1.2. Financing of local government units

Local government in Poland is part of the public finance sector. This sector is comprised of the units listed in the Public Finance Act (*Ustawa z dnia 27 sierpnia 2009 r. o finansach publicznych*) such as, for example, public authorities, public universities, and state and local government cultural institutions. These units are established to perform public tasks in a non-commercial manner and financed mainly from public resources.

The financial autonomy of a local government unit is exercised within three main areas: 1) the revenue system; 2) the expenditure system; and 3) the budgetary management system. This text will focus primarily on the first and third systems.

Revenue system

According to the Polish Constitution (Article 167), local government units shall be provided with a share in public income according to their respective tasks (for more information about the provision on public services, please see Chapter 1.3). Changes in the scope of the tasks and competences of local government units should take place together with appropriate changes in the distribution of public financial resources. This means that when local government units are tasked with more responsibilities, they should receive more funding to deal with them, and vice versa.

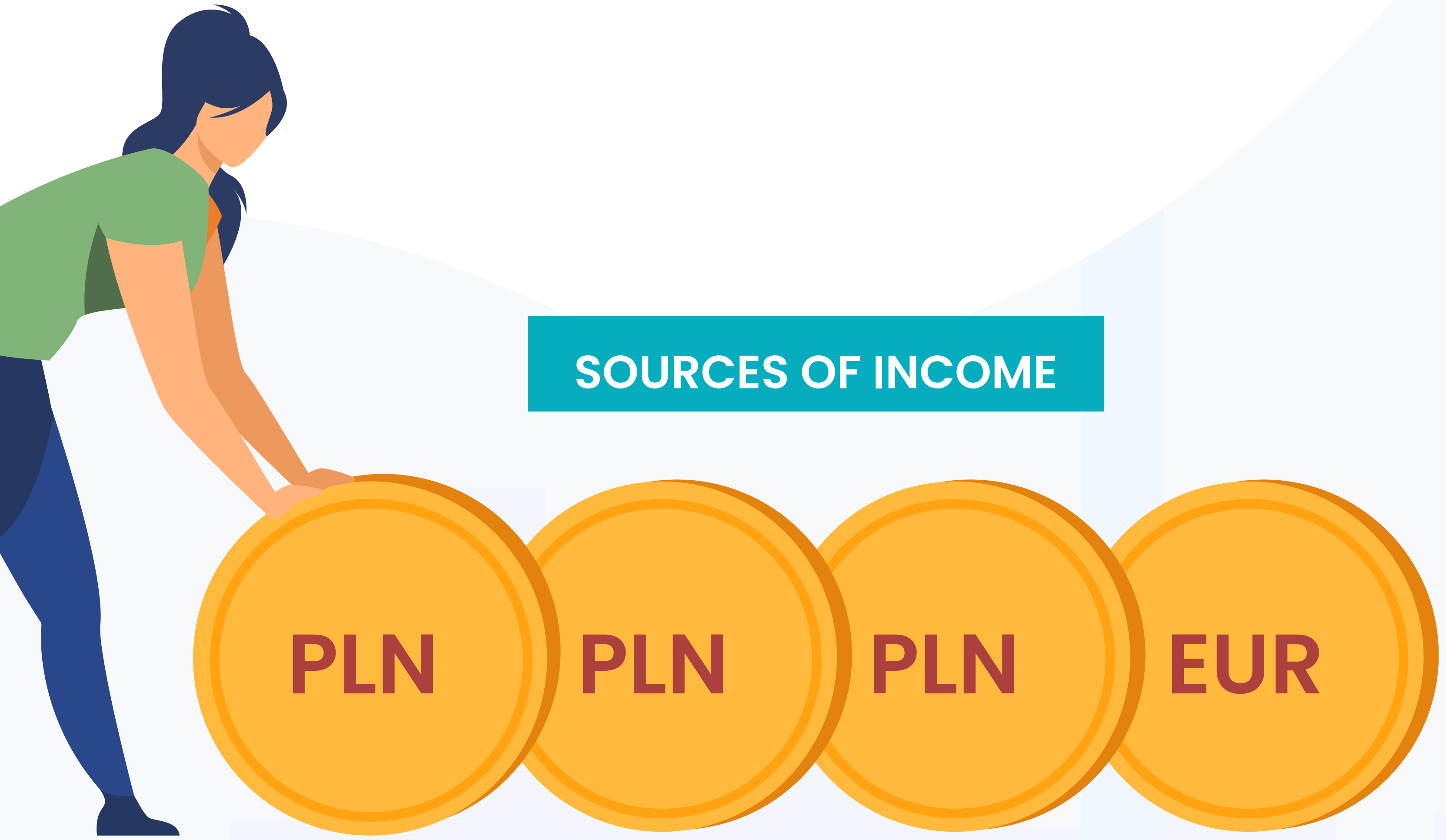
The sources of income of local government units are specified in the Law on Local Government Units Incomes (*Ustawa z dnia 13 listopada 2003 r. o dochodach jednostek samorządu terytorialnego*). They might be divided into the following general categories:

1. own income;
2. general subsidy from the state budget;
3. earmarked subsidies from the state budget.

In addition, the income of local government units may come from non-refundable funds from foreign sources, funds coming from the European Union budget, and other funds (for more information about absorbing external funds by Polish local government units, please see Chapter 1.4).

Select aspects of **financing** of local government units in Poland

SOURCES OF INCOME



OWN INCOME

GENERAL SUBSIDY & EARMARKED SUBSIDIES from the state budget

OTHER NON-REFUNDABLE FUNDS (e.g. EU funding)

YEARLY BUDGET

Basic instrument for budgetary management

INCOME

EXPENDITURES

REGIONAL CHAMBER OF ACCOUNTS

External and independent body for the control and supervision

INDIVIDUAL DEBT INDEX

Limits on debt are established for each unit individually

RULES ON GENERAL RESERVE

GENERAL RESERVE

The general reserve should not be less than 0.1% and not more than 1% of the budget expenditure

0.1-1%

SPECIAL PURPOSE RESERVES

The special purpose reserve may not exceed 5% of the budget expenditure

<5%

BUDGET EXPENDITURE

Ministry of Foreign Affairs Republic of Poland

Created as part of the project "Direction – an efficient state. Polish experiences of decentralisation and modernisation – lessons learnt for Armenia and Georgia" co-financed by the Ministry of Foreign Affairs of the Republic of Poland

Sources of own income of local government units in Poland are also defined in the Law on Local Government Units Incomes. The overview of such sources for municipalities is presented in Table 1.2.

Self-governments with tax revenue exceeding the rates set out in the Law on Local Government Units Incomes must make payments to the state budget. Money from these payments is transferred to poorer local governments.

The own income of local government units includes shares in income from personal income tax (PIT) and corporate income tax (CIT). The participation of municipalities, counties (poviats), and regions (voivodeships) in PIT and CIT contributions is also defined in the Law on Local Government Units Incomes. Generally, flat percentage rates have been set for each of three levels of local government units, as shown in Table 1.3.

TABLE 1.2 **Own income of municipalities in Poland**

TYPE OF OWN INCOME	SPECIFICATION		
Tax revenue	Real estate tax Agricultural tax Forestry tax	Tax on means of transport Personal income tax (PIT), paid by means of a tax card	Inheritance and donation tax Tax on civil law transactions (TCLT)
Fees	Treasury fee Marketplace fee	Operational fee (in part) Advertising fee	Local fee, spa and dog ownership fees Other revenue of the municipality, paid under separate regulations
Revenue received by municipal budgetary entities and payments from municipal budgetary entities			
Income from the municipality's assets			
Inheritances, legacies, and donations to the municipality			
Revenue from fines and penalties laid down in separate regulations			
5.0% of revenues obtained for the state budget in connection with the performance of government administration tasks and other tasks commissioned by acts, unless separate provisions provide otherwise			
Interest on loans granted by the municipality, unless otherwise specified			
Interest on late payment of receivables constituting municipal revenue			
Interest on funds deposited in the municipality's bank accounts, unless otherwise specified			
Subsidies from the budgets of other local government units			
Other revenue due to the municipality under separate regulations			

Source: Law on Local Government Units Incomes, 2003.

The **general subsidy** is transferred to all local government units and is non-refundable, and its aim is to finance exclusively the own tasks of local government units. The exact purpose of spending the subsidy is decided by the body constituting the given local government unit. In general, this type of subsidy consists of five parts:

1. basic, which is set for all units under the same conditions;
2. educational, which depends on the scope of educational tasks carried out by the units and the number of students (this part is distributed according to the rules set out in the regulation of the Minister of Education);
3. compensatory, which aims to artificially equalise the wealth of individual regions of the country through providing additional funding for local government units with a lower income per capita;
4. balancing, to compensate lost income;
5. roads-related one, related to the construction, modernisation, maintenance and protection of roads.

The composition of the general subsidy allocated for municipalities, counties (poviats), and regions (voivodeships) differs. For example, only municipalities are entitled to the basic part of the subsidy, while only counties and regions are entitled to the roads-related one. Generally, the general subsidy for counties consists of three parts: compensatory, balancing, and educational. In the case of regions, the general subsidy consists of compensatory and educational parts as well as an additional one, the regional part.

TABLE 1.3 **Participation of municipalities, counties (poviats), and regions (voivodeships) in PIT and CIT contributions**

	PIT	CIT
Municipalities	39.34%	6.71%
Counties	10.25%	1.40%
Regions	1.60%	14.75%

Earmarked subsidies are transferred to some local government units, with the exception of funds related to tasks commissioned in specific acts, and are refundable. It means that unused amounts should be reimbursed to the state budget. With some exceptions, they are assigned to finance concrete commissioned tasks performed by local government units. According to the Act on Revenue of Local Government Units, earmarked subsidies can be used, among other purposes, to finance tasks implemented under agreements concluded with government administration, for the purpose of removing direct threats to public safety and order, including the effects of floods and landslides and other natural disasters, and for the implementation of tasks resulting from international agreements.

The analysis of the structure of earmarked subsidies reveals that in the case of municipalities, a large share of such transfers covered social assistance, agriculture, and hunting. In the case of counties (poviats), the largest part is assigned to public safety and fire protection, as well as health protection; in the case of regions (voivodeships) – to transport and communication, as well as agriculture and hunting. Subsidies for social protection as well as for public safety and fire protection dominate in cities with county rights[13].

13. For more information see: Swianiewicz, P., Łukomska, J. (2020) 'Ewolucja sytuacji finansowej samorządów terytorialnych w Polsce po 2014 roku', *Fundacja im. Stefana Batorego*, available at https://www.batory.org.pl/wp-content/uploads/2020/05/Ewolucja-sytuacji-finansowej-samorzadow_final.pdf

Tychy on the top of financial ranking

According to the 2019 Financial Ranking of Local Government in Poland, Tychy is the best managed city with county rights in Poland when considering finances. Its financial standing was evaluated as very good. The city was investing and also successfully raising funds for the implementation of development activities. In 2019, the budget of the municipality exceeded one billion zlotys for the first time in history. The individual debt ratio for Tychy was 3.5% in 2019, with 13.8% allowed. The good financial situation of the city was also important because of the challenges related with the COVID-19 pandemic and the increasing financial burden imposed by central authorities on local government units.

The Financial Ranking of Local Government in Poland is the analysis prepared by a group of researchers covering all local governments on the basis of the official financial statements that each local government unit submits to the District Chamber of Accounts.

One of the main indicators of the financial fitness of the revenue system of local government units – as well as of the expenditure one – is **the share of earmarked subsidies in total revenue of the given unit.** In general, the higher share of revenues other than earmarked subsidies, the greater the expenditure autonomy of the local government unit and the greater development prospects. In fact, income from taxes, public property, and general and earmarked subsidies (with the exception of income from the sale of property and investment subsidies) is intended to finance the current tasks of local government[14]. In order to invest in development, local government units are often forced to reach for extraordinary sources of financial supply, such as loans, credits, or bonds[15]. Moreover, researchers argue that the principle of local government units being provided with a share in the public income according to their respective tasks is not respected and that in reality local government units are underfinanced[16]. Last but not least, in the period of 2008-2020, an increase of earmarked subsidies in the structure of local government units' revenue has been observed. The most important causes of this increase have been the introduction of development subsidies in 2008[17] and the implementation of the Family 500+ Programme[18] which started in 2016.

System of budgetary management

Regarding the system of budgetary management of local government units, the basic instrument is **the budget,** allowing local government units to plan how to allocate available financial resources. As a financial plan it includes information on income and expenses, and as well as revenue[19] and expenditures[20]. It takes the form of a normative act, i.e. a resolution, adopted by a local government body for the period of the financial year (which in the case of Poland is the same as the calendar year).

14. See: Surówka, K., Owsiak, K. (2018) 'Administrowanie czy rozwój – 20 lat doświadczeń finansowania polskiego samorządu terytorialnego', *Nierówności Społeczne a Wzrost Gospodarczy*, No 56.
15. A financial document confirming the buyer that the given local government unit has incurred a debt.
16. A. Surówka, A., Owsiak, K., op.cit.
17. For the implementation of EU-funded projects in the programming period 2007-2013.
18. The state social policy programme, implemented since 1 April 2016, aimed at helping families to raise their children through monthly upbringing benefits of 500 PLN per child in the family. Benefits are distributed through local government units at the municipality level.
19. Revenue is repayable and serves to finance the budget deficit. Revenue of the public finance sector entities also encompass revenues from their operations and other sources.
20. For example, repayment of loans and credits, granted loans and credits, and financial operations related to public debt and liquidity management.

BeSTi@ system for better budget management

According to the 2019 Financial Ranking of Local Government in Poland, Tychy is the best managed city with county rights in Poland when considering finances. Its financial standing was evaluated as very good. The city was investing and also successfully raising funds for the implementation of development activities. In 2019, the budget of the municipality exceeded one billion zlotys for the first time in history. The individual debt ratio for Tychy was 3.5% in 2019, with 13.8% allowed. The good financial situation of the city was also important because of the challenges related with the COVID-19 pandemic and the increasing financial burden imposed by central authorities on local government units.

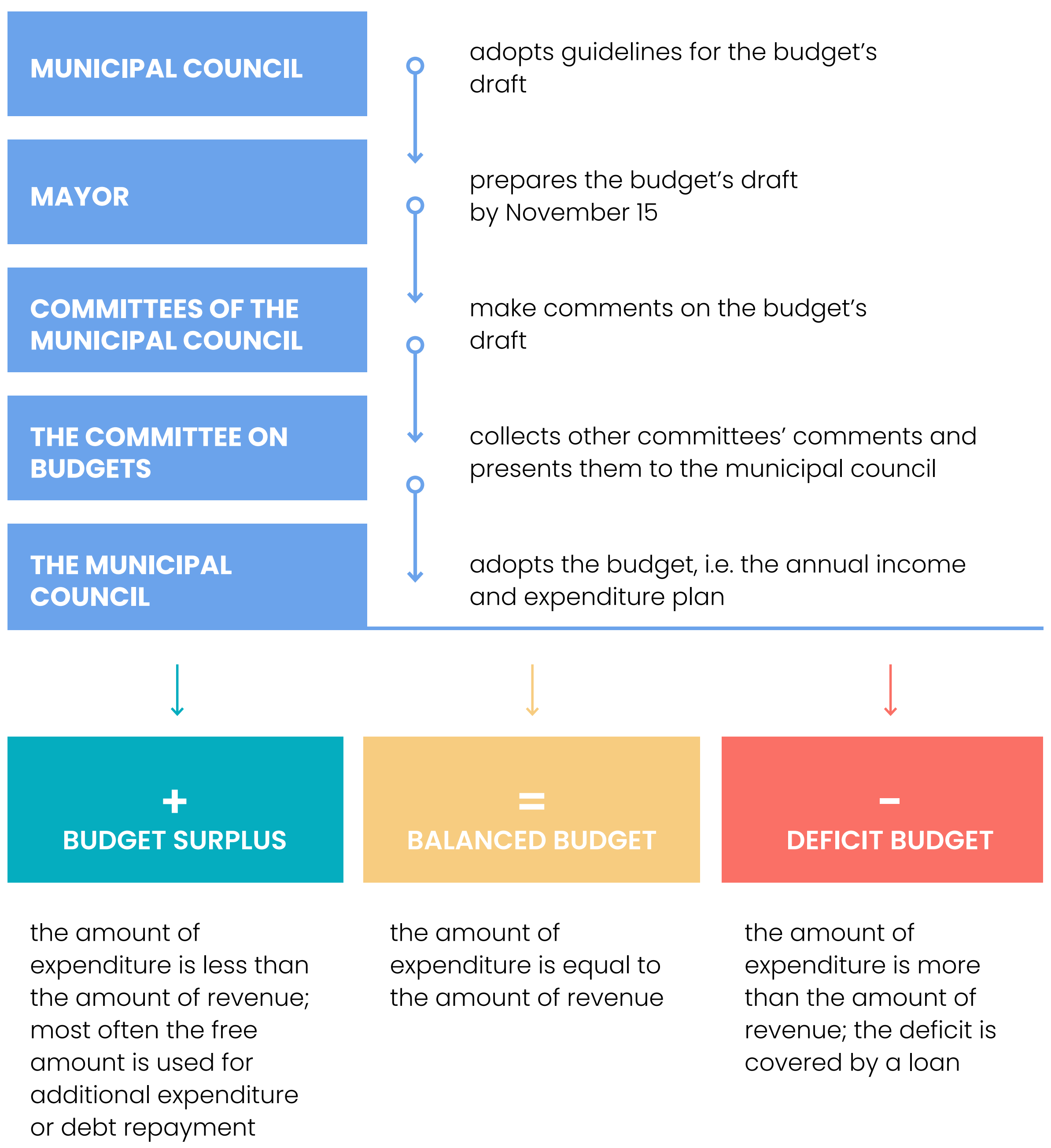
The Financial Ranking of Local Government in Poland is the analysis prepared by a group of researchers covering all local governments on the basis of the official financial statements that each local government unit submits to the District Chamber of Accounts.

Work on the draft budget for a given year usually starts after the summer of the previous year. A budget resolution should be passed, in accordance with the principle of advancement, by the end of the financial year preceding the financial year in which it is to apply. However, this principle is not absolutely binding and in exceptional cases it is possible to adopt the budget later during the budget year, until deadlines set by the Public Finance Act.

The initiative to draw up a draft budget resolution is exclusively for the executive of a local government unit (*wójt*, mayor, president, county board, region board). The constituent body (council) has the exclusive competence to adopt the budget and to make budgetary changes to it during the financial year. In case the budget is not adopted by latest possible date of the budget year, it is established within the timeframes set by the law by the **Regional Chamber of Accounts** (*Regionalna Izba Obrachunkowa,* RIO), which is the state, external, and independent body for the control and supervision of local government units.

Once the budget has been adopted by the constituent body, it is passed by resolution on to the Regional Chamber of Accounts and the budget execution system is prepared. The Regional Chamber of Accounts analyses the budget resolution for compliance with the law. If inconsistencies are found, it calls on the constituent body to provide corrections and sets a deadline by which changes are to be made. If this deadline is not met, the Regional Chamber of Accounts has the right to determine the budget itself in the same way as if the constituent body had not adopted it by the end of the longest possible period envisaged by the law.

GRAPH 3. **Stages of the budget adoption in municipalities** (simplified version)



In 2014, the **Individual Debt Index** (Indywidualny wskaźnik zadłużenia samorządów, IWZ) of local government units was introduced. It sets individual debt limits for each local government unit, and its constituent body cannot adopt a budget in which the relation resulting from the IWZ formula would not be maintained[21].

According to the Public Finance Act, local government units create a **general reserve** in the budget. The reserve shall not be less than 0.1% and not more than 1% of the budget expenditure. Also, special purpose reserves may be established in the budget of a local government unit, the sum of which may not exceed 5% of the expenditure of the budget.

The introduced system of financing self-government units facilitated their empowerment as they were granted general competences in deciding on income sources and expenditure directions. For example, some local taxes – such as the real estate tax – are at the full disposal of the given self-government unit.

The main problem of self-government is limiting the possibility of acting autonomously by imposing specific tasks without ensuring adequate financial resources for their implementation.

Furthermore, as a significant part of their income has a strictly defined purpose, local government units in Poland are too concerned with 'administration' and not with deciding on the directions of their development.

The financial independence of local government units in Poland is further undermined by limitations in the scope of indebtedness.

Local government units in Poland should have more financial autonomy, including influence on their income. In this context, such instruments and products already available on the market as income bonds or capital financing could be popularised.

21. IWZ states that in a given financial year, the value of the repayment of liabilities together with the costs of their servicing to the total income of a local government unit's budget cannot exceed the arithmetic mean of the ratio of its current income calculated for the last three years, increased by income from the sale of assets and decreased by current expenses to the total income of the budget.