentary republic with a parliamentary cabinet system, based on the tripartite division of power.

Due to decentralization in 1999, Polish public administration has been divided into three levels:

- Municipality (PL: gmina) – the local unit that is smallest and nearest to citizens' needs; there are 2,479 municipalities in Poland;
- County (PL: powiat) – the second level unit that can consist of several municipalities (ex. 10–14 municipalities create one province); there are 380 counties in Poland;
- Province (PL: województwo) – the third level unit; there are 16 Polish provinces and each can consist of 17 to 35 counties.

Previously, from 1975 till 1998, there was a two-level division which consisted only of municipalities and provinces. During that time, there were 49 provinces.

The purpose of decentralization was to change the central-planned economy and autho-

ritarian model into a democratic model of the state, where local needs could be satisfied by local governments. Thus, each level of public administration has been equipped with its own internal sources of revenue and it must fulfil its own tasks. These tasks are designed to meet the needs of local citizens. Each decision is associated with allocating money to carry out tasks. Finances play an extremely important role in local economy. Any decision concerning current businesses and local development has a financial background.

Municipalities are basic self-government units. Their authority is a municipal council elected by direct and universal vote for a term of 4 years. There are three types of municipalities: rural communities covering only rural areas; urban-rural, which cover both the city and the countryside around that city; and urban municipalities covering only city areas. The executive powers in municipalities are mayors (PL: wójt, burmistrz – in rural communities or in the urban-rural and urban areas), or presidents (PL: prezydent) (in large urban municipalities) appointed by direct election.

Counties were created as the second level of local government. Their existence is still disputable and seems to be challenged. Authority governing the county is a county council elected by direct and universal vote for a term of 4 years. The county governor holds executive power and is elected by the city council. There are two types of counties: 1. called ‘ziemskie’ counties (314 units), and 2. called ‘grodzkie’ – cities with county rights established for larger Polish cities (66 units).

Provinces were created as a third level of decentralized public administration. The local province government is a council appointed by direct universal election for a period of four years. The executive body is the Marshal Office whose head is the Province Marshal (PL: marszałek województwa) elected by province council. Central authorities are represented by the Province Office, headed by a province governor, who is appointed by the Prime Minister to be the legal actions advisor in the provincial government (<http://ksng.gugik.gov.pl/>).

In July of 2000, (*Journal of Law* [JoL] 2000, no. 58, item 685 as amended) a division of the country into territorial units which complied with both EU requirements and the Nomenclature of Territorial Units for Statistics (NUTS) applied by Eurostat was introduced to Polish statistics. The standard that was introduced is a five-tier hierarchical classification system and is used in collecting information, conducting surveys and sharing their results. The Polish NUTS system consists of 5 levels. The Regional level includes NUTS level 1 (the entire country), NUTS level 2 (provincial) and NUTS level 3 (sub-regional). The local level includes NUTS level 4 (districts) and NUTS level 5 (municipalities). Four of these levels (with the exception of the 3rd) align with the existing territorial divisions of the country, and the division of the country into 44 sub-regions, made up of counties, includes the Council of Ministers as of 13 July 2000 (JoL 2000 No. 58, item. 685 amended) (www.igipz.pan.pl/).

Modern local government operates within the State and its authority. It determines the

scope of activities for the various tiers of government and defines the legal system. Local government has gained legal status, independence and judicial protection (Izdebski 2009: 342). The most complex aspect of decentralization is the decentralization of public finances, which is very difficult to achieve. It requires transferring public financial resources from central to local government in order to finance assigned tasks (i. e., the decentralization of expenditure), equipping local government with their own sources of income and the ability to develop income parameters (i. e., the decentralization of revenue), as well as granting LGUs the right to independently form and implement organizational and financial planning (procedural-organizational decentralization). Some authors emphasize the necessity to transfer more power to local government for the acquisition of resources (www.nik.gov.pl).

As may be read in OECD report “Expenditures structure by level of government” (<http://www.oecd-ilibrary.org/>) the higher level of sub-central levels’ autonomy the better realization of shaping policies and programmes.

In Polish literature, the most commonly used measurement that measures the degree of decentralization of public finances is the index (Index A) represented by the ratio of local government expenditure to GDP. The second measure is the index (Index B) that compares the size of government spending budgets to the state budget expenditures. The following table shows the value of both indicators for the years 2009–2013.

Table 1: Value of decentralization indices (A and B), (%)

Years	Index A	Index B
2009	12.49	55.92
2010	12.56	59.02
2011	11.88	57.95
2012	12.76	54.89
2013	11.24	56.17

Source: own study on the basis on statistical data

It is believed that the rate of Index B is more reliable than the rate of Index A. However, in both cases, the higher value of the indices, the higher level of decentralization in public finance.

OECD proposes to analyze other indices regarding local revenues:

- Local tax revenues as % of GDP (Index C).
- Local tax revenues as % of total central revenues (Index D).

In this case local autonomy of Polish sub-central levels is described by such numbers:

Table 2: *Value of Polish sub-central levels autonomy according to OECD (2009–2013)*

Years	Index C	Index D
2009	4.15	13,24
2010	3.98	12,74
2011	3.96	12,45
2012	4.07	12,69

Source: http://www.oecd.org/ctp/federalism/oecdiscaldecentralisationdatabase.htm#F_Title

Such indices may be disputable regarding Polish financial decentralization. In Poland, local governments collect not only taxes but also local fees. These types of incomes creates the set of own incomes, that demonstrate the level of decentralization. In this case, the presented indices A and B give better view of the public finance decentralization in Poland, than these proposed by OECD.

As a result, there has been a decentralization of public finance task division between local governments (previously carried out by the state). It was launched by the Local Government Act dated March 3, 1990 (JoL 2001 No.142, item 1591 as amended) and the Act of 1998: District Government (JoL 1998 no. 91, item 578) and the Regional Government (JoL 1998 no. 91, item 676).

Tasks of local governments in Poland

The tasks of local government and their nature were subject to change just as the concept of local government was amended.

The Local Government Act of 8 March 1990 specifies in Art. 6 that municipalities carry out tasks that relate to public affairs of local interest and which are not reserved by law for other entities. From the point of view of the criterion of independence of municipal public tasks, tasks are designated as either own tasks or assigned tasks. The law defines own tasks as tasks meeting the collective needs of the community. Municipal self-government executes these tasks on their own behalf and in the interest of the general public. Assigned tasks, including administrative government tasks, are performed by the municipality on behalf of and for assigned body. Financial resources for the implementation of their own tasks should come from own municipality revenue or non-earmarked transfers. On the other hand, financing for assigned tasks should be provided by the commissioner. The funds for this purpose come mainly from the state budget, and are provided as earmarked grants (Act on Local Government Units' Incomes).

According to an Act on 8 March 1990, local municipality own tasks include such matters as:

- land management, real estate, environmental and nature protection and water management (e.g., the reconstruction and renovation of buildings that are owned by municipalities, construction of new buildings, maintenance of lawns)
- municipal roads, streets, bridges, squares and traffic organization (renovation and construction of municipal roads, squares, sidewalks, bicycle paths, laying out of parking spaces)
- waterworks and water supply, sewage system, disposal and waste water treatment, maintenance and order of sanitary facilities, landfills and disposal of municipal waste, supply of electricity, heat and gas (keeping the community clean, keeping up landfills, maintaining segregation of garbage)
- local public transport (e. g., the creation of new bus and tram stops, repair of motor vehicles)
- health care (e. g., health centers, hospitals, preventive action and information campaigns for children and youth, creation and support centers to engage alcohol-related problems)
- social assistance, including care centers and facilities (e. g., to provide shelter, food and necessary clothing to those without, feeding children, establishment and maintenance of social welfare center)
- municipal housing (e. g., construction of municipal housing)
- public education (e. g., maintenance and construction of public schools, including special and integrated schools, providing money for the organization of extra-curricular activities)
- culture, including municipal libraries and other educational dissemination of culture (e. g., construction and renovation of libraries, conducting community centers, protection of historical monuments)
- physical culture and tourism, including recreational and sports facilities (e. g., construction and maintenance of sports facilities, support for the development of sport among children and young people with tasks related to tourism, tourist information)
- markets and market halls (e. g., designating market places)
- communal green areas and tree plantings (e. g., maintenance of parks and squares)
- municipal cemeteries
- public order, public safety including fire and flood protection, equipment and maintenance of municipal flood storage (e. g., the financing activities of the Municipal Police, working with the police)
- the maintenance of municipal buildings, public facilities and administrative buildings

(e. g., development and maintenance of playgrounds, gymnasiums and buildings owned by municipalities which are used for events)

- pro-family policies, including the provision of care to pregnant women and social, medical and legal assistance (e. g., the implementation of medical care and legal assistance for pregnant women, providing social support)
- support and promote the idea of self-government
- promotion of the municipality
- cooperation with NGOs
- cooperation with local and regional communities of other countries (e. g., the establishment of partnerships and cooperation with partner cities in other countries, the implementation of activities together with partner cities).

Generally speaking, these tasks can be classified into three groups:

- tasks for ensuring the improvement of residency in the municipality,
- tasks relating to land management,
- information and promotional tasks.

Among the above-mentioned own tasks, some are compulsory and some are optional. The question of which of these should be assigned to a group of mandatory tasks and which should be voluntary is decided by legal regulations and relevant law. In the category of mandatory obligations, the municipal government has no right to refuse to execute such a task. To accomplish the task, the municipality can create organizational units and enter into agreements with other entities. In the case of public tasks beyond the capabilities of the municipality, it can take advantage of the different forms of cooperation permitted by law, i. e., inter-municipal agreements, unions, associations. In the case of the transfer of public tasks, they may be transmitted from a higher to a lower level of local government, but they cannot be transferred from lower to a higher-level local self-government (Izdebski 2009: 137).

According to the Act, the county is designed to perform the tasks that are “extra-municipal”. This means that it performs similar tasks as a municipality, but they involve legal institutions belonging to the county. The Law on local self-governing tasks of the county are formulated in the same way as the tasks of the municipality. The situation is similar in tasks assigned to provinces. For example, all levels of government are assigned the task of public education issues, with the exception that the municipality take care of education in nurseries, kindergartens, primary and secondary schools; the county concern itself with secondary schools (high schools, technical schools); and the province take care of higher education (universities).

The provincial government determines the development strategy of the region, taking into account in particular the following objectives:

- cultivating nationalism, developing and shaping national, civic and cultural consciousness of inhabitants, as well as nurturing and developing local identity,
- stimulating economic activity,
- raising the level of competitiveness and innovation in the economy of the region,
- preserving cultural and natural environment, taking into account the needs of future generations,
- forming and maintaining spatial order.

The provincial government also runs the region's development policy, which consists of:

- creating conditions for economic development, including the creation of the labour market,
- maintaining and developing the social and technical infrastructures that are of regional significance,
- acquiring and pooling financial resources, both public and private, in order to implement tasks for the good of the public,
- promoting and carrying out activities to raise the level of education of citizens,
- employing the rational use of natural resources and the development of the environment in accordance with principles of sustainable development,
- supporting the development of science and cooperation between science and the economy, promoting technological progress and innovation,
- supporting the development of culture and caring for cultural heritage and its rational use,
- promoting advantages and opportunities for regional development,
- supporting and carrying out activities for social inclusion and combating social exclusion.

Legal acts regulating the finance economy of LGUs

The legal basis for financial management of LGUs has undergone many changes over time. There are number of laws regulating finance of LGUs indirectly or containing many financial issues. The ordinance of the Council of Ministers and the Minister of Finance have prime legislative importance in determining the shape of financial management in LGUs. They are issued on the basis of the Public Finance Act and the Act on LGU income, as well as acts of local law, or resolutions of municipal councils (e. g. concerning tax rates).

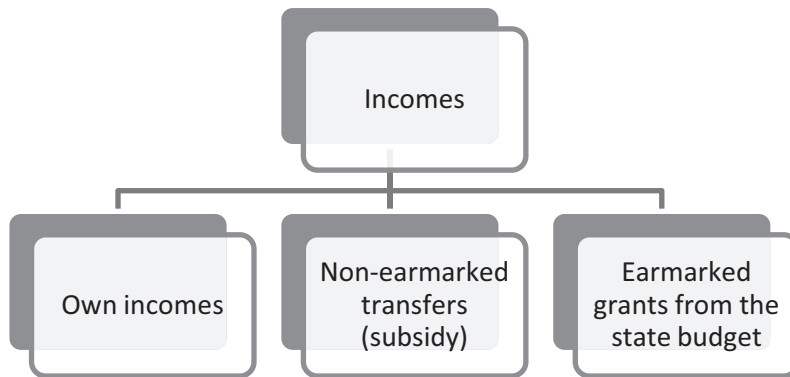
A key aspect of the functioning of local governments is the issue of funding, and an optimal system of financing local government should have the following characteristics:

- transparency, an openness both to the municipal residents as well as to investors,
- stability of rules and regulatory frameworks,
- diversification of funding sources,
- flexibility – allowing appropriate response to structural changes in the level of income and expenditure,
- balance between revenue and expenditure.

Hence, an important element of the entire financial management toward the LGU functioning well is the supervising and control exercised over it by a number of legal institutions. In LGUs, bodies of executive power are in control, as well as treasurers (head LGU accountants), representatives (the municipal council in the municipality, the district council in the district, province council in the province and separate correlating inspection committees), and the internal auditor. The Regional Chamber of Audit and the Supreme Audit Office staff perform external audits. These audits relate primarily to the legality or compliant actions to legal regulations (especially laws) of the entity being audited. Other criteria the entity must pass in the audit are tests of economics, reliability, and expediency. Execution of local government units' tasks is possible thanks to the financial resources at the disposal of local governments.

Sources of local incomes in Poland

For any economical entity to function, it must have necessary resources essential for operation. Local government units accumulate funds earmarked for the implementation of tasks related to addressing the needs of the local and regional community. The European Charter of Local Self-Government stipulates that local communities have the right, within the framework of national economic policy, to have their own financial resources, the distribution of which is within their rights. The Polish Constitution provides units of local government with public funds suitable to the tasks that fall to them. It also provides that changes in the tasks and responsibilities of local government shall correspond with changes in the share of public revenues. In art. 167, the Constitution of the Republic of Poland lists LGU incomes:

Figure 1: Sources of LGU incomes

Source: own on the basis of Constitution of Poland

The table below presents sums of income generated by each level of public administration from 2009–2013.

Table 3: Incomes of LGUs (2009–2013, mln PLN)

	2009	2010	2011	2012	2013
Municipalities	115,210	126,196	132,690	139,654	144,260
Counties	20,084	22,496	23,552	22,523	23,078
Provinces	19,548	14,104	15,067	15,236	16,121
Total	154,842	162,797	171,309	177,413	183,458

Source: on the basis of Statistical Office data; http://stat.gov.pl/bdl/app/dane_podgrup.hier?p_id=249266&p_token=-941885888

As one can see, municipalities collect the highest level of income. This is due to the fact that legislature has assigned them the most revenue sources. It is municipalities that have income from taxes and fees. The other two levels of government, counties and provinces, have much lower incomes with fewer tasks to be performed and the ability to transfer tasks to a lower level, i.e. to the municipality. In addition, the amount of money from non-earmarked transfers and earmarked grants is also smaller for districts and regions (see *Tables 8, 10*). The level of income in the different levels of public administration remains relatively constant. Only in the municipalities did government revenues increase by 25% in 2013 compared to 2009.

Among the total income available, own income holds a very important position. The concept of own income has a specific legal meaning. On the one hand, own income is the source of funding for own tasks of local government, but on the other hand, it is deductible

when applying for funding from external sources. Regulations of the European Charter of Local Self-Government and Local Government Income Act indicate own income to be a source for funding own tasks. Own revenues are of great importance in the functioning of municipalities as a local government body (Hanusz et al. 2009: 20–23). Own income is income:

- in regards to which there is power of taxation, i.e., local authorities can enforce and set parameters for tax discounts, exemptions and relief,
- whose sources are in the possession of the LGU, on its premises,
- for which the municipal authorities have the right to make and shape their scope.

Own income is usually a permanent budget income. In Poland, in this group, there are four main categories of income (Smoleń 2011: 105):

- local taxes,
- shares in state taxes,
- fees,
- property capital.

In understanding LGU income tax law, LGU own income shares PIT and CIT tax revenue (Act on Local Governments Units' Incomes).

Own income demonstrate the degree and scope of financial independence of local authorities. It is treated as an element indicating the level of autonomy (Marczak 2007: 175).

Table 4: Sources of own income

Municipality	County	Province
<ul style="list-style-type: none"> – taxes (property tax, personal income tax – paid in the form of a tax card, agricultural tax, forestry tax, transport tax, inheritance tax, donations tax, civil law tax), – local fees (stamp duty, fair charges, administrative fees, operational charges, service charges, and others), – shares in income coming from PIT and CIT, – incomes from municipalities' property, – income received by the communal budgetary units, – payments from budgetary establishments and communal ancillary farms, – financial support from other local government units, – inheritances, bequests, and donations for the municipality, – interest on late repaid loans, penalties and fines. 	<ul style="list-style-type: none"> – county fees, – shares in income coming from PIT and CIT, – incomes from counties' property, – income received by the county budgetary units, – payments from budgetary establishments and counties' ancillary farms, – financial support from other local government units, – inheritances, bequests, and donations for the counties, – interest on late repaid loans, penalties and fines. 	<ul style="list-style-type: none"> – shares in income coming from PIT and CIT, – incomes from provinces' property, – income received by the provinces' budgetary units, – payments from budgetary establishments and provinces' ancillary farms, – financial support from other local government units, – inheritances, bequests, and donations for the provinces, – interest on late repaid loans, penalties and fines.

Source: Own study based on Local Government Revenue Act, dated 13th Nov 2003 (JoL No. 203 item 1966)

Table 5: *Own incomes of LGUs in Poland (2009–2013, mln PLN)*

	2009	2010	2011	2012	2013
Municipalities	63,284	66,548	70,442	73,931	78,605
Counties	5,699	6,337	6,531	6,612	6,894
Provinces	6,315	5,703	6,673	6,549	6,303
Total	75,297	78,588	83,646	87,092	91,802

Source: on the basis of Statistical Office data;

http://stat.gov.pl/bdl/app/dane_podgrup.hier?p_id=249266&p_token=-941885888

Own incomes in municipalities are higher than in the districts and provinces. Since the beginning of the analysed time period (2009), own income in municipalities represents over 80% of all revenue generated by LGUs throughout the country. As mentioned earlier, this is due to the fact that there are more sources for municipality own income than for any other local government unit. Unfortunately, the lack of data on tax revenues and the amounts of local fees prevents detailed statistical analysis of own income. However, the largest sources of municipality own income are: property tax revenues and the tax revenues from PIT and CIT.

Although PIT and CIT are state revenues, part of the proceeds is transferred to local governments. This is due to the fact that the taxpayers (the country's citizens and businesses) are residents of the municipality, county, or province. The Local Government Income Act indicates what percentage of proceeds each individual government receives from PIT and CIT. This value can be adjusted and announced by ordinance of the Minister of Finance. According to Polish law, shares in PIT and CIT belong to own revenue.

Below are the amounts of money that local governments received in 2009–2013 from PIT and CIT.

Table 6: *Income collected from PIT and CIT (2009–2013, mln PLN)*

		2009	2010	2011	2012	2013
Municipalities	PIT	23,323	23,215	25,337	26,486	27,893
	CIT	2,304	2,025	2,280	2,252	2,084
Counties	PIT	2,765	2,797	3,131	3,322	3,513
	CIT	136	128	159	164	154
Provinces	PIT	889	882	962	1,004	1,054
	CIT	4,178	3,968	4,438	4,385	4,062

Source: on the basis of Statistical Office data;

http://stat.gov.pl/bdl/app/dane_podgrup.hier?p_id=249266&p_token=-941885888

In order to supplement insufficient own revenues, local governments are equipped with external sources, earmarked grants and non-earmarked transfers, that come from state budget. Both non-earmarked transfers and earmarked grants can be defined as payments remitted from the state budget or local government in order to finance or fill in missing funds for tasks. A non-earmarked transfer is a non-returnable, free-of-charge type of resource transferred from the state budget to the local government budget, on whose purpose the local government body decides.

The standards contained in the Local Government Revenue Act defines the essence of the general non-earmarked transfer. The quota size of general non-earmarked transfers is determined when the state budget is set.

In Polish law, the non-earmarked transfer is defined as a transfer from state budget to local budgets that should supplement the shortage in local units' incomes. Its main purpose of functioning is to equalize the financing situation of local governments. The characteristic features of a non-earmarked transfer are:

- non-refundable – a properly transferred non-earmarked transfer is not refunded to the state budget by the local authorities. However, this does not preclude the return of wrongly collected non-earmarked transfers,
- free-of-charge – local government does not have to provide any services to the Treasury in exchange for non-earmarked transfers from the state budget,
- general in character with freedom of disposal – the non-earmarked transfer may be spent on any assigned task without specifying the purpose,
- supplementary character – a non-earmarked transfer is a source of income that supplements own revenues.

According to the Polish Constitution, (2 Apr 1997), a non-earmarked transfer is a guaranteed source of revenue for local government units. It occurs immediately after own income, which means that its share in the local government unit's total income should not be higher than the level of own income, but it is essential because of the degree of independence available in its spending. It should be more important in the total amount of income than earmarked grants, which are listed third in order of importance in the Constitution.

It is a tool that fills the allocative and redistributive functions of the state. Non-earmarked transfers also carry out regulations of the European Charter of Local Self-Government: “the protection of financially weaker local authorities calls for the institution of financial equalisation procedures or equivalent measures which are designed to correct the effects of the unequal distribution of potential sources of finance and of the financial burden they must support. Such procedures or measures shall not diminish the discretion local authorities may exercise within their own sphere of responsibility”.

As a part of a local governments' income, a non-earmarked transfer realizes three basic functions (Hanusz et al. 2006: 229):

- it is a supplemental form of income, to enhance funds which are often inadequate for tasks and have not been adjusted to the level of expenditure incurred by local governments. This function relates primarily to support the implementation of tasks in the field of education,
- it is a form of selective support to poorer local governments, which have limited access to sources of own income. Not every local government receives a non-earmarked transfer (compensatory), and some ("prosperous") local governments even make contributions to the state budget as a subsidizing mechanism,
- it is a tool for the redistribution of national income that allows local governments to maintain liquidity. It is guaranteed by law and is transferred in monthly installments so that the local government is assured regular payments out of its account.

Taking this under consideration, a non-earmarked transfer is significantly different from a grant which is also transferred from the state budget. However, it is very important not to confuse the non-earmarked transfer with earmarked grants from the state budget. Although both of them come from the state budget and constitute the financial support for local governments, only the non-earmarked transfer may be spent without specific purpose (for the realization of own tasks).

Table 7: *General non-earmarked transfer and earmarked grants – a comparison*

General non-earmarked transfer	Earmarked grants
Spent for any purpose, associated with current activity of LGU	Spent for a special purpose as indicated in the application form
Decision on allocation of the money from non-earmarked transfer is made by the local authorities	Decision of the funds' allocation is made by the institution that transferred the grant
It is transferred monthly	It is transferred in one rate (investment grant)
It depends on the income level of LGU	It does not depend on LGU income but investment costs
It does not have to be returned to the state budget if it is not totally spent	The remaining sum of money has to be returned to the budget of the institution that transferred the grant
It equalizes the income situation of LGU within the country	Grant spent contrary to the purpose must be obligatorily returned to the institution that transferred the grant
It is calculated according to objective rules	It is calculated according to the investment cost analysis (investment grant)
The use of a non-earmarked transfer is subject to control in context of legality	The use of the grant is subject to control in aspects of legality, appropriateness, reliability and economy

Source: own analysis

Non-earmarked transfers for LGUs as an expenditure from the state budget are one of the most important items. Non-earmarked transfer amounts transferred to the accounts of local governments are the third largest in total state spending between the years 2009–2013. Each year it accounted for 16% of total state expenditures (www.mf.gov.pl).

Table 8: *Non-earmarked transfer for local governments (mln PLN)*

	2009	2010	2011	2012	2013
Municipalities	33,292	34,480	35,751	37,930	38,340
Counties	9,212	9,750	10,098	10,222	10,278
Provinces	2,792	2,942	2,499	2,506	2,639
Total	45,295	47,171	48,348	50,658	51,257

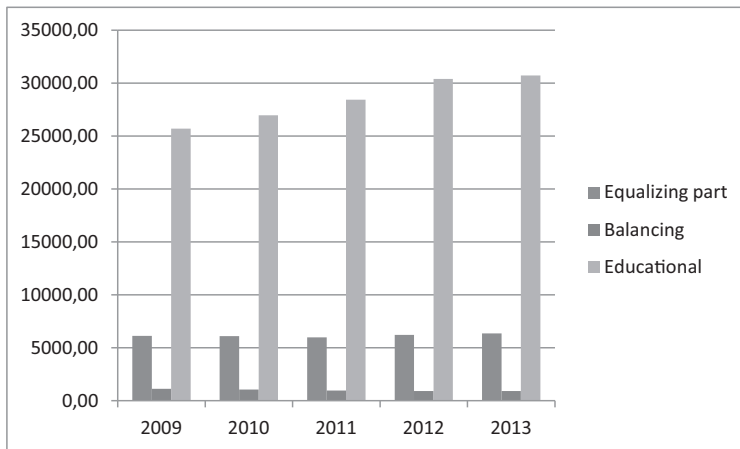
Source: on the basis of Statistical Office data; http://stat.gov.pl/bdl/app/dane_podgrup.hier?p_id=249266&p_token=-941885888

The non-earmarked transfer for local government units is divided into parts depending on the level of public administration. Transferred sums are also different for each local unit. The whole system of LGU subsidizing is described in the Local Government Income Act, dated 13th Nov 2003 (JoL No. 203 item 1966, as amended).

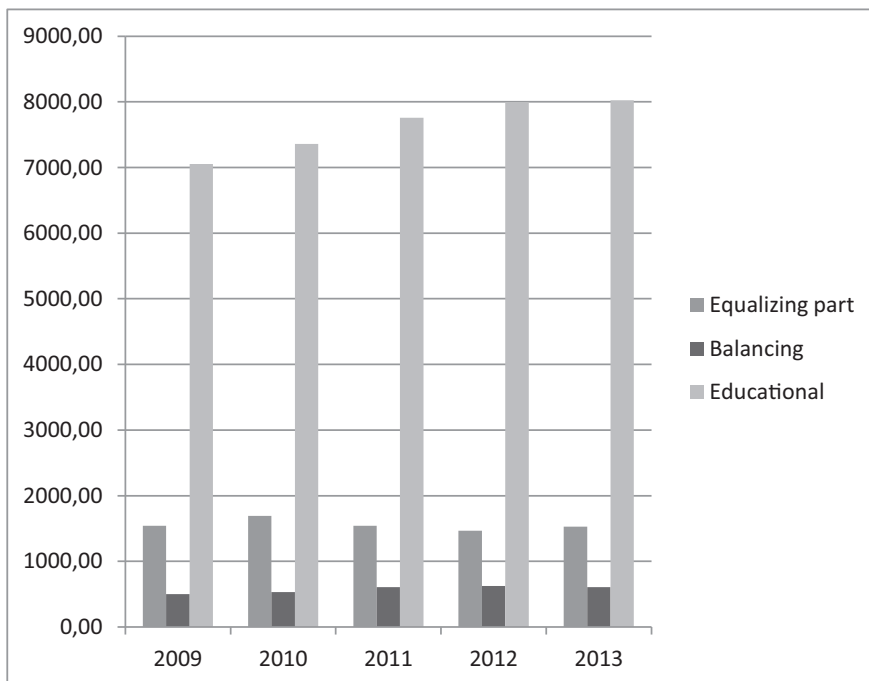
Table 9: *Elements of the non-earmarked transfer*

Municipalities	Counties	Provinces
Equalizing part:	Equalizing part:	Equalizing part:
– basic sum	– basic sum	– basic sum,
– complementary sum	– complementary sum	– complementary sum
Balancing part	Balancing part	Regional part
Educational part	Educational part	Educational part

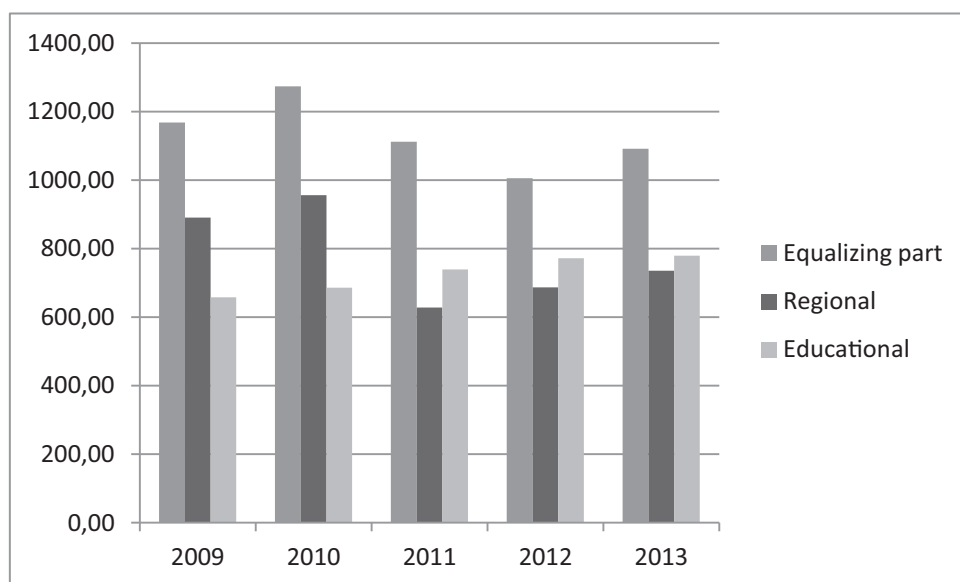
Source: Own study on the basis of Local Government Revenue Act, dated 13th Nov 2003 (JoL No. 203 item 1966, as amended)

Figure 2: *Non-earmarked transfer for municipalities (2009–2013, mln PLN)*

Source: own study on the basis of Statistical Office data; http://stat.gov.pl/bdl/app/dane_podgrup.hier?p_id=249266&p_token=-941885888

Figure 3: *Non-earmarked transfer for counties (2009–2013, mln PLN)*

Source: own study on the basis of Statistical Office data; http://stat.gov.pl/bdl/app/dane_podgrup.hier?p_id=249266&p_token=-941885888

Figure 4: *Non-earmarked transfer for provinces (2009–2013, mln PLN)*

Source: own study on the basis of Statistical Office data;
http://stat.gov.pl/bdl/app/dane_podgrup.hier?p_id=249266&p_token=-941885888

In municipalities and counties, the highest sum of money is transferred within the educational part of the non-earmarked transfer. It constitutes almost 80% of the total sum of the general non-earmarked transfer. This money is spent on educational tasks and investments made in education. It is a very important financial support for LGUs that definitely helps to fulfil educational tasks.

In provinces, the equalizing non-earmarked transfer is noticeably much higher than other parts of the non-earmarked transfer. This is due to the fact that the development in each provinces as well as their financial potential are very diverse. And the aim of an equalizing non-earmarked transfer is to equalize such issues, especially income situations in LGUs.

The second type of transfer funds that local governments in Poland receive is earmarked grants. Earmarked grants are non-refundable, free-of-charge transfers of funds and are related to the realization of public interest. This transfer of funds is intentional, which means that the transferred money has to be spent on a specific task. Earmarked grants are provided by the state or another local government to a local government. In practice, by provisions of law, earmarked grants empowering government budgets have been expanded by intentional fund earmarked grants and earmarked grants for the fulfillment of contractual agreements between local government units and government agencies or other local government units (Pietrzak et

al. 2008: 166). Target earmarked grants are awarded to local government units that perform tasks assigned by the government or other commissioned tasks. It should be noted that these earmarked grants must be returned to the state budget in case of that the commissioned task is not completed. The LGU may also receive a grant from the state budget to finance its own specific tasks (but is moving away from this method of financing).

The Local Government Income Act, which establishes the rules for the transfer of earmarked grants from the state budget, enumerates earmarked grants for:

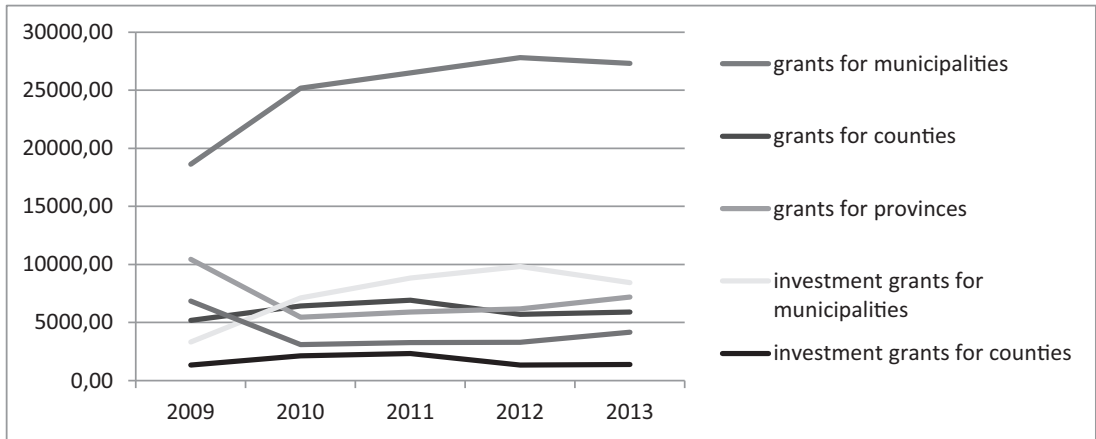
- tasks of government administration and other tasks commissioned/assigned by law,
 - tasks performed by local authorities under agreement with government agencies,
- immediate removal of threats to public safety and order, effects of floods and other natural disasters,
- financing or co-financing own tasks,
 - carrying out tasks under international agreements (for counties, the Act also lists specific earmarked grants for the execution of tasks demanded by the guard and inspectors).

The grant is characterized by a lack of universality (Wakuła 2008: 109). If the terms and conditions under which an LGU will receive a grant from the state budget are not specified, a contract must be signed. Such an agreement should include a detailed description of the task and the purpose for which the funds were awarded, the amount of the monies granted, the period of its use, the maturity of the grant date, the date of the return of any unused portion, and the mode of task control. Earmarked grants are very important for local governments, because they can be used for financing investments.

Table 10: *Earmarked grants for LGUs (mln PLN) and share of investment earmarked grants (%), (2009–2013)*

	2009		2010		2011		2012		2013	
	earmarked grants (mln PLN)	share of investment earmarked grants (%)	earmarked grants (mln PLN)	share of investment earmarked grants (%)	earmarked grants (mln LN)	share of investment earmarked grants (%)	earmarked grants (mln PLN)	share of investment earmarked grants (%)	earmarked grants (mln PLN)	share of investment earmarked grants (%)
Municipalities	18,634.02	17.85	25,168.27	28.24	26,498.04	33.30	27,794.37	35,31	27314,93	30,89
Counties	5,174.02	25.90	6,410.13	33.34	6,922.20	33.49	5,688.99	23,58	5906,17	23,51
Provinces	10,441.68	65.41	5,459.15	56.68	5,895.48	55.27	6,180.68	53,41	7178,38	58,02

Source: own study on the basis of Statistical Office data; http://stat.gov.pl/bdl/app/dane_podgrup.hier?p_id=249266&p_token=-941885888

Figure 5: Earmarked grants for LGUs in Poland (2009–2013, mln PLN)

Source: own study on the basis of Statistical Office data; http://stat.gov.pl/bdl/app/dane_podgrup.hier?p_id=249266&p_token=-941885888

Local expenditures

The final stage in the activity of public authorities is their proper implementation of collected funds. It is associated with the implementation of tasks and goals set by the governing authorities. By its actions, local government strives to meet the collective needs of the population while considering the limited financial resources. It enforces a rational management of the funds that are the basis for the implementation of public tasks. Key issues in the rational allocation of these funds are the priorities of development projects and projects that must be undertaken in a timely way.

The local government spending measures previously collected are used to perform public duties. Tax resources gathered from citizens and other stakeholders are converted into usable social services. Therefore, behind the idea of public expenses lie financial resources that can be used to meet the needs of public services (Brzozowska et al. 2013: 54).

In accordance with the Public Finance Act, public expenditures should be made:

- in a targeted and cost-effective way, with the principles of:
 - obtaining the best results from a given expenditure
 - selecting optimal methods and measures to achieve goals
 - in a timely way of executing tasks
 - in the amount and timeframe of previously contracted obligations.

Local government expenditures may be classified as current spending or assets-related spending. Current spending consists primarily of salaries and wages and the purchase of goods and services for current operations (repairs, fees, premiums). Expenses related to the administrative operation of local government and business travel expenses are also related to current spending. Assets-related expenses are for enlarging capital: investment expenses and purchases, expenditures on the acquisition of shares and equities.

The following tables show the amount of the expenditures of municipalities, counties and provinces between 2009 and 2013.

Table 11: *Total spending of municipalities (2009–2013, mln PLN)*

	2009	2010	2011	2012	2013
Total spending	126,203.72	138,694.76	141,197.34	142,222.23	144,395.09
Assets-related expenditures	29,091.42	33,105.82	31,319.92	26,862.79	25,590.29
Current expenditures	97,112.29	105,588.94	109,877.42	115,359.45	118,804.80

Source: own study on the basis of Statistical Office data; http://stat.gov.pl/bdl/app/dane_podgrup.hier?p_id=249266&p_token=-941885888

As one may noticed the total sum of expenditures in municipalities is increasing year by year. This upward trend is stimulating by growing sums of current expenditures. In 2013 they become higher 22% in comparison to 2009 and 2% to 2012. Analyzing the assets-related expenditures, they present downward trend and, in 2013 they decrease 12% compared with 2009.

Table 12: *Total spending of counties (2009–2013, mln PLN)*

	2009	2010	2011	2012	2013
Total spending	21,155.79	23,826.37	24,058.77	22,476.52	22,916.55
Assets-related expenditures	4,075.66	5,200.80	4,502.01	2,801.25	2,854.11
Current expenditures	17,080.12	18,625.57	19,556.76	19,675.28	20,062.43

Source: own study on the basis of Statistical Office data; http://stat.gov.pl/bdl/app/dane_podgrup.hier?p_id=249266&p_token=-941885888

Total spending of counties remains stable. Its amount oscillates 21–22 mln PLN in analysed years. So the current expenditures which level off 19,5–20 mln PLN. From 2010, asset-related expenditures has dropped significantly (about 36% in 2013).

Table 13: Total spending of provinces (2009–2013, mln PLN)

	2009	2010	2011	2012	2013
Total spending	20,468.69	15,245.03	16,338.63	15,760.51	16,527.00
Assets-related expenditures	9,958.99	5,942.62	6,612.26	5,952.45	6,562.30
Current expenditures	10,509.70	9,302.41	9,726.37	9,808.07	9,964.71

Source: own study on the basis of Statistical Office data; http://stat.gov.pl/bdl/app/dane_podgrup.hier?p_id=249266&p_token=-941885888

During 2009–2013, provinces' spending fluctuates, however its amount has been falling since 2009. The same trend is noticeable in asset-related expenditures, whereas current expenditures remain relatively constant.

Table 14: Consolidated government expenditure as percentage of GDP (2010–2013, %)

	2010	2011	2012	2013
Central	31.10	30.06	29.78	29.25
Local	14.78	13.89	13.14	12.98

Source: http://www.oecd.org/ctp/federalism/oecdiscaldecentralisationdatabase.htm#C_3

The percentage share of state expenditure in GDP shows downward trend. The changes are not big but during three last years it has decrease by 1.85. Local expenditure share has been dropping, too by 1.8.

Deficit and public debt of local self-governments

Budget deficit is most often defined as the excess of budgeted spending over incomes, or as the proportion of budget expenditure not covered by income.

The Polish public finance sector consists of three sub-sectors:

- Government (public authorities, state control and law enforcement, courts, tribunals, government administrators, the National Academy of Sciences, and others).
- Local government (local government units, their entities, unions and agencies, whose founding body or regulatory authority is the local government unit).
- Social Insurance Institution (ZUS, ASIF).

Thus, the sum of budget deficit should be preceded the name of sub-sectors it relates to.

As regards LGUs, budget deficit may be covered by the revenues from the:

- sale of securities issued by the municipality,
- credit taken from domestic banks,
- loans,
- privatization of communal property,
- surplus budget of the local government from previous years.

Public debt is the state of the obligations of the public finance sector (i. e., government or local government entities at all levels of government) at any given moment. It is the corollary of the interest-bearing commitment of resources (as an alternative to the issue of money) to finance the excess of expenditures over obtained incomes.

Debt that is incurred by local authorities includes the following (Korolewska 2011: 2):

- issued securities for cash claims,
- credit and loans,
- accepted deposits,
- maturing liabilities.

As of 2013, local government debt limits were enforced by the Public Finance Act (dated August 27, 2009). These limitations include a:

- 15% limit in relation to planned credit payments, loans, and bond redemptions, including interest and discount to the budget revenue during the fiscal year,
- 60% limit in relation to the total amount of debt to budget revenue.

As of 2014, a debt indicator for LGUs, called the Individual Government Debt Index, alone applies. The Individual Government Debt Index (IWZ) provides that in any given fiscal year, the value of liabilities payments along with service costs to total revenue of the LGU shall not exceed the arithmetic mean calculated for the last three years for current spending, plus the income from the sale of assets minus current spending to total revenue (www.sejm.gov.pl).

The introduction of this indicator has provoked discussion on its use and the consequences of what it brings to LGUs. The most common comments reported by the local authorities concern (<http://orka.sejm.gov.pl>).

- the fact that calculations are based on historical data that does not reflect the current financial situation of local governments and their predicted situation (including a long-term financial prediction),
- the method of calculating operating surplus (which includes expenses for interest on

- liabilities) to total revenue, which is compared to the ratio of expenditure to interest and liabilities payments to total revenue resulting in inadequate numbers in both ratios,
- the prevention of debt in local governments, which have not reached an operating surplus,
 - pressure put on governments to sell communal assets in order to improve their ability to service debt.

Table 15: *Public debt of Polish LGUs (2009–2013, mln PLN)*

	2009	2010	2011	2012	2013
Municipalities	33,341	45,366	54,066	55,747	56,655
Counties	3,908	5,435	6,137	5,975	5,878
Provinces	3,046	4,292	5,555	6,113	6,625
Total	40,295	55,093	65,758	67,835	69,158

Source: own study on the basis of Ministry of Finance data: <http://www.finanse.mf.gov.pl>

Over the analysed period, a significant increase in the amount of debt in local government units is very noticeable. Compared to 2009, the total value of debt almost doubled by 2013. The largest amount of debt occurs in municipalities. There are many possible reasons for such a situation, but the most significant reason is the investments that have been co-financed by the EU. In order to implement an investment, municipalities are obliged to go into debt in order to realize the investment and development.

LGU debt in relation to the Polish GDP is as follows:

Table 16: *Local government units' debt in relation to GDP (2009–2013, mln PLN)*

	2009	2010	2011	2012	2013
Polish GDP	1 361 850,00	1 437 357,00	1 553 582,00	1 615 895,00	1 662 052,00
LGU Total Debt	40 295,00	55 093,00	65 758,00	67 835,00	69 158,00
%	2.96	3.83	4.23	4.20	4.16

Source: own study on the basis of Statistical Office data and table 13 as well as http://www.oecd.org/ctp/federalism/oecdiscaldecentralisationdatabase.htm#C_3

A gradual increase in local government debt in relation to Polish GDP is noticeable till 2011. Debt increase results in an increase in costs for servicing debt. This means that the local government has fewer and fewer funds for the implementation of public tasks, i.e. less and

less are they able to provide free services and benefits for local communities. However since 2012 one may notice downward trend, as the percentage share of local debt in GDP has decreased.

LGUs mainly borrow from banks. As table 16 shows, bank loans account for over 90% of total debt owed. Less popular are securities. Their share in total amount of debt is estimated at between 7.2% to 12.8%.

Table 17: Structure of local governments debt (2009–2013, %)

	2009	2010	2011	2012	2013
Securities	12.8	8	7.6	7.2	7.6
Loans	86.7	91.5	92	92.4	91.8
Due liabilities	0.5	0.5	0.4	0.4	0.6

Source: own study on the basis of Ministry of Finance data: <http://www.finanse.mf.gov.pl>

Summary

Issues relating to the local government finance system in Poland are very extensive. This is due to the complexity of the whole system of public finance and the frequent changes made in laws. However, this article presents the main elements of local government finance: the legal basis, theoretical aspects and statistical data that illustrate the financial condition of local government units in Poland between the years 2009–2013.

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