Zeszyty Naukowe
Wyższej Szkoły Bankowej w Poznaniu
2016, t. 70, nr 5

Przemiany strukturalne w jednostkach sektora publicznego

The WSB University in Poznan
Research Journal
2016, Vol. 70, No. 5

Structural Changes in Public Sector Units

edited by

Marek Dylewski

The WSB University in Poznan Press
Poznan 2016

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redakcja naukowa

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Wydawnictwo
Wyższej Szkoły Bankowej w Poznaniu
Poznań 2016

Czasopismo umieszczone na liście „B" MNiSW, w bazach Index Copernicus, BazEkon, PBN i POL-Index.
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oraz w ostatnim numerze czasopisma z danego roku.

Journal included in List B of the Ministry of Science and Higher Education
as well as in Index Copernicus, BazEkon, PBN and POL-Index databases.
Journal reviewed in compliance with the standards set forth by the Ministry of Science and Higher Education.
A list of referees is available at www.wydawnictwo.wsb.poznan.pl
and published in the last issue of the Journal each year.

Procedura recenzowania / Review procedure
www.wydawnictwo.wsb.pl/informacje-dla-recenzentow

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Publikacja finansowana przez Wyższą Szkołę Bankową w Poznaniu.
Publication financed by the WSB University in Poznan.

Wersja pierwotna – publikacja drukowana / Source version – print publication
Nakład: 150 egz. / Circulation: 150 copies

ISSN 1426-9724

Stworzenie anglojęzycznej wersji publikacji sfinansowano w ramach umowy 857/P-DUN/2016 ze środków Ministra Nauki i Szkolnictwa Wyższego przeznaczonych na działalność upowszechniającą naukę.

Ministerstwo Nauki
i Szkolnictwa Wyższego

Wydawnictwo Wyższej Szkoły Bankowej w Poznaniu
ul. Powstańców Wielkopolskich 5, 61-895 Poznań, tel. 61 655 33 99, 61 655 32 48
e-mail: wydawnictwo@wsb.poznan.pl, dzialhandlowy@wsb.poznan.pl, www.wydawnictwo.wsb.poznan.pl
Druk i oprawa / Printed and bound by Zakład Poligraficzny Moś i Łuczak, Poznań

Contents

Changes in Local Government Units

Spis treści

Przemiany w jednostkach samorządu terytorialnego

Introduction

The changes that take place in the public finance system are reflected in the processes, events, and situations occurring in a county's economy and its environment. Poland belongs to the group of a few countries in the European Union which only felt the effects of the global financial crisis to a limited extent. During this period, there was an increase in government spending (not only nationally, but also locally), despite limited budget revenues caused by the economic slowdown. This situation forced the need for more radical action in the public finance sector.

Contemporary public finances should not be restricted to the study of the management of public funds. There is a real need to identify and explain the economic and social phenomena implying changes in the functioning of the public sector. These changes affect both the financial structure of the phenomena, as well as, the internal structure of entities and processes related to the management of public funds.

In stable macroeconomic conditions, the decisions of public authorities do not arouse any emotion. New regulations and policies for the management of public funds in the long term at the national level and within the European Union are generally accepted and put into operation within the public finance sector. However, in times of financial and economic crisis there is a need to seek new tools and methods to boost economic growth and balance the economic system. In addition, there needs to be an appropriate way, given the circumstances, to carry out structural changes in the public sector. In the new legal, financial, and organizational conditions, it is an essential element to implement changes in the public finance sector in order to adjust the feasibility of expenditures and collecting revenue at a level that is adequate in the current state of the economy.

This number of the research journal, which is given the title of "Structural Changes in Public Sector Units," gives a voice to the discussion of the scientific community on the changes, the evolution of paradigms, as well as, the diverse concepts of changes occurring in the functioning of the public sector in Poland.

The intention of all the authors of the studies was to present observed phenomena and events from the point of view of the changes taking place and evaluating them, as well as, to point out the dysfunction and necessary actions needed for modification of these changes. In the hands of the reader, this collection of individual positions the authors take on these important structural changes will inspire further research and scientific discussion.

Marek Dylewski, PhD
Associate Professor & Editor

Meso and Macro Approaches
to Structural Change in the Public Sector

Zeszyty Naukowe
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2016, t. 70, nr 5

Agnieszka Alińska

University SGH in Warsaw
Collegium of Socio-Economics
e-mail: aalin@sgh.waw.pl
phone: 22 564 86 76

Fiscal Sustainability and Financial Stability – Challenges and Experiences during a Time of Financial Crisis*

Abstract. *The public finance sector is an element of the economic system which increasingly feels the negative impact of the current financial crisis and has been paying dearly for it. Therefore, developing and implementing an appropriate strategy in the field of fiscal policy, and preserving the stability of the public finance system becomes a challenge for many governments and public institutions in the whole world. The purpose of this article is to present the substance, role, and importance of fiscal sustainability and financial stability in a changing financial and economic environment due to the financial crisis. The author attempts to prove that in the post-crisis reality fiscal sustainability is one of the elements of financial stability, which in turn is the basis for long-term economic growth and obtaining social benefits. Policy makers and representatives of the public should, first and foremost, strive to maintain financial stability, including financial stability in the public sector.*

Keywords: *public finance, fiscal sustainability, financial crisis*

Introduction

In times of crisis, due to market consequences, an increasing role in the financial and economic system is attributed to public institutions and assessment in the area of public finance. The public finance sector is one of the elements of the economic system which increasingly feels the negative impact of the financial crisis;

* The project was financed by the National Science Center and granted based on Decision No. DEC-2013/09/B/HS4/03610.

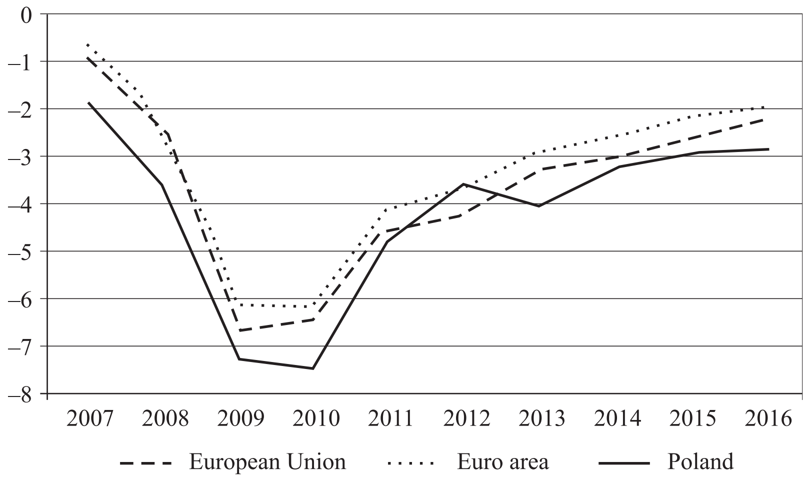
it has become the sector that has paid most dearly for the current crisis. Therefore, developing and implementing appropriate strategies in the field of fiscal policy and preserving the stability of the public financial system becomes a challenge for many governments and public institutions all around the world. Experiences drawn on from the global financial crisis show that the stability of the public financie system requires the use of appropriate instruments within the framework of fiscal policy including, in particular, the observance of the fiscal rules adopted at the European and national levels. These types of behaviours are the basis, not only for obtaining positive results in the state of public finance, but above all, for achieving optimal values, desired behaviours, and the development of entities from the field of the real economy. This, in turn, leads to improved living conditions for society, positive economic growth, and maintaining long-term stability of the market financial system as well.

The purpose of this article is to present the substance, role, and importance of fiscal sustainability and financial stability in a changing financial and economic environment due to the financial crisis. The author attempts to prove that in the post-crisis reality, fiscal sustainability is one of the elements of financial stability which, in turn, is the basis for long-term economic growth and obtaining social benefits. Policy makers and public authorities should, first and foremost, strive to maintain financial stability, including financial stability in the public sector. The presentation of issues related to financial stability is the basis for obtaining positive effects in the sphere of the real economy, and especially for achieving inclusive growth, and thus, will contribute to obtaining positive effects in terms of fiscal sustainability.

1. Assessment of the situation in the Polish public finance sector in comparison to the EU

The state of public finance is reflected primarily in the level of budgetary deficit and public debt of the general government sector [cf. Alińska 2016b; Kosycarz 2015]. Poland is one of a few European Union states which takes effective measures to keep the budget deficit below 3% of its GDP. Since 2012, in comparison to other EU countries and the Eurozone, Poland has generated a budget deficit value which is above average. At the end of 2015, the value of the budget deficit amounted to 3.0% in Poland and the Euro area countries averaged 2.17%. However, in the last decade, periods can be seen where the general government sector deficit was far in excess of the reference value (3% of GDP). In this situation, the European Commission introduced the excessive deficit procedure. Poland was covered by this deficit program from 2004 to 2007, and from 2009 to 2015.

Chart 1. The general government balance as a % of GDP between 2007-2015 and a projection for 2016 (ESA 2010)



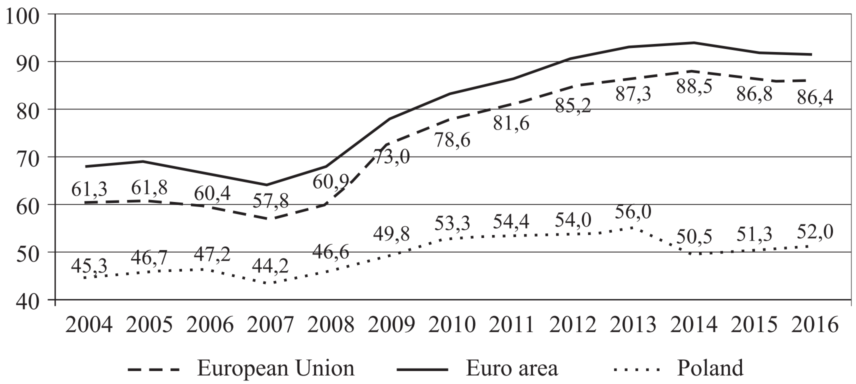
Source: European Commission, http://ec.europa.eu/economy_finance/ameco/user/serie/SelectSerie.cfm [access: 10.10.2016].

Analysis of public debt in Poland compared to the EU and the euro area indicates that Poland meets the values set out in the Maastricht criteria (60% of GDP). Taking care of the sustainability of public finances, Poland introduced several provisions limiting the value of public debt. E.g. a provision on the maximum level of public debt is already in the Constitution, Art. 216(5), as well as, other fiscal rules which involve numerous financial consequences if not followed [Alińska & Kosycarz in press].

Since the economic crisis, public debt has continued to increase, both nominally and in relation to the GDP. In 2014, a significant decrease in the public debt in Poland resulted from a one-time shift of assets from open pension funds to the Social Insurance Institution (ZUS). This was not associated with any changes in fiscal policy, but only with a sovereign decision of the government. Existing debt affects the amount of current flows required to service it and, therefore, may be important for the ability of the country to fulfil its obligations within the scope of satisfying its liabilities, as well as, it may determine the ability to incur new liabilities. The size of the debt also affects the perception of the credibility of a given country by investors. A country that has a low cost of issuing new debt may borrow with greater ease and lower costs than a country for which the marginal cost of debt is higher.

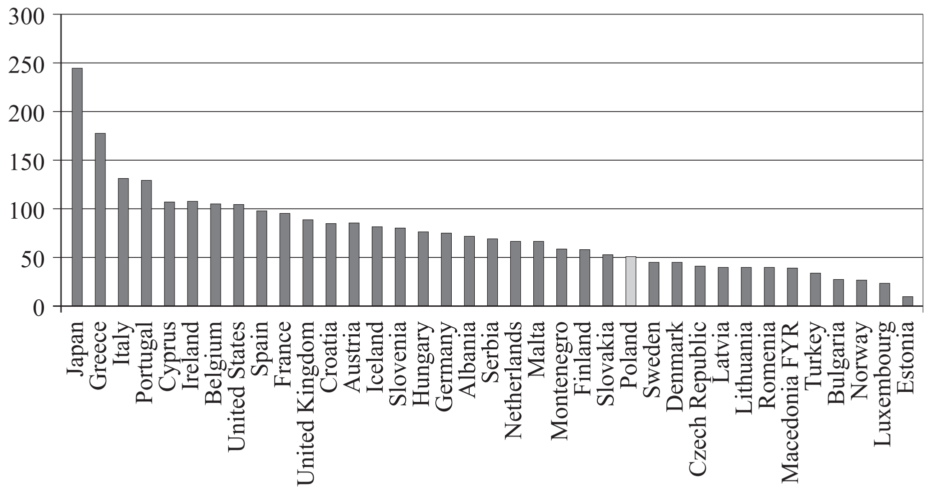
Compared to other EU countries, Poland shows a relatively low level of public debt, which results mainly from strict legislation in the public sector, the eco-

Chart 2. General government debt as a % of GDP (ESA 2010)



Source: European Commission, http://ec.europa.eu/economy_finance/ameco/user/serie/SelectSerie.cfm [access: 10.10.2016].

Chart 3. Consolidated gross debt for general governments in 2014 (ESA 2010)

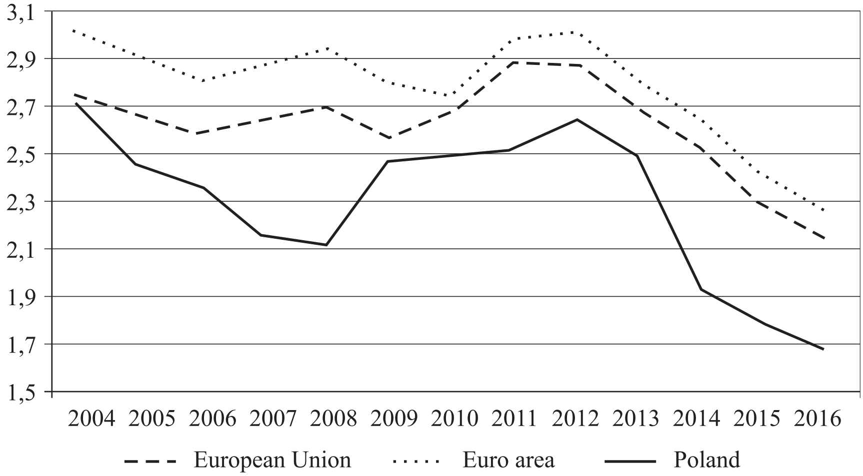


Source: European Commission, http://ec.europa.eu/economy_finance/ameco/user/serie/SelectSerie.cfm [access: 10.10.2016].

nomic policy of the country, and the impact of the financial crisis on the state of the real economy.

In most of the countries studied the main problem in the effective implementation of fiscal policy are not problems with balancing the budget, but the need to incur expenses related to debt servicing. In recent years, the costs of public debt

Chart 4. General government interest as a % of GDP (ESA 2010)



Source: European Commission, http://ec.europa.eu/economy_finance/ameco/user/serie/SelectSerie.cfm [access: 10.10.2016].

servicing have been the highest in Hungary (4.6% of GDP in 2013, and 4.1% of GDP in 2014).

In summary, the assessment of the situation in the public finance sector in Poland compared to other EU countries and the Euro Area indicates that the financial and economic crisis, which most European countries face, has not affected the public sector in Poland to a significant degree. Both the value of the budget deficit and the public debt remain at safe levels. Convergence criteria from the Maastricht may serve as an example of international rules, specifying the maximum size of the public finances deficit in EU Member States at 3% of the GDP, and public debt at 60% of the GDP. While Polish examples of national fiscal rules include the following: the public debt limit (from Art. 216 sec. 5 of the Constitution of the Republic of Poland), set at the level of 3/5 of the annual GDP, or also the so-called prudence limits (from Art. 86 of the Public Finance Act), obliging government and local government authorities to take specific and diverse recovery actions in situations of exceeding certain levels of association between the state public debt in relation to the GDP, i.e. prudence limits of 55% and 60% of the GDP. Non-standard restrictions introduced in the form of national fiscal rules have a large part in this area of management of the public funds. Usually a fiscal rule is expressed as the maximum level of a numerical index or the target or desired value, expressed in relation to GDP or in nominal value. The fiscal rule can also apply to procedures of creating a budget or a certain model, best practices, or regulations for increasing the transparency and predictability of fiscal policy

[Próchnicki 2013: 30; Schaechter, Kinda, Budina & Weber 2012: 5]. In praxis, on the subject there are four main types of fiscal rules: (I) the debt rule, (II) the budget balance rule, (III) the expenditure rule, and (IV) the revenue rule [Marchewka-Bartkowiak 2010: 4-6].

The specificity of the public financial system lies also in the fact that in contrast to the market system it is subject to parliamentary (social) scrutiny. Budgetary procedures, fiscal rules, and instruments of fiscal policy are discussed, evaluated, and implemented by the Sejm, as the supreme body of state control. Therefore, the analysis of issues related to the maintenance of the stability of the public finance system should be carried out in terms of:

– regulatory issues,
– economic and financial issues.

In terms of regulatory issues, attention should be drawn to two essential aspects of the issues at stake:

– regulations at the EU level, which are required to be implemented within the Polish legal system,
– national regulations.

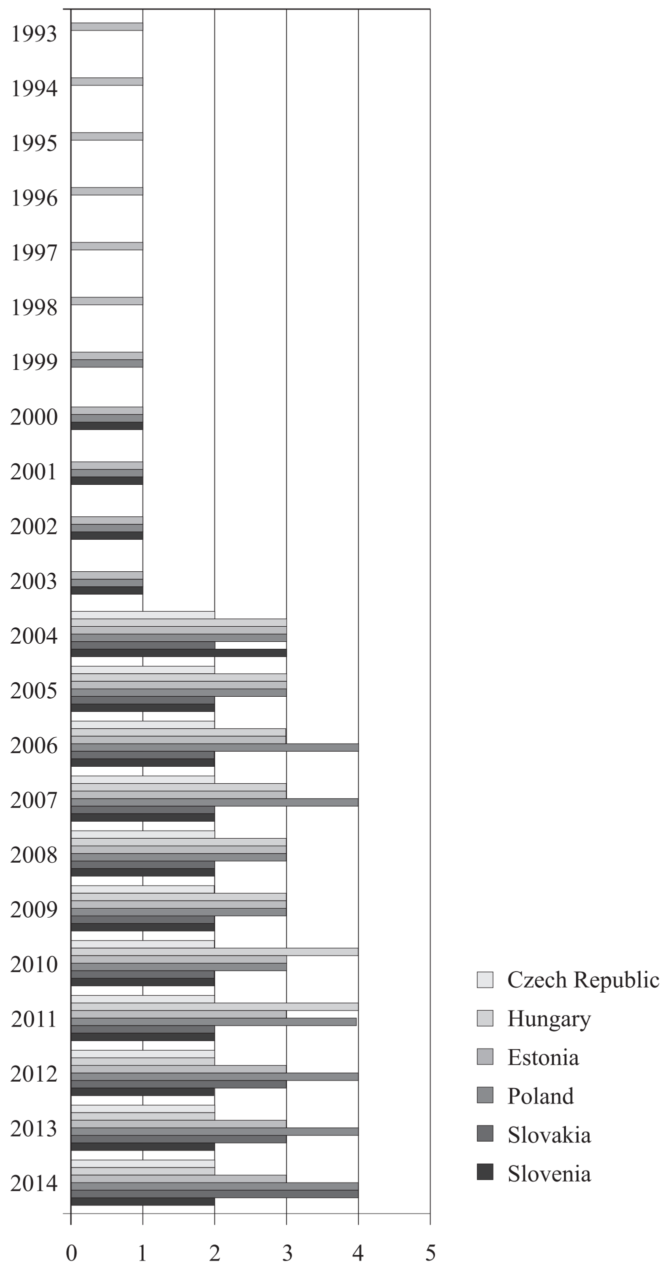
Among the European legal framework of the EU relating to the public finance sector, in terms of relevance of the introduced solutions these deserve special mention:

– six-pack (2011), consisting of five Regulations and one Directive, the aim of which was to introduce greater macroeconomic surveillance,
– two-pack (2013), consisting of two Regulations, the aim of which was to further strengthen macroeconomic surveillance [Dziemianowicz & Kargol-Wasiluk 2015: 154].

At the national level, regulatory solutions for the management of public funds have been defined in the highest legal act which is the Constitution of the Republic of Poland [Art. 216(5)], as well as, in the Public Finance Act and other extraordinance regulations, such as fiscal rules. Poland belongs to countries in which the number and scope of fiscal rules are one of the largest. Generally, in the early 90s there were only 13 fiscal rules in force across the EU. In 2010, the entire EU had 70 numerical fiscal rules, and the countries of Central and Eastern Europe had 16. Among the countries of Central and Eastern Europe, at the end of 2014, the most advanced framework disciplining fiscal policy was in force in Poland and Slovakia.

It should be noted that on one hand, fiscal rules protect against uncontrolled formation of the deficit and public debt, but on the other hand however, their excessive number and stringency may result in restrictions on the conduct of fiscal policy in a changing and unstable socio-economic environment, including times of economic crises. This is why fiscal rules in the financial or economic system should be used with caution during a period of turbulence, and during a downturn,

Chart 5. The number of numerical fiscal rules in selected countries
of Central and Eastern Europe between 1993-2014



Source: author's own study based on data from www.imf.org/external/datamapper/FiscalRules/map/map.htm [access: 23.05.2016].

solutions of this type are often referred to as sub-optimal. Fiscal policies that are too restrictive, aimed at fiscal consolidation, may result in a reduction in economic growth and a decline in GDP. As a result of the persistence of such a situation, the opposite effect can be achieved, i.e. an increase in the debt to GDP ratio in the long term.

2. Fiscal sustainability versus financial stability in the public sector

Measures taken by institutions in the public finance sector, in terms of maintaining the stability of the financial system, must be considered in both a narrow and broad sense [Alińska 2016a].

In a narrow sense, the stability of the public finance system is identified as activities focused on the conduct of fiscal sustainability. The result of such activities is the maintenance of the budget deficit and public debt at a level lower than the one required in the Maastricht criteria. This means that the concept of fiscal sustainability is closely linked to fiscal policy (generating a budget surplus or deficit), and the value and/or the dynamics of public debt. In literature, there are usually three approaches to distinguish fiscal sustainability: in the first approach, fiscal balance is related to solvency (i.e. the ability to service current debt);according to the second approach, sustainable fiscal policy provides an adequate (required) ratio of debt to GDP; the third approach takes into account both the solvency and the limiting of public debt growth [Krejdl 2006; Keliuotytė-Staniulėnienė 2015].

More broadly, the stability of the public financial system refers to the activities in the long, multi-faceted term, serving not only the assessment of the state of finances in the public sector, but also assessing their impact on social behaviour and the state of the real economy. According to the International Federation of Accountants (IFAC) [2015], there are three dimensions indicated of long-term financial sustainability of the public sector. They are identified in the following areas of activity:

- the possibility of collecting public revenues,
- shaping the optimum value of public debt,
- the provision of services in the public sector.

A more detailed and highly accurate description of the stability of the public finance system is suggested by experts from the OECD [2009: 8]. They point out that the sustainability of public finance should be based on the following four essential criteria:

- accountability and the capacity of governments to finance existing and future obligations and liabilities;

– the ability of governments to sustain economic growth over an extended period of time;

– fairness and the capacity of the government to provide net financial benefits to future generations that are not less than the net benefits provided to current generations;

– the maintenance of a tax system at a stable level, without increasing the tax burdens in the future.

The stability of the financial system should be assessed in terms of not only the current state, but from the perspective of at least one financial or economic cycle. This view of the changes and an assessment of the financial crisis impact on the public sector can create a basis for identifying indicators and values considered important from this point of view. As emphasized by V. Rutkauskas [2015: 73] the increase in debt can hardly be assessed as a measure of risk in itself. The existing liabilities have a risk potential which evolves when the debtors' abilities to repay financial liabilities are deteriorating. The situation becomes even worse when there are no suitable assets (financial and/or real) which could be used in order to meet obligations. In turn, deterioration of a debtor's financial standing, through direct and indirect channels, will make the financial standing of creditors worse due to expected losses. The consequences of one debtor's default for its obligations will affect a number of participants in the whole economy, dragging down both financial stability and fiscal sustainability.

Considering the stability of the public financial system, one must also pay attention to the need to implement basic functions by the public sector, i.e. allocative, redistributive, and stabilisation, in addition to preventing long-term imbalances in public finances. This is possible to achieve by creating an effective system of public expenditure and income to the public finance sector. There is also significance to the level of fiscalism, measured by the share of income to the public finance and public expenditure sector in relation to the GDP, but also to the structure of public duties and expenses.

3. Trends and challenges in maintaining stability in the public finance system in the context of lessons learned from the financial crisis

In the context of lessons learned from the financial crisis of 2007 onwards, action should be taken to develop and implement fiscal policy that will take into account the current state of public finance, the situation and needs in the field of the real economy, and social expectations. Thus in the post-crisis period, anti-crisis fiscal policy should be developed and implemented [Alińska 2015]. It should be equated with the need to take action in the public finance sector and with the use of available fiscal instruments so as to:

- reduce the effects of the current financial crisis,
- prevent the emergence of problems within the financial system in the future,
- strive to maintain long-term fiscal sustainability,
- ensure long-term and stable economic growth of the country based on the principles developed in the inclusive growth strategy.

Actions taken by individual Member States in the field of public finance were primarily aimed at maintaining stability in the financial system and to ensure permanent, long-term, and sustainable economic growth at the national level.

For a number of reasons, fiscal policy pursued by the government does not always lead to the stabilisation of the public finance system and long-term economic growth. It is, therefore, not surprising that there are suggestions to appoint an independent opinion institution that would carry out fiscal policy and impose restrictions in this area or implement fiscal rule, for example in the form of a Fiscal Policy Council [Gołębiowski 2010]. Fiscal rules are instruments that, on one hand, prevent uncontrolled formation of deficit and public debt, and on the other hand, can be too stringent resulting in restrictions in the conduct of fiscal policy. This is particularly important in a situation of high volatility and instability of socio-economic conditions in the real economy and the financial system. A tendency to introduce new legislation in the field of the public finance discipline can be seen in many European countries. Between the years 2010-2014, restrictions were introduced (in Hungary, Poland, and Slovakia to name a few). At the beginning of the 1990s, Estonia introduced a numerical fiscal rule which disciplined the rules of public spending [Schaechter et al. 2012]. Assessment of the solutions within the scope of implementing fiscal rules and other restrictions on public spending reduction should be used primarily to implement a fiscal policy that should be used to maintain fiscal sustainability. Present legal, financial, and economic conditions caused by the effects of the financial crisis indicate the need for the implementation of counter-cyclical fiscal policy. At the same time, it should be noted that countries with stable public finances, having "fiscal space," which is the freedom to reduce fiscal burdens and increase expenditure, are not in danger of exceeding the deficit over the level of 3% of their GDP, and as a result cope better with periods of economic downturn or even a recession [Samojlik 2012].

Conclusions

Since 2007, Poland has been dealing with the global financial and economic crisis, which has had a significant impact on the state of public finance in many countries of the world. In the member states of the Euro Area there is a tendency to decline in fiscal revenue with a simultaneous increase in the total expenditure, in particular, those relating to the financing of current operations and covering primary expenses. In addition, problems related to the maintenance of stability in the financial sector have contributed to the increase in the value of the budget deficit and maintenance of public debt in most Member States of the EU at a level above the Maastricht criteria. In these circumstances, it is worth to consider the stability of public finance taking into account the following aspects:

– perception of the public finance system as a link of the national financial system, the operations of which should be strongly coordinated with the operations of the market financial system, and these two links together forming the basis for the socio-economic development of the country;

– distinction between issues related to the concept of public finance stability and fiscal sustainability;

– identification of the maintenance of stability in the essential components of the public financial system, i.e. government, local government, and insurance sectors;

– identification of internal (endogenous) factors and the estimation of the impact of conditions outside the public sector (exogenous) on the stability of the public financial system.

Consideration of issues related to the assessment of stability of the public financial system in the short-, mid-, and long-term.

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Równowaga fiskalna i stabilność finansowa – wyzwania i doświadczenia w dobie kryzysu finansowego

Streszczenie. *Sektor finansów publicznych jest jednym z elementów systemu gospodarczego, który w coraz większym stopniu odczuwa negatywne skutki globalnego kryzysu finansowego i staje się jednym z największych jego płatników. Dlatego istotnym jest, aby rządy i inne instytucje publiczne podjęły wysiłek opracowania i wdrożenia odpowiedniej strategii w zakresie polityki fiskalnej, której celem będzie zachowanie długoterminowej stabilności publicznego systemu finansowego i osiągnięcie innych celów makroekonomicznych. Celem niniejszego artykułu jest przedstawienie istoty, roli i znaczenia równowagi fiskalnej, jako elementu zachowania stabilności publicznego systemu finansowego w zmieniającym się, pokryzysowym środowisku finansowym i gospodarczym. Autorka zwraca uwagę na znaczenie, identyfikuje miejsce oraz rolę równowagi fiskalnej jako jednego z elementów stabilności finansowej w pokryzysowej rzeczywistości gospodarczej. Równowaga fiskalna i stabilność publicznego systemu finansowego stanowią podstawę do długofalowego wzrostu gospodarczego i świadczenia usług społecznych na odpowiednim poziomie. Politycy i przedstawiciele władz publicznych powinni dążyć i podejmować działania w zakresie utrzymania stabilności finansowej, w tym stabilności w sektorze finansów publicznych.*

Słowa kluczowe: *finanse publiczne, równowaga fiskalna, kryzys finansowy*

Zeszyty Naukowe
Wyższej Szkoły Bankowej w Poznaniu
2016, t. 70, nr 5

Kamilla Marchewka-Bartkowiak

Poznań University of Economics and Business
Department of Monetary Policy and Financial Markets
e-mail: kamilla.bartkowiak@ue.poznan.pl
phone: 61 854 33 77

Numerical Fiscal Rules – The Experience of Poland

Abstract. *For years, fiscal rules have been considered to be one of the most important tools of disciplining public authorities in their fiscal policy execution. Over the past 20 years, the number of fiscal rules in the world, and particularly in Europe, has grown tenfold. The structure of fiscal rules is subject to constant evolution and changes. The article is a synthesis of the phenomena prompting the evolution of fiscal rules. They have been classified and characterised, and an analysis is done of the fiscal rules that are in force, specifically, in Poland.*

Keywords: *fiscal rules, public budget, fiscal policy, Poland*

Introduction

The departure from the classical rule of balancing the public budget resulted in the introduction of rules aimed at limiting public resource expenditures. As a consequence, the amount of planned deficit and public debt is legally limited.

The historical reason for the introduction of numerical fiscal rules was the departure from the traditional treasury rules to the Keynesian government intervention model. The fast evolution of fiscal rules began in the 1990's, following a period of the accumulation of public debt in many states with a free market economy. However, we ought to remember that the first fiscal rules emerged as early as right after World War II in countries such as Germany, Italy, Japan, or the United States.

Numerical fiscal rules, alongside budgetary procedures or independent fiscal institutions, became a part of the joint concept of institutional economics which points to solutions aimed at disciplining public authorities.

In the European Union, numerical fiscal rules have become one of the major criteria of the assessment of economic policies implemented by EU member states. The cohesion or convergence criteria are applied as the international assessment of a country's creditworthiness. Furthermore, not only the EU rules but also the national fiscal rules are becoming increasingly important. The European Commission data shows that by the end of 2014, the EU member states had introduced as many as nearly 120 fiscal rules.[1] That demonstrates the increasing significance of numerical fiscal rules in the verification of the, so called, "economic management."

Poland, too, has a broad range of numerical fiscal rules implemented both at thepublic sector level as a whole, and at the level of particular subsectors. The quantity, as well as, the quality of fiscal rules is constantly evolving from the rules determined, as constant annual relations to the rules are based on the multiannual perspective of historical data which show particular limits of nominal values.

The purpose of this article is to analyse the current fiscal rules in Poland, and to comment on the evolution of their structural changes.

1. The selected causes and effects of the introduction of fiscal rules

The findings of research conducted globally in the sphere of economic and political sciences justify, in many ways, the introduction of fiscal rules. The most important scientific phenomena include the issue of lags, the incoherence of fiscal policy over time, and the deficit bias.

Fiscal policy lags primarily concern the inability of public authorities to respond promptly to the changing market and economic conditions. The inability results mainly from procedural-institutional requirements (i.e. from failing to involve all decision-making bodies in the process, including Parliament). The lags phenomenon is not typical of fiscal policy as it derives from the identified problem of lags in monetary policy. However, as opposed to the fiscal policy, it is recognised that the response time of the market and the economy to the decisions of the central bank (e.g. in terms of interest rate changes) is relatively shorter. The lags issue is particularly important during an economic crisis, when it often takes too long between making a decision to apply a particular instrument and imple-

[1] http://ec.europa.eu/economy_finance/db_indicators/fiscal_governance/fiscal_rules/index_en.htm [access: 10.07.2016].

menting it. That results in the non-coordination of the authorities' response and the society's needs, i.e. an inconsistency in time [Fisher 1988]. What is more, in a dynamically unfolding crisis, not only might some decisions implemented "after due time" fail to be effective, but they can cause adverse effects outright. In such a case, the decision-making procedures before the implementation of a response, crucial to the transparency of policy-making, can hinder the countermeasures aimed at fighting the effects of the recession. To minimise the above-mentioned phenomena, it is accepted that the best solution is to implement a properly formulated fiscal rule which is to automatically adjust the budget to a country's changing economic situation [Marchewka-Bartkowiak 2010].

Overall, it must be acknowledged that the fiscal rule ought to induce the effect of anti-cyclicality, enabling the operation of automatic stabilisers of the economic cycle (which are part of the solution of some instruments, such as taxes, or unemployment benefits) without the active participation on the part of the authorities. That also means that the effect of the applied rule, during economic growth, ought to be the tightening of the fiscal policy (restrictiveness), and during a downturn – its loosening (expansiveness). The fiscal rule should also be a credible rule, i.e. deemed by the society as in line with the authorities' intentions, long-lasting, but primarily, one that delivers the desired results that are in line with social expectations. A credible rule is expected to create the basis for a predictable fiscal policy, which would enable businesses and the society to adjust their own individual behaviour to it. Thus, it should indirectly impact the rational of the society's decisions under conditions of its limited access to information.

Another premise to apply a fiscal rule is also the politicians' excessive deficit bias due to their short-term political interest. Research shows that this phenomenon depends, among other things, on the electoral cycle phase, i.e. the closer the election the more need there is for rapid and often unexpected modifications to the budget (an increase in expenditure, or tax cuts) resulting in excessive deficit. Additionally, the so called "common pool problem" may occur, i.e. the pursuit to increase spending and deficit by particular interest groups, notably in multi-party governing coalitions, which may result in the intensification of the deficit increase. The inclination to go into deficit impairs the appropriate adjustments of the budget towards cyclical changes through the adverse impact of politics [Alesina & Perotti 1994]. That is because during economic growth politicians are inclined to increase budget expenditures and loosen their policies so as to allow the consumption of the "fruits of economic growth." In turn, during a recession, they are increasingly focused on maximising the public intervention so as to rescue the economy. Furthermore, it must be stressed that the phenomenon in question triggers the political assent to implement the policy of running into debt. The overlapping of the two effects often causes the so called debt ratcheting, which means that during prosperity the surplus generated does not go towards its repayment, while during a downturn the debt increases rapidly. In this way, the country falls into a trap or the debt spiral, which may ultimately lead to declaring insolvency.

We ought to remember though that fiscal rules can bring undesirable results through attempts to evade their restrictive construction. An example of that can be the process of debt transfer. It is recognised that the strict rules of borrowing imposed on the central or state authorities result in increased debt locally. This phenomenon also works the other way around, which means that if local authorities are forbidden to seek finance externally, they will exert pressure on the central authorities to go into debt with the intention of transferring resources to the local government. Additionally, what can also occur are the phenomena of creative accounting and fiscal illusion [Easterly 1999]. They consist of computational and statistical manipulation of data or the construction of performance indicators (such as budget deficits, budget expenditures, and public debt). Such actions are also of legal character. Typically, they concern the use of public guarantees which are a form of contingent liabilities rather than, for example, direct subsidies or a budget loan. In this way, public authorities do not increase the current budget deficit or the public debt; instead, they can postpone the possible financial consequences (i.e. the payouts under the guarantees provided) until later years. Another example is that of manipulation in terms of the rules of accounting financial operations executed by public authorities. The examples include recording privatisation proceeds as income rather than budget revenues so as to reduce deficit, the proposal to include social insurance contributions in pension schemes as budget revenues, or the more sophisticated solutions such as excluding the securitisation operations from the debt indicator which result in its reduction or stabilization. Obviously, those actions impair the transparency of the fiscal policy and the creditworthiness of the fiscal rule. Therefore, common views now are that the rules that enable *ex ante* control are becoming an increasingly less effective tool, notably so, over the long-term.

3. The types of numerical fiscal rules

According to the definition by G. Kopits and S. Symansky [1998], the fiscal rule is “a permanent limit of fiscal policy reflected in budget indicators identifying its progress.”. Based on the above statement and on the solutions postulated in the literature, the most important rules of establishing the fiscal rule include as follows:

– determining precisely the budget indicator which the rule comprises (e.g. budget or structural deficit, the primary deficit or the total budget expenditures, the current expenditure or the total budget revenues, tax revenues or gross debt, net debt, etc.),

– introducing a high rank legal rule by setting it out in the constitution or an act (e.g. the Public Finance Act) to confirm its long-term character,

– formulating the rule in a simple and explicit way for the general public to have a good understanding of it as well,

– defining the sanctions for failing to obey the set out rule and the principles of executing them by a body independent of the state authorities,

– selecting a rule consistent with the adopted medium- and long-term financial and economic strategy of the state [Marchewka-Bartkowiak 2010].

The above stated principles mark the level of reference to the optimal fiscal rule formula, which ought to be pursued.

Fiscal rules are broken down by different criteria (Table 1). There are quantity rules (also known as numerical, based on the determined limits of budgetary indicators) and quality rules (which determine the limits introduced in a descriptive or procedural way), rules referring to a short term (e.g. to a one-year budget), multiannual rules (based on historic data or setting the direction of financial limits), and national and international rules (including those which refer mainly to the EU rules comprising uniform rules for all member states). There are also rules concerning a government budget, some other public entities (the local government or the pension system units, separately), or the public sector as a whole. It is also noteworthy to point out the division in terms of the legal framework which deter-

Table 1. The selected criteria for the division of the numerical fiscal rules

Criteria	Rule type
Geographic	International (supranational) National
Subject	Balance (deficit) Expenditures (total, current, capital) Debt (liabilities) Revenues
Subjective	Concerning the whole public sector (according to the adopted sector rule) Concerning government budget Concerning local government budget Concerning selected sector units
Legal	Of the international (including EU) legal basis Of the constitutional basis Of the statutory basis Of other legal basis
Structural	Concerning the nominal values of the indicated budget items Concerning the relation of the selected budget items to items overall Concerning the relation to GDP Concerning the relation to other macroeconomic and budget quantities

Source: own elaboration.

mines the possibilities of political intervention (the higher the rule's legal rank, the more possible it usually is to change it over a short time).

However, the most important division of fiscal rules is based on their construction. In this case, the possibilities of creating fiscal rules seem limitless. Nonetheless, bearing in mind the above criteria, we must point to four basic groups of rules. The first and simplest rule is based on setting annual nominal limits of the determined budget volumes (e.g. offsetting the budget at 0, the public sector debt limit in the USA, the possibilities to boost spending by some specific nominal values). Another often used construction is limiting the specific relation of budget items to the GDP generated in a given year (that concerns, for instance, the budget criteria established in Maastricht). In addition, it is also possible to limit some selected budget items in relation to overall revenues or expenditures of a sector or a unit, to be achieved within a specified time (such a solution is often used in regards to the limits set for the local government or pension sectors). Moreover, there are also limits that are based on the corrections of budget data that are based on some other macroeconomic and fiscal variables (e.g. inflation, potential GDP, or non-recurring expenditures).

The plethora of fiscal rules in force around the world today makes it easy to select a rule to meet some specific need. According to the International Monetary Fund, in 2013 fiscal rules were enforced in 97 countries, of which 47 countries had national rules only, while 48 countries also depended on international rules. This figure shows a very rapid evolution towards tightening fiscal budgetary discipline using those measures. It is worth adding that according to the IMF, in 1990 as few as seven countries had fiscal rules defined in the classical way [IMF 2015].

Thus, basically, the right selection of a rule in a given country must entail that it is efficient, and ought to be assessed by independent institutions on the basis of an impartial financial analysis of a long-term character.

4. Fiscal rules in force in Poland

Taking account of provisions in acts of both national and international character, we should assume that in Poland during the year 2016 there are ten fiscal rules concerning four budget lines, i.e. balance, expenditures, debt, and revenues (Table 2).

Within those rules, the most numerous group is **the balance rules**. They are mostly EU rules setting quantity limits concerning the balance of the general government, i.e. calculated under EU methodology. The sector type, to which the three EU rules in question are subject, is one of the two crucial common elements of those rules. Basically, the most important goal of their gradual implementation was meeting the deficit criterion of 3% GDP calculated on the basis of the fiscal year that was imposed on all EU member states in 1992. The justification of such a level of this criterion is to be found at the then level of budget expenditures linked to the costs of servicing the public debt of Western Europe's states, standing on average between 2 and 2.5% GDP. Thus, it may mean that effectively the criterion ought to be the goal to offset the primary balance. However, while constructing the criterion, the overall balance was regarded as the base volume, rather than the primary balance of the sector. Poland, as an EU member state since 2004, has been subject to the fiscal criterion of deficit. Failing to observe the criterion results in imposing the EU excessive deficit procedure on the given member state. Poland has twice been subject to this sanction procedure.

Since 2005 the assessment of the capability to meet the budget deficit criterion has been closely linked to the implementation of the balance rule based on the formula of structural balance. Thus, the rule is included in the prevention arm of the Stability and Growth Pact. The rule itself was dubbed *medium term objective* (MTO), as it sets out an objective measured over a medium-term (rather than fiscal or annual). The structural balance, in crude terms, is the sector balance adjusted for cyclical factors, as well as, non-recurring and temporary actions. MTO is set individually for particular states, having considered their economic and fiscal situation, as well as, the potential threats to their public finance stability. In the case of Poland, it is set at the level of anegative sector balance (i.e. deficit) of 1% GDP. It should be added that since the Stability and Growth Pact reform in 2011, more elements have been launched aimed at disciplining the authorities in their implementation of the rule in question , including, among other things, the following ones: if the MTO has not been achieved, the correction of the structural outcome should be 0.5% of GDP (assuming that the output gap in Poland will be in the range of ±1.5%, and debt will remain at or below 60% of GDP).

Formally, Poland is also subject to the third balance rule of general government, introduced in 2012 under the so called "Fiscal Compact" which was ratified by national public authorities in 2013. Under this solution, all countries ought to pursue offsetting the balance or to aim for a higher budgetary surplus. It is the most radical approach of all of the EU rules on public finance. This rule has also been linked to MTO as it is considered to be only fulfilled if the annual structural balance of the general government corresponds to the medium-term objective of the given country, where the bottom of the structural deficit stands at 0.5% of GDP in market prices. This rule may be considered to be of low-level binding character, and it is not subject to formal assessment as stated in the update of the Convergence Programme.

The final rule of the above-mentioned balance rules in force in Poland is not linked directly to EU rules, and it concerns the local government directly. It takes the form of a restriction imposed on particular annual local budgets, which assumes that the current budget of the local government must be offset. This rule is

Table 2. Numerical fiscal rules in force in Poland

Rule Subject	Structure	Rule Formula	Subject	Legal Entity
The Balance Rule	Deficit criterion	3% of GDP	General government sector	EU
	Structural balance rule (MTO)	The medium-term fiscal objective, i.e. target structural outcome of the general government sector stands at -1% GDP	General government sector	EU
	Balance offsetting rule	The general government's balance must be offset or in surplus	General government sector	EU
	Local government's current budget offsetting rule	The planned current expenditures must not exceed the planned current revenues plus the budget surplus of the previous years and free resources	Local government sector	National
The Debt Rule	EU debt criterion	60% of PKB	General government sector	EU
	Relation of public debt to GDP	It is prohibitted to take out loans or provide financial guarantees resulting in government public debt exceeding 3/5 of annual GDP	Public finance sector	National
	Prudential thresholds of public debt	Limiting the maximum level of public debt in relation to GDP to between 55% and 60%; Introducing remedial processes; The thresholds of 48% and 43% GDP are linked to corrective measures in the stabilising expenditure rule.	Public finance sector	National
	Restrictions in debt-serviced by local government authorities (JST)	The individual debt ratio of JST determined so that the ratio of debt and interest payment to total revenues in a given year must not exceed the arithmetic mean of the three successive years prior to a given year, based on the current budget and the proceeds from the sale of property to total revenues	Local government sector	National
The Expenditure Rule	Stabilising expenditure rule	Basically, the sector's expenditure can rise over a medium-term GDP real growth rate multiplied by the CPI inflation forecast	General government sector	National
The Revenue Rule	Obligation to transfer part of the proceeds from privatisation to the Demographic Reserve Fund	DRF receives financing from, among others, the transferred funds from the privatisation of State Treasury property amounting to 40% of the revenue from the overall gross amount, minus obligatory write-offs towards obligatory earmarked funds, obtained from all privatisation processes conducted in a given year	Public finance sector	National

Source: own elaboration based on relevant acts.

linked to the local government debt rule (and furthermore, to the debt of the whole sector) indicating that the only area of providing finance through going into debt, can be property (i.e. investment) expenditures.

Another group of rules, often applied in Poland, are the **debt rules**. At present, there are four restrictions in force, in that regard. Much like in the case of the balance rule, the EU fiscal rule has been top-down imposed on Poland as well. It aims to limit the level of going into debt by the general government to 60% of GDP. Despite the findings of numerous scientific studies questioning the validity of the level of the above-mentioned relationship, it should be assumed that the figure of 60% GDP results from the relationship average typical of the 1980's, i.e. prior to the creation of the Maastricht Treaty.

The 60% GDP debt level was inscribed into the Constitution of the Republic of Poland in 1997, and into the "Public Finance Act" in 1998 as the highest statutory safety threshold, the exceeding of which results in some specified sanctions imposed on public authorities. The difference consists in the sector approach to this indicator. The EU criterion refers to the sector structure formulated by Eurostat, while the constitutional provision and prudential thresholds concern the public finance sector. As a result of the above, there are, in fact two performance indicators which refer to separate debt rules.

At present, the statutory debt rules, known as safety thresholds, comprise two groups of limits. One (i.e. the 55% and 60% GDP thresholds), are linked to some specific remedial procedures, which are launched on exceeding the above-mentioned thresholds. This solution is of *ex post* assessment character, after obtaining the ultimate debt nominal values as announced by the Ministry of Finance and the GDP nominal values as provided by the GUS (Central Statistical Office of Poland). The other group of limits are the 43% and 48% GDP thresholds.Defaulting on these means an obligation for relevant disciplinary corrective action in order to determine the sector's expenditure value, subjected to the stabilising expenditure rule.

The final type of debt rules applies to the local government sector within individually imposed restrictions based on the historically (within three years) developed figures in the local government's budget, such as, current revenues and expenditures, property revenues, and total revenues. This rule directly concerns the limit imposed on the servicing of local debt, including the principal and interest on the debt incurred. This rule, first applied in 2014, replaced two numerical rules which set, in a uniform manner, the restriction for both the total debt and the servicing of the debt of all types of units. As mentioned before, the recently introduced local debt rule has been augmented by the current budget offsetting rule. It has also allowed a broader coordination of actions aimed at asset and liabilities management on the part of the particular units.

The stabilising **expenditure rule** introduced in Poland in 2014 is a peculiar solution. First, it is linked to the MTO rule which means that it concerns achieving a particular value of structural balance over a medium-term. Second, it is only correlated to MTO, as it does not comply with all the provisions of an EU rule (it concerns the expenditure aspect only and some other assumptions of the historical data period, plus being provided in nominal values). Third, despite being a national rule, it is based on the sector calculated under EU methodology. Fourth, it is based on the econometric model determined by the MF, which, when entered into the Public Finance Act, set new standards for the fiscal rules legal provisions. We must also add that the assessment of the expenditure rule implementation was vested in the Supreme Audit Office (Najwyższa Izba Kontroli) (however, as for now, no assessment has been made in this respect yet). This rule replaced the before-introduced 'temporary' rule which encompassed the state budget only and allowed the raising of annual expenditure by 1%, plus CPI inflation.

The last of the discussed rule types is **the revenue rule,** concerning the provisions of financing the Demographic Reserve Fund. Highlighting this rule results from the fact that it is linked to the safeguarding of society's ageing process. Thus, it refers to a phenomenon which is mentioned explicitly in the "Stability and Growth Pact". It provides that all fiscal rules, including balance, debt, and revenue rules ought to take account of the above-mentioned demographic processes. The revenue rule, which defines part of the privatisation revenues as the source of financing the special security fund, is an immediate execution of the Pact's provision.

Conclusions

In recent years, fiscal rules have been one of the most important instruments of disciplining public authorities engaged in fiscal policies. The international rules enforced in the EU have gained importance. As shown by the above-presented data, the number of rules has increased by as many as several dozen in relation to the time the Maastricht Treaty was developed.

Over the span of a few years, new fiscal rules were introduced in Poland, and some of the old rules have changed their character. Those changes can be summarised as follows:

– over the past 25 years the number of fiscal rules in use has been growing steadily,

– the national fiscal rules are increasingly aimed at supporting the execution of EU rules,

– the construction of many national fiscal rules is not, however, fully adjusted to the construction of EU rules, which results in an additional lack of transparency in their execution assessment and in the duality of solutions,

– most of the currently applied fiscal rules concern the whole sector, while Poland is still lacking in the planning and execution of the public budget, i.e. the budget of the whole sector,

– the fiscal rules in force in Poland are increasingly complex as they are based on legally binding mathematic and econometric formulas,

– there are no detailed assessments made of the fiscal rule execution efficiency in the execution reports of state and local government budgets.

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Numeryczne reguły fiskalne – doświadczenia polskie

Streszczenie. *Reguły fiskalne zostały uznane za jedno z najważniejszych narzędzi dyscyplinowania organów publicznych w realizacji ich polityki fiskalnej. W ciągu ostatnich 20 lat liczba reguł fiskalnych na świecie, a szczególnie w Europie, wzrosła dziesięciokrotnie. Struktura reguł fiskalnych podlega ciągłej ewolucji. W artykule zaprezentowano syntezą zjawisk wpływających na ewolucję reguł fiskalnych. Zostały one także sklasyfikowane i scharakteryzowane. Szczegółowa analiza reguł fiskalnych dotyczyła doświadczeń polskich.*

Słowa kluczowe: *reguły fiskalne, budżet publiczny, polityka fiskalna, Polska*

Zeszyty Naukowe
Wyższej Szkoły Bankowej w Poznaniu
2016, t. 70, nr 5

Teresa Famulska
University of Economics in Katowice
Department of Public Finance
e-mail: tfamulska@wp.pl
phone: 32 257 77 400

Bożena Ciupek
University of Economics in Katowice
Department of Public Finance
e-mail: bozena.ciupek@ue.katowice.pl
phone: 32 257 77 400

The Effects of Selected Tax Preferences on Public Finance

Abstract. *Taxes are considered to be basic, yet the most effective instruments of the state's fiscal policy. This results from the universal nature of imposing taxes and from considerable impact of taxes on taxpayers' behaviours. Public authorities assume that a relevant construction of particular taxes may facilitate economic growth, and that is the reason why they implement some tax preferences. This article aims to identify the nature and scope of using selected tax preferences in the area of taxes imposed on corporate revenues and incomes in the field of public finance.*

Keywords: *fiscal policy, tax preferences, income tax, value added tax*

Introduction

Taxes are considered to be basic, yet the most effective instruments of the state's fiscal policy. This results from the universal nature of imposing taxes and from the considerable impact of taxes on taxpayers' behaviours. Taxes in their very nature are used to satisfy the state's demand for public income, which consequently means that there is some strong relationship between the financial sector's needs and expenditures. However, this does not mean that the fiscal function is the only function that is reserved for fiscal instruments. In the contemporary economy, taxes in their different forms and their increasingly wider scopes, additionally serve various other non-fiscal functions. The legislator, while constructing a particular fiscal solution, may equip this solution with contents that either dissuade taxpayers to undertake some activities, or encourage them to follow certain directions.

Public authorities assume that relevant construction of particular taxes may facilitate economic growth and this is the reason why they implement tax preferences. Companies are particular targets of such preferences. By giving up a part of tax revenues, public authorities expect that the a decrease to the whole, or some part of the tax burden, would generate some willingness to undertake business activities or, in the case of already existing companies, encourage entrepreneurs to undertake investment related activities to create new employment opportunities or to increase their expenditures on innovations.

In this context, the article aims to identify the nature and scope of using selected tax preferences in the area of taxes imposed on corporate revenues and incomes in the field of public finance. The realisation of the objective was based on the analyses of Polish fiscal solutions in the context of companies and based on statistical data found in reports prepared by the ministry of finance during the years 2009-2013 (in the case of tax on goods and services) and 2009-2014 (in the case of corporate income tax).

1. Nature and scope of tax preferences

Adoption and use of a tax standard is nowadays a launch pad for any discussion concerning the very nature of tax preferences that are applied within a state's fiscal policy. In Poland, much like in other European Union countries, different tax standards [Patrzałek 2015: 53-55] were adopted for the two different basic types of taxation imposed on tax revenues and income. In the case of tax on goods and services the tax standard is understood in the following way:

– tax neutrality, i.e. the tax should be economically invisible (neutral) for a company that is not a final consumer of the goods or services;

– tax universality, i.e. taxation is imposed on all possible trade in goods and services;

– taxed consumption, i.e. imposing a tax on the final consumer of the goods and services;

– no interference in competition, i.e. some necessity to limit tax exemptions that are used by the state and to reduce rates of the tax on goods and services applied.

However, in the case of income taxes the tax standard is believed to serve its function when it includes the following elements:

– universality of taxation, i.e. taxation is imposed on each entity regardless of its sector, scope, or form of activities undertaken;

– comprehensive nature of taxation, i.e. taxation is imposed on every possible income regardless of its source, category of a taxpayer, or income destination;

– taxation of real income, i.e. the income that may be used to consume or increase wealth;

– taxation that is imposed on an individual, i.e. taxation of entities that generate some income without any opportunity for joining the income in question with incomes generated by other entities;

– the annual nature of taxation.

Each exception to the standard adopted in particular tax constructs is believed to be a tax preference. Economic consequences of using tax preferences may include the reduction of public incomes and leaving them at the disposal of private entities. Therefore, tax preferences are frequently considered to be an alternative to direct budget transfers. The difference is mainly attributed to the fact that the spending budget means aimed at supporting business entities require means prior to accumulation, while the application of tax preferences simply means an elimination of the very process to obtain the same economic effects [Dziemianowicz 2015].

In practice, tax preferences may take different forms. If legal solutions of the way such tax preferences are acquired are taken into consideration, the following tax preferences may be distinguished:

– systemic, i.e. tax preferences that are defined in universally binding tax regulations, are characterised by homogeneous principles aimed at all taxpayers involved, and whose application depends in fact on the will of the entity entitled;

– discretionary (related to decisions made), i.e. tax preferences that result from delegation of tax bodies' authority and whose application depends on decisions made by tax bodies at the involved taxpayer's request [Dziemianowicz 2015].

The most frequent systemic tax preferences include exemptions, deductions, and reduced rates. Discretionary tax preferences mainly refer to tax collection waivers and tax remissions. Tax preferences may be subject, object, or both subject and object in nature, which means that it is necessary to meet some criteria to enjoy a particular preference and/or some particular situation that is defined by tax regulations has to be observed.

Reports on tax preferences that are published in Poland indicate that in the years subject to this research there were approximately 500 differences within the tax system. 40% of them referred to the tax on goods and services. Over 40% of the preferences involved income taxes. Tax preferences that were in use in each of the years subject to this research amounted to at least 5.1% of the GDP (the global amount of tax preferences amounted to 85 billion PLN in 2013, which equals 5.2% of GDP). The largest part of the tax preferences in question refers to preferences of a social nature (approximately 50%). Preferences that support the economy are the next largest part of tax preferences and they amount to approximately 20%. Major taxes that are imposed on corporate revenues and incomes are dominated by the tax on goods and services (51% of the total value of preferences used, which amounts to 2.7% of the GDP). In the case of corporate income tax, the value of the preferences used is remarkably lower (15% of the total value of all preferences, which amounts to approximately 0.8% of the GDP) [*Preferencje podatkowe...* 2011-2015].

2. Selected preferences in corporate tax on goods and services

Tax on goods and services (a Polish version of the value added tax) is a major tax that is imposed on corporate revenues (turnover) (Act on Goods and Services Tax).[1] This tax belongs to the group of consumer taxes because it is included in the price of goods and services, thus theoretically, burdening final consumers. The tax on goods and services as a universal tax is characterised by its wide subject and object scope. On the other hand, the major element that decides the tax burden in this case is attributed to a particular tax rate. It is worth highlighting that any basic rate would affect the general level of prices as a result of the universality of its application. Excessively high rates are not desired since they result in the limitation of citizens' consumer capacities, especially those who are not wealthy. If public authorities wish to protect the basic consumption of households, they may apply decreased rates in the case of basic goods. It is obvious that the preferential treatment of consumers (buyers) is simultaneously some protection for companies (sellers) [Famulska 2007: 154]. Lower tax rates in the tax on goods and services are, therefore, of interest not only for consumers but also for entrepreneurs since in this way they are provided with opportunities to fix respectively lower prices.

In the analysed period, tax rates of the tax on goods and services were diversified. In the period between 2009-2010 the basic tax rate amounted to 22%. There were some decreased tax rates used during this time, i.e. 0%, 3% and 7%. However, in the years 2011-2013 the basic tax rate was 23% and decreased tax rates were 5% and 8%. The subject scope of rate application is really comprehensive but it does not interfere with the European Union regulations and standards. Preferential rates were predominantly applied in the case of inter alia, basic foodstuffs and groceries, housing construction, selected goods and services related to healthcare, education science and sport, transportation services, hotel services,

[1] Ustawa z dnia 11 marca 2004 r. o podatku od towarów i usług, Dz.U. 2011, nr 177, poz. 1054 ze zm. [Act dated March 11, 2004 on Goods and Services Tax, Journal of Laws of 2011, No. 177, item 1054 as amended].

Table 1. Budget effects of preferences that enjoy the highest value in the case of tax on goods and services between the years 2009-2013 in Poland

Type of preference	Value of preference (in mln of PLN)	Share in the total value of preferences related to the tax on goods and services (in %)	Percentage of budget revenues resulting from the tax on goods and services (in %)	GDP percentage (in %)
2009				
1. Construction and assembly works (housing construction)	8 886	25.98	8.93	0.66
2. Healthcare products	3 559	10.41	3.58	0.26
3. Bread, bread related products pastry, fresh	1 643	4.81	1.65	0.12
4. Dairy products	1 545	4.52	1.55	0.11
5. Catering services	1 383	4.04	1.39	0.10
2010				
1. Construction and assembly works (housing construction)	9 883	26.78	9.16	0.70
2. Healthcare products	3 723	10.08	3.45	0.26
3. Bread, bread related products pastry, fresh	1 692	4.58	1.57	0.12
4. Dairy products	1 548	4.19	1.43	0.11
5. Catering services	1 408	3.82	1.31	0.10
2011				
1. Construction and assembly works (housing construction)	11 004	26.76	9.11	0.72
2. Healthcare products	4 659	11.11	3.78	0.30
3. Meat and meat related products	2 940	7.15	2.43	0.19
4. Passenger inland transportation (municipal and suburban)	1 750	4.26	1.45	0.12
5. Dairy products	1 724	4.19	1.43	0.12
2012				
1. Construction and assembly works (housing construction)	11 204	26.35	9.34	0.70
2. Healthcare products	4 867	11.45	4.06	0.31
3. Meat and meat related products	2 864	6.74	2.39	0.18
4. Plants other than non-perennial crops	1 841	4.33	1.53	0.12
5. Catering related services	1 824	4.29	1.52	0.11
2013				
1. Construction and assembly works (housing construction)	11 320	26.09	9.98	0.69
2. Healthcare products	5 079	11.71	4.49	0.30
3. Meat and meat related products	2 817	6.49	2.48	0.17
4. Inland transportation	1 892	4.36	1.67	0.12
5. Dairy products	1 882	4.33	1.66	0.12

Source: own elaboration based on *Preferencje podatkowe*... 2011-2015.

and catering. These preferences were mainly aimed at not increasing households' spending on specific goods that, in a majority of cases, are used to satisfy basic human needs. Therefore, preferences are related to the following sectors: 'farming,' 'education,' 'science, culture and sport,' 'health,' 'family and social issues,' and 'transportation with environmental protection.' In the field of 'the economy' support is offered to the following sectors: the hotel industry, catering, and selected labour-intensive services (like e.g. hairdressing). It is necessary to note that in all analysed years, 'family and social issues' was a dominating target for supporting preferences in the context of the tax on goods and services. In the years 2009-2011 this area was followed by 'health' and in 2012-2013 by 'farming.' This regularity is also manifested in values of preferences identified for specific groups of goods and services (comparison seen in Table 1).

The data analysis allows for concluding that from the value related perspective, preferences related to housing construction were the most important in the period between the years 2009-2013. They amounted to over a quarter of the total value of preferences in the case of tax on goods and services. This was followed by healthcare related products in all of the years subject to this analysis. It is also necessary to highlight an interesting fact that the five preferences of the highest values amounted to approximately half of the total number of preferences that are applied in the case of taxes on goods and services.

Preferences used in the case of the tax on goods and services result in respectively lower budget revenues. A list of 'lost benefits' resulting from this fact are presented in Table 2.

Table 2. Budget effects of preferences related to tax on goods and services in the years 2009-2013 in Poland

Details	2009	2010	2011	2012	2013
Value of Preferences (in billions of PLN)	34.2	36.9	41.1	42.5	43.4
Percentage of Budget Revenues Resulting from the tax on Goods and Services (in %)	34.4	34.2	34.0	35.4	38.3
GDP Percentage (in %)	2.5	2.6	2.7	2.7	2.7

Source: own elaboration based on *Preferencje podatkowe*... 2011-2015.

In the analysed period, the value of preferences related to tax on goods and services increased nominally from 34.2 billion PLN in 2009, to 43.4 billion in 2013, i.e. by almost 27%. On the other hand, the value share of preferences in tax revenues resulting from tax on goods and services increased in those years from 34.4% to 38.3 % respectively, i.e. by approximately 11%. However, when discussing the value of the preferences in question with reference to the GDP, an increase from 2.5 % (in 2009) to 2.7 % (from 2011 and later) is reported, i.e. by 8%. One of the most important reasons for the increase in value of preferences related to the tax on goods and services in 2013 is attributed to changes in the structure of sales. The value of consumption observed in the group of goods and services subject to the basic 23% rate decreased simultaneously with an increase in sales of other goods and services subject to lower tax rates. It is necessary to stress here that in the years subject to this research no new preferences were introduced in the case of tax on goods and services.

3. Selected preferences in corporate income tax

Corporate income tax is a direct tax, which means that its payment involves a direct burden on corporate income (Act on Corporate income Tax).[2] This tax is universal and it is imposed on all companies regardless the type and source of income generated. Moreover, organisational and legal forms of companies or their ownership structure do not affect the tax in question. This is a state tax, although some of its part goes towards self-government budgets. It is also suggested that the corporate income tax is the tax that depends on the economic effectiveness of a particular company. Construction of this tax allows the inclusion of all variables in the tax base that determine the amount of income, by means of exact identification of all economic events that decide about categories of tax incomes and income generating costs. Corporate income tax realises the fiscal function of taxes, thus being an effective source of budget revenues. In Poland, between the years 2009-2014, average budget revenues related to this tax amounted to over 30 billion PLN at a nominal tax rate of 19%.[3]

The features and construction of corporate income tax were used by public authorities to influence the economy and to support multidirectional activation of companies. In the period subject to this analysis, the construction of this tax burden provided for major tax preferences that took the form of tax exemptions and deductions. Those preferences mainly referred to incomes generated in special economic zones, incomes generated by joint ventures, donations, expenditures related to the acquisition of new technologies, and losses resulting from previous years along with tax deductions. By introducing tax preferences related to corporate income tax, the legislator assumed that they were mainly aimed at supporting corporate liquidity, as well as, activating development and investment activities in

[2] Ustawa z dnia 15 lutego 1992 r. o podatku dochodowym od osób prawnych, Dz.U. 2014, poz. 851 ze zm. [Act dated February 15, 1992 on Corporate income Tax, Journal of Laws of 2014, item 851 as amended].

[3] www.finanse.mf.gov.pl/budżet-panstwa/wplywy-budzetowe [access: 30.10.2015].

Table 3. The types and values of selected tax preferences in the context of corporate income tax in Poland in the years 2009-2014 (in millions of PLN)

Details	2009		2010		2011		2012		2013		2014		Average	
	Amount	%	Amount	%	Amount	%	Amount	%	Amount	%	Amount	%	Amount	%
Tax exempted incomes including:	7,051	50.1	7,690	39.5	9,528	38.6	8,625	37.4	12,026	42.0	13,249	44.7	9,695	41.7
– special economic zones	3,690	26.2	5,269	27.1	9,383	38.0	8,403	36.5	11,844	41.3	13,221	44.6	8,635	37.1
– joint ventures	883	6.2	71	0.4	145	0.5	222	0.9	182	0.6	25	0.1	255	1.1
Tax deductions including:	6,801	48.3	11,644	59.8	15,042	61.0	14,340	62.2	16,560	57.8	16,284	55.0	13,445	57.8
– previous year losses	6,482	46.1	11,280	58.0	14,487	58.7	13,557	58.8	15,929	55.6	15,608	52.7	12,891	55.4
– donations	315	2.2	310	1.5	279	1.1	320	1.4	284	0.9	301	1.0	302	1.2
– new technologies	20	0.1	31	0.2	271	1.1	439	1.9	307	1.1	284	1.0	225	1.3
Tax deductions	222	1.6	129	0.7	95	0.4	81	0.4	80	0.2	85	0.3	115	0.5
Total	14,074	100.00	19,463	100.00	24,665	100.00	23,046	100.00	28,666	100.00	29,618	100.00	23,255	100.00

Source: own elaboration based on *Information about corporate income tax settlements. Reports for the years 2009-2014*, www.finanse.mf.gov.pl/cit/statystyki [access: 30.10.2015].

companies. The types and values of tax preferences in the structure of corporate income tax are presented in Table 3.

Between 2009-2014, a systematic increase was observed in the value of corporate income tax related tax preferences used by companies (the average level of such preferences amounted to over 23 billion PLN at the dynamics of 162% in 2014 as compared to the value of 2009). The highest level of growth, when compared to 2009, was observed in the case of acquisition of new technologies (over 1.125%), although the value of such technologies is still low and the average expenditures related to the acquisition of new technologies amounts to slightly over 225 million PLN, i.e. 1.3% of the average value of tax preferences used by companies. The greatest level of a decrease is characteristic for preferences that were introduced in the nineties of the last century. Those preferences were intended to encourage foreign capital in Poland and included incentives for joint ventures (a decrease from 222 million PLN in 2012, to 25 million PLN in 2014). With reference to changes of the economic goals that were not focused on foreign capital acquisition any more, but on innovative activities, this type of preference will be gradually decreasing in its importance. Tax preferences that are aimed at supporting new technologies will gain more popularity. Tax preferences with the most important role in the structure of preferences used by companies include tax exemptions of incomes generated as a result of activities undertaken in special economic zones, and the right to deduct losses generated in previous years. The use of preferences aimed at companies that functioned in special economic zones during the analysed period amounted to over 8.6 billion PLN on average, which was 37.1% of the average value of tax preferences used. The deductions of losses generated in previous years from income reached higher values (on average the values in question exceeded 12.9 billion PLN, which amounted to 55.4% of the average values of tax preferences used). It is worth mentioning that exemptions related to incomes generated in special economic zones were characterised by higher dynamics in particular years, as compared to 2009. The dynamics of using the right to deduct loss reached the level of –241% in 2014.

Tax preferences used translate to a decrease in budget revenues. It is therefore interesting to look for answers that would help us understand the effects of the preferences in question for public incomes. The value of budget effects due to tax preferences that were used by companies in the context of corporate income tax and the importance of such preferences are presented in Table 4.

During the analysed period, the average level of decreasing budget revenues resulting from corporate income tax amounted to almost 4.5 billion PLN, which was almost 15% of the value of average corporate income tax revenues. Similarly, as in the case of the increase in the value due to the tax preferences used, it is necessary to mention an increase in budget effects from 2.8 billion in 2009 to 5.7 billion in 2014 (an increase by 103%). The dynamics of growth in the budget ef-

Table 4. The value of budget effects due to tax preferences in the context of corporate income tax (in millions of PLN) and their participation in tax related revenues (in %) in Poland during the years 2009-2014

Details	2009		2010		2011		2012		2013		2014		Average	
	Amount	%	Amount	%	Amount	%	Amount	%	Amount	%	Amount	%	Amount	%
Incomes exempt from taxation including:	1,340	4.4	1,461	5.3	1,810	5.7	1,638	5.1	2,285	7.8	2,517	8.5	1,842	6.1
– special economic zones	701	2.3	999	3.6	1,783	5.6	1,597	5.0	2,250	7.7	2.512	8.4	1,640	5.4
– joint ventures	168	0.5	14	0.1	28	0.1	42	0.1	35	0.1	5	0.1	49	0.2
Tax deductions including:	1,292	4.2	2,212	7.9	2,858	9.0	2,725	8.5	3,146	10.7	3,093	10.4	2,554	8.5
– previous year losses	1,232	4.0	2,143	7.7	2,753	8.7	2,575	8.1	3,027	10.3	2,966	10.0	2,449	8.1
– donations	60	0.2	59	0.2	53	0.2	61	0.2	53	0.2	57	0.2	57	0.2
– new technologies	4	0.0	6	0.0	52	0.2	83	0.3	58	0.2	54	0.2	43	0.2
Tax deduction	222	0.7	129	0.4	95	0.3	81	0.3	80	0.3	85	0.3	116	0.3
Total effect of preference usage	2,854	9.3	3,802	13.6	4,763	15.0	4,444	13.9	5,511	18.8	5,695	19.2	4,512	14.9
Value of CIT revenues	30,774	100.00	27,892	100.00	31,739	100.00	31,950	100.00	29,380	100.00	29,709	100.00	30,241	100.00

Source: own elaboration based on *Information about corporate income tax settlements. Reports for the years 2009-2014*, www.finanse.mf.gov.pl/cit/statystyki [access: 30.10.2015].

fects are slightly lower than the dynamics of growth seen in value as a result of the very nature of tax preferences. The preferences that involve income deductions or exemptions result in lower budget effects than their nominal values – there are some decreases in revenue to be generated if not for the use of preferences. However, the preferences that involve tax deductions generate budget effects that are equal to the tax deductions.

It is necessary to observe that during the period subject to this analysis no changes were reported in the scope of regulations that were connected with corporate income tax and that could affect tax preferences. Stability in the scope of regulations did not, however, translate into the stability of values of the tax preferences used. The socio-economic situation remarkably influenced an increase in effects of using tax preferences in the case of corporate income tax, mainly in the case of those taxpayers who ran their business operations in special economic zones (from nearly 0.7 billion PLN in 2009, to 2.5 billion PLN in 2014; on average this value amounted to 5.4% of the effects of tax preferences used) and who deducted their losses generated in previous years (from slightly over 1.2 billion PLN in 2009, to 2.9 billion PLN in 2014; on average 8.1%)

Conclusions

Tax preferences are instruments of the state's fiscal policy. They allow, as is in the case of direct public spending, for meeting specific economic goals. The conducted analysis of selected preferences related to the tax on goods and services, and corporate income tax allows for drawing the conclusion that Polish legislators are really active in this context. Sophisticated tax preferences are beneficial for taxpayers and they perform a protective function in the context of business entities. Simultaneously, public authorities use tax preferences and, in this way, give up some part of their budget revenues. In the time period subject to this analysis, the estimated so-called 'lost benefits' amounted to approximately 5% of the GDP, which should be considered a remarkable effect for public finance.

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Skutki wybranych preferencji podatkowych w finansach publicznych

Streszczenie. *Do podstawowych, a zarazem najskuteczniejszych instrumentów polityki fiskalnej państwa zalicza się podatki. Wynika to zarówno z powszechnego charakteru ich stosowania, jak i ze znaczącej siły oddziaływania na zachowania podatników. Władza publiczna, zakładając, że odpowiednia konstrukcja poszczególnych podatków może sprzyjać wzrostowi gospodarczemu, wykorzystuje preferencje podatkowe. Za cel opracowania przyjęto określenie istoty i zakresu stosowania preferencji w polityce fiskalnej państwa oraz prezentację wybranych preferencji podatkowych w zakresie podatków obciążających przychody (obroty) i dochody przedsiębiorstw co do ich skutków w finansach publicznych.*

Słowa kluczowe: *polityka fiskalna, preferencje podatkowe, podatek dochodowy, podatek od wartości dodanej*

Zeszyty Naukowe
Wyższej Szkoły Bankowej w Poznaniu
2016, t. 70, nr 5

Ryta Dziemianowicz

University of Białystok
Faculty of Economics and Management
Chair of Treasury
e-mail: r.dziemianowicz@uwb.edu.pl
phone: 85 745 77 02

Renata Budlewska

University of Białystok
Faculty of Economics and Management
Chair of Treasury
e-mail: r.budlewska@uwb.edu.pl
phone: 85 745 77 02

The Problem of an Excessive State Fiscal Policy – Fact or Illusion?

Abstract. *This paper evaluates whether, and to what extent, the previously used indicators for the measurement of fiscal policy reveal its actual level. In addition to, whether one can indicate the borderline between rational and excessive fiscal policy based on those indicators. The conducted studies have shown that the measurement of fiscal policy by means of traditionally formulated indicators may lead to conflicting conclusions. The studies have been conducted based on literature and statistical data regarding selected EU countries published by Eurostat.*

Keywords: *fiscal policy, shadow economy, non-observed economy, fiscal burden, the EU*

Introduction

The needs of the public sector, which is broadly defined by Stiglitz [2004] as the state[1], increasingly determine the amount of fiscal burden. At present, an average of approx. 30-40% of GDP flows through its channels. Although without public income, the main source of which are taxes, a modern state is not able to perform its functions; however, raising or imposing new public levies does not always lead to the obtainment of maximum income, and the additional loss of

[1] Economic sciences do not clearly define the concept of the public sector. Generally, the public sector can be defined as a part of the economy, which is financed from public funds in order to fulfill the functions of the state. According to Kleer, it is "the part of the economy, in which economic and political rules are mixed. This relationship cannot be ruled out completely" [Kleer 2005: 7].

prosperity resulting from the introduction of every tax increases faster than the tax rate. The question therefore is: where is the boundary between rational and excessive fiscal policy and whether there is a universal index, based on which the boundary can be determined?

According to Owsiak, one may speak about a rational level of fiscality when the scale of intervention of public authorities in the income of business entities makes it possible to satisfy reasonable needs of public authorities in terms of income and, at the same time, allows businesses to operate and develop, and households to meet consumer needs at an appropriate level, which in effect, on a macroeconomic scale, provides the basis for sustainable economic growth [Owsiak 2005: 366]. Excessive fiscal policy means "aggressive" interference of the state in the private sector's income, which can lead to an economic slowdown. As a result of the attempts made by taxpayers to evade excessive burdens or avoid them, as well as, to limit legal businesses and transfer them in part or in whole to the shadow economy, a barrier is created from the growth of the tax burdens. The limit of fiscal capacities of the state is then exceeded, public revenues stop rising despite the increase in rates, while the size of shadow economy increases. Where does the boundary run today? Is excessive fiscal policy a fact, or rather, an illusion?

The main goal of this article is to evaluate whether and to what extent the previously used indexes for the measurement of fiscal policy are adequate, i.e. whether they reveal its actual level, and on the other hand, whether one can indicate the boundary between rational and excessive fiscality on their basis. The evaluation has been carried out based on a critical analysis of the traditional measures of fiscal policy, such as tax rates, the level of fiscal burden, or the scope of the public sector in the economy and based on the analysis of the phenomenon of the shadow economy. Verification of theoretical assumptions has been supplemented with an analysis of the state of fiscal policy between the years 1996-2014 in the Member States of the European Union. The article has been prepared based on literature studies and using elements of statistical analysis. The research has been conducted based on statistical data regarding selected EU countries published by Eurostat.

1. The Scope and Limits of Fiscal Policy in the Member States of the European Union

The definition of fiscal policy is not directly explained on the ground of economic sciences and financial sciences, but is commonly used for the description of the amount of tax burdens in Poland from the angle of their impact on the budget and taxpayers' decisions. Such an understanding of fiscal policy has been confirmed in the *Dictionary of the Polish language* [1996: 209], according to which fiscal policy is the "tax policy of the state." In the *Dictionary of words of* *foreign origin* Kopaliński [2007: 190] clearly attributes a negative meaning to this phenomenon, describing it as "a tendency for over-taxation of the population, searching for more and more new sources of tax revenue and their ruthless enforcement." In this sense, the concept is also used, among others, by the already quoted Owsiak. Verifying the thesis, according to which excessive fiscal policy is one of the fundamental problems of fiscal policy in Poland during the transformation period, he states that the issues of the tax system and the form of tax policy should be analyzed from the angle of the concept of a small budget [Owsiak 2005: 671-672]. On the other hand, Tarchalski refers fiscal policy to the expenditure side of the budget, describing it as a tendency to incur excessive public spending [Tarchalski 2009: 11].

While in the mentioned definitions it is difficult to be compliant in terms of attributing fiscal policy to the specific flows of the state budget, there is no doubt as to its consequences – excessive fiscal policy is regarded as one of the major factors hindering economic growth, reducing the competitiveness of economies, and hampering the solving of socio-economic problems that are growing in many countries [Dziemianowicz 2008: 138-139]. The so-presented problem comes therefore to the question of the optimal (or excessive) level of public revenue and spending, whereas the starting point to its solution is to establish the borderline of public revenue and spending, beyond which one may speak of an excessive fiscal policy.

The measurement of the borderline in literature is carried out indirectly, by international comparisons, using data from various economies in the analysis. The following measures are most often applied for comparisons:

– tax rates,
– the level of fiscal burden in relation to GDP,
– the scope of intervention of the public finance system in the GDP,
– the level of coverage of public spending with public revenue,
– building of tax brackets,
– the difference between the nominal and effective tax rate,
– the extent of the shadow economy [Dynus 2007: 35].

Tax rates are one of the simplest measures allowing a comparison of the level of fiscal policy. In recent years, one can observe a clear trend to reduce tax burdens and expand the tax base in the European Union. It is reflected in the gradual decline in the average marginal tax rates on personal and business income. The average marginal PIT tax rate in the EU Member States between the years 1996-2014 decreased by 14.2 percentage points, i.e. from 53.7% in 1996, to 39.5% in 2014. CIT rates were reduced in the same period from 37.8% to 22.8%, which means that, with respect to the base year, the decline was even higher and amounted to 39.8% (Table 1).

A more detailed analysis of tax rates in the EU countries brings attention to the unevenness of the reduction of rates in individual Member States. The level of fiscal policy described by average rates of both taxes is significantly higher in the EU-15 countries. In 5 of the 15 countries, the average marginal PIT rate between the years 1996-2014 exceeded 50%, among others in countries like France, Belgium, and Finland, and even exceeded 60% in Denmark. At the same time, the authorities of 12 out of the 15 countries decided to reduce the rates, while the big-

Table 1. Marginal PIT and CIT rates in the European Union between the years 1996-2014

Country	Marginal PIT Rates						Marginal CIT Rates					
	1996	2000	2004	2008	2012	2014	1996	2000	2004	2008	2012	2014
Belgium	60.6	60.6	53.7	53.7	53.7	53.8	40.2	40.2	34.0	34.0	34.0	34.0
Bulgaria	50.0	40.0	29.0	10.0	10.0	10.0	40.0	32.5	19.5	10.0	10.0	10.0
Czech Republic	40.0	32.0	32.0	15.0	15.0	22.0	39.0	31.0	28.0	21.0	19.0	19.0
Denmark	64.7	62.3	62.3	62.3	55.4	55.6	34.0	32.0	30.0	25.0	25.0	24.5
Germany	57.0	53.8	47.5	47.5	47.5	47.5	56.7	51.6	38.3	30.2	30.2	30.2
Estonia	26.0	26.0	26.0	21.0	21.0	21.0	26.0	26.0	26.0	21.0	21.0	21.0
Ireland	48.0	44.0	42.0	41.0	48.0	48.0	33.0	24.0	12.5	12.5	12.5	12.5
Greece	45.0	45.0	40.0	40.0	49.0	46.0	40.0	40.0	35.0	35.0	20.0	26.0
Spain	56.0	48.0	45.0	43.0	52.0	52.0	35.0	35.0	35.0	30.0	30.0	30.0
France	59.6	59.0	53.4	45.4	50.3	50.3	36.7	37.8	35.4	34.4	36.1	33.0
Croatia	41.3	41.3	53.1	53.1	47.2	47.2	25.0	35.0	20.0	20.0	20.0	20.0
Italy	51.0	45.9	46.1	44.9	47.3	47.9	53.2	41.3	37.3	31.4	31.4	31.4
Cyprus	40.0	40.0	30.0	30.0	35.0	35.0	25.0	29.0	10.0	10.0	10.0	12.5
Latvia	25.0	25.0	25.0	25.0	25.0	24.0	25.0	25.0	15.0	15.0	15.0	15.0
Lithuania	33.0	33.0	33.0	24.0	15.0	15.0	29.0	24.0	15.0	15.0	15.0	15.0
Luxemburg	51.3	47.2	39.0	39.0	41.3	43.6	40.9	37.5	30.4	29.6	28.8	29.2
Hungary	44.0	44.0	38.0	40.0	20.3	16.0	19.6	19.6	17.6	21.3	20.6	20.6
Malta	35.0	35.0	35.0	35.0	35.0	35.0	35.0	35.0	35.0	35.0	35.0	35.0
Netherlands	60.0	60.0	51.0	52.0	52.0	52.0	35.0	35.0	34.5	25.5	25.0	25.0
Austria	50.0	50.0	50.0	50.0	50.0	50.0	34.0	34.0	34.0	25.0	25.0	25.0
Poland	45.0	40.0	40.0	40.0	32.0	32.0	40.0	30.0	19.0	19.0	19.0	19.0
Portugal	40.0	40.0	40.0	42.0	49.0	56.5	39.6	35.2	27.5	26.5	31.5	31.5
Romania	40.0	40.0	40.0	16.0	16.0	16.0	38.0	25.0	25.0	16.0	16.0	16.0
Slovenia	50.0	50.0	50.0	41.0	41.0	50.0	25.0	25.0	25.0	22.0	18.0	17.0
Slovakia	42.0	42.0	19.0	19.0	19.0	25.0	40.0	29.0	19.0	19.0	19.0	22.0
Finland	61.2	54.0	52.1	50.1	49.0	51.5	28.0	29.0	29.0	26.0	24.5	20.0
Sweden	61.4	51.5	56.5	56.4	56.6	56.9	28.0	28.0	28.0	28.0	26.3	22.0
United Kingdom	40.0	40.0	40.0	40.0	50.0	45.0	33.0	30.0	30.0	30.0	24.0	21.0
UE Average[a]	53.7	50.8	41.9	37.9	38.3	39.5	37.8	35.4	27.2	24.0	23.0	22.8
EA Average[b]	–	50.6	46.7	43.6	43.5	43.8	–	36.7	31.9	27.1	25.4	25.0

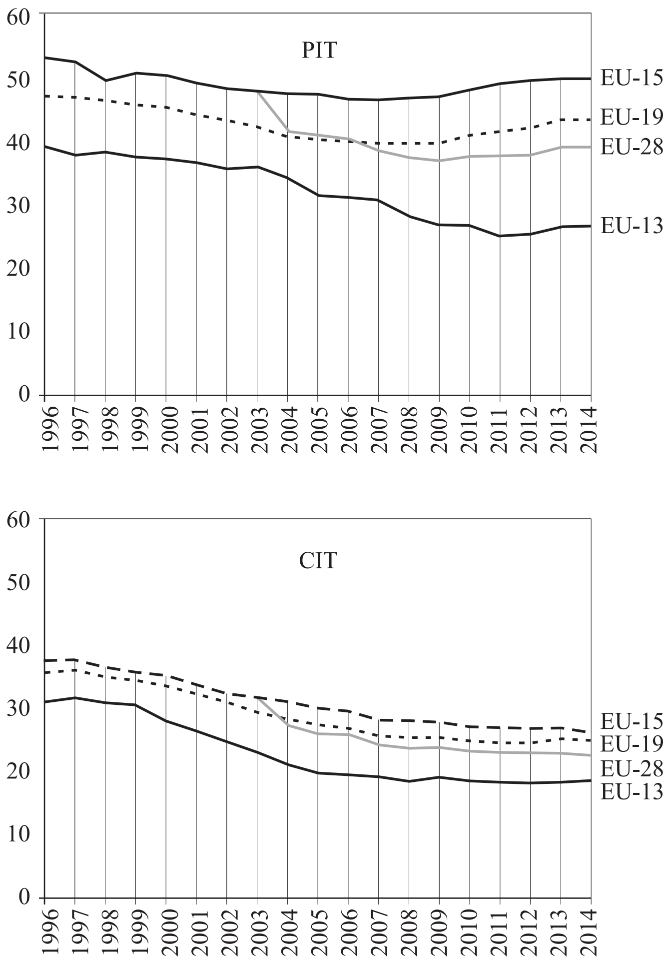
[a, b] For calculation of the arithmetic averages, marginal tax rates of only those Member States which are actually included in the European communities in a given year were taken into account.

Source: Denis, Hemmelgarn & Sloan 2015: 142-145.

gest cuts were also carried out in the countries with the highest rates, and ranged from 4.5 percentage points in Sweden, to 9.7 percentage points in Finland. The highest CIT tax rates in both new and old Member States exceeds 30%, whereas in the vast majority of the old Member States (9 out of 15 countries), the average rates fluctuated between 30 and 40%, while in the new ones (8 out of 13 countries) between 20 and 30%.

In total, during the analyzed period between 1996-2014, the average marginal PIT and CIT tax rates in the old Member States were 49.4% and 31.2% respectively, and were higher than the rates in countries which joined the European Union

Chart 1. Average marginal PIT and CIT rates in the European Union in 1996-2014



Source: own elaboration based on Denis, Hemmelgarn & Sloan 2015.

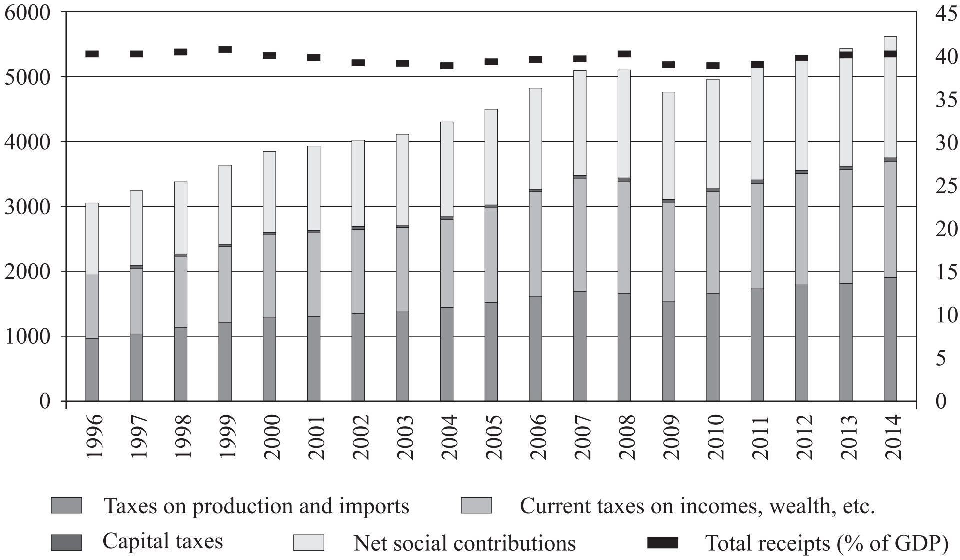
in and after 2004 by more than one third in the case of the PIT, and by more than a quarter in the case of the CIT[2] (Chart 1). Therefore, one can state that a clear relaxation of fiscal policy in the European Union (EU-28) presented earlier, is largely described not by the actual reduction in tax rates in the whole community, but by the addition of new Member States in and after 2004.

Another index of measuring the fiscal policy is the level of fiscal burden in relation to the GDP. Compared to the meter discussed above, this measure is more accurate because it informs about executed tax revenues, and therefore takes into account the effective rates of tax burden, that is the data that is difficult to access and often incomparable, especially over long time series. Essentially, the meter illustrates the total amount of public revenues collected in the form of direct and indirect taxation, taking into account the additional burdens significantly affecting its level, i.e. social security contributions. However, comparison of the total level of fiscal burdens between the countries can be difficult and confusing because their amount is significantly affected by legal solutions adopted in the given country. Since pension contributions are not collected in the public system in all countries, and despite not being formally rated among fiscal burdens, there is no doubt they exist as economic phenomenon and constitute a burden for the enterprises [Wernik 2008]. Therefore, in some countries, the official level of fiscal burdens in relation to the GDP may be lower, yet it will not actually mean a lower level of fiscal policy.

The downward trend in average tax rates in the European Union is not accompanied by a decrease in the amount of public revenues from taxes and social security contributions. Over the last 20 years, in the countries belonging to the EU, receipts from fiscal burdens in absolute terms almost doubled and in the year 2014 amounted to approx. 5.6 billion EUR (Chart 2). Such a dynamic growth is not confirmed by a relevant measurement index, i.e. the level of fiscal burden in relation to the GDP. In this perspective, tax revenues and revenues from social security contributions during the years 1996-2014 were stable (the annual average growth is 0.0 percentage points), adopting the highest value in 1999, i.e. 40.6%, while the lowest, 38.5% in 2009 and 2010. About two-thirds of the value of fiscal burden in the EU Member States in 2014, i.e. 27.4% of the GDP, was constituted by tax revenues, and 14.7% by social security contributions, while the share of the contributions in the total sum of the fiscal burden since 1996 has been steadily decreasing – between the years 1996 to 2014 it decreased by 3.2%, i.e. 1.3% of the GDP. The sum of receipts from taxes and social contributions in 1996-2001 doesn't include Croatia.

[2] The average marginal tax rates in the EA-19 and EU-13 were calculated for the time between the years 1996 to 2014, including all Member States as of 2014, regardless of the date of accession. The EU-28 index takes into account the Member States actually included in the EU in a given year.

Chart 2. The total sum of receipts from taxes and social contributions in the European Union Member States between the years 1996-2014 (in billions of EUR, and % of the GDP)



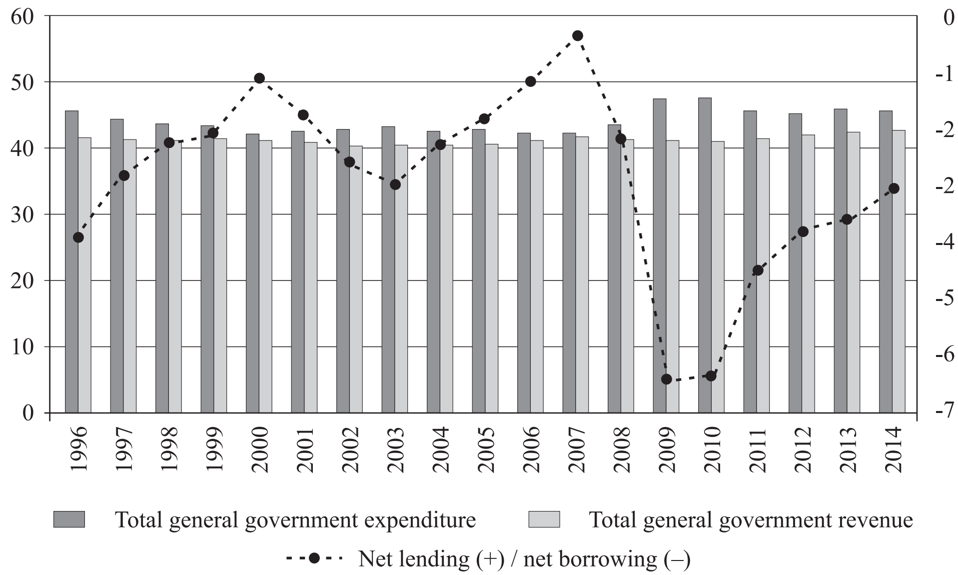
Source: *Main national accounts tax aggregates*, Eurostat, http://appsso.eurostat.ec.europa.eu/nuishow.do-?dataset=gov_10a_taxag&lang=en [access: 21.07.2016].

Accession of new Member States in and after 2004 has not significantly changed the amount of total fiscal burden in relation to GDP, which has been observed in the case of tax rates, whereas the level of fiscal policy also varies between individual groups of countries. In the new Member States, the level of fiscal policy measured by cumulative fiscal burden in relation to GDP is relatively low: in 2014, it was the lowest in Romania and Bulgaria, amounting to 27.7% and 27.8% of the GDP respectively, while in other countries, with the exception of Hungary and Slovenia, it did not exceed 35% of the GDP. The highest fiscal burdens are recorded primarily in the Nordic countries, i.e. in Denmark, Finland, and Sweden (50.8%, 43.8%, and 44.0% of the GDP respectively), as well as, in Belgium and France where the fiscal burdens exceed 45%. In Slovakia, Sweden, Poland, and Ireland revenues from fiscal burdens in relation to the GDP have clearly decreased over the past 20 years (by 3.4% of GDP in Ireland and 7.5% in Slovakia). On the other hand, Cyprus, Malta, and Greece, where the level of total fiscal burden in relation to the GDP has increased by approx. 9.5 percentage points, are struggling with the increase of fiscality.

The broadest index of fiscality is the level of public revenue and expenditure in relation to the GDP. The total value of all public revenues and expenditure is determined by the scope of intervention of the public finance system in the economy.

The higher the level of revenues and expenditure in relation to GDP, the higher the share of the state in the economy and the larger, and usually less effective, the public sector and the smaller the private sector. Moreover, the coverage ratio of public expenditure with public revenues, i.e. the balance of the public finance sector, informs about the current level of national debt. A larger deficit may be the evidence of lower fiscality because in such a case, the country decides to increase liabilities instead of increasing the fiscal burden. On the other hand, lack of or a relatively low deficit is not always synonymous with a low level of tax burden. One should note that covering the difference between public expenditure and revenue requires additional sources of financing, which usually limit the capital needed for the development of the private sector or requires foreign borrowing, which in turn may have a significant impact on the rate of economic growth [Dziemianowicz 2008: 143-144].

Chart 3. The balance of the general government sector of the European Union between the years 1996-2014 (in % of GDP)



Source: *General government revenue, expenditure and main aggregates*, Eurostat, http://appsso.eurostat.ec.europa.eu/nui/show.do?dataset=gov_10a_taxag&lang=en [access: 21.07.2016].

In the EU countries, on average, a half of the GDP flows through the sector of public finances (Chart 3). In 2014, public revenues of the EU-28 accounted for 43.4% of the GDP, while expenditures accounted for 46.3%. In 2014, in 9 of the 28 Member States, public expenditure in relation to the GDP exceeded 50% of GDP, where the highest values were in Finland (58.1% of GDP), France (57.3% of GDP), and Denmark (56.0% of GDP). At the same time, public expenditures in 8 out of the 13 new Member States took the lowest values on the EU-28 scale, led by Romania (at 34.3% of GDP), then Lithuania, Latvia, and Estonia (at 34.8%, 37.5%, and 38.0% of GDP, respectively).

It seems that a wide range of the public sector does not determine the balance of the public finance sector of the EU Member States. Among the countries that recorded a budget surplus in 2014, or had their public finance sector relatively balanced, there are countries in which the tax burden was high (e.g. Denmark at 1.5% of GDP, and Sweden at 1.6% of GDP), but also in countries having the smallest public sector in the EU-28, among others, Lithuania and Estonia (–0.7% and 0.8% of GDP, respectively). Irrespective of the current balance of public finances, some countries have made, over a long period of time, a significant reduction in the public finance sector - in relation to 1996, the public sector in Slovakia, measured by public spending, has been reduced by 11.2% of GDP, in Sweden by 9.7% of GDP, and in Poland by 8.8% of GDP. The opposite tendency was observed in Cyprus (an increase of 15.9% of GDP), in Portugal (an increase of 8.6% of GDP), and in the UK (an increase of 6.2% of GDP) and is accompanied by a relatively high public finance sector deficit (–8.9%, –7.2%, and –5.6% of GDP, respectively).

The analysis carried out above shows that an explicit assessment of the level of fiscality using the above indexes is not possible. The EU consists of countries with relatively small public sectors, through which only approx. 30% of the GDP flows, and countries in which public revenues and expenditure exceed 50% of the GDP. That means that in relation to specific economic structures, the limit of the state fiscal capacities can be determined at a different and inconsistent level. Therefore, is it possible to conclude that a wide range of the public sector (which usually goes hand in hand with a high fiscal burden and tax rates) translates into an excessive fiscal policy? One can speak about a reasonable level of fiscal policy when the scale of intervention of public authorities in business entities' revenues is not very aggressive so that it allows the business entities to operate and develop. In contrast, one can state that high taxes and excessive fiscal burden may lead to the phenomenon of tax avoidance or evasion, and thus, to the limitation of activity and often its transfer, in part or in whole, to the shadow economy. Due to such a defined concept of rational fiscalism, one of the key meters of its level, especially with regard to the negative impact on the economy, may be the index determining the extent of the shadow economy.

2. The Shadow Economy and Methods of its Measurement

Taxation almost always distorts economic decisions and results in the generation of costs, both for individuals, consumers and producers, as well as, the society. As a result of levying a tax, consumers lose a part of consumption, whereas manufacturers reduce employment and sales, lowering the operating costs. They often attempt to evade the tax burdens imposed or avoid them, especially when they are excessive, and then transfer a part of their business to the shadow economy.

The shadow economy, also known as the "gray economy," "black economy," "underground economy," "subterranean economy," "second economy," "informal, irregular, or parallel economy," is a part of the economy and occurs with varying intensity in all its types. In literature, there is no uniform definition of this phenomenon, which in fact results directly from its non-uniform nature. At the same time, two different approaches can be noticed in the formulated definitions. Firstly, unregistered activity is regarded as activity in the informal sector. Secondly, definitions refer to the behavioral realm, primarily to the evasion of certain obligations imposed by the applicable law, under the registered business [Gołebiowski 2007].

Schneider defines the shadow economy as: "business activity and revenues from such activity that avoid or otherwise evade the provisions of taxation or observation" [Schneider, Marcinkowska & Cichocki 2008: 6]. Such a formulated definition combines the two above-mentioned approaches, which covers both the unregistered sale from a legal business and any activity that would be subject to taxation after declaration of, for example, revenues in the full amount. Difficult-to-measure activity of criminal nature is also ranked among the informal zone.

Raczkowski similarly defines the shadow economy, proposing to organize the conceptual apparatus relating to this issue. According to the author, the shadow economy is a part of the informal economy and takes a semi-legal form [Raczkowski 2013]. The informal economy includes unregistered activity of households, provision of services, and the production without notification, permission, concession, or license, and their declaration in a manner that is inconsistent with the reality. Raczkowski also includes the, so-called, black market, i.e. a completely illegal activity, in the informal economy. Both components of the informal economy (semi-legal and illegal) merge and complement each other, "offering different natural weight of the committed criminal offenses" [Raczkowski 2013: 353]. According to Raczkowski, it is very difficult to differentiate between the informal economy and the so-called black market, so one should rather use the term unofficial economy, which includes both of these phenomena.

Tanzi uses the term underground economy and believes that there are at least two definitions and, therefore, also at least two different measures of the underground economy. The first one is associated with the production (or income) not included in official statistics, and the other one relates to the revenue unregistered by the tax authorities [Tanzi 1999: 334].

Mróz, however, assumes that the informal economy includes "unregistered activity aiming at the obtainment of material benefits in natural or monetary form and triggering value-creative and/or redistributable effects" [Mróz 2002: 23].

Analyzing the above-cited, very brief overview of academic definitions, one can say that their authors agree that the activity in the shadow economy usually comes down to: conducting an activity without appropriate permits, failure to comply with regulations governing business practices, and the avoidance of incurring fiscal burden, taxes, and quasi-fiscal charges. It includes "criminal activity and unregistered profit from the production of legal goods and services and cash or swap deals, namely any activity that would be subject to taxation if notified to relevant institutions" [Pietrzak 2013: 16] (Table 2).

Table 2. Taxonomy of the types of activities in the informal economy

Type of Business Activity	Pecuniary Transactions		Non-Pecuniary Transactions	
Criminal/ Illegal Activity	Handling stolen goods, drug production, drug trafficking, prostitution, gambling, smuggling, fraud, etc.		Interchangeable trade with drugs and goods from theft, smuggling, etc. Cultivation or manufacture of drugs for personal use. Stealing for personal use.	
	Tax Evasion	Tax Avoidance	Tax Evasion	Tax Avoidance
Legal Activity	Undeclared earnings from self-employment, salaries and income from unregistered work related to legal services and goods	Discounts for employees, bonuses	Barter of legal goods and services	Any form of DIY and neighbor's assistance

Source: Schneider et al. 2013: 26.

According to statisticians, academic definitions of the informal economy are too general and not very accurate. From 2014 onwards, the National Statistical Authorities of the EU Member States have been using the definition contained in the *System of National Accounts* ESA 2010. The European Commission defining the informal economy uses, in this document, the term *non-observed economy* and classifies to it[3]:

[3] Guidelines on this subject can be found in the document with the guidelines concerning the national accounts system in the European Union (ESA 2010). Definition of this phenomenon developed by the European Commission has a significant impact on the scope and range of estimates of shadow economy prepared by the national official statistics. European System of Accounts. ESA 2010, www.lb.lt/n22873/esa_2010-en_book.pdf [access: 23.07.2016].

– illegal activities (parties participate voluntarily in a transaction that is prohibited by law),

– hidden activities (transactions in accordance with the law which, however, are not registered, and thus actions taken in order to avoid inspection are invisible to the bodies of tax administration authorities),

– activities of an informal nature (usually conducted occasionally or on a very small scale, in which case no record is kept).

The unregistered economy, in line with the guidelines of ESA 2010 does not include the illegal activities, where one of the parties is not a voluntary participant, because these type of activities do not constitute a transaction in economic terms and the production of goods or services within the household for personal use [Schneider, Marcinkowska & Cichocki 2008: 8]. As one can see between the scientific perspective and statistical definition, there are many discrepancies; therefore, the measurement of the informal economy, depending on the assumptions, could materially differ.

The consequence of a lack of uniform definition for the phenomenon of informal economy is the existence of many methods of its measurement. Most often in the literature, one distinguishes two groups of methods for estimating the informal economy: direct and indirect ones. Direct methods examine the gray market with the help of surveys, interviews, analysis of asset declarations, or tax returns etc. In contrast, indirect methods (also called "indicative" methods) rely primarily on the analysis of documents and statistical data. They are mostly macroeconomic methods for which the estimation of the size of the gray market utilizes various economic indicators carrying information on the development of the phenomenon over time [Schneider, Marcinkowska & Cichocki 2008: 8].

3. An Assessment of the Relationship Between the Level of Tax Burden and the size of the Shadow Economy in the EU Member States

The extent of the occurrence of the gray market is mentioned as one of the main measures allowing to determine the borderline of public revenue and expenditure, after the exceedance of which one can talk about excessive fiscal policy. At the same time, the majority of scientific studies show that one of the main reasons for the existence and growth of the shadow economy, in addition to psychological factors, is the presence of high fiscal burdens (Table 3), tax, and quasi-tax commitments. Therefore, these measures should not be considered separately, and the full analysis of the level of fiscal policy and its borderlines cannot be carried out without a thorough analysis of the scope of the gray market in the economy.

Table 3. Main Reasons for the Growth of the Shadow Economy

Factors Affecting the Black Economy	Impact on Black Economy (in %)	
	Average value (out of 12 tests)	Average value (out of 22 tests)
1) Growth in the tax burden and social security contributions	35-38	45-52
2) The quality of state institutions	10-12	12-17
3) Regulations of the labor market	7-9	7-8
4) Social transfers	5-7	7-8
5) Services of the public sector	5-7	7-8
6) Tax Morality	22-25	–

Source: own elaboration based on Schneider et al. 2013*:* 44.

Scientists seek a starting point to determine the relationship between the decision on moving to the black economy, and the amount of tax burden in the selection between working time and leisure time. As a result of taxation, gross salary paid by the company is higher than net salary received by employees. Employees, when deciding on how much of their work to offer, compare the amount of net salary with the marginal value of their free time. The greater the difference between the overall cost of work and the amount of income (from work) after taxation in the official economy, the greater the encouragement to do work in the black economy. Due to the fact that this difference depends largely on the overall burden of taxes and social security contributions, these are the issues that have the greatest impact on the existence and expansion of the black economy [Schneider, Marcinkowska & Cichocki 2013: 8].

A positive correlation between the fiscal burden and the size of the black economy is confirmed by empirical research conducted by Schneider [2000, 2003] and Johnson, Kaufmann and Zoido-Lobaton [1998a, 1998b], in which the authors present strong evidence indicating a significant impact of direct and indirect taxes, as well as, social security contributions on its growth. Moreover, the size of the black economy, according to Schneider, is determined to a great extent by the intensity of legislation: the more bureaucratic the economy is (ie. more regulations), the greater the size of the shadow zone[4]. The reasons for the existence of the shadow economy are also confirmed by research carried out in Poland, involving a group of 271 companies from the SME sector, according to which the decision on the functioning of the black economy were mainly taxes that were too high and social security contributions, which reduced the businesses' competitiveness [Gołębiowski 2007: 19].

[4] According to Schneider, a one-point increase in the regulation indicator (on a scale from 1 to 5) means a 10% growth of gray area in the economy.

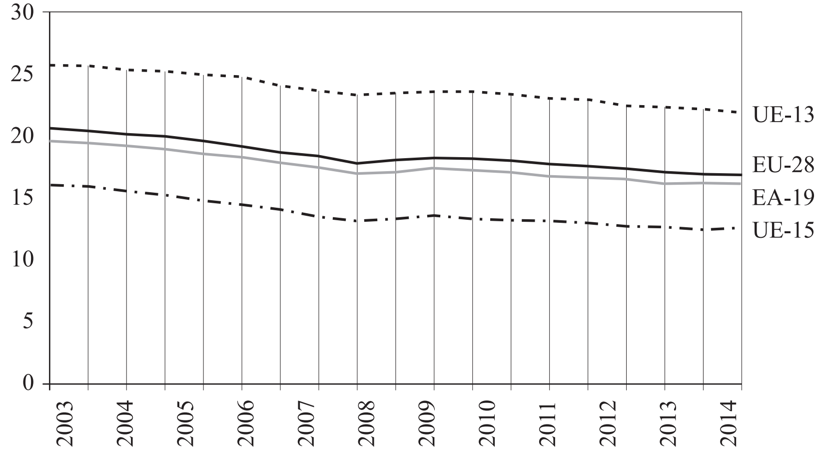
Table 4. The Size of the Shadow Economy of the EU-28 Member States during the years 2003-2014 (as a % of the GDP)

Country	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
Belgium	21.4	20.7	20.1	19.2	18.3	17.5	17.8	17.4	17.1	16.8	16.4	16. 1
Bulgaria	35.9	35.3	34.4	34.0	32.7	32.1	32.5	32.6	32.3	31.9	31.2	31.0
Czech Republic	19.5	19.1	18.5	18.1	17.0	16.6	16.9	16.7	16.4	16.0	15.5	15.3
Denmark	17.4	17.1	16.5	15.4	14.8	13.9	14.3	14.0	13.8	13.4	13.0	12.8
Germany	17.1	16.1	15.4	15.0	14.7	14.2	14.6	13.9	13.7	13.3	13.0	13.3
Estonia	30.7	30.8	30.2	29.6	29.5	29.0	29.6	29.3	28.6	28.2	27.6	27.1
Ireland	15.4	15.2	14.8	13.4	12.7	12.2	13.1	13.0	12.8	12.7	12.2	11.8
Greece	28.2	28.1	27.6	26.2	25.1	24.3	25.0	25.4	24.3	24.0	23.6	23.3
Spain	22.2	21.9	21.3	20.2	19.3	18.4	19.5	19.4	19.2	19.2	18.6	18.5
France	14.7	14.3	13.8	12.4	11.8	11.1	11.6	11.3	11.0	10.8	9.9	10.8
Croatia	32.3	32.3	31.5	31.2	30.4	29.6	30.1	29.8	29.5	29.0	28.4	28.0
Italy	26.1	25.2	24.4	23.2	22.3	21.4	22.0	21.8	21.2	21.6	21.1	20.8
Cyprus	28.7	28.3	28.1	27.9	26.5	26.0	26.5	26.2	26.0	25.6	25.2	25.7
Latvia	30.4	30.0	29.5	29.0	27.5	26.5	27.1	27.3	26.5	26.1	25.5	24.7
Lithuania	32.0	31.7	31.1	30.6	29.7	29.1	29.6	29.7	29.0	28.5	28.0	27.1
Luxemburg	9.8	9.8	9.9	10.0	9.4	8.5	8.8	8.4	8.2	8.2	8.0	8.1
Hungary	25.0	24.7	24.5	24.4	23.7	23.0	23.5	23.3	22.8	22.5	22.1	21.6
Malta	26.7	26.7	26.9	27.2	26.4	25.8	25.9	26.0	25.8	25.3	24.3	24.0
Netherlands	12.7	12.5	12.0	10.9	10.1	9.6	10.2	10.0	9.8	9.5	9.1	9.2
Austria	10.8	11.0	10.3	9.7	9.4	8.1	8.5	8.2	7.9	7.6	7.5	7.8
Poland	27.7	27.4	27.1	26.8	26.0	25.3	25.9	25.4	25.0	24.4	23.8	23.5
Portugal	22.2	21.7	21.2	20.1	19.2	18.7	19.5	19.2	19.4	19.4	19.0	18.7
Romania	33.6	32.5	32.2	31.4	30.2	29.4	29.4	29.8	29.6	29.1	28.4	28.1
Slovenia	26.7	26.5	26.0	25.8	24.7	24.0	24.6	24.3	24.1	23.6	23.1	23.5
Slovakia	18.4	18.1	17.6	17.3	16.8	16.0	16.8	16.4	16.0	15.5	15.0	14.6
Finland	17.6	17.2	16.6	15.3	14.5	13.8	14.2	14.0	13.7	13.3	13.0	12.9
Sweden	18.6	18.1	17.5	16.2	15.6	14.9	15.4	15.0	14.7	14.3	13.9	13.6
United Kingdom	12.2	12.3	12.0	11.1	10.6	10.1	10.9	10.7	10.5	10.1	9.7	9.6
EU-28	22.6	22.3	21.8	21.1	20.3	19.6	20.1	19.9	19.6	19.3	18.8	18.6

Source: Schneider, Raczkowski & Mróz 2015: 45.

Table 4 presents the size of the gray area in the EU Member States, estimated by Schneider using econometric MIMIC (*Multiple Indicators Multiple Causes*), including such features of the examined economies as: inflation, unemployment level, and the rate of economic growth or GDP level. Based on the analysis of this data, one can state that the size of the gray area in the EU decreased in relation to GDP by 4 percentage points, assuming the value of 18.6% of GDP in the year 2014 (Table 4). The size of the gray area described in relation to the registered GDP of the Member States of the European Union is therefore still significant as

Chart 4. The size of the shadow economy of the EU-28 Member States during the years 2003-2014 (as a % of the GDP)



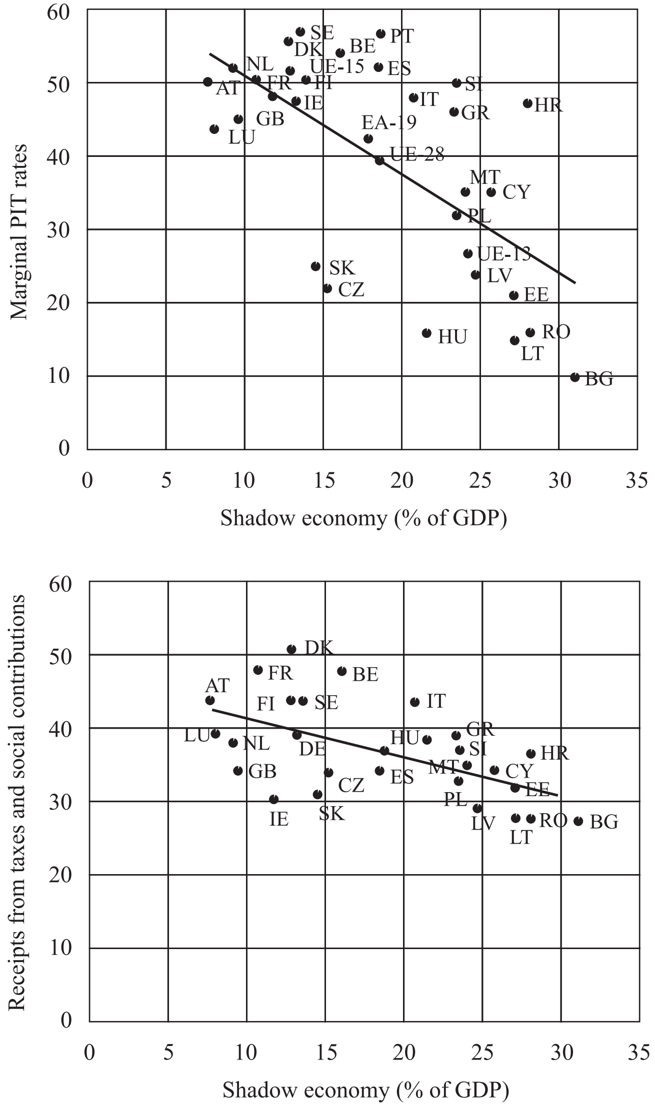
Source: own elaboration based on Schneider, Raczkowski & Mróz 2015.

it represents nearly half of public revenues collected in the form of fiscal burden and 38.6% of the public finance sector in the whole community.

In the observed period, in all EU countries including new Member States, the gray area has decreased, while its size is significantly higher in the countries which joined the community in and after 2004 (Chart 4). The highest drop, by more than 5 percentage points, in the size of gray area occurred in Latvia, Romania, Italy, and Belgium. The biggest gray area is invariably in the new Member States, Bulgaria and Romania, at 35.9% and 33.6% of GDP respectively, while the smallest is in Austria, where in 2014 its value amounted to 7.8% of GDP, as well as, Luxembourg, and the Netherlands (at 8.1% and 9.2% of GDP respectively).

An analysis of the level of fiscal policy measured by the size of gray area in an economy thus leads to an opposite conclusions than was formulated during the analysis of the previous measures. It turns out that the Member States, where the fiscal burden is expressed as tax rates, income tax, and taken from social security contributions, and where the size of public sector was higher, did not simultaneously record greater sizes of an informal economy as expected. The conducted tests of the Pearson correlation coefficient confirmed a negative and statistically significant relationship between the size of the gray area in the EU-28 Member States in the year 2014 and the level of fiscal policy measured by the amount of tax rates and fiscal burdens, and the size and balance of the public sector (Table 5). A very strong and negative linear correlation (Chart 5) exists between the total sum of fiscal burden and the rate of the PIT, which means that the higher the revenues from taxes and quasi-fiscal charges and the higher the marginal rates of PIT, the

Chart 5. The size of the gray economy, the marginal PIT rates, and the amount of fiscal burden in the EU Member States in the year 2014



Source: own elaboration.

smaller the size of the gray area. On the basis of the conducted analyses, one can further state that in accordance with previously formulated assumptions, the balance of public finances is a poor indicator of the level of tax burden, which is also confirmed by the very weak link with the size of the gray area.

Table 5. A correlation analysis of the gray area and traditional measures of tax burden in the EU Member States in the year 2014

	Marginal PIT Rates		Marginal CIT Rates		Receipts from Taxes and Social Contributions	
	Pearson Correlation	Sig. (2-tailed)	Pearson Correlation	Sig. (2-tailed)	Pearson Correlation	Sig. (2-tailed)
Shadow Economy	–0.618**	0.000	–0.397*	0.037	–0.626**	0.000
	Total Tax Receipts		Total General Government Expenditure		Net Lending (+) / Net Borrowing (–)	
	Pearson Correlation	Sig. (2-tailed)	Pearson Correlation	Sig. (2-tailed)	Pearson Correlation	Sig. (2-tailed)
Shadow Economy	–0.561**	0.002	–0.440*	0.019	–0.278	0.153

* Correlation is significant at the 0.05 level (2-tailed); ** Correlation is significant at the 0.01 level (2-tailed).

Source: own elaboration based on Schneider, Raczkowski & Mróz 2015; *General government revenue, expenditure and main aggregates*, Eurostat, http://appsso.eurostat.ec.europa.eu/nui/ show.do?dataset=gov_10a_taxag&lang=en [access: 21.07.2016].

Conclusion

The analysis conducted above shows that one cannot, based on traditional measures, clearly determine the borderline between rational and excessive fiscal policy. It is not always a high level of public revenue that signifies excessive fiscal policy. As already stated above, one of the key measures of the level of fiscal policy, especially with regard to the negative impact on the economy, is an indicator determining the extent of the occurrence of the informal economy. Its scope, due to a negative impact not only on the economy but also on the public finances sector itself, should lead to the reflection on whether the level of tax burden and public spending is not excessive. An analysis of the level and structure of fiscal burden and the size of the public sector in the EU Member States has shown that countries with relatively high fiscal burdens and those that interfere in the private sector to a greater extent, enjoy a smaller scale of the informal economy, and vice versa – in countries where fiscal policy is much more gentle, the gray area of the economy is the greatest. Assuming that one of the major causes of the enlargement of the gray area is excessive fiscal policy, the quoted conclusions clearly reject this thesis.

In conclusion, the conducted studies have shown that the measurement of fiscal policy by means of traditionally formulated indicators may lead to conflicting conclusions. In light of the conducted analyses, the occurrence of excessive fiscal policy in quantitative terms within the EU countries is an illusion. Contrary to the interest of the state taxpayers' behavior, namely the avoidance and evasion of taxation, in addition to the extent of the occurrence of the shadow economy, all indicate however, that it is otherwise, and not in fact an illusion as originally suggested. It is therefore necessary to build new measures, which will take into account not only the amount of fiscal burden, but also the quality of legal regulations and tax morality. Without this, determining the borderline of the state's fiscal capacities may be impossible.

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Problem nadmiernego fiskalizmu państwa – fakt czy iluzja?

Streszczenie. *W artykule podjęto próbę oceny czy i w jakim stopniu dotychczas wykorzystywane wskaźniki pomiaru fiskalizmu ukazują jego rzeczywisty poziom oraz czy na ich podstawie można wskazać granicę pomiędzy racjonalnym a nadmiernym fiskalizmem. Przeprowadzone badania dowodzą, że pomiar fiskalizmu za pomocą tradycyjnie formułowanych wskaźników może prowadzić do sprzecznych wniosków. Badania przeprowadzono na podstawie literatury przedmiotu oraz danych statystycznych dotyczących wybranych państw UE publikowanych przez Eurostat.*

Słowa kluczowe: *fiskalizm, szara strefa, gospodarka nierejestrowana, obciążenia fiskalne, UE*

Zeszyty Naukowe
Wyższej Szkoły Bankowej w Poznaniu
2016, t. 70, nr 5

Małgorzata Magdalena Hybka

Poznań University of Economics and Business
Department of Public Finance
e-mail: malgorzata.hybka@ue.poznan.pl
phone: 61 854 39 44

Evolution and Composition of Central Government Tax Revenue in Poland since 2006

Abstract. *The topic of this article is the evolution of central government tax revenue in Poland during the years 2006-2015. It contains an analysis of the amount, structure, and dynamics of this revenue. The article presents an overview of the most important factors affecting the formation of revenue from taxes, which play a key role as sources of revenue for the central budget. This article presents statutory shares of different levels of the public finance sector in tax revenue and describes the principles of tax revenue sharing. The final part of the article is devoted to comparing the structure of tax revenue by the economic functions in Poland and other Member States of the European Union.*

Keywords: *tax revenue, central government, Poland*

Introduction

In all of the Member States in the European Union, taxes and social security contributions represent the most important sources of public revenue. Despite the advanced process of harmonization, particularly including indirect taxes, there are still significant differences between the tax systems of specific EU Member States. These differences result in discrepancies in the fiscal performance of the tax systems. They are, to a large extent, historically-conditioned, but also determined by political, social, economic, and cultural aspects.

As far as taxing power is concerned, the central government is the dominant entity in most of the EU Member States. The central authorities are usually equipped with broad powers in terms of tax law making and obtaining tax revenue. As a result, in the last decade in the EU-28, the share of tax revenue collected by the central government in the GDP oscillated around 18%, while it reached 27% for all levels of the public finance sector. There are a number of factors influencing the amount and structure of tax revenue of the state (central) budget. These include both those resulting directly from the tax system and macroeconomic conditions. The first group of factors is related to the legal structure of the tax system as a whole and the design of particular taxes, as well as, the principles of revenue redistribution between the various levels of the public finance sector. The other group of factors include the most important macroeconomic indicators, which are among others, the GDP per capita, the sectoral composition of output, the share of agriculture in the GDP, the inflation rate, the unemployment rate, foreign aid, trade openness, political stability, and informal economy.

In Poland, the tax system has evolved over the centuries. Its beginnings can be traced back to the sixteenth century, when various taxes on income and wealth, and excise duties were imposed on the clergy and the residents of towns and villages. In the period of the economic transition, the Polish tax system underwent a thorough transformation. The reforms of the 1990s included important changes in the principles of income taxation imposed on individuals and legal persons, as well as, the introduction of the value added tax. The next stage of the tax system reforms was connected to the Polish accession into the European Union. These reforms resulted from the need to adjust the structure of certain taxes to the requirements of European Union law. The subject of this article is the evolution and composition of the tax revenue of the state (central) budget in Poland. The scope of the analysis, due to the availability of comparable statistical data, has been limited to the last ten years. This article concentrates not only on the analysis of the amount, structure, and dynamics of tax revenue but also the principles of their redistribution between the different levels of the public finance sector. It also compares the structure of tax revenue in Poland and other EU Member States.

1. Redistribution of tax revenue between different levels of the public finance sector

An important factor determining the structure of tax revenue of the different levels of the public finance sector is the power to obtain this revenue. Similarly, as it is the case in other EU Member States, in Poland there are two kinds of taxes: joint taxes (shared taxes), the revenue from which is distributed among the various levels of the public finance sector, and regular taxes, whos revenue inheres at only one level. The most fiscally efficient taxes belong to the group of joint taxes or are paid in total to the central budget. The former includes personal income tax and corporate income tax, whereas the latter include the following taxes: excise duty (on such products as: tobacco products, alcoholic beverages, energy and electricity, passenger cars), value added tax, mineral extraction tax, gambling tax, tonnage tax, flat-rate tax on registered income, tax on the sale of securities, and flat-rate tax on the income of clergy.

Table 1. The share of public finance subsectors
in the revenue from joint taxes in Poland (in %)

Tax	Years	Public finance subsector			
		State	Regions	Districts	Municipalities
CIT	2004-2007	75.99	15.90	1.40	6.71
	2008-2009	77.89	14.00	1.40	6.71
	since 2010	77.14	14.75	1.40	6.71
PIT	2004	50.64	1.60	8.42	39.34*
	since 2005	48.81	1.60	10.25	39.34*

* The participation share of municipalities in revenue from personal income tax was 35.72% in 2004, 35.61% in 2005, 35.95% in 2006, 36.22% in 2007, 36.49% in 2008, 36.72% in 2009, 36.94% in 2010, 37.12% in 2011, 37.26% in 2012, 37.42% in 2013, 37.53% in 2014, 37.67% in 2015, 37.79% in 2016. The share of municipalities in revenue from personal income tax decreases by the number of percentage points equal to the product of 3.81 of the percentage point of the index calculated for the whole country. The index rate is established by dividing the number of inhabitants admitted to residential homes before the 1st of January 2004, as of the 30th of June of the base year, by the number of inhabitants admitted by the 1st of January 2004, as of the 31st of December 2003.

Source: Jastrzębska 2012: 114.

In Poland, taxation powers enabling local self-governments to generate tax revenue are regulated primarily by the Law on the Revenue of Local Government Units (Act on Revenue of Local Government Units).[1] This Act includes the list of tax revenue sources for regions, districts, and municipalities. The legislator granted the regions, districts, and municipalities the right to participate in personal income tax paid by taxpayers residing in their territory, as well as, the corporate income tax paid by companies with headquarters located in their area.

The percentage share of particular local government units in the revenue from joint taxes has changed since its introduction. Municipalities were given the right to participate in personal income tax as early as 1992 and in corporate income tax in 1994. In 1999, as part of the reform of the local self-government financial system, the shares in income tax were granted to the newly established local self-government units – regions and districts [Poniatowicz & Dziemianowicz 2016: 296]. The first table shows the percentage share of local self-government units in the revenue from joint taxes since 2004. The percentage share of districts in per-

[1] Ustawa z dnia 13 listopada 2003 r. o dochodach jednostek samorządu terytorialnego, t.j. Dz.U. 2014, poz. 1115, 1574, 1644 [Act dated November 13, 2003 on Revenue of Local Government Units, consolidated text: Journal of Laws of 2014, item 1115, 1574, 1644].

sonal income tax has remained constant since 2004. For regions, this share was reduced in 2008, and then since 2010 it has slightly increased. The percentage share of districts inpersonal income tax has been raised since 2005. In the case of regions, it has not changed since 2004.

Pursuant to Art. 4.1 of the Law on the Revenue of Local Government Units, apart from the shares in joint taxes, the sources of income for municipalities also include revenue from such taxes as farm tax, forest tax, motor vehicle tax, real estate tax, gift and inheritance tax, tax on civil law transactions, and a fixed sum tax on the business activity of individuals (the so-called tax assessment card).

Despite the fact that the statutory amount of shares in personal income tax varies depending on the level of the public finance sector, the method for calculating the amount of this share is always the same. This share is calculated by multiplying the total amount of the revenue from this tax by a certain percentage ratio and an index equal to the share of the personal income tax from residents of a given local self-government unit due in the year preceding the base year in the total amount of the tax due in the same year, established on the basis of tax returns. The amount of revenue from corporate income tax depends on the location of seats of the legal persons and the location of their plants. If a branch or a plant belonging to an entity, which does not have its registered office within the territory of a given local self-government unit, operates in the territory of this unit, this unit receives part of the revenue from the tax, calculated in proportion to the number of workers employed in this branch or plant under an employment contract [Dylewski, Filipiak & Gorzałczyńska-Koczkodaj 2007: 86-87].

2. Structure and dynamics of central government tax revenue since 2006

Tax revenue in Poland feeds the state budget primarily, and to a lesser extent, the budgets of local self-governments. The state budget receives about 80% of the total tax revenue. Regions receive nearly 2% of the tax revenue, counties receive slightly over 1%, and cities with district rights receive about 8%. In the last five years, the share of municipalities in tax revenue fluctuated between 8% and 9%.

Tax revenue is the most important source of state budget revenue. Its share in the state budget revenue between the years 2006-2015 ranged from 78% to 90%. It was lowest in 2009. The share of tax revenue in the GDP is also significant (Table 2). This share was decreasing steadily and between the years 2006-2015 fell by almost two percentage points. Compared to the preceding year, it increased only in 2007, 2011, and 2014. Depending on the year analysed, this was due to either a decrease in tax revenue compared to the year before or a growth rate slower than in the case of the GDP (Table 3).

Table 2. Shares of the state budget tax revenue in the GDP
and the shares of total state budget revenue between the years 2006-2015 (in %)

Year	Share of the tax revenue in the GDP	Share of the tax revenue in the state budget revenue
2006	16.4	88.5
2007	17.4	90.1
2008	17.2	86.6
2009	15.8	78.4
2010	15.5	88.9
2011	15.7	88.8
2012	15.4	86.3
2013	14.5	86.6
2014	14.7	89.9
2015	14.5	89.8

Source: NIK 2011: 52; NIK 2014: 84; NIK 2015: 96-97.

The main source of state tax revenue is the value added tax (Table 4). Its share in the tax revenue fluctuated in the years 2006-2015 between 46% and 50%. In terms of fiscal performance, the excise duties rank second. In the period analysed, the highest revenue was generated from the taxation of motor fuels. In 2015, the share of this revenue in the revenue from the excise taxes in total was as high as 44.4%. The state budget obtains a relatviely high revenue from the taxes imposed on tobacco and alcohol. Other significant sources of tax revenue are personal income tax and corporate income tax. However, between the years 2006-2015 the significance of corporate income tax in the tax revenue decreased slightly. Less than 1% of the tax revenue of the state budget comes from the mineral extraction tax. This tax was introduced into the Polish tax system on April 18, 2012 (from the Act dated March 2, 2012).[2] It was imposed on entities engaged in the extraction of copper, silver, and – from January 1, 2016 – natural gas and crude oil. The tonnage tax, introduced by the Act dated August 24, 2006,[3] has a marginal significance in the total breakdown of tax revenue. It is imposed on some income sources obtained by ship owners operating seagoing commercial vessels that deal in international shipping.

By analyzing the dynamics of national tax revenue, it is apparent that between the years 2006-2015, its nominal value generally rose when compared to the value

[2] Ustawa z dnia 2 marca 2012 r. o podatku od wydobycia niektórych kopalin, t.j. Dz.U. poz. 362, z późn. zm. [Act dated March 2, 2012 on mineral extraction tax, consolidated text: Journal of Laws of 2012, item 362 as amended].

[3] Ustawa z dnia 24 sierpnia 2004 r. o podatku tonażowym, t.j. Dz.U. 2014, poz. 511; 2015, poz. 211 [Act dated March 2, 2012 on tonnage tax, Journal of Laws of 2014, item 511, 2014, item 211].

Table 3. Tax revenue of the state budget between the years 2006-2015 (in thousands of PLN)

Tax Category	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015
Value Added Tax	84 439 484	96 349 847	101 782 739	99 454 721	107 880 327	120 831 951	120 000 697	113 411 541	124 262 243	123 120 798
Excise Duties	42 078 023	49 025 521	50 490 116	53 926 887	55 684 476	57 963 709	60 449 853	60 653 116	61 570 430	62 808 633
Gambling Tax	894 854	1 106 725	1 404 861	1 576 073	1 624 843	1 476 951	1 441 634	1 303 910	1 234 718	1 337 125
Corporate Income Tax	19 337 483	24 540 193	27 159 663	24 156 597	21 769 869	24 861 922	25 145 736	23 075 275	23 266 188	25 813 386
Personal Income Tax	28 125 288	35 358 533	38 658 537	35 763 728	35 592 648	38 074 916	39 809 425	41 290 531	43 021 971	45 040 043
Tonnage Tax	–	–	9	7	3	7	7	7	1	0
Mineral Extraction Tax	–	–	–	–	–	–	1 426 949	1 916 304	1 425 044	1 553 465
Other Taxes	877	4 383	3 456	822	520	1 480	270	239	382	60
Total Tax Revenue	174 876 010	206 385 202	219 499 380	214 878 835	222 552 687	243 210 936	248 274 572	241 650 924	254 780 985	259 673 511

Source: *Wpływy budżetowe* 2016.

Table 4. Structure and dynamics of state budget tax revenue between the years 2006-2015 (in %)

Tax Category		2006	2007	2008	2009	2010	2011	2012	2013	2014	2015
Value Added Tax	*S*	48.29	46.68	46.37	46.28	48.47	49.68	48.33	46.93	48.77	47.41
	D	–	14.11	5.64	–2.29	8.47	12.01	–0.69	–5.49	9.57	–0.92
Excise Duties	*S*	24.06	23.75	23.00	25.10	25.02	23.83	24.35	25.10	24.17	24.19
	D	–	16.51	2.99	6.81	3.26	4.09	4.29	0.34	1.51	2.01
Gambling Tax	*S*	0.51	0.54	0.64	0.73	0.73	0.61	0.58	0.54	0.48	0.51
	D	–	23.68	26.94	12.19	3.09	–9.10	–2.39	–9.55	–5.31	8.29
Corporate Income Tax	*S*	11.06	11.89	12.37	11.24	9.78	10.22	10.13	9.55	9.13	9.94
	D	–	26.90	10.67	–11.06	–9.88	14.20	1.14	–8.23	0.83	10.95
Personal Income Tax	*S*	16.08	17.13	17.61	16.64	15.99	15.66	16.03	17.09	16.89	17.34
	D	–	25.72	9.33	–7.49	–0.48	6.97	4.56	3.72	4.19	4.69
Tonnage Tax	*S*	–	–	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
	D	–	–	–	–22.22	–57.14	133.33	0.00	0.00	–85.71	–100.00
Mineral Extraction Tax	*S*	–	–	–	–	–	–	0.57	0.79	0.56	0.60
	D	–	–	–	–	–	–	–	34.29	–25.64	9.01
Other Taxes	*S*	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00
	D	–	399.77	–21.15	–76.22	–36.74	184.62	–81.76	–11.48	59.83	–84.29
Total Tax Revenue	*S*	100.00	100.00	100.00	100.00	100.00	100.00	100.00	100.00	100.00	100.00
	D	–	18.02	6.35	–2.11	3.57	9.28	2.08	–2.67	5.43	1.92

$S = D_p / D_o \times 100$, where D_p – tax revenue from a given tax, D_o – total tax revenue,
$D = (Dt_2 - Dt_1) / Dt_1 \times 100$, where Dt_2 – tax revenue in year t_2, Dt_1 – tax revenue in year t_1.

Source: *Wpływy budżetowe* 2016.

of the previous year. Exceptions to this increasing trend can be seen in the years 2009 and 2013. The decrease in tax revenue seen in 2009 was associated with a decrease of revenue from income taxes and the value added tax in comparison to the previous year. The loss of revenue from the value added tax was caused, in particular, by the slowdown in economic growth. The decrease in revenue from personal income tax was predominantly the result of the introduction (on January 1st, 2009) of the two-tier tax rate system, with rates of 18% and 32%, and the deterioration of the economic situation in relation to the financial crisis. This factor was also responsible for the decrease in the revenue from corporate income tax in 2009-2010, when the the number of business entities obliged to pay this tax decreased significantly due to decline in corporate profitability. This also resulted in a surge of tax arrears. In 2013, there was a decrease in revenue from the value added tax, the gambling tax, and the corporate income tax. This decrease was due to the deteriorating economic situation and the growing difficulties of economic entities to settle their current tax liabilities. Moreover, the decrease of revenue from the value added tax was partially caused by the change in the method of calculating VAT reimbursements in the period of January 1 to 21, 2013. In this transitional period, the reimbursements were not financed from the revenue of 2012, but reduced the revenue of 2013. The decrease in revenue from the gambling tax was primarily the result of changes introduced by a new gambling law (Act dated November 19, 2009)[4] and a gradual decrease in the number of slot machine saloons and lower prizes with points from slot machine games.

Tax revenue increased significantly compared to the preceding year in both 2007 and 2011. Its increase in 2007, by as much as 18%, was due to favorable macroeconomic conditions. The real GDP growth in this year amounted to 6.6%. Furthermore, in comparison to the preceding year, there was a significant drop in the unemployment rate. The dynamics of tax revenue were also affected by changes in tax legislation, in particular, the elimination of a number of income tax reliefs for personal income taxpayers, including the right to deduct the interest on credits taken to finance investments aimed at meeting personal housing needs, or the possibility of deducting from personal income tax the expenses incurred by a person running a household on social security contributions of an unemployed person with whom the person running the household concluded the so-called activation contract. The relatively high positive growth rate of tax revenue in 2011 resulted from, among other factors, raising the rate of the value added tax by 1 percentage point in the transitional period, until the end of 2016.

[4] Ustawa z dnia 19 listopada 2009 r. o grach hazardowych, t.j. Dz.U. 2015, poz. 612, z późn. zm. [Act dated November 19, 2009 on gambling tax, consolidated text: Journal of Laws of 2015, item 612 as amended].

3. Evolution and composition of tax revenue in Member States of the European Union

The EU Member States vary significantly with respect to the fiscal efficiency of particular taxes and the structure of tax revenue. Tax revenue, along with revenue from social security contributions, constitutes a significant part of public revenue. In 2012, for the EU-28, their share in public revenue amounted to as much as 90%. In the last ten years, the share of taxes and social security contributions in the GDP were also high and oscillated around 40%. It should be noted that the share of income taxes in the GDP is, in itself, significant. In 2012, it amounted to as much as 26.8% for the general government.

Between 2004-2008, the share of tax revenue in the GDP for the EU-28 showed an upward trend; then, in 2008-2009, it decreased from 26.7% to 25.1% [Main national tax, 2016]. One factor responsible for this decline was the financial crisis and discretionary attempts made by EU Member States to stimulate demand, including reducing income tax rates [Taxation Trends 2014: 16]. In subsequent years, one could observe a steady increase in this share, as a result of which, in 2014 it reached the level from before the financial crisis. Just as in Poland, the share of tax revenue in the GDP decreased during the financial crisis, but in 2012 and 2013 one could observe a relatively higher rate of tax revenue growth in the EU-28 than what was observed in Poland.

In Poland, the main sources of central budget revenue are indirect taxes. In 2012, they accounted for approximately 40.4% of the total tax revenue. The situation is different in the EU-28, where the share of indirect taxes and direct taxes in the central budget revenue is similar. The Eurostat holds the functional classification of overall tax revenue dividing it into revenue from the taxation of consumption, labour, and capital. This classification is presented in Table 5. In the EU-28, the largest proportion of general government tax revenue comes from taxes on labour. They account for over 50% of the total tax revenue. In Poland, although this group of taxes also currently has the highest share intotal tax revenue, this share is much lower than in the EU-28.

Only in countries such as Malta, Cyprus, Romania, and Bulgaria, are the shares of taxes imposed on labour in the total tax revenue lower than in Poland. Another important source of revenue is tax on consumption. However, the fiscal significance of these taxes is also lower in Poland than in countries such as Croatia, Bulgaria, and Romania. The dynamics of tax revenue from taxes imposed on consumption in Poland and the EU-28 grew in a similar way in more recent years. After a significant decline in this revenue during 2009, 2010, and 2011, one could observe their increase. However, in 2012, while their share in the GDP for the EU-28 remained stable, it fell by nearly one percentage point in Poland. The share

Table 5. Structure of tax revenue according to economic functions in EU Member States in the years 2004, 2009 and 2014 (in %)

EU Member State	Taxes on:								
	consumption			labour			capital		
	2004	2008	2012	2004	2008	2012	2004	2008	2012
Austria	28.5	27.3	27.6	55.3	55.8	57.4	16.3	17.1	15.2
Belgium	24.6	24.1	23.7	53.5	53.3	53.9	21.6	22.3	22.0
Bulgaria	47.7	53.3	53.3	38.5	30.2	32.9	13.9	16.6	13.8
Croatia	49.6	46.5	49.1	40.2	40.6	40.7	10.2	12.9	10.3
Cyprus	44.0	39.4	36.8	32.3	28.8	37.1	23.7	31.8	26.1
Czech Republic	30.0	30.0	33.4	51.0	52.3	51.7	19.0	17.7	14.9
Denmark	32.3	32.2	31.0	51.4	53.3	51.0	16.7	14.8	18.4
Estonia	38.2	36.8	41.9	53.2	54.8	51.0	8.6	8.4	7.1
Finland	31.3	29.8	32.4	51.6	52.7	53.2	17.0	17.5	14.3
France	26.0	24.4	24.7	51.6	51.6	52.3	22.8	24.0	23.3
Germany	26.8	27.5	27.6	59.3	56.1	56.6	14.0	16.3	15.9
Greece	36.0	36.0	36.3	39.9	39.4	41.9	24.2	24.6	21.8
Hungary	39.7	35.3	40.0	47.8	51.4	46.4	12.6	13.3	13.5
Ireland	37.3	36.7	34.8	34.4	38.1	42.7	28.3	25.2	22.5
Italy	25.9	24.0	24.7	50.1	51.1	51.1	24.1	24.9	24.2
Latvia	38.8	36.0	38.4	51.1	49.7	49.0	10.1	14.2	12.6
Lithuania	36.4	36.9	39.8	50.6	48.2	46.5	13.3	15.0	13.9
Luxembourg	30.1	28.0	28.1	40.5	43.0	44.3	29.3	28.9	27.5
Malta	40.9	40.5	38.8	35.9	31.5	34.6	23.2	28.0	26.6
Netherlands	31.2	29.2	28.3	50.6	52.7	57.5	18.3	18.1	14.2
Poland	37.3	38.0	36.3	39.2	37.1	40.4	23.7	25.2	23.7
Portugal	39.8	37.5	37.4	38.3	38.4	41.4	21.8	24.1	21.1
Romania	40.9	40.1	45.1	39.4	41.2	40.0	19.7	18.7	15.0
Slovakia	37.4	35.4	33.4	42.2	43.1	45.4	20.4	21.5	21.2
Slovenia	35.4	35.9	37.9	54.1	51.2	52.5	10.7	13.1	9.8
Spain	27.7	24.1	26.1	45.8	51.2	52.2	26.7	25.0	22.1
Sweden	26.0	27.4	28.4	61.5	59.7	58.6	12.5	12.9	13.0
UK	32.6	28.5	33.8	39.0	38.0	38.9	28.3	33.6	27.4
UE-28	28.8	27.7	28.5	50.2	49.9	51.0	21.2	22.6	20.8

Source: *Structure of taxes by economic function* 2016.

of revenue from taxes imposed on capital in total tax revenue in Poland is slightly higher than in the EU-28. In 2012, this share is only higher in countries such as the UK, Malta, Luxembourg, Italy, and Cyprus, than it is in Poland.

The changes in the dynamics and structure of tax revenue in the EU-28 during the period of 2004-2012 resulted not only from macroeconomic factors but also from the modifications of tax law. These modifications are subject to regular analyses, the results of which are presented in publications about tax reforms issued since 2010 by The Publications Office of the European Union. In the studied years, a key driver of reforms was the financial crisis. A number of EU Member States adopted measures aimed at reducing the negative effects of the crisis, including stimulating economic growth in the initial phase, and later, reducing the deficit and public debt. One of these measures was increasing VAT rates [Tax Reforms 2012: 24]. Just as in Poland during 2011-2012, VAT rates were raised in almost half of the EU Member States, including, for example, Hungary, where the VAT rate grew by as much as 7%. During these years, a number of countries, including Poland, decided to broaden the tax base for personal income tax. Recently in the EU-28, there has been an increase in the share of both direct and indirect taxes in the GDP. In 2014-2015, the reforms of tax systems had a narrower scope than immediately after the crisis and focused on implementing measures aimed at reducing the scale of tax avoidance and tax evasion. Such measures were introduced in most EU Member States [Tax Reforms 2015: 20-21].

Conclusions

In Poland during the years 2006-2015, the amount and structure of tax revenue and its significance for the central budget were influenced by both reforms of tax law and economic conditions. The most important factor affecting the role played by this revenue in financing central government expenditure was the financial crisis. In 2009, due to the slowdown in economic growth, a decline in corporate profitability, a rising unemployment rate, and an increase in tax arrears, the nominal value of revenue from value added tax and income taxes decreased. Raising the rate of the value added tax in Poland contributed to the increase in revenue from VAT only in the year in which the new rate was introduced. In subsequent years, this revenue decreased. This resulted in a slight change in the structure of the tax revenue, which involved an increase in the significance of taxes imposed on labour and a simultaneous decrease in the share of revenue from taxes imposed on consumption in total tax revenue. At the same time, it should be noted that the decrease in tax revenue during 2013 in comparison to the year before, and the low rate of growth of this revenue in the other years analyzed, contributed to a decrease in the share of total tax revenue in the GDP.

Poland belongs to the group of EU Member States in which indirect taxes play a dominant role as a source of tax revenue. This group of taxes has prevailed in tax revenue since, as early as, the period of economic transition. The structure of tax revenue in Poland differs from the average structure of tax revenue for the EU-28. For the Polish general government a very important role is played by consumption taxes, while in the EU-28, taxes imposed on labour account for more than 50% of the total general government tax revenue. This structure of tax revenue, in which taxes imposed on consumption and labour have a similar share in total tax revenue, can result in the relatively high sensitivity of the tax system to economic fluctuations, including in particular, fluctuations in domestic demand.

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Ewolucja i struktura dochodów podatkowych budżetu państwa w Polsce od 2006 roku

Streszczenie. *Przedmiotem analiz w artykule jest ewolucja dochodów podatkowych budżetu państwa w Polsce w latach 2006-2015. Analizie poddano wysokość, strukturę i dynamikę tych dochodów. W treści artykułu odniesiono się do najistotniejszych czynników wpływających na ukształtowanie dochodów z podatków odgrywających kluczową rolę jako źródło dochodów budżetu państwa. W artykule przedstawiono ustawowe udziały poszczególnych szczebli sektora finansów publicznych w dochodach podatkowych i opisano zasady podziału tych dochodów. Ostatnią cześć artykułu poświęcono porównaniu struktury dochodów podatkowych według funkcji podatków w Polsce i pozostałych państwach członkowskich Unii Europejskiej.*

Słowa kluczowe: *dochody podatkowe, budżet państwa, Polska*

Zeszyty Naukowe
Wyższej Szkoły Bankowej w Poznaniu
2016, t. 70, nr 5

Jolanta Szołno-Koguc

Maria Skłodowska-Curie University of Lublin
Faculty of Economics
e-mail: jszolno@hektor.umcs.lublin.pl
phone: 81 537 55 95

Special-purpose (Earmarked) Funds in the Public Finance Sector – An Evolution of the System

Abstract. *Public finance is organised into budgetary institutions, as well as, off-budgetary or para-budgetary economic forms. Budgetary economy, which is frequently contrasted with the formula of budget-based management of public funds, ranks among the latter group. The discussion has been on for a long time now, among theoreticians and practitioners, as to the legitimacy of building special-purpose or earmarked public funds – in particular, as to their number and legal character. This study seeks to analyse the reformatory efforts taken since the earliest 1990s with respect to special funds in the public finance sector, and to assess the present situation in light of the Polish Public Finance Act of August 27th,2009.*

Keywords: *public finance sector, special-purpose/earmarked funds, fund-based economy*

Introduction

Special-purpose funds, also referred to as earmarked funds, have always been an essential element in the public finance sector, functioning within a defined relationship with the major legal financial institution – that is, the budget. In general terms, a special-purpose public fund may be defined as a form of public finance management, established or developed under a law (high-ranking piece of legislation) and designed in order to amass funds from strictly indicated sources for specified purposes. The institution of special-purpose funds infringes on the classical principle of budgetary material unity, as the public funds acquired within an earmarked fund are dedicated for specified tasks in view of which the fund has been set up. The discussion, in the finance doctrine, as well as, in practice, is not so much as to whether a fund-based economy ought to be developed[1] but, primarily, what its scope or character should be, so as to form a sort of 'complementary system', has not ceased to this day. Therefore, the reformatory efforts taken with regards to organisational and legal forms of public finance have not infrequently been with respect to restricting or, conversely, expanding the fund-based economy.

It should be noted that organisational change in the sector has been the underlying aspect of almost all the attempts at reforming public finance in Poland throughout the 1990s and the early 2000s [cf. Szołno-Koguc 2007]. Regrettably, the actions taken in this respect have never been supported by a clear model concept. Public finance is an instrument of public authority, and no reform of their system can prove successful without being appropriately correlated with a thorough social and economic transformation of the country. Due to a lack of a model for the state to assume and consistently implement, the social and economic transitions and the attempted reforms in the public finance sector have appeared severely incoherent throughout the period: the Government and Parliament members changed one after the other, and so did the political doctrines, with particular programmes often appearing internally contradictory. Despite identifying and declaring the need to rationalise public spending and improve the State's finances, the actions taken have proved rather inefficient and the results, short-lived.

1. Budgetary reforms in the systemic transition period

One of the basic assumptions of the reform of the budget and budgetary system in the early 1990s was to restrict the fund-based economy. The regulations laid down by the Act of December 14th, 1990[2] enabled the dissolusion of a total of twenty-eight State-owned special-purpose funds, together with their field counterparts, and the liquidation of another four. Thus, it was an action designed on a large-scale, the first step that was meant to further integrate the public finance system into an institutional order. In practice, though, there was not enough consistency or determination to complete the project; or perhaps, the change had not been thought over and prepared thoroughly. Some apparent transformations had taken place, as in the case of the emergence of the Industry Development Agency, which already, in December of 1990, came in lieu of the wound-up "Fund for

[1] Some authors go as far as stating that the fund-based economy system historically precedes the budgetary economy. Cf. Grodyński 1932: 156.

[2] Ustawa z dnia 14 grudnia 1990 r. o zniesieniu i likwidacji niektórych funduszy, Dz.U. nr 89, poz. 517 ze zm. [Act of 14th December 1990 on the abolition and elimination of some funds, Journal of Laws no. 89, item 517, as amended].

Industrial Structural Change." Other funds, dissolved one after another, were replaced by new ones. For instance, the responsibilities of the dissolved "Housing Construction Development Fund" were "taken over" by the "National Housing Fund" (in operation from 1995 to 2009), while the tasks of the "Fund for Construction of Highways and Expressways" were followed by the "Highway Construction and Operation Agency" and the "National Road Fund", both set up in 1994. Due to there not being any final settlement made, some of the dissolved special-purpose funds continued operating after the 1st of January 1991, though without a factual legal base.

Some important solutions limiting, to an extent, the freedom of forming earmarked funds were introduced by means of the Budget Law of 1991,[3] which directly provided that such a fund might only be set up under a law (or act); in the preceding period, special-purpose funds were also established through lower-level legislation (ordinances/decrees, or even intra-departmental/intra-ministerial orders or instructions). Furthermore, the Budget Law implied the requirement that the financial plans of special-purpose funds had to be included in the Budget Law, and that the funds' operations needed to be accounted for under the procedure outlined for the State budget (Art. 2 Budget Law) [cf. Misiąg, Roguska-Suchocka & Tymiński 1992: 44]. The provisions in question did not, however, sufficiently restrict the development of the fund institution as such – certain, rather specific, interpretations of these provision appeared which stressed that the budget law only regulated matters of State-owned special-purpose funds. Some earmarked funds were set up that only satisfied the condition of having been established on a statutory basis whilst their respective financial plans were not made part of the Budget Law. Thus, special-purpose funds to which the Budget Law pertained (to be specific, those whose financial plans had been appended to the Budget Law) coexisted with special-purpose funds, many of which made use of considerable public funding but functioned outside the State budget and beyond the strictly defined budgetary system (as regulated by the Budget Law). The issue of special-purpose funds operating on the local government unit level appeared on top of that, once the territorial governments were reactivated in Poland [Szołno-Koguc 2006].

The need for a thorough change in the fund-based economy has many a time been emphasised in the reports on inspections carried out by the Supreme Chamber of Control (NIK) in the years 1991-1996 [NIK 1996]. Based thereon, the NIK postulated in 1996 that the Government has cause to review all the State-related earmarked/special-purpose funds, be it those formed under a law or set up resulting from an international agreement, along with the apparently dissolved funds

[3] Ustawa z dnia 5 stycznia 1991 r. Prawo budżetowe, Dz.U. nr 5, poz. 18 ze zm. [The Act of 5th January 1991 – Budget Law, i.e. Journal of Laws no. 5, item 18, as amended].

whose influences and functions had been taken over by institutions operating under another name, such as foundations, agencies, and the like. Such a review was relevant and essential as there was urgency to undertake rearrangement and corrective actions forced by the intensifying crisis phenomena in the public finance market, particularly the growing financial deficit and public debt.

The Public Finance Act that entered into force in Poland as of January 1st 1999, initially formally banned the emergence of new special-purpose or earmarked funds. Yet, instead of successfully preventing the fund-based economy, the imprecise provision has left a legal loophole for para-budgetary institutions to emerge, which, even though named a "fund," would have formally never been categorised as a State-owned or local-government special-purpose/earmarked fund. A classical example is the National Health Fund (NFZ), which was established in 2003 as a State organisational unit with a legal personality.

It is also worth noting that the Act of November 26th 1998, rendered the Council of Ministers obligated to survey, by December 31st 1999, the then-existing special-purpose funds and to voice conclusions with regards to the purposefulness of managing public funds in this particular form. Resulting from the Government's actions in this respect, the report titled *Analysis of the purposefulness of action of State-owned special-purpose funds and agencies*[4] was produced and it confirmed that the State's task for the delivery of which the funds and agencies are legitimate and ought to be continued (albeit it is worth noting that the aforesaid Government document limits itself to the so-called State-owned special-purpose or earmarked funds established under the law and excludes other fund-type institutions from analysis). The conclusions phrased on that occasion basically referred to general solutions, mainly with respect to appropriate coverage by the laws constituting the funds. There was a need, among other things, to ban the acquisition of shares or stocks in companies, determine the rules of investing free funds, introduce the regulations that would enable the fund to enforce the accounts receivable with use of the procedure and under the principles laid down in the Law on the enforcement proceedings in the administration, introduce a delegation that would enable the supervisory bodies to issue secondary legislation to regulate in detail the rules of spending the money, establish the method of control for the use of funds provided to the entities not representing the public finance sector, and regulate the salaries of employees and managerial teams.[5] The government document in ques-

[4] Druk (załącznik) nr 1627 Sejmu RP III kadencji [print (Annex) no. 1627 of the Sejm of the Republic of Poland, 3rd Term-of-Office]; druk (załącznik) nr 49 Sejmu RP IV kadencji [print (Annex) no. 49 of the Sejm of the Republic of Poland, 4th Term-of-Office]; www.sejm.gov.pl [access: 25.07.2016]. See also Piotrowska-Marczak 2000.

[5] See J. Strzelecka, *Fundusze celowe*, Informacja Biura Studiów i Ekspertyz nr 823 (IP-96G) [Information note no. 823 of the Parliamentary Office for Studies and Expertises (IP-96G)]. The solution based on a delegation that would enable the supervisory body to issue the secondary le-

tion mentions the option to forward, in a further perspective, the tasks delivered within the specified special-purpose funds to the territorial government authorities, in terms of their own tasks or Government administration-related ordered tasks. Such transfer of tasks would have been related to the funds' incomes, indispensable as they were for funding the delivery of such tasks, being adequately assigned to the local governments. Concrete solutions in this respect for the specified earmarked funds, particularly local-government ones, were rendered dependent upon the analysis of these institutions in 1999, which was in fact an additional evaluation of the efficiency of their operations after the planned reform of public administration was made effective. Potential reorganisation opportunities have been formulated in respect of some funds, particularly the State Fund for Rehabilitation of the Disabled (PFRON), the Labour Fund, the Guaranteed Employee Benefits Fund, and the Alimony Fund. Additional post-audit materials thematically connected with special-purpose funds or agencies have been provided by the Supreme Chamber of Control, which expressed their expectation that the survey should not be limited to funds within the budgetary system (encompassed by the budget law); the other ones, established based on separate laws/acts, should also be included. Among these were funds invested in the Bank Gospodarstwa Krajowego (The State Development Bank of Poland), delivering the State's tasks and using budgetary money; also, the funds turned into agencies and State Treasury foundations. On commission of the Ministry of Finance, an expert team of the Market Economy Research Institute produced a report emphasising that the problem of rearranging the 'roadside areas' in the public finance sector has a broader dimension to it. Rather than remaining confined to earmarked funds and agencies, the change should embrace the other institutions that, although formally not having such a status, operate under similar rules [Malinowska & Misiąg 1999]. The opinion of third-party experts coincided with the conclusions submitted by the Supreme Chamber of Control at a session of the Parliamentary Committees dealing with "assuming a position with respect to the purposefulness of maintaining the organisational form of agencies and funds as the administration becomes decentralised", in February of the year 2000 [NIK 2000]. The same year saw the appointment by the Prime Minster of a special inter-departmental team that was chiefly tasked with preparing a diagnosis of the functioning of any and all funds and agencies, and also preparing the criteria of appraisal for those funds and

gislation ought to be deemed strongly disputable, since the general rules of financial management of special funds should not divert from the rules binding for the sector as a whole, as appropriately included in the Public Finance Act. Compared against the sector's other institutions, the funds should only have been distinct with their purposeful and objective-oriented interrelation between the income amassed and the expenditure. One ought to be doubtful about whether any other minister, apart from the Minister of Finance, should be in a position to determine the detailed rules for the flow of financial means within the institutions supervised.

agengies, and forming conclusions regarding their purposefulness and method of operation, as well as, the assumptions for legislative change.[6]

2. Attempts at systemic reorganisation of a fund-based economy

A bill of the new Public Finance Act submitted at the Sejm (the Lower House of the Parliament of the Republic of Poland) by a group of MPs in 2003 proposed detailed changes in the organisation of the public finance sector, with a focus on restrictions on off-budgetary and para-budgetary institutions.[7] The draft assumed that the local-government special-purpose funds would be wounded up, as would any off-budgetary forms such as budgetary establishments (entities), auxiliary enterprises, and special-purpose measures. The justification pointed to several arguments in support of the dissolution of local-government special-purpose funds, with their existing incomes being included in the respective budgets of local-government units. Primarily, the need to consolidate the funds remaining at the disposal of the territorial governments was emphasised. While the inclusion of local-government special-purpose funds in the appropriate budgets would have not affected the pool of funding to be put at the disposal of individual local-government units, or the scope of their respective tasks, it would have essentially enabled a more rational and efficient management of local or regional finance, free of irrelevant limitations. The need to reinforce the income base of territorial-government budgets in view of efficient absorption of the European Union funding, especially the structural funds, was accepted as an argument of importance. The deputies' bill became the point of departure for work on a draft of the new Public Finance Act, which was initiated in February 2006 by Zyta Gilowska, the Deputy Prime Minister and Minister of Finance.[8]

[6] Zarządzenie nr 2 Prezesa Rady Ministrów z dnia 14 stycznia 2000 r. w sprawie Międzyresortowego Zespołu ds. dokonania analizy celowości działania państwowych funduszy celowych oraz innych jednostek organizacyjnych (agencji), niepublikowane [Instruction no. 2 of the President of the Council of Ministers of 14th January 2000 re. the Interdepartmental Team for analysis of the purposefulness of operation of State-owned special funds and other organisation units (agencies), unpublished].

[7] Projekt ustawy o finansach publicznych, druk nr 1828, Sejm RP [Draft Public Finance Act, print no. 1828, of the Sejm of the Republic of Poland, 4th Term-of-Office]; www.sejm.gov.pl [access: 25.07.2016]. The bill was based on an expert opinion prepared by Z. Gilowska and W. Misiąg, which stemmed from the research and analyses carried out at the Market Economy Research Institute [IBnGR] (cf. Gilowska, Mierzwa & Misiąg 1997, 1999].

[8] Projekt ustawy o finansach publicznych. Cele, zasady, instrumenty, Ministerstwo Finansów, Warszawa, 7.04.2006 [Draft Public Finance Act. Objectives, Principles, Instruments, Ministry of Finance of the Republic of Poland, Warsaw, 7th April 2006]; www.mf.gov.pl [access: 25.07.2016].

Rearrangement of earmarked funds and other para-budgetary institutions (Government agencies) for the verification of the purposefulness of delivery of their statutory tasks and advisability of amassing the income and efficiency of spending public monies were at the centre of the reforming efforts envisioned in a series of Government programmes prepared since 2003. A *Programme for recovery of the finances of the Republic of Poland* is worth giving special attention. Published in June 2003, based on a diagnosis of the practical functioning of the institution of public finance, part of which was a comprehensive review of State-owned and local-government special-purpose funds, it was proposed that the PFRON, the Alimony Fund, the Privatisation Fund, the Central and Regional Branches of the Fund for Protection of Arable Lands, the State Fund for War Veterans, the Fund for the Promotion of Creative Activity, the *powiat* (district/county) and *gmina* (commune)-level Funds for Environmental Protection and Water Management, and two funds within the Agricultural Social Insurance Fund (KRUS) (the Incentive Fund and the Reserve Fund) should all be dissolved. Radical changes were also planned with respect to the other off-/para-budgetary forms. It was proposed that the so-called special-purpose measures and two Government agencies, the Agricultural Property Agency of the State Treasury and the Military Housing Agency, be liquidated as well. As for the other five agencies active at the time, increased ownership supervision was assumed. Unfortunately, the personal changes in the Government and resignation of Grzegorz Kołodko, the author of the finance recovery programme, as Deputy Prime Minister and Minister of Finance, prevented the launch of those proposed changes. New programme documents appeared very soon afterwards; while referring to the "Kołodko Programme," they differed as to the proposed solutions. Diagnosing the condition of the public finances and drafting three scenarios for economic growth, the *Medium-term strategy for public finance* [2003], assumed a rationalisation of the State expenditure primarily through consolidating the dispersed disposers (administrators) of public monies and disciplining the financial management of earmarked funds and Government agencies. The need to reduce the number of those institutions was indicated. These suggested alterations were further detailed in a *Programme of rearrangement and reduction of public expenditure* [2003; cf. Piotrowska-Marczak 2004]. In light of the postulated detailed solutions, the legal status of the Provincial (Voivodeship) Funds for Environmental Protection and Water Management was to be amended; these units were to be deprived of their legal personality and become departments of the related National Fund (NFOŚiGW). All in all, a reduction in the administrative expenses, particularly headcount costs, were assumed along with an increased effectiveness and efficiency in the funding of ecological tasks to be achieved through the consolidation of means and stricter oversight of their use. The solution thus proposed was meant to enter into force as od January 1st 2005.

Another proposition envisaged liquidation/winding-up or the dissolution of certain special-purpose funds, in particular, the Privatisation Fund, the Central and Regional Branches of the Fund for Protection of Arable Lands, and the PFRON. In proposing the dissolution of the PFRON, the remarkable operating expenses of this particular institution were emphasised; they were glaringly higher than those incurred by the National Insurance Institution (ZUS), for that matter [*Program uporządkowania*... 2003: 45].[9] It was pointed out, moreover, that most of the Fund's monies were managed outside the institution (primarily by territorial government units). The *Programme of rearrangement and reduction of public expenditure* noted that the PFRON's tasks ought to be taken over by the central budget and other public institutions (for instance, the Labour Fund). The *Programme* also postulated a reform of the farmers' insurance system, assuming the indispensable simplification of the KRUS's financial structure, particularly through a reduction in the number of its funds. There was a necessity to clearly define the legal status of the KRUS, as a State-owned unit with a legal persona, and all its funds, as State-owned earmarked funds. The subsidising of the KRUS with use of State budget money was to be diminished, owing to increased cash inflows from social insurance contributions (the amounts to be dependent on the farmers' incomes – main and supplementary, such as agritourism; the collection system to be "sealed up") [*Program uporządkowania*... 2003: 49-50].

The propositions regarding the rationalisation of public spending obviously embraced the Social Insurance Fund (FUS), the largest of the special-purpose funds. The new solutions in the old-age pension/retirement system (such as a gradually restricted early-retirement allowance system and an equalised pension age for males and females) and in the pension system (pension benefits to become a mobilising factor, and new rules of determining the rights and amounts of allocated pensions), or those related to sickness allowances, were to imply an altered structure of the Fund's expenditure. The "rearrangement and reduction programme" assumptions included alterations in Government agencies/departments; primarily, a dissolution of the Military Housing Agency and limitation of third-party tasks (other than core tasks) of the Agency for the Restructuring and Modernisation of Agriculture.

In parallel with the programme under discussion, a Green Book was published which offered a comprehensive picture of the sphere of social expenditure; it discussed in detail the reforms proposed in this respect, and discussed the effects of the changes in the long run (up to the year 2020) [*Racjonalizacja wydatków*... 2003].

[9] To give an example, the PFRON had a total headcount of 744 as of 2002, with the mean salary of PLN 4,130 per month (almost double the national average).

Most of these programme-based solutions meant to rearrange and set an order for budgetary system institutions have never been put into practice, or only partially so. The PFRON has not been dissolved; the status of the funds reporting to the KRUS has not been thoroughly altered. Contrary to what the reforming/improvement programmes intended, instead of limiting the range of the fund-based economy, the Sejm enacted, in as early as 2004, an amendment to the Public Finance Law by altering the definition of 'special-purpose (earmarked) funds' in a manner so as to fully enable the formation of new institutions of this sort. As a result, at least fifteen new State-owned earmarked funds appeared after January 1st 2005 (thirteen of which came in place of the dissolved special-purpose measures). A modified definition was also included in the Public Finance Act of June 30th 2005, which imposed no time limit for the formation of a special-purpose fund, but set forth certain terms that were basically meant order, as one might conclude, the scope of the fund-based economy. This, regrettably, was only done formally; bank accounts set up on a statutory basis but not defined by the said Law as funds, and funds whose only source of revenue, save for interest on bank accounts or donations, was a budgetary subsidy, were not classed in statutory terms as special-purpose/earmarked funds.

3. Special-purpose (earmarked) funds as per the 2009 Public Finance Act

The recent reorganisation of the public finance sector, envisioned by the Act from August 27th 2009,[10] has implied an essential change in the fund-based economy as it formally limits the possibility for such an economy to function only with respect to State-owned special-purpose funds, with the assumed lack of a legal persona. As defined in the said Act, such funds are to be set up under a separate law, their revenues to come from public money whilst the costs would be expended in view of the execution of certain specified State tasks. As a dedicated bank account, a fund is to be managed by the minister or another authority as indicated by the underlying law (based on which the fund is formed). The limitation whereby funds whose only source of revenue is a State budgetary subsidy, save for interest on bank accounts or donations, are not to be classified as State-owned special-purpose funds, has been retained, following the previous regulation (of 2005).

[10] Ustawa z dnia 27 sierpnia 2009 r. o finansach publicznych, Dz.U. nr 157, poz. 1240 [Public Finance Act of 27th August 2009, i.e. Journal of Laws no. 157, item 1240]; ustawa z dnia 27 sierpnia 2009 r. Przepisy wprowadzające ustawę o finansach publicznych, Dz.U. nr 157, poz. 1241 [Act of 27th August 2009 – The provisions implementing the Public Finance Act, Journal of Laws no. 157, item 1241].

Thus, the launch of a new public finance law was meant to cause an essential change in the organisation and functioning of the funds that had had a legal persona – namely, the State Fund for Rehabilitation of the Disabled (PFRON) and the Guaranteed Employee Benefits Fund (FGŚP). They were meant to be transformed into State-owned special-purpose funds within the means of the new Public Finance Act, which meant that they would lose their legal persona along with the authorities (the Management Board and Supervisory Board), and be transformed into a separate bank account to beat the disposal of the minister in charge of social security. However, no transformation has been made in the case of the PFRON; the date of the launch of the change was successively shifted, and the Fund's status finally remained that of a separate State-owned legal persona.[11] Yet, things have changed about the FGŚP as its tasks were taken over by the Minister of Labour, as the holder, and the marshals of the voivodeships acting on his behalf; consequently, the handling of the Fund has become the responsibility of the office of the Ministry of Labour or the competent respective provincial (voivodeship) labour offices.

The new Public Finance Act has eliminated the option to develop local-government earmarked funds and included the monies of previously existing funds in the respective budgets of territorial government units. The funds for the 'protection of arable lands' and the 'management of the geodesic and cartographic resource' have been wound up. A special approach was employed with respect to the funds for environmental protection and water management; only the communal and county-level funds were liquidated; their provincial-level institutional counterparts, as well as, the central-level fund (the National Fund) were to have their legal and organisational form altered to become local-government legal personas (the National Fund being a "State legal person"). The legal personas in question have taken over the tasks of the special-purpose funds being transformed, in their entirety, as well as, their names, with all the consequences in terms of financial management and the implementation of public tasks.[12]

It is worth emphasising that the change envisioned under the 2009 Public Finance Act extended to the verification of the number, as well as, the quality of the organisation of earmarked funds and their functioning, all in the context of soundness and rationality, openness (or publicness) and transparency. The Act provided for intensified supervision of the funds' financial management or the standardisa-

[11] Initially, as per the 2009 Law – The provisions implementing the Public Finance Act, the PFRON was to be transformed at the beginning of 2012; the date quoted later on was early 2015. Finally, by means of amended Law on professional and social rehabilitation and employment of the disabled, enacted by the Sejm on 29th August 2014 (Journal of Laws item 1457), the Fund's legal personality and authorities (Management Board and Supervisory Board) have been preserved.

[12] These changes were to be made by means of amended Environmental Protection Law of 20th November 2009, i.e. Journal of Laws no. 215, item 1669.

tion of the methods of drafting financial plans. The role of the revenue and expense plan, fundamental as it is to the financial management of State-owned earmarked fund, was meant to be reinforced, any modifications to such plan being subject to restriction (consent from the relevant minister or another fund administering authority, and notification to the Minister of Finance, were made obligatory). The scope of planning was extended to include financial plans drawn up on a by-task basis for the budgetary year and the two following years, including a description of the objectives, as well as, measures, criteria, and benchmarks.

These provisions certainly marked an important step toward a reorganisation of the fund-based economy; yet, it was still unsatisfactory, given the transparency of public finance as a whole. In parallel to special-purpose/earmarked funds, within the Public Finance Act there are institutions functioning with a different legal status and amassing monies on a special-purpose basis, in view of specifically defined tasks – some of them being literally named a "fund" (the examples being the National Health Fund, National Fund for Environmental Protection and Water Management and its voivodeship-level counterparts, or the State Fund for the Rehabilitation of the Disabled). In spite of the changes enacted, the status of the funds managed by the Bank Gospodarstwa Krajowego (The State Development Bank of Poland), the National Road Fund in particular, remains unclear. Although potential conditions have been provided for increased consolidation of public finance, the exercise is hindered in practice by considerable dispersion of means in the existing earmarked funds and the tendency for such new funds to appear, with no formal limitations put in place.[13]

Conclusion

With regards to Poland's fund-based economy, the situation still calls for a systemic alteration, in spite of the efforts made to this end over recent years. The

[13] Annex no. 13 to the 2016 Budget Law specifies the financial plans of a total of twenty-nine State-owned special/earmarked funds: the Fund for Management of the Geodesic and Cartographic Resource; the Agency Stock Fund (formed in 2014); the Technological Credit Fund; the Cultural Promotion Fund; the Fund for Development of Physical Culture; the Fund of Sports Classes for School Students; the Fund for Polish Science and Technology; the Fund for Modernisation of the Armed Forces; the Labour Fund; the Guaranteed Employee Benefits Fund; the Reprivatisation Fund; the Entrepreneur Restructuring Fund; the State Treasury Fund; the Compensation Fund; the Fund for Aid to the Injured and Post-Penitentiary Assistance; the Fund for Vocational Mobilisation of the Sentenced and for Development of Prison Industrial Workshops; the Police Support Fund; the Fund for Modernisation of Public Security; the 'Central Register of Vehicles and Drivers' Fund; the Frontier Guard Support Fund; the State Fire Service Support Fund; the State Fund for Rehabilitation of the Disabled; the Fund for Support of Public Benefit Institutions (since 2016); the Fund for Solving Gambling Problems (est. 2009); the Pension Fund; the Prevention and Rehabilitation Fund; the Administrative Fund; the Bridging Pension and Allowance Fund; the Social Insurance Fund.

maintenance and development or, on the contrary, diminishment or winding up of special-purpose funds and the similar organisational forms functioning outside the State budget framework is conditional upon a concept of the organisational model of public finance that is articulated, adopted, and, in the first place, consistently applied in the State. A concrete declaration of the representative and governmental bodies with regards to the preferred philosophy of managing public means is thus a must, especially that the theoretical doctrine can give no clear answer. Whilst special-purpose funds do cause a dispersion of means and infringe on the traditionally comprehended principles of budgetary unity and universality, they still offer an appropriate advantage may nonetheless, that should be taken as an alternative option to not-quite-flexible budget management practices, given today's scale and significance of public finance.

In search of systemic solutions in the area of public finance management, it is worth emphasizing that once the possibility of special-purpose/earmarked funds coexisting along with the central budget is finally found acceptable, then any like institutions are in need to be clearly defined by means of relevant legislation. That such funds form part of the public finance sector – based, primarily, on substantive criteria (such as the purpose-oriented use of public means available from the specified sources, relative to the implementation of the specified tasks of the State or other public-law entities) and their subordinate formal/legal criteria – should be beyond any question.

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Fundusze celowe sektora finansów publicznych – zmiany systemowe

Streszczenie. *Organizacja finansów publicznych obejmuje zarówno instytucje budżetowe, jak i formy gospodarki pozabudżetowej czy parabudżetowej. Do tych ostatnich należy nierzadko przeciwstawiana formule gospodarowania środkami publicznymi w oparciu o budżet, gospodarka budżetowa. Od dawna trwa w teorii i praktyce dyskusja co do zasadności tworzenia publicznych funduszy celowych, a w szczególności ich liczby i charakteru prawnego. Celem niniejszego opracowania jest analiza podejmowanych od początku lat 90. ub. wieku wysiłków reformatorskim w zakresie funduszy celowych sektora finansów publicznych, wraz z oceną aktualnej sytuacji w świetle regulacji ustawy z dnia 27 sierpnia 2009 r. o finansach publicznych.*

Słowa kluczowe: *sektor finansów publicznych, fundusze celowe, gospodarka funduszowa*

Zeszyty Naukowe
Wyższej Szkoły Bankowej w Poznaniu
2016, t. 70, nr 5

Bożena Kołosowska

Nicolaus Copernicus University in Toruń
Department of Economics and Management
e-mail: bozkolos@umk.pl
phone: 566 114 899

Challenges for the Social Insurance System in Poland

Abstract. *The study on the background of the current situation in the existing pension systems gives a glimpse into challenges which they face as a result of changes in the labour market, changes in the financial markets, and above all, as a result of demographic change (an aging population, the increasing number of pensioners in relation to people of working age, a low birth rate, etc.). The gradual raising of the retirement age in Poland up to 67 years started in 2012. It is relevant to introduce solutions within social security that will allow the system to adapt to the new social conditions, both demographic and economic. The challenge is to find a solution that would make Poles more interested in saving through voluntary pension saving systems by the introduction of tax preferences in this area. The introduction of the repartition system in 1999, with a defined contribution scheme in part managed by ZUS, resulted in the emergence of retirement debt, which is also a challenge that Poland has faced since the beginning of the reform.*

Keywords: *social security, pension, retirement benefits*

Introduction

Currently, social security systems, including pension schemes, are facing new challenges. On the one hand there are changes to the labour market, such as: unemployment, as well as, flexible and variable forms of employment relationships; and on the other hand, demographic changes arise, which include: drops in fertility rates and longer life expectancy. Both affect the situation of the pension systems in most countries globally. Emerging financial crises have negatively affected the fulfilment of commitments made and, at the same time, significantly worsened the financial situation of public systems. The usual reasons behind the modernization of social security systems are the process of population ageing and rising imbalances in financial pension systems. The goals of those changes include: stimulating the system's long-term financial stability and providing benefits that ensure a quality of life that is considered decent in most European countries.

The aim of this paper is to highlight the changes occurring in the Polish social security system. Particular emphasis is placed on the retirement security system, including the challenges it faces. The paper proposes that, due to the low level of benefits and growing concerns over even lower levels expected in the future, it might be necessary to initiate changes that also cover people who are socially excluded and are not subjects of social security systems.

The research method adopted in the paper is the descriptive method.

1. Terms of social protection, social security, and the pension system

When presenting the concept of social security, it should be pointed out that the state is obligated to provide social security to its citizens. At the same time, it needs to carry out its activities in a way to reduce and repair the effects of social risks. According to the Encyclopedia PWN "social risks are created mainly by events, which are causes of a significant deterioration in the financial situation of an individual or family, and are arising from the loss or reduction of opportunities to gain livelihood and ensure minimum social standards."[1] Polish law defines nine types of social risks, linked to different branches of social security:

– the death of a breadwinner (allowance benefits),
– sickness (sickness benefits),
– lack of employment and job loss (unemployment benefits),
– old age (pension benefits),
– periodic or permanent incapacity (work related disability benefits),
– health loss (healthcare),
– occupational diseases and work related accidents (accident benefits),
– shortage of income in the family (family allowances),
– birth and upbringing of a child (maternity benefits) [Kowalczyk & Kamiński 2013: 60].

The concept of social protection has not obtained a clear definition that is accepted by all communities. According to Wojciech Muszalski "social protection is the idea, according to which the general public through its organizations (i.e.

[1] http://encyklopedia.pwn.pl/haslo/ryzyko-socjalne;3970589.html [access: 1.03.2016].

the state) is obligated to provide living conditions for all whom, not by their fault, cannot provide for themselves through their own work" [Muszalski 1995: 83]. The state, as a main social organization, should provide the necessary resources to people who cannot, or are not able to, acquire the necessary amount of money to sustain a minimal lifestyle. The reasons that people may not be able to provide the means to survive are: unemployment, illness, old age, disability, and other involuntary causes.

Social protection is defined in a slightly different way by Zbigniew Salwa, who states that "social protection is a set of tools and benefits that protect citizens against the effects of events that can deprive them of the necessary means to provide for themselves" [Salwa 1995: 311].

Art. 67 of the Constitution of the Republic of Poland of April 2, 1997 states that: "Each citizen has the right to social protection in the event of the inability to work due to illness or disability, or after reaching retirement age. The scope and forms of social security are specified by law.

A citizen without work through no fault of their own, and no other means of support, has the right to social protection, the scope of which is determined by law."[2]

The Constitution also states in art. 68 § 3, that public authorities have an obligation to provide special health care to pregnant women, children, the disabled, and the elderly.

There are three techniques (forms) of social protection: the insurance method, the supply method, and the welfare technique. Tadeusz Szumlicz [2010: 39] calls the welfare technique the philanthropic rule.

The primary purpose of social care is to fulfil vital needs of families and people unable to work, as well as those who temporarily found themselves in a difficult life situation. Benefits that are granted using welfare techniques are discretionary and are awarded individually from public funds (local, central, and endowments) after having examined the situation of people who apply for it. Benefits are granted on the basis of legislation and the person requesting it has no possibility to influence the form of the benefit [Kowalczyk & Kamiński 2013: 61].

Benefits provided in the supply method have a restitutionary character. The State grants the right to benefits for selected citizens belonging to a particular social group or a profession (students, people with disabilities from birth, war invalids, soldiers, civil servants). The size of those benefits and conditions that are required to be met are governed by statutory conditions. Just as in the welfare method, benefits are financed from public funds (taxes). Entitlement to the aid

[2] Konstytucja RP z dnia 2 kwietnia 1997 r., Dz.U. nr 78, poz. 483 [The Constitution of the Republic of Poland dated 2 April 1997, Journal of Laws No. 78, item 483].

occurs as a result of the fulfilment of the conditions laid down by law [Bednarz 2008: 56].

The last method of social protection is the insurance technique. It states that provided benefits are of a restitutionary and obligatory character. To receive them, it is required to register for insurance and pay contributions that form the insurance fund that finances the benefits [Kowalczyk & Kamiński 2013: 61]. The amount of benefit depends on the size of contributions, while the payment of benefits is determined by law[3]. Within the insurance fund, all persons covered by insurance bear the cost of risks.

Social security is treated as one of the techniques of social protection, which protect the public from the consequences of unforeseen mishaps. The occurrence of sudden events usually leads to loss of income but also to unexpected expenses due to the situation in life.

According to the Encyclopedia PWN, social security is a "system of benefits protecting employees and their families from the negative consequences of the loss or limitation of opportunities, loss of the breadwinner, or increased family burdens (illness, maternity, disability, old age, death, unemployment)."[4] In contrast, Muszalski defines social insurance "as a form of the social security concept, and derives from business insurance, especially various forms of social insurances. Therefore, it has features in common with business insurance. Namely, it always includes following elements: contributions, joint funds, risks, damages, and damages liquidation coverage" [Muszalski 1995: 84].

Benefits within social insurance can be divided by the type of insurance protection. This division is consistent with the division of social insurances, which is presented in art. 1 of the Polish social insurance system Act. Social insurance includes:

– pension insurance,
– disability insurance,
– insurance in the case of sickness and maternity, known as sickness insurance,
– insurance against accidents at work and occupational diseases, known as accident insurance.

Another division of benefits recognizes the period in which they are drawn:

– short-term (grants),
– long-term (pensions).

A feature common to all types of social insurance is to provide benefits in the event of the inability to work due to: old age, disease, accident (having no direct

[3] In the year 1999, a defined contribution system was introduced; it determined the amount of benefits based on the amount of contributions paid and the average life expectancy.

[4] http://encyklopedia.pwn.pl/szukaj/ubezpieczenie-spo%C5%82eczne.html [access: 1.03.2016].

connection with work), childbirth, care for a child or other family member, occupational disease, or an accident at work. In the case of an inability to work for any of those reasons, the benefit takes a different form also depending on the type of social insurance [Sułkowska 2014: 34].

Maciej Żukowski hailed social insurance as one of the greatest social innovations in history, limiting the effects of social risks. At the same time, there is a discussion on changing the approach to the so-defined social insurance [Żukowski 2014: 51]. Marek Góra sees that "Population changes, which have presented themselves in the last decades of the twentieth century, force a revision of the traditional approach, and therefore to make changes in the way various parts of social security are handled, and more broadly, to make profound changes in the way individual social risks are approached" [Góra 2014: 114].

The Act dated October 13, 1998 on Social Insurance System[5] in Art. 2 § 3 and Art. 2a formulates two important principles: the principle of equal treatment of insured persons and the principle of guaranteeing the solvency of benefits handled by the social security system of the state.

The pension system implemented in a given country is the result of a specific breakdown of gross domestic product between the generation of working people and the generation of retirees [Góra 2003: 37-41]. This division, which can be made in very different ways, exposes the differences between systems in different countries. A universal question arises: What is the best way to ensure people will receive adequate income throughout the period of their retirement?

When describing the pension system it is important to emphasize the fact that it is a form of security. Usually, it consists of multiple elements sharing a specific purpose which can be regarded as "a provision of living conditions for people who, due to their old age, no longer have an earning capacity" [Dybał 2008].

The Polish pension system is heterogeneous. It consists of a universal employee pension system, the pension system for farmers, and the so-called pension protection system for uniformed services, judges, and prosecutors namely, the "Zaopatrzeniówka".

The universal system, by itself, is differentiated in terms of rules for granting pension. The decisive factor is age. Citizens born before 1949 are classified under the so-called "old rules", which relate the size of the pension to the retirement age reached and the contribution periods. The "new rules" apply to the majority of people born after 1949. They receive a pension, which size depends on their retirement age and amount of paid contributions. The main difference between these systems is the relation of the size of the pension, under the "new rules", to

[5] Ustawa z dnia 13 października 1998 r. o systemie ubezpieczeń społecznych, Dz.U. nr 137, poz. 887 [Act dated October13, 1998 on Social Insurance System, Journal of Laws of 1998, no. 137, item 887].

the base of calculation of pension contributions (which usually means that the value of received pension is related to the earnings achieved during the person's whole working life). The universal system has a pay-as-you-go, capital scheme which, in practice, means that in addition to gathering funds on the basis of an intergenerational contract, a portion of paid premiums should work for the benefit of the future pensioner.

This aspect of the system underwent a lot of changes over time. The last modification was allowing members of the Open Pension Fund (OFE) to transfer a part of their pension contributions during the period of April 1st to July 31st, 2014. It created alternative options for investing funds. Currently, the total pension insurance contribution amounts to 19.52%, of which:

– 12.22% of the base goes to the individual account within the Social Insurance Fund (ZUS),
– 4.38% of the base is transferred to a sub-account in ZUS,
– 2.92% of the base ends-up on a sub-account either in ZUS or OFE.

Therefore, it is possible to transfer all contributions to the Social Insurance Fund (where 7.3% will be indexed), or send 16.6% to the Social Insurance Fund (where 4.38% will be indexed) and the remaining 2.92% to OFE (the value of which will depend on the management performance of a chosen Pension Fund Company – PTE)[6].

Table 1. Number of benefit recipients in the pension protection system in Poland during the years 2005-2013 (in %)

Year	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
Universal System	78.4	77.9	79.5	80.1	80.7	81.0	81.3	81.4	81.6	81.8
Agricultural System	17.9	17.3	16.7	16.0	15.3	14.9	14.5	14.2	13.9	13.7
Supply Systems	3.7	4.8	3.2	3.9	4.0	4.1	4.2	4.4	4.4	4.5

Source: own work based on GUS 2015: 38.

Table 2. Gross pension and benefit structure in accordance to different social protection systems in Poland during the years 2005-2014 (in %)

Year	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
Universal System	80.5	81.1	81.7	82.6	83.3	83.6	83.8	83.7	83.7	83.9
Agricultural System	12.4	11.8	11.1	10.3	9.6	9.2	8.9	8.8	7.7	7.8
Supply Systems	7.1	7.1	7.2	7.1	7.1	7.2	7.3	7.5	8.6	8.3

Source: own work based on GUS 2015: 55.

[6] www.mpips.gov.pl/download/gfx/mpips/pl/defaultopisy/8587/1/1/ofe_zus_Informacja.pdf [access: 22.04.2016].

When analyzing the share ratio of individual pension and benefit systems it is important to compare them, both in terms of the number of beneficiaries (Table 1), and the value of gross spending on pensions and benefits (Table 2).

The data confirms that a wide range of people are covered by the universal pension system (currently over 80% of beneficiaries). There are also small benefits under the pension scheme for farmers and those of privileged status in the supply pension system (a much higher percentage in terms of value than in numbers).

Table 3. Replacement rates measured as a ratio between mean monthly gross pension benefit and average salary in the national Polish economy during the years 2000-2014

Year	2000	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
Universal System	63.7	66.6	66.1	66.8	59.1	60.8	62.2	62.0	62.9	64.0	64.0
Agricultural System	40.2	40.5	40.9	37.7	34.8	35.0	35.3	34.6	35.6	36.1	35.6

Source: own work based on GUS 2015: 29, 30.

The ratio of replacement rates for a given part of the pension system shows the amount of the average benefit in relation to the average salary. It points to the redistribution of income in the different periods of our lives. In the year 2013, the value of the replacement rate is at a high 64.0% level and is similar to that during the year 2000. A significant decrease in this ratio from 66.8% to 59.1% occurred in 2008. Since then, however, we have seen a steady growth of this relationship. Nevertheless, we must remember that the benefits paid in the majority of cases have been based on the old pension system, or a mixed system. Payouts determined by the new rules were still not made.

When looking at the average gross monthly pension paid from the Agricultural Social Insurance Fund between the period of 2000-2006, the ratio of its value in relation to the average salary in the Polish economy remained at a similar level: 40.2% in 2000, and 40.9% in 2006. Between 2007 and 2008 there was a decline to a level of 34.8%. The ratio of about 35% lasted until 2011, followed by its increase to 36.1% in 2013, and then a decline to 35.6 % in the year 2014 [GUS 2015].

2. Challenges of the Polish pension system

Pension systems in different countries are dealing with great challenges from the changes related to the labour market, financial markets, and above all, the challenges of demographic changes (an aging population, increasing number of people at retirement age in relation to people of working age, low fertility, etc.). A gradual increase of the retirement age in Poland to 67 years started in 2012 and can be considered as an important solution tailored to the social conditions that are both demographic and financial [Żukowski 2014: 49].

The challenges relate to the growing problem of pension debt, which was caused in 1999 by the introduction of the repartitional system with a defined contribution scheme in parts that were managed by the Social Insurance Institution. The creation of individual retirement accounts in the repartition part allows ease in calculating the size of the current debt of the pension system for its participants who have not yet gone into retirement. It can be calculated by adding current values of individual pension accounts – these are the rights of the people subject to the pension system that will be executed in the future from the next generation of citizens paying premiums. The full amount of the pension debt must also cover liabilities to current retirees. Pension debt in the repartition part resulting from obligations to professionally active people (funds gathered on retirement accounts kept by ZUS) amounts to, according to published estimates, about 2 trillion PLN [Rutecka 2014: 6].

As a result of the reform, a deficit was generated in the repartitional system (the so called first pillar) during the transitional period as a result of a situation where benefits had to be paid from the "old" system, while a part of the pension contributions was already transferred to the accounts of the insured in the capital part of the system. This resulted in the need for financing the deficit from the state budget in the part of the system dealing with payments covering benefits for current retirees, who earned their pension rights under the previous system.

Since mid-January 2014, anew act of law came into effect introducing significant changes in the functioning of the pension system, as well as, new rules for benefit payments from the funds accumulated in open pension funds (OFE) [Rutecka 2014: 6]. The payment of retirement benefits from the entire universal system is performed by one institution (ZUS), and the benefit amount is calculated by dividing the account balance (sub-account) by the average life expectancy of a person at a given age.

Shifting assets from open pension funds to ZUS can be observed from the perspective of changes drastically limiting the multidimensional nature of the pension system and the earlier introduced safety rule based on the diversity that guided the reform of the pension system in 1999. The repartition role of the system increased significantly, financed by the currently accumulated premiums which, with the deteriorating demographic situation in Poland and the less favourable relationship between the number of working people and the number receiving pensions, may raise important concerns about the finances of the pension system and its ability to maintain liquidity. Unfortunately, the forecast of the Central Statistical Office for the next 25 years indicates that in addition to a deepening negative population growth, the phenomenon of the declining of population in the working age while increasing the number of people in the retirement age comes into play[7]. In the year

[7] Prognoza ludności na lata 2014-2050, GUS, http://demografia.stat.gov.pl/bazademografia/Prognoza.aspx [access: 8.06.2016].

2050, it is expected that there will be nearly 10 million people in the retirement age (currently this number is approx. 7 million). Its proportion to the total population number will increase from approx. 18% of the population today, to almost 30% in the next 35 years. This situation raises many concerns because of the disproportion between these groups. People currently paying their contribution to the system are financing retirement benefits and their beneficiaries each year, but the required amount is considerably increasing over time. This may result in a growth of the deficit in this area.

The challenge of generating wider interest among Poles for saving in a voluntary pension saving system is addressed by introducing tax preferences in this area. There are now exemptions on contributions paid into IKZE. Additionally, instead of the standard payment taxation from these accounts, a 10% flat-rate tax has been introduced. The European Commission also recognizes the need to implement a comprehensive strategy which will correspond to overlapping demographic and economic changes. Reforms are proposed that are aimed at extending the working age and increasing the employment rate (especially of women and older workers). There are also incentives given to accumulate additional retirement savings that will increase revenues at the end of a person's professional activity [Petelczyc 2014: 20]. The vital role of taxes and other financial incentives and collective agreements is emphasized. The "White Paper" states that "the EU can strongly support occupational pension schemes within the universal pension systems in Member States and contribute to the reduction of the cost of pensions" [Plan na rzecz... 2012].

3. Changes proposed in different social insurance systems around the world

Many countries introduced a solution that ensures a minimum value of benefits, by: allowing the purchase of missing contribution periods necessary to receive pension, as well as, creating ways to determin the minimum pension (which may be a part of the minimum wage) under the condition of participation in the pension system during a given number of years.

Solutions are being looked at that deal with ways of indexing benefits. Luxembourg introduced a mixed indexation (on a wage-price basis), if prices increase by 2.5%, pension benefits are automatically valued [Poteraj 2009: 27]. In Denmark, the benefits of the universal system are indexed automatically depending on the growth of the average salary[8]. In Australia, state pension is indexed according to the Consumer Price Index [Owczarek 2014].

[8] www.zus.pl/defaultasp?p=2&id=751 [access: 12.04.2016].

To maintain the current level of benefits paid, solutions are being introduced that increase economic activity (providing contributions) or raise the retirement age. This is being performed in the majority of pension systems throughout the world, possibly increasing the amount of transferred contributions. This can be done by removing the upper limit of salary, which is subject to the pension premium.

Incentives for the gradual extension of the retirement age are introduced. A flexible retirement age can help in solving emerging problems. In Luxembourg, the pension reform envisages that after completing the full 40-year contribution period citizen will be entitled to a pension that will be lower than today. Working during consecutive years will result in a raising of their pension. This decision will be entirely voluntary; everyone will be able to decide on the amount of their pension. Implemented solutions do not force to work longer but provide incentives to do so[9].

Solutions are introduced in the area of reliefs and incentives due to individual savings, or reliefs and exemptions for employers who show greater involvement in the creation of occupational retirement provision schemes. Tax exemptions are used, as well as, reliefs in the payment of social security contributions. Additionally, income tax can be calculated from contributions, for example, at 20%, which the employer is responsible for (this is practiced in Luxembourg) [Szumlicz & Żukowski 2004: 224-225].

Increasing the system stability of the individual forms of saving for old age can be achieved by introducing solutions that are based on systematic savings plans, as well as, in terms of regular payments of partial savings in the form of regular benefits. In Poland, within the IKE or IKZE, participants can make one-time payments. There is no preference for those making regular payments. To ensure greater security, a requirement is being introduced for an annual reporting on retirement savings. In Poland this role is performed by ZUS and the PTE providing information on the state of retirement accounts in the FUS and OFE.

According to the Melbourne Mercer Global Pension Index in 2013, the highest rated pension systems were in the following countries: Denmark, Australia, the Netherlands, Finland, Sweden, and Canada.[10] The Mercer Company strongly prefers solutions that increase support for the poorest pensioners, or the level of savings of households.[11] Great emphasis is placed on the economic activity increase

[9] The reform stipulates that after 40 years of contributions, an individual will be entitled to a lower pension; to increase it, an individual would have to decide to continue working consecutive years: *Reforma emerytalna w Luksemburgu*, https://polska.lu/forum/139/11953 [access: 12.04.2016].

[10] www.rp.pl/artykul/945257-Dunski-system-emerytalny-najwyzej-oceniony.html#ap-1 [access: 13.04.2016].

[11] http://finanse.wp.pl/gid,15767229,kat,1033803,title,Najlepsze-systemy-emerytalne-swiata-i-Polska,galeria.html [access: 12.04.2016].

Table 4. Countries issuing minimum citizen pensions

Country	Introduced Solutions
Australia	State pension, financed from the budget granted to persons over 65 years of age (until 2023 this age will be gradually increased to 67 years), who's income level is below a certain threshold.
Denmark	Obtained pension is guaranteed by the state when reaching retirement age (currently 65 years, extended to 67 years). To receive the full amount, it is necessary to live in Denmark for over 40 years after the age of 15. A shorter period of residence means lower pension benefits.
Netherlands	State pension is determined in relation to the minimum wage. The right to receive it is given to all citizens of the Netherlands regardless of employment. Each year of stay in the Netherlands between the ages of 15 and 65 means the acquisition of 2 percent of pension rights. There is a possibility to „purchase" the missing contribution years.
Canada	Minimal pension is guaranteed by the state (up to approx. 1,700 PLN), the basis of its acquisition is living in Canada for 40 years. The minimum pension is paid depending on the amount of total income; the richest are not able to receive payments from this system.
Norway	Basic pension is granted to persons residing in Norway for at least 40 years and having been members of the Folketrygden (Norwegian Social Insurance Institution).
Sweden	Minimum pension (entitled to which in full extent are those who lived in the country for at least 40 years, its amount is usually equal to 35% of the average salary) paid to the poorest.

Source: own work based on: www.australove.com [access: 12.04.2016]; www.wiatrak.nl/27524/emerytura-w-holandii [access: 20.04.2016]; www.rijksoverheid.nl/ [access: 20.04.2016]; www.mojanorwegia.pl/praca-w-norwegii/emerytura-norweska-1503.html [access: 20.04.2016].

in the older age groups[12]. Linking retirement age to life expectancy is highly regarded. The Danish pension system is following such rules; hence their retirement age in 2050 is expected to reach 69 years[13].

Adopted in 1999, pension reform will be the subject of revision in a few years due to the introduction of a defined contribution scheme, which will lead to a significant diversification of benefits and the emergence of low pensions. These systems assumed a citizen's economic career is based on the continuity of employment throughout their working lives, low unemployment, as well as, stable and steadily rising wages. We are seeing a different career paths, which differ from the pattern presented above. In such situations, calculating the amount of paid benefits based on the principle of defined contribution, which strongly reflects careers that have been described above, puts many people at risk of receiving a low pension.

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[12] http://finanse.wp.pl/gid,16194095,kat,36874,title,Ranking-systemow-emerytalnych-2013,galeria.html?ticaid=116cbd [access: 10.04.2016].

[13] www.rp.pl/artykul/945257-Dunski-system-emerytalny-najwyzej-oceniony.html#ap-1 [access: 21.04.2016].

Simulations carried out on the amount of future benefits from the new pension system indicate that women are especially vulnerable to poverty. Other groups that this effects include people working in the black market or through civil law contracts and working in a temporary capacity.

There is a need to establish a minimum pension or other solutions in the field of social security, which would ensure solutions on an acceptable social level [Golinowska 2014: 108]. Table 4 shows that countries occupying the top places of the Mercer ranking provide minimum guaranteed benefits.

Conclusion

Modern pension systems are exposed to many risks which largely affect the amount of individual pensions. This presents many challenges before national governments who want to minimize their negative effects. Those that want to make further changes in their system, should carefully analyze the situation in other countries, to develop the best solutions or to possibly predict problems that may occur, and act to minimize their effects as soon as possible. When reforming the system it is prudent to look in a long term perspective and consider how the planned changes will affect the future functioning of the pension system.

Similar solutions are employed throughout the world: raising the retirement age, bringing new ways to index benefits, promoting additional and voluntary forms of saving for retirement age, or encouraging citizens to lead longer working lives. Many countries have introduced the payment of benefits guaranteed to all citizens, regardless of affiliation to the social security system. The challenge is to find a solution that would make Poles more interested in saving through voluntary pension saving systems by the introduction of tax preferences in this area.

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Wyzwania stojące przed systemem ubezpieczeń społecznych w Polsce

Streszczenie. *W opracowaniu na tle obecnie obowiązujących systemów emerytalnych przedstawiono wyzwania przed jakimi one stoją na skutek zmian zachodzących na rynku pracy, na rynkach finansowych, a przede wszystkim na skutek zmian demograficznych (proces starzenia się populacji, wzrastająca liczba osób w wieku poprodukcyjnym w stosunku do osób w wieku produkcyjnym, niska dzietność, itp.). Stopniowe podwyższanie wieku emerytalnego w Polsce do 67 lat, zapoczątkowane w 2012 r., można uznać za istotne dostosowanie rozwiązań ubezpieczeń społecznych do warunków zarówno demograficznych, jak i ekonomicznych. Wyzwaniem na pewno staje się szersze zainteresowanie Polaków oszczędzaniem w dobrowolnym systemie oszczędzania emerytalnego poprzez wprowadzenie preferencji podatkowych w tym zakresie. Wprowadzenie w 1999 r. repartycyjnego systemu o zdefiniowanej składce, w części zarządzanej przez ZUS, spowodowało ujawnienie długu emerytalnego, który także jest wyzwaniem, z którym borykamy się od początku wprowadzenia reformy.*

Słowa kluczowe: *system ubezpieczenia społecznego, system emerytalny, świadczenia emerytalne*

Zeszyty Naukowe
Wyższej Szkoły Bankowej w Poznaniu
2016, t. 70, nr 5

Magdalena Zioło

University of Szczecin
Faculty of Management and Economics of Services
e-mail: magdalena.ziolo@wzieu.pl
phone: 503 828 891

Fiscal Consolidation Used as a Way to Stabilise Public Budgets – A Perspective from the Level of Subnational Governments

Abstract. *This paper outlines the current data about the subnational government's fiscal position and points out the issue and role of fiscal consolidation in the process of deficit and debt reduction at a subnational government level. The theoretical framework of fiscal consolidation has been presented in detail. The policies and instruments of fiscal consolidation have also been mentioned within the paper. In addition, the fiscal consolidation instruments and rules have been discussed. The aim of the paper is to highlight and diagnose the importance of fiscal consolidation after the financial crisis of 2008, and to highlight the factors contributing to successful fiscal consolidation. This manuscript presents the issues for Organisation for Economic Co-operation and Development (OECD) countries during the years 2010-2016. The study uses methods such as the critical analysis of literature, observations, case studies, and logical reasoning.*

Keywords: *deficit, debt, fiscal consolidation, self-government, fiscal rules*

Introduction

The importance of fiscal consolidation as an economic phenomenon arose after the financial crisis of 2008. Many countries in Europe, and elsewhere in the world, have had critical problems with stabilizing their budgets due to the crisis and its aftermath, which include excessive deficit and debt [Lassen 2010: 3; The Great Recession 2010]. There are many reports and analyses that focus their research on fiscal consolidation (IMF, OECD, and WB) however, theoretical and empirical approaches are not the same. There are two crucial paths of fiscal consolidation presented in related works: the first one carries out research on the influence of fiscal consolidation on economic growth, development, and consumption [e.g. Hernández de Cos & Moral-Benito 2013; Kleis & Moessinger 2016; Eyraud & Weber 2012; Favero & Giavazzi 2007], and the second one shows the effects and efficiency assessment of fiscal consolidation and the evaluation of the probability of success of debt reduction [e.g. Heylen, Hoebeeck & Buyse 2013; Afonso & Jalles 2012; Alesina & Ardagna 1998; Ardagna 2004; Guichard et al. 2007; Larch & Turrini 2011; McDermott & Wescott 1996].

The effects of fiscal consolidation are different, and determined by many factors. The kind of fiscal consolidation[1] also matters according to its final effect. Silvia Ardagna, Alberto Alesina, and Roberto Perotti emphasized that the output effect of fiscal consolidation based on expenditure is much more sustainable than if it were based on revenue [Ardagna 2004; Alesina & Perotti 1997]. In the empirical study done in 2015 (which looked at 16 OECD countries over a 30-year period) Alberto Alesina, Carlo Favero and Francesco Giavazzi argue that the effects of consolidations depend on their design. The authors stated that "fiscal adjustments based upon spending cuts are much less costly, in terms of output losses, than tax-based ones and have especially low output costs when they consist of permanent rather than stop-and-go changes in taxes and spending" [Alesina, Favero & Giavazzi 2015]. According to other studies prepared by Emanuele Baldacci, Sanjeev Gupta, and Carlos Mulas-Granados [2013] "fiscal adjustments that are gradual and rely on a mix of revenue and expenditure measures can support output expansion, while reducing public debt" [Baldacci, Gupta & Mulas-Granados 2013].

It is important to mention that the effects of fiscal consolidation are determined inter alia by the type and level of government, the nature of consolidation[2], the period during which the fiscal episodes have occurred, and the time perspective (short and long-term effects of fiscal consolidation). The type of spending (operating or capital expenditures) that has been cut is equally crucial. The empirical evidence provides findings that show that cuts in transfer programs and government wage expenditures are more effective than capital expenditure cuts [Alesina & Perotti 1997]. In additional research carried out by Charles Amo-Yartey, Machiko Narita, Garth Peron Nicholls, Joel Chiedu Okwuokei, Alexandra Peter, and Therese Turner-Jones in several successful fiscal consolidation episodes, spending cuts were used to reduce deficits and associated with economic expansions rather than recessions [Amo-Yartey et al. 2012: 10].

One of the crucial outcomes of fiscal consolidation should be debt reduction, as austerity pro-grams are designed for dealing with excessive debt. The research in this field is generally focused on an analysis, how strong the effect may be, and

[1] Fiscal consolidation based on expenditures or revenue based fiscal consolidation.

[2] Gradual or sharp consolidation, large or small.

what factors determine this effect, while taking into account consolidation based on revenue and expenditures (for example as seen in Maria Grazia Attinasi Luca Metelli 2016). For the purpose of this paper, the analysis will focus strongly on the relation between debt reduction and fiscal consolidation at the subnational government tier in OECD countries.

The aim of the paper is to present the theoretical background regarding the issues of fiscal consolidation (with special mention to the sub central government level) and its importance as a tool of reducing excessive deficit and debt in the public sector, especially after the financial crisis of 2008. The objective of the study is to present different approaches and results of empirical research carried out by many authors from different countries, and to diagnose any gaps in their research. The study is uses methods such as the critical analysis of literature, observations, case studies, and logical reasoning.

The paper is organized as follows: in section one, the theoretical background and related works have been presented, particularly the problem of fiscal imbalances and fiscal consolidation as an economic phenomena; in section two, there is a discussion about fiscal rules and fiscal consolidation across the sub-central government. Conclusions are presented in the final part of the paper.

1. Fiscal consolidation as an answer to the fiscal imbalance problem

The problem of fiscal balance is widely discussed and presented in almost every school of economic thought. The theory of general equilibrium was the subject of research done by Leon Walras and Vilfredo Pareto. On the other hand, Alfred Marshall worked on the cash balance theory. Representatives of the various economic schools differ in their views on the issue of financial imbalances. Generally, the discussion mainly relates to arguments and evidence in the sphere of the legitimacy (or lack thereof) in maintaining a balanced budget. At this point, it should be noted that budgetary imbalances are a smaller category of imbalances in the scope of public finance or the public sector finance imbalance. An overview of the main trends represented by the different schools of economic theory leads to the conclusion that the views of the imbalances were twofold and related to postulate a balanced budget, or the budget of an unbalanced nature (surplus/deficit). However, in the case of an unbalanced budget a deficit balance is an important instrument of fiscal impact. Keynesians believe that deficit may stimulate demand and economic growth and, during the recession, an imbalance in the budget is a must, as any kind of deficit reduction will temper economic growth and increase recession [Miron 2015: 3-4]. This opinion was not shared by classical economic school representatives such as Adam Smith, David Ricardo, and John Stuart Mill et al. who were convinced of the absence of the need to intervene with the creation of a deficit budget and believed that the budget should not affect the economy in any way. The balanced approach to budgets was also supported by economists like Jean-Baptiste Say and Alvin Harvey Hansen. The negative impact of imbalanced budgets, such as financial burdens created by debt cost, was emphasized by economists like James M. Buchanan and Joseph Alois Schumpeter.

In light of the discussion about the cost of benefits of imbalanced budgets, the question about the reason of fiscal distress and imbalanced budgets arises, as well as, that of public finance. According to Jon Riley and Robert Chote, the key economic developments that have shaped public finances are: the weakness of nominal GDP, the stubbornly high inflation of consumer price, productivity, the fall of real wages, a disproportionate hit to the financial sector, very low interest rates, and weak asset markets [Riley & Chote 2014: 2-3]. Besides the economic factors mentioned above, the impact of the so-called "old and new social risks" on public finance is crucial, especially demographic ones like the problem of an aging society, a longer life expectancy, and a decreasing birth rate. Richard Hudson highlights the problem of financing long-term health care related to the above mentioned problem [Hudson 1997: 105-107]. This influences the increase of the material costs of providing public services, which becomes highly problematic in the case of excessive indebtedness and an unsolved problem of threats resulting from the so-called "old social risk". The following causes determining fiscal imbalance are also pointed out: conjectural cycles, political aspects,[3] budgetary processes, structural factors, and ineffective tax collecting [Tujula & Wolswijk 2004: 13-14].

Besides the determinants mentioned below, a crucial role in destabilizing public budget is played by the financial market, especially the banking sector who created a new phenomenon called "financialization." The crisis that started on subprime marked credit spilt over to the public sector and public sector finance, as the governments took the cost of the restructuring and resolution of financial institutions that seemed to be "too big to fail". The condition of the public finance PIGS group (Portugal, Ireland, Greece and Spain) was especially problematic; however, this was not a complete list because in 2012 and 2013, only Luxemburg and Germany had a positive budget balance out of all the EU countries. Japan's debt in relation to its GDP, is the largest one in the world, similarly to the total debt of the USA (Chart 1 and 2). The financial crisis of 2008 showed that the instruments of debt control that were used so far were insufficient. Countries across the word started to implement austerity programs that were generally based on cutting public expenditures, in order to improve budgets balance. Austerity programs are

[3] Political-economy aspects, political fragmentation, political business cycle, political orientation of cabinet etc.

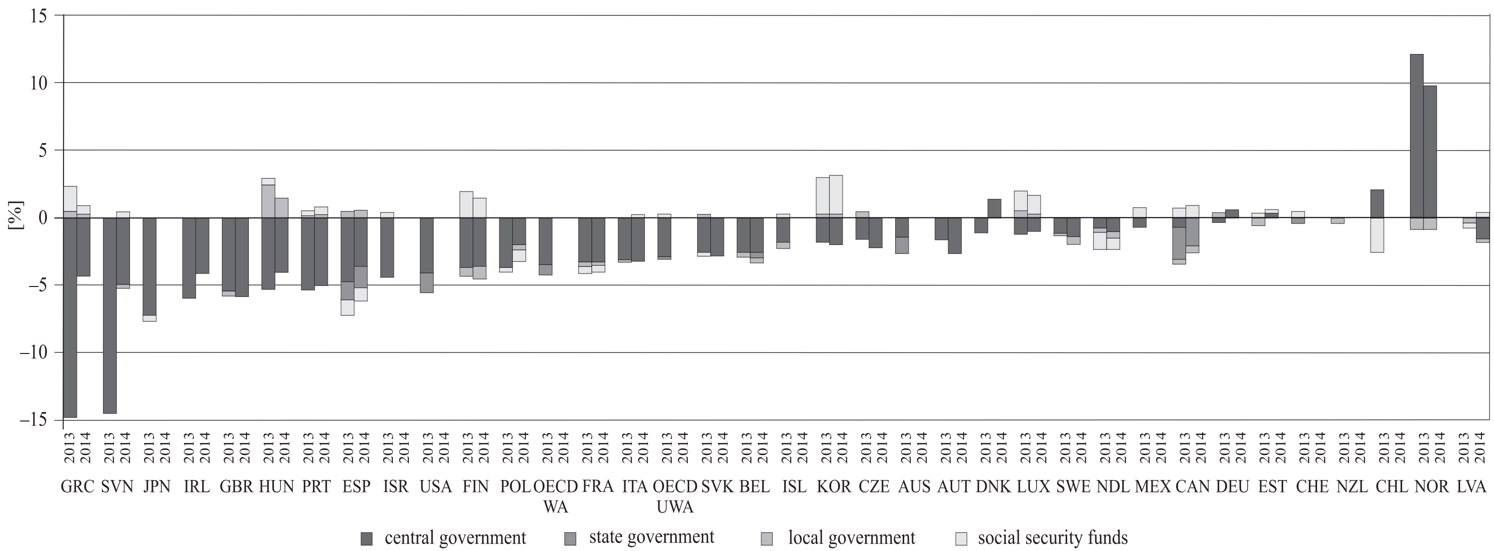
important tools of fiscal consolidation. In most commonly presented definitions, fiscal consolidation is defined as "an improvement in the CAPB[4] of at least 1.5% taking place in one single year (cold shower) or taking place over three years if each and every year the CAPB does not deteriorate by more than 0.5% of GDP (gradual consolidation)" [Barrios, Langedijk & Pench 2010: 11; Alesina & Perotti 1995]. According to the definition presented by OECD, fiscal consolidation is defined as "concrete policies aimed at reducing government deficits and debt accumulation. These consolidation plans and detailed measures are given as a percent of nominal GDP" [Fiscal consolidation... 2011: 17]. The definition of fiscal consolidation itself is homogenous and, in parallel, successful fiscal consolidation is defined and explained. Generally, in literature, fiscal consolidation is successful if the reduction in the debt-to-GDP ratio (or the primary budget balance) is sufficiently large and persistent [Alesina & Perotti 1995]. The alternative criterion of successful fiscal consolidation points out that there is a relationship between cutting public wages and successful fiscal adjustment as follows: the higher the proportion of the consolidation conducted via reducing public wages, the higher the probability of the adjustment being successful in terms of persistence in the deficit reduction [Hernández de Cos & Moral-Benito 2013: 4]. There are also many definitions of expansionary fiscal consolidation [Holden & Midthjell 2013: 26][5]. The discussion about the outcomes of fiscal consolidation is still open. Doris Prammer stated that, "even though the theoretical rationale for the existence of non-Keynesian effects of fiscal policy is straightforward, its empirical relevance crucially hinges on whether consolidation efforts of governments are credible and based on the empirical result, concluded that fiscal policy has lost some of its ability to stabilize the economy over the recent past" [Prammer 2004: 49].

There are many reports and studies about the impact of fiscal consolidation on growth. Fabio Padovano and Emma Galli studied a group of 23 OECD countries and showed that progressive taxation and marginal tax rates during the years 1951-1990 remained negatively correlated with economic growth [Padovano & Galli 2001]. On the other hand, Eric M. Engen and Jonathan S. Skinner analyzed the relationship between taxes and economic growth in the US and abroad. They have shown that the reduction of marginal tax rates by 5 percentage points leads to an increase in a long-term economic rise, for example, by 0.2-0.3 percentage points in the past century [Engen & Skinner 1996]. Alberto Alesina, Silvia Ardagna, and Roberto Perotti indicate a higher durability of fiscal consolidation based on expenditure rather than on income, and a smaller negative impact of such a consolidation on economic growth [Ardagna 2004; Alesina & Perotti 1995].

[4] Cyclically adjusted primary balance.

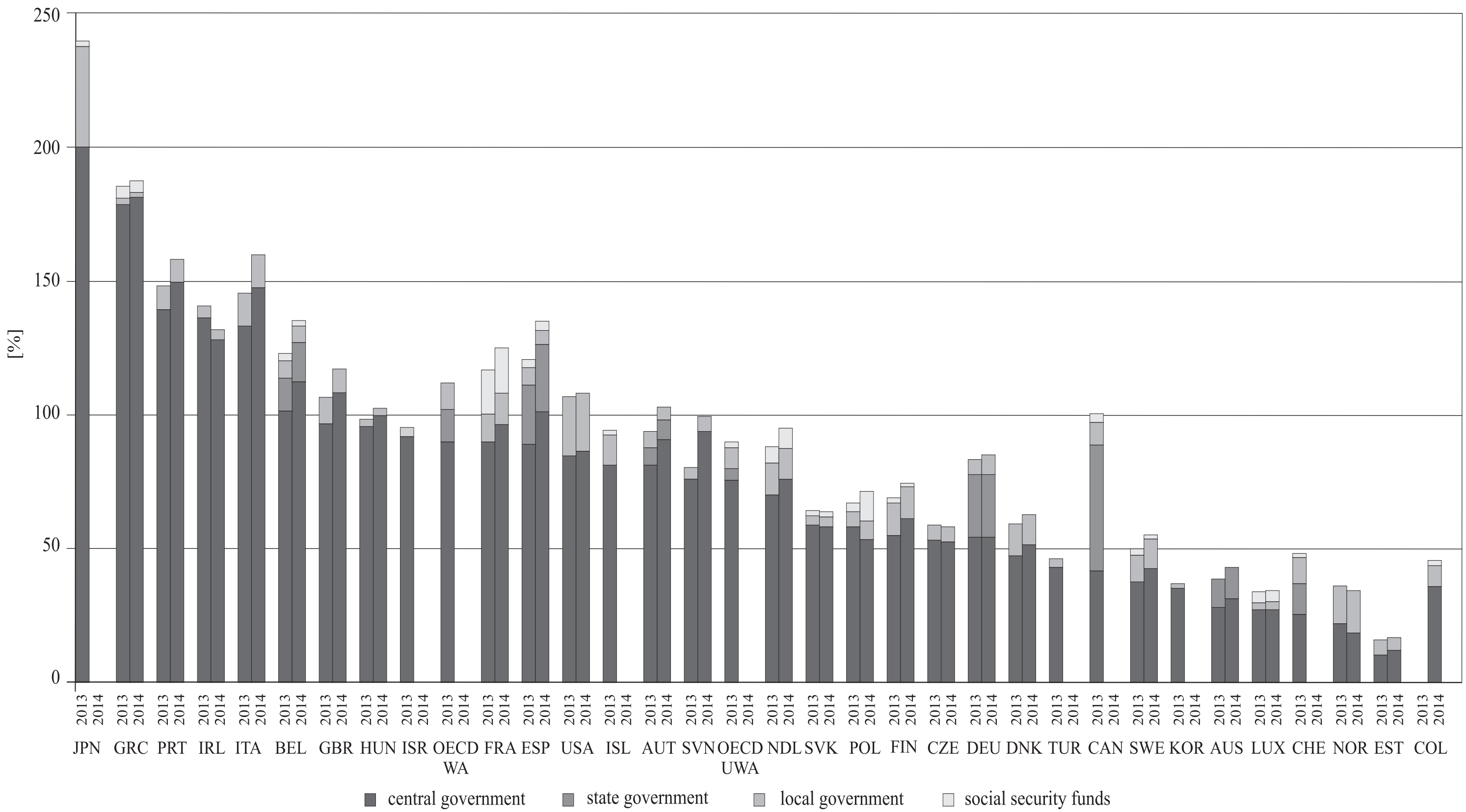
[5] Expansionary fiscal consolidation is an episode of fiscal adjustment is expansionary if the average real GDP growth in each adjustment year and in the two years after is greater than the average real GDP growth in the two years before.

Chart 1. Government fiscal balances across levels of government as a percentage of GDP in the years 2013 and 2014



Source: OECD National Accounts Statistics (database), Government at a Glance 2015 – OECD 2015.

Chart 2. Government gross debt across levels of government as a percentage of GDP in the years 2013 and 2014



Source: OECD National Accounts Statistics (database), Government at a Glance 2015 – OECD 2015.

Katarzyna Anna Bilicka and Michael P. Devereux researched the effects of fiscal consolidation on short-term growth and found out that a brief review of the macroeconomic theory suggests that the impact of fiscal consolidation programs on short-term growth is ambiguous. The impact depends on several factors, including the type and credibility of the consolidation. The authors concluded that there are a number of weaknesses in empirical literature. These include the lack of a very clear identification of both fiscal consolidations and expansionary effects.[6]

2. Fiscal consolidation at the subnational government level

Fiscal and economic crises strongly affected public finances OECD-wide, at both central and sub central government levels. The crisis was the leading factor responsible for the deterioration of local finance across OECD countries; however, the consolidation programs launched by central governments, especially the reduction of transfers into the sub central government level and a decreasing cash flow from income tax, were also the ones that determined the poor shape of the local finance budgets. Finally, the removal of financing from financial institutions (borrowing conditions have deteriorated significantly after Lehman collapsed in 2008) in many cases, resulted in being able to sustain public investment and preserve their operational expenditures as well [Vammalle & Hulbert 2013: 7-8]. This situation is especially difficult, as the government is solely responsible for spending an average of 50% of their budget on education, health, and social protection sectors, so there are the fields where cuts are particularly visible, unpopular, or may create high costs in the long run [Vammalle & Hulbert 2013: 7-8].

According to public statistics, the general government deficit in OECD countries shot up from 1.3% in 2007, to 8.2% of the GDP in 2009. It then declined to 7.7% in 2010, and further down to 6.5% in 2011, while subnational government deficits rose from 0.3% of GDP in 2007, to 1.7% in 2009, and up again to 1.8% in 2010. In 2011 it declined to 1.5% [Blöchliger 2011: 4]. That year, almost half of the OECD countries showed primary deficits (especially Australia, Canada, and Spain). Subnational government debt increased form an average of 8% of GDP in 2007, to 10% in 2010, and thereby accounted for an average of 14% of total public debt, with the sub-national debt share ranging from 1% in Greece, to 53% in Canada [Vammalle & Hulbert 2013: 10]. Taking into consideration the debt externalities (descending, ascending, and horizontal), and the fact that the subnational government is responsible for public safety and providing public goods

[6] www.oxfordscholarship.com/view/10.1093/acprof:oso/9780199698165.001.0001/acprof-9780199698165-chapter-10 [access: 5.07.2016].

and services that are crucial for local society, the health section of local finance should be the highest priority for local authorities. One of the ways to stabilize subnational government budgets is to use austerity measures in the form of fiscal consolidation which has taken place at the subnational government level in OECD countries since 2009 [Blöchliger 2011:4]. The fiscal consolidation at the subnational level is generally expenditure-based and is not a new phenomenon. The large fiscal episodes in the past which are worth mentioning are: Australia (between 1984-88 and 1994-98), Canada (between 1993-97), Denmark (between 1983-86), Finland (between 1993-2000), the United Kingdom (between 1993-98), Greece (between 1990-94), Ireland (between 1982-88), Italy (between 1990-95), Japan (between 1979-87), Sweden (between 1981-87 and 1994-97), and the United States (between 1993-98). Nowadays, after the subnational governments made efforts to stabilize their budgets after the crises, sub-central fiscal consolidation needs are relatively low in general, with some exceptions. According to the analysis of Hansjörg Blöchliger in terms of GDP, the state level in Australia, Canada, and Spain have the largest consolidation needs, while the fiscal gap is negative at the local level in Greece and Hungary [Blöchliger 2011: 11]. As the fiscal consolidation at the subnational government level is based generally on cutting expenditures, it is important to know the role of intergovernmental transfers for the success of general government consolidation, as the transfers are usually reduced at first while the economic downturn is happening [Vammalle & Hulbert 2013: 15][7]. James R. Hines and Richard H. Thaler (1995) point out that an analysis of the impact of intergovernmental transfers on fiscal consolidation should be done only with special emphasis on the "flypaper effect." They stated that in the condition of the *"*flypaper effect lower transfers would improve budget balance at the central level more than they would deteriorate them at the sub-central level, hence the net effect would be positive" [Hines & Thaler 1995, after: Blöchliger 2011: 14].

Supporting policies are significantly important for successful fiscal consolidation at the subnational government level. Policies and their implements may include two kinds of instruments which affected the revenue or expenditure sectors. Generally, the policies are based on revenue and spending instruments and should include such actions as: increasing the sub-central tax share, reducing the procyclicality of grants, simplifying the grant system, improving coordination across governments, transparency in public investment, relying more on the private sector, promoting market mechanisms in sub-central public service provisions, strengthening the property tax base, fighting tax evasion to increase revenue, and pricing services better (for example, water pricing) [Blöchliger 2011]. Taking into

[7] Ireland was one of the first countries reducing transfers to SNGs by 15% in 2009 and by 18% in 2010.

consideration the fact that the fiscal autonomy of subnational governments is generally limited, spending instruments are more commonly used than the revenue ones in fiscal consolidation programs. Nowadays, almost every subnational government has taken steps to strengthen budget discipline by conducting a responsible fiscal policy. The fiscal consolidation goals and responsible fiscal policies are strongly supported by fiscal rules. The fiscal rule is a kind of government inter-

Table 1. The Types of Fiscal Rules in Selected EU Countries

Country	Type of fiscal rule in place				National (0), supranational (1), both (2)				Year of implementation			
	ER	RR	BBR	DR	ER	RR	BBR	DR	ER	RR	BBR	DR
Austria	–	–	1	1	–	–	2	1	–	–	1995	1995
Belgium	–	–	1	1	–	–	1	1	–	–	1992	1992
Bulgaria	1	–	1	1	0	–	2	2	2006	–	2006	2003
Cyprus	–	–	1	1	–	–	1	1	–	–	2004	2004
Czech Republic	–	–	1	1	–	–	1	1	–	–	2004	2004
Denmark	1	–	1	1	0	–	2	1	1994	2001	1992	1992
Estonia	–	–	1	1	–	–	2	1	–	–	1993	2004
Finland	1	–	1	1	0	–	2	2	2003	–	1995	1995
France	1	1	1	1	0	0	1	1	1998	2006	1992	1992
Germany	1	–	1	1	0	–	2	1	1982	–	1969	1992
Greece	–	–	1	1	–	–	1	1	–	–	1992	1992
Hungary	–	–	1	1	–	–	1	1	2010	–	2004	2004
Ireland	–	–	1	1	–	–	1	1	–	–	1992	1992
Italy	–	–	1	1	–	–	1	1	–	–	1992	1992
Latvia	–	–	1	1	–	–	1	1	–	–	–	–
Lithuania	1	1	1	1	0	0	1	2	2008	2008	2004	1997
Luxembourg	1	–	1	1	0	–	1	2	1990	–	1992	1990
Malta	–	–	1	1	–	–	1	1	–	–	2004	2004
Netherlands	1	1	1	1	0	0	1	1	1994	1994	1992	1992
Poland	1	–	1	1	0	–	1	2	2011	–	2004	1999
Portugal	–	–	1	1	–	–	1	1	–	–	1992	1992
Romania	1	–	1	1	0	–	1	1	2010	–	2007	2007
Slovak Republic	–	–	1	1	–	–	1	2	–	–	2004	2004
Slovenia	–	–	1	1	–	–	1	1	–	–	2004	2000
Spain	1	–	1	1	0	–	2	1	2011	–	1992	1992
Sweden	1	–	1	1	0	–	2	1	1997	–	1995	1995
United Kingdom	–	–	1	1	–	–	2	2	–	–	1992	1992

ER: Expediture rule, RR: Revenue rule BBR: Budget balance rule DR: Debt rule.

Source: IMF Fiscal Rules Dataset 2012; Schaechter, Kinda, Budina & Weber 2012; Zioło 2013.

vention that imposes a long-lasting constraint on fiscal policies through numerical limits on budgetary aggregates [Schaechter, Kinda, Budina & Weber 2012: 12]. George Kopits and Steven Symansky define fiscal rule as "permanent constraint on fiscal policy through simple numerical limits on budgetary aggregates" [Kopits & Symansky 1998: 2]. Generally, there are four kinds of fiscal rules: the budget balance rules, the debt rules, the expenditure rules, and the revenue rules. After 2008, the number of fiscal rules increased in response to the crisis. The types of fiscal rules in selected EU countries are presented in Table 3.

Based on Table 3, budgetary rules (deficit and debt rules) are dominant for subnational governments, while expenditure rules are usually restricted for the general government tier. Revenue rules, among all the other types of fiscal rules, are very rare. In the case of European Union countries, the debt rule is compulsory and is included in the Maastricht Treaty (1992). After 2009, some deficit and debt control mechanisms have had to be revisited as they had failed and were inefficient. Also, after 2009, most countries required and included SNGs when taking part in national fiscal consolidation plans, in order to achieve budget deficits and targets, and to fulfill the objective of stability programs (for example, Belgium's Stability Programme of 2012, Spain's Organic Law 2/2012, Denmark's target of zero growth in expenditure, Italy's Internal Stability Pact, etc.) [Vammalle & Hulbert 2013: 17]. Sub-national government deficit objectives (as a % of GDP) in selected countries are presented in Table 4.

Table 2. Sub-National Government Deficit Objectives (as a % of GDP)

Country	2010	2011	2012	2013	2014	2015	2016
Austria (state and local)		–0.70	–0.50	–0.40	–0.30	–0.10	0
Belgium	–0.70	–0.30	–0.40	0.0	0.10	0.10	
Czech Republic	–0.30	–0.50	–0.30	–0.20	0		
Poland	–1.10						
Slovenia	–4.80	–5.20	–3.70	–2.80	–1.90		
Spain	–0.60	–0.80	0	0	0		
Germany	Länder budgets must be structurally balanced as of 2020						

Source: Vammalle & Hulbert 2013: 7-8.

Although it is not popular, some subnational governments (like Australia, Belgium, Canada, the Czech Republic, Denmark, Estonia, Finland, Greece, Hungary, Italy, Poland, Spain, and the United Kingdom) besides strengthening fiscal responsibility and the fiscal balance with fiscal rule support, decided to increase their own tax rates and fees or to broaden their tax base as well. The scale and size of a tax policy depends on the tax autonomy and fiscal federalism regulations of each country [Vammalle & Hulbert 2013: 17]. In Belgium, the subnational government eliminated tax breaks. In 2010, the Flemish Community abolished a tax cut. In Spain, local governments increased some taxes and cut some expenditure by spending on the side. Some countries also increased their local fees (Austrian municipalities, local Greek and English authorities). Activities strengthening tax evasion were implemented in Spain, Greece, Canada, and Ireland. Canada, Estonia, and the United States also decided to cut on spending (personnel, health and social benefits, and intergovernmental transfers) in order to increase fiscal consolidation effects and improve financial efficiency.

Conclusion

The subnational government plays a crucial role in the national economy as it is responsible for public safety and delivering public goods and services that secure the needs of local communities and determine the quality of life. This is the reason why public finance, and especially public budgets, should be sound in the long run. The financial crisis of 2008 strongly affected public budgets and, as a result, many public entities were financially distressed or about to fail. At the same time, access to external financing was limited – or nonexistent – because of the condition of the financial sector, especially within the banking sector. It is very important to emphasize that fiscal stability is strongly determined by the condition of the financial sector, and the safety and stability of financial institutions, while taking into account bail outs and state aid.

As central governments started austerity programs and stability plans, subnational governments were also required to take proper steps to adjust their plans, programs, and strategies. Subnational governments put a lot of effort into stabilizing their budgets and design fiscal consolidation programs at the sub central government level, which is especially required, because the financial autonomy of subnational governments is very often limited.

Taking into account the steps which were taken after the crisis of 2008 at the sub central government level, OECD-wide subnational governments have been in a fiscal consolidation process since 2009 to stabilize their budgets with revenue and expenditure instruments, with special emphasis on budgetary fiscal rules. The fiscal consolidation at the sub central government level is still in progress, and it is mainly focused on the strengthening of fiscal rules, especially designing fiscal rules that are dedicated for subnational government. The fiscal consolidation programs are still upgraded according to subnational government limitations and expectations. The restructuring process and reforms are concentrated on intergovernmental transfers, which are not transparent and are ineffective. Generally, the reform of transfers is strictly connected with restructuring of the layout of operational expenditure. The big challenge in the context of fiscal consolidation which is based on revenue is tax evasion and increasing the effectiveness of taxation (tax rates and tax base action). The crucial challenge is also the proper pricing of public good and services, especially in the sectors where a monopoly exists and where environmental costs are important, like in the case of water, whose price depends on tariffs which are usually set up by local authorities. Finally, there is the problem in the assessment of the cost of public services which varies across governments and countries, and governments do not always know the cost of the public goods or services.

All of the factors mentioned have affected successful fiscal consolidation programs at the subnational government level and are crucial in local finance management, especially debt management. The condition of local finance is coherent with the condition of central government finance, so it is crucial to design an efficient system of local financing in order to avoid the need of fiscal consolidation in the future.

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Konsolidacja fiskalna jako sposób stabilizowania budżetów publicznych. Perspektywa jednostek szczebla samorządu terytorialnego

Streszczenie. *W artykule przedstawiono aktualne dane i problemy dotyczące sytuacji budżetowej na szczeblu samorządowym oraz zwrócono uwagę na rolę konsolidacji fiskalnej w procesie redukcji deficytu i długu na poziomie samorządowym. W szczególności odniesiono się do teoretycznych ram konsolidacji fiskalnej oraz omówiono towarzyszące jej zasady i instrumenty. Celem artykułu jest wskazanie na rolę konsolidacji fiskalnej w stabilizowaniu budżetów publicznych po kryzysie finansowym z 2008 r. oraz zwrócenie uwagi na determinanty udanej konsolidacji fiskalnej. Zagadnienie zaprezentowano posługując się przykładem krajów OECD w latach 2010-2016. W badaniu wykorzystano metody, takie jak krytyczna analiza literatury, metoda obserwacji, analiza przypadków i rozumowania logicznego.*

Słowa kluczowe: *deficyt, dług, konsolidacja fiskalna, samorząd, reguły fiskalne*

Zeszyty Naukowe
Wyższej Szkoły Bankowej w Poznaniu
2016, t. 70, nr 5

Beata Guziejewska

University of Lodz
Department of Public Finance
e-mail: beata.guziejewska@uni.lodz.pl
phone: 42 635 53 20

Decentralization and Debudgeting as Manifestations of Structural Changes within the Public Sector in Poland

Abstract. *This article discusses the problems of the structure of the Polish system of public finance in the context of decentralization and debudgeting (debudgetization). The considerations are based on the data from reports on the execution of the state budget for the year 2015. The analysis reveals a wide range of internal transfers within the system, an important redistributive role of the state budget, and numerous forms of extra-budgetary economy. The system is characterized by a considerable degree of decentralization, which, however, is founded more on the decentralization of tasks and expenditures, than on the transfer of public revenues in the form of taxes. These features have led to a situation where structural changes result in poor manageability of the total public revenue and expenditure. Despite their numerous advantages with regard to a higher flexibility and rationalization of financial economy, the processes of decentralization and debudgetization also have some negative consequences.*

Keywords: *public finance sector, decentralization, debudgetization, state budget*

Introduction

Modern systems of public finance form complex structures characterized by a decentralization of public services and a diversity of organizational and legal forms. Moreover, their specific tools and solutions vary substantially depending on historical, political, economic, and geographic conditions. There are, however, two elements that are shared by contemporary public finance systems in democratic states. These are decentralization and various forms of extra-budgetary economy designed to meet specific, socially important, public services; a process which is also known as debudgeting (or debudgetization). In recent years the share of the subsector of local government revenues in the GDP of Poland has amounted to about 13%, which puts the country above the average for all of the EU countries. The share of the subsector of local government expenditures is slightly higher and, for example stood at 14.1% in 2011, and at 13.1% in 2013. The importance of the local government subsector in the Polish economy is reflected in the fact that it spends over 30% of total public funds in Poland. The other group of entities, which play a role in the Polish economy, consists of appropriated funds and executive agencies, which are the most important entities for the extra-budgetary economy. In 2015 there were twenty-eight state appropriated funds in Poland. Their expenditure towards social security amounted to 40% of the total public expenditure in Poland. The important areas of public services, for which the funds were established, include social security and welfare, privatization, national security and defense, science, as well as, cultural and environmental protection. The management of the State Treasury property lies within the executive agencies. Currently there are ten entities that have been granted the status of an executive agency. The number of appropriated funds and agencies (formerly known as governmental funds and agencies) in Poland has varied considerably over the years.

The processes of the decentralization of public finances are manifestations of the subsidiarity and adequacy principles, and the foundation of appropriated funds and agencies is yet another form of financial management. An attempt to create a form of collecting and spending public funds, which would be an alternative to the budget, aims at withdrawing from the rigid rules of the economy that is restricted by the framework of the budget in order to ensure a smooth implementation of important tasks that the state is held responsible for. This process may, in particular, concern social security, health care, etc. The aim of this discussion is to present selected theoretical topics related to the processes of decentralization and debudgetization, and to describe the relations between the segments of the public finance sector in Poland and their effects on the overall result of the sector.

1. The concept and importance of decentralization and debudgetization

Modern systems of public finance are characterized by specific features that have evolved under historic, economic, and social conditions in individual countries. However, despite a large number of unique institutional and financial arrangements, it is possible to indicate the processes that are common in most democratic countries. These include decentralization and debudgetization of public finance, which have consequences for the control over public revenues and expenditures as a whole. The manageability of the system of public finance means that there is a possibility of making quick and flexible decisions concerning the management of the total public funds, particularly their spending in a versatile and unpredictable environment. Such control has its limitations as the decisions on public funds require long and cumbersome legislative and executive procedures. Decentralization in the context of financial autonomy has been a subject of many a study and analysis due to the distribution of the state tax revenues and the programs of subsidizing local governments, which pose a burden for the state budget. However, the range of services financed with appropriated allocations, which enable many countries to canalize local public expenditure, is wide and covers most areas of public activity [Kim, Lotz & Blochliger 2013: 27].

The decentralization of public finance limits the overall management of public funds as the funds are partially placed outside the direct control of the state government. Although the state legislator defines the scope and type of financial decentralization, it can no longer interfere with the financial autonomy of local government entities. Financial autonomy relies on independent policies for collecting tax and non-tax revenues, and for the spending of such revenues. In practice, the degree of independence in spending is usually higher than that in collecting revenues. Despite the common belief that local government revenues should be based on own revenues, the limited scope of revenue autonomy results mainly from two factors: namely the transfer of a growing number of public services, which do not have enough funding from local tax revenues, onto the municipal level; and the attractiveness of subsidies and grants from the state budget, which operate as a form of control over local government entities. Another important element of financial autonomy and independence is a possibility of local governments to incur financial liabilities on the financial market, which contributes to a rise in the level of public debt in the country. This fact also results in the poor controllability of public funds as a whole. The legal norms that limit borrowing at the local government tier, and a relatively small proportion of local government debt in the total public debt, only mitigate but do not solve the problem as much depends on the level of imbalance within the sector. A high degree of unpredictability for financial crises may, despite the curbs, for example on liabilities in foreign currencies, lead to the bankruptcy of towns and communes.

Although it limits the manageability of the system, decentralization of public finance remains a fundamental and essential attribute of a territorial self-government, of a more rational spending of public funds, and of better catering to social needs. The other of the discussed processes, the so-called debudgetization of public finance, poses a far more serious problem. Broadly speaking, debudgetization is directly responsible for the formation of various enterprises within the extra-budgetary economy, which means, in Polish conditions, a proliferation of appropriated funds. The term *debudgétisation* comes from France where it is widely used in literature on public finance law [Buisson & Deruel 2001: 68; Muzellec 2000: 57; Saïdj 2000: 75]. The phenomenon of debudgetization is generally understood as a deviation from the organizational and financial principles characteristic of the entities within the public sector, enabling the implementation of the tasks excluded from the budget under the rules that are different from the ones that have been laid down for these entities in the Budget Law. Debudgetizing includes any action with a purpose to circumvent the rather rigid mechanism of financing public services and has the characteristic features of a budgetary economy. The concept of debudgetization has been used in the Polish literature in the context of budgetary principles [Kosikowski & Ruśkowski 2003: 311] and the problems within public finance generated by the origin of appropriated funds, state agencies, and other extra-budgetary entities in the public finance sector [Stankiewicz 2007]. Excessive debudgetization contradicts two important budgetary principles: the principle of non-assignments (in the material and financial sense), and the principle of unity (in the formal and legal sense). A failure to comply with these principles is viewed critically by the doctrine in various aspects. However, from the economic vantage point, the growing issue nowadays is that the comprehensive management of revenues and expenditures and the flexibility of the decision-making process have been extremely impaired in such a volatile and dynamic environment.

The reasons for, and the consequences of, establishing appropriated funds and other forms of an extra-budgetary economy have been widely described in the literature on the subject [Szołno-Koguc 2007; Owsiak 2005: 148; Denek, Sobiech, Wolniak & Wierzbicki 1995: 72; Kosikowski & Ruśkowski 2003: 405]. The reason for establishing extra-budgetary funds, which is most commonly quoted, is a need to search for an alternative to the rigid budgetary principles of collecting and spending public funds [Alińska & Woźniak 2015: 86]. This is all about bypassing the annual nature of the budget and its consequences, such as rigid limits and plans on expenditure. What is also important is to ensure stable and efficient sources of funding for particular tasks. There are also political factors related to limited control by the decision-making bodies over the use of funds and incurred liabilities. The positive effects of debudgetization include more flexible financial management and a more stable, legally granted, source of funds for a particular task of a given entity. The positive effect, which has not yet been emphasized, is the possibility of using the competition mechanism in providing selected services and a partial payment for them. Unfortunately, in practice, there are numerous negative effects that raise much controversy. J. Stankiewicz [2007: 37-39] enumerates five basic negative effects of debudgetization: the parliament tends to lose part of its political power over a section of the state finances; the principle of transparency of public finances is impaired; there is an impediment to efficient and optimal management of state finances, as well as, a susceptibility to various pathologies in the management of public funds, and finally, public finances become excessively politicized. The author emphasizes the problem of the manageability of the whole public finance system by enumerating the sources of difficulties in the efficient management of public finance. In his view, debudgetization:

– makes the state finances more rigid as a whole, by excluding a part of the funds from the budget and earmarking them for particular expenditures,

– indirectly leads to less flexibility and liberty in the decision-making process,

– makes the optimal use of the funds impossible, allowing funds to be frozen [Stankiewicz 2007: 38].

Decentralization and debudgetization result in problems with the coordination of fiscal policy. Mature democracies use both formal and informal fiscal rules such as [Boadway & Shah 2011: 477] budgetary balance controls, debt restrictions, tax and expenditure controls, referenda for new taxing and spending initiatives, and penalties for noncompliance.

2. Revenue and expenditure balance for the sector and the problem of internal transfers

The public finance sector in Poland consists of three subsectors: the central government, the local government, and the social security sectors. The same pattern is used to present the revenue, expenditure, and the summary result of the sector. The local government sector is directly related to the decentralization of public finances, whereas the social security sector relies on debudgetization.

Non-equivalent cash flows (revenues and expenditures) that are characteristic of public finances are called transfers. They usually take the form of a public entity's expenditure, which is a non-refundable, free transfer of funds. Transfers include taxes, contributions, public and legal charges, donations, subsidies, grants, benefits, allowances, and pensions. Grants and subsidies constitute a group of very important transfers within and outside the public finance sector. They are divided into general subsidies and appropriated allocations depending on such criteria as the purpose of, and the conditions for, the grant. Other important categories include earmarked subsidies and specific grants. Earmarked subsidies are granted to a particular entity or a group of entities as a general financial support for their activities. The subsidy programs tend to avoid this type of transfers as they are usually arbitrary and economically inefficient.

From the point of view of an analysis of the balance of public finances, it is essential to differentiate between internal and external transfers. This is also indispensable for a consolidation of all revenues and expenditures, which, in turn, serves as a basis for drafting a balance sheet. Internal transfers involve moving funds between entities that belong to the public finance sector the effect of which is not a change in the amount of money at their disposal, but a change to the structure of the final spending. External transfers, on the other hand, involve the transfers of such funds as benefits for individuals or subsidies for enterprises to entities that do not belong to the sector. A consolidation of public sector revenues and expenditures is an operation that eliminates the double-counting of the transferred funds. On the revenue side, such an operation excludes the sums of money transferred to other entities in the public sector from the revenues of each subsector. On the expenditure side, the sums transferred to the entities which are also included in the public finance sector are omitted. After consolidation, the expenditure stands for the sum that was transferred to the entities outside the public sector.

The revenues of the public sector in Poland, without the mutual transfers between the subsectors and within the subsectors, have been presented in Table 1. Only the receipts from outside the sector are considered to constitute the revenue of the public finance sector and its subsectors. Therefore, the total revenue of the sector as a whole (including the subsectors) is lower than the sum of revenues presented in the reports by the individual entities that belong to this sector. In 2015, the revenue of the public finance sector, after consolidation, amounted to 687,781.8 million PLN. In 2015, the ratio of the consolidated revenues to GDP stood at 38.4%, and was lower when compared to the previous year by 0.9 per-

Table 1. Summary of Public Finance Sector Revenues for 2015 (in millions of PLN)

Specification	Public Finance Sector*	Central Government Subsector**	Local Government Subsector**	Social Security Subsector**
Total revenue	687,781.8	382,931.0	232,812.8	293,383.2
Tax revenues	327,979.7	259,382.2	69,370.4	0.0
– indirect taxes	186,713.5	187,058.6	0.0	0.0
– CIT	32,756.7	25,730.4	7,076.1	0.0
– PIT	83,140.1	45,040.0	38,100.1	0.0
– other taxes	25,369.4	1,553.2	24,194.2	0.0
Non-tax revenues	359,802.1	123,548.8	163,442.4	293,383.2
– dividend	6,836.1	6,351.2	382.1	102.8
– receipts from the NBP revenues	0.0	0.0	0.0	0.0
– custom duties	2,928.9	2,928.9	0.0	0.0
– contributions	196,734.3	407.2	0.0	220,815.8
Other revenues	85,890.1	47,609.0	147,042.9	71,761.1
EU funds	67,412.7	66,252.5	16,017.4	703.5

* Excluding intra-sectoral transfers, ** Excluding intra-subsectoral transfers.

Source: *Report on the execution*... 2016: 333.

centage points [Report on the execution... 2016: 320]. The decline resulted from a fall in both tax and non-tax revenues.

Receipts from taxes are the primary source of revenue for the public finance sector. In 2015, they stood at over 327 billion PLN, which means that they grew nominally by 2.8%, and 3.7% in real terms, when compared to 2014. Tax revenues accounted for 48% of the total revenues for the sector. Non-tax revenues, on the other hand, exceeded 359 billion PLN and rose by 0.7% nominally, and 1.6% in real terms, in comparison with the previous year's figures. Non-tax revenues accounted for 52% of the total revenues for the sector.

Table 2 presents a summary of consolidated expenditures. The expenditure of the sector as a whole, and of individual subsectors, is defined as only those funds that were transferred outside of the sector. The total expenditure for the sector is therefore lower than the sum of expenditures reported by the organizational entities that belongs to the public finance sector.

Table 2. Summary of Public Finance Sector Expenditure Divided into Subsectors for 2015 (in millions of PLN)

Specification	Public Finance Sector*	Central Government Subsector**	Local Government Subsector**	Social Security Subsector**
Total expenditure	731,838.0	426,693.6	229,305.2	297,184.4
Grants and subsidies	58,756.0	188,987.7	12,029.9	292.1
Benefits for individuals	296,996.4	26,692.0	17,360.7	267,489.0
Other current expenditures	242,270.3	101,930.5	157,532.1	8,582.6 820.7
Capital expenditure	84,852.4	61,880.9	40,049.3	
Expenditure for public debt servicing	30,713.8	28,953.4	2,333.2	0.0
EU own funds	18,249.1	18,249.1	0.0	0.0
Deficit/Surplus (revenue – expenditure)	–44,056.2	–43,762.6	3,507.6	–3,801.2

* Excluding intra-sectoral transfers, ** Excluding intra-subsectoral transfers.

Source: *Report on the execution*... 2016: 333.

After consolidation, the expenditure of the sector amounted to 731.8 billion PLN in 2015. The share of expenditure in the GDP was 40.9% and was lower by 0.7% when compared to the previous year. Social security spending, which includes pensions, family allowances, unemployment benefits, benefits and allowances for individuals, and scholarships invariably constitute a large part of the expenditure. In 2015, the consolidation on the expenditure side relied on both direct and indirect fiscal principles, which define the foundations for a budget draft.

The comparison between the revenue and the expenditure allows for an analysis of the financial result. In 2015, the deficit of the public finance sector exceeded 44 billion PLN. The summary in Table 2 demonstrates that the central government subsector, with a deficit of 43.7 billion PLN, had the largest share in the result for the entire public finance sector. The local government subsector recorded a surplus while the social security subsector had a deficit of 3.8 billion PLN. Clearly, in the unconsolidated approach, it is the central government sector (mostly the state budget) that bears the entire burden of the deficit for the sector as a whole. This is important from the point of view of the economization of debt as the cost of the State Treasury debt is lower than in the case of other entities. Taking into account the level of controllability and manageability of the system of public revenue and expenditure as a whole, it is possible to enumerate several negative elements such as a high level of internal transfers, rigidness in the liabilities of the state budget towards other public entities, and a necessity to service debt, which may easily spin out of control in a political or economic crisis.

Table 3 presents a summary of the analysis of the results for the public finance sector for the year 2015. It demonstrates relations between individual segments and the effect of those relations on the financial results. The local government sector presented in the summary is strictly associated with the decentralization processes discussed in this paper, whereas the social security subsector and other entities rely on the so-called debudgetization.

After the consolidation that excluded mutual transfers, there is a new situation in the area of surplus and deficit in individual subsectors, which is presented in the ‘net’ line of the table. The state budget records a surplus of 130.3 billion PLN, while the local government and social security sectors have a very high deficit of 99.6 billion PLN and 56.5 billion PLN respectively. The system is characterized by an imbalance on the side of revenues and tasks attributed to the entities in the analyzed subsectors. A reallocation of public funds inside the public finance sector in the form of various transfers substantially changes the financial situation of individual subsectors. While supporting appropriated funds and state agencies can somehow be justified (despite the long-standing criticism of such support), such a vast extent of external funding for the local government sector is incompatible with its financial independence and autonomy, which have been advocated for years. The ultimate effect of decentralization and debudgetization of the system of public finance in Polish conditions manifests itself in the ever-growing redistributive role of the state budget with all the possible repercussions. Certainly this effect was not intentional. It was rather a result of the reform and evolution of the system after 1990.

Table 3. Relations between segments of the public finance sector and their financial results for 2015 (in billions of PLN)

Specification	Central Government Subsector	State budget	Executive agencies	Other entities	Local Government Subsector	Budget for entities	Other entities	Social Security Subsector	Social Insurance Fund	Old-Age and Disability Pension Fund	Other entities	Public fFnance Sector
1. Total revenue	420.1	289.1	11.7	110.3	245.7	199.0	46.6	302.7	193.5	20.4	88.8	968.5
Intra-sectoral transfers	49.3	4.7	7.7	37.0	134.5	99.3	35.2	96.9	64.5	18.9	13.5	280.7
2. Revenue exclusive of transfers	370.8	284.4	4.0	82.3	111.1	99.7	11.5	205.9	129.0	1.5	75.4	687.8
3. Total expenditure	463.9	331.7	11.2	120.9	242.2	196.4	45.7	306.5	199.5	19.9	87.1	1012.5
Intra-sectoral transfers	205.2	177.6	5.2	22.4	31.4	27.7	3.7	44.1	5.2	2.2	36.7	280.7
4. Expenditure exclusive of transfers	258.7	154.2	6.0	98.5	210.8	168.7	42.0	262.4	194.2	17.7	50.5	731.8
5. Results (1-3)	–43.8	–42.6	0.5	–1.6	3.5	2.6	0.9	–3.8	–6.0	0.5	1.7	–44.1
6. 'Net' result (2-4)	112.1	130.3	–2.0	–16.2	–99.6	–69.1	–30.6	–56.5	–65.3	–16.1	24.9	–44.1

Source: *Report on the execution*... 2016: 323.

In such a situation it is the state budget that is hit by the turbulences, which can be clearly seen in the analysis of the 2014 and 2015 data, even after the amendment to the budget in 2015. The planned state budget deficit for 2014 amounted to 28,976,820 thousand PLN and 49,980,000 thousand PLN in 2015 [Report on the execution... 2016: 23].

In 2015, as in previous years, the transfers from the state budget in the form of grants and subsidies accounted for the largest share in the total state budget expenditure and stood at 51%. The execution of expenditures in the category of grants and subsidies in 2015 rose by 11% when compared to 2014. This was mainly due to an increase in the allocations from the state budget to the Social Insurance Fund for 2015 (11,702,861 thousand PLN more than the amount of subsidies used by the Social Insurance Fund in 2014). Such a significant difference resulted, inter alia, from the higher spending on old-age and disability pensions following the indexation of these benefits. The current expenditures of budgetary entities (18.7%) and the servicing of the State Treasury debt (8.8%) also accounted for a significant part of the total expenditure. In light of the subject matter of this discussion, it is symptomatic that, as early as 2015, the state budget expenditures towards the implementation of the current tasks of the local government entities, 44.2% in total, and the allocations to the appropriated funds, 35.4% of the expenditure for the whole group, accounted for the largest section of the subsidies and grants from the state budget. Thus, 20.4% of the funds belonging to this group of expenditures, including 12.6% for earmarked subsidies, were spent towards other grants [*Report on the executio*n... 2016: 82-89].

Conclusions

The structural changes to the public sector in Poland are reflected in the processes of decentralization and debudgetization which parallel the creation of a market economy after 1990. The system that has resulted from these changes is characterized by several features, the most important of which are the following:

– a highly important redistributive role of the state budget in the general redistribution of public funds

– a large scope of internal transfers associated mainly with subsidizing local government entities and the Social Insurance Fund

– an imbalance in the primary and secondary sources of deficit, which ultimately pose a burden for the state budget.

The aforementioned features make the management of public revenues and expenditures difficult. It should be admitted, however, that, in a way, it is a natural phenomenon in the conditions of decentralization and debudgetization of the public finance system. The basic conclusion from these considerations leads to a postulate of more decentralization in the revenues of the sector and a higher amount of tax revenues attributed to the local government. As far as the large scope of debudgetization is concerned, apart from the postulate of limiting appropriated funds (which may be irrational at times), it may be reasonable to introduce changes to the way the Social Insurance Fund operates, particularly in reference to the way the Fund is financed, which, in turn, should lead to even more serious structural changes to the system of old-age and disability pensions.

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Sprawozdanie z wykonania budżetu państwa za rok 2015, 2016, t. I: *Omówienie*, Warszawa: Rada Ministrów [*Report on the execution of the state budget for 2015*, Vol. I: *Elaboration*, Warsaw: Council of Ministers].

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Decentralizacja i debudżetyzacja jako przejawy zmian strukturalnych w sektorze publicznym w Polsce

Streszczenie. *W artykule podjęto problem struktury polskiego systemu finansów publicznych w kontekście decentralizacji i debudżetyzacji. Rozważania oparto na danych ze sprawozdań z wykonania budżetu państwa w 2015 r. Przeprowadzona analiza wskazuje na duży zakres transferów wewnętrznych w systemie, dużą redystrybucyjną rolę budżetu państwa oraz duży zakres różnego rodzaju form gospodarki pozabudżetowej. System charakteryzuje się znaczącym stopniem decentralizacji, ale opartej głównie na decentralizacji zadań i wydatków, w mniejszym zaś stopniu na przekazaniu dochodów publicznych w postaci podatków. Cechy te sprawiają, że zmiany strukturalne w niewielkim stopniu umożliwiły zarządzanie całością dochodów i wydatków publicznych. Procesy decentralizacji i debudżetyzacji mimo wielu zalet związanych głównie z uelastycznieniem i racjonalizacją gospodarki finansowej, mają więc również negatywne konsekwencje.*

Słowa kluczowe: *sektor finansów publicznych, decentralizacja, debudżetyzacja, budżet państwa*

Changes
in Local Government Units

Zeszyty Naukowe
Wyższej Szkoły Bankowej w Poznaniu
2016, t. 70, nr 5

Marzanna Poniatowicz

University of Białystok
Faculty of Economics and Management
e-mail: marzanna@poniatowicz.pl
phone: 85 745 77 11

Self-Government National Debt in Poland – Current Issues and Challenges

Abstract. *One of the most dynamic categories of local finances in Poland is self-government debt. The dynamic entails certain risk not only for the system of local/regional finances, but also for the entire public sector, an integral component of which is the self-government sub-sector. The basic aim of the study is to identify the most important and most current legal and economic issues related to the self-government national debt in Poland, while indicating possible methods of solving it or at least mitigating its negative effects. Not only the stability of self-government finances, but also the entire public finances sector, will depend on the actions taken in this respect.*

Keywords: *local self-government, local debt, debt issues*

Introduction

It is difficult to imagine a local self-government separated from debt instruments (credits, loans, or municipal securities). Of course, their use in the local financial economy is dependent on many legal and financial factors which, in Polish conditions, are changing very rapidly. Some parts of these factors are systemic or external, i.e. independent of self-government decision-makers. Examples of those factors are: a lack of the possibility of declaring bankruptcy of local self-government units in the Polish legal system; the tightening of fiscal rules by the state, thus limiting self-government debt; the need to compensate for the decrease in budget revenues of local self-government units by means of debt instruments, resulting from imposing additional tasks on the self-government unit without simultaneous provision of financial resources for their implementation; the obligation to provide the self-government beneficiary's own contribution resulting from EU regulations – in this context, local debt is used by the local self-government units as an absorption tool. Some parts of the factors affecting the changes in terms of self-government national debt are, by contrast, of a purely internal nature, i.e. deriving from individual and local financial policies of individual local self-government units. Examples associated with it are as follows: increasing the use of customized sources of financing budgetary needs by some local self-government units (equity financing, sale back, leaseback, payment in installments, subrogation, etc.), resulting in the formation of a new category of financial liabilities with consequences similar to those in the case of credits and loans; the processes, observed in some cities, of "crowding out" debt beyond the budgets of local self-government units, i.e. to municipal companies, and thus creating the so-called gray market of the self-government debt; the more and more frequently appearing practice of self-government authorities taking out financial obligations in non-bank lending institutions, like the so-called quasi-banks; pejoratively understood specific "financial creativity" of self-government authorities of some local self-government units in terms of long-term financial forecasts developed by them, which undermines the usefulness of these documents as tools for the effective management of local debt.

The aim of the study is to identify, from the point of view of the local finance system, the most important problems and challenges regarding self-government national debt, while indicating the possible methods of solving it or at least mitigating its negative effects.

1. The debt of local government in Poland in light of national and foreign statistics

Before we go on to identify the problems arising in the area of debt issues of local self-government units (LGUs), it seems appropriate to at least generally characterize the amount and structure of the self-government debt in Poland. It should be noted that, contrary to a popular belief on the large debt of the Polish local self-government units (LGUs) compared to other countries, debt ratios of the *local government* sub-sector in Poland in relation to GDP are much lower than the average of the EU-28 (see Table 1). It is true that they were characterized by a very high growth rate in the years 2008-2011 (respectively from 2.3% to 4.2% of GDP), sustaining a similar level in the subsequent years (i.e. a little over 4%, with the EU average oscillating around the level of 6%). However, one should clearly emphasize that the Polish self-government sub-sector shows the highest debt rates

Table 1. Debt of the Local Government sub-sector in the EU-28 Member States
in relation to GDP during the years 2008-2015 (in %)*

Country	2008	2009	2010	2011	2012	2013	2014	2015
Austria	:	:	:	3.9	3.8	3.9	3.9	4.0
Belgium	5.0	5.0	5.2	5.2	5.6	5.8	6.1	5.7
Bulgaria	:	:	:	1.2	1.2	1.1	1.2	1.4
Croatia	:	:	1.3	1.3	1.3	1.6	1.7	1.6
Cyprus	:	:	:	1.7	1.6	1.6	1.6	1.5
Czech Republic	:	:	:	2.6	2.8	2.9	2.7	2.5
Denmark	:	:	:	7.1	7.1	7.4	7.4	7.3
Estonia	:	:	:	3.2	3.1	3.6	3.8	3.6
Finland	:	:	:	6.5	7.2	8.0	8.6	8.9
France	:	:	:	8.3	8.5	8.7	8.8	9.0
Greece	0.7	0.9	0.9	0.9	0.9	1.0	1.0	0.9
Spain	2.8	3.2	3.3	3.4	4.2	4.1	3.7	3.3
Netherlands	7.1	7.6	8.1	8.7	9.0	8.9	8.8	8.6
Ireland	:	:	:	3.1	3.1	2.8	2.5	1.9
Lithuania	1.2	1.6	1.6	1.8	1.9	2.0	2.1	2.0
Luxembourg	2.3	2.4	2.4	2.3	2.3	2.1	2.1	2.1
Latvia	:	:	:	6.2	5.8	6.0	6.0	6.0
Malta	:	:	:	0.1	0.1	0.1	0.1	0.0
Germany	:	:	:	5.4	5.5	5.4	5.3	5.1
Poland	2.3	3.0	3.8	4.2	4.2	4.3	4.3	4.2
Portugal	4.7	5.4	5.9	6.2	6.1	6.3	6.2	5.9
Romania	1.8	2.3	2.4	2.5	2.6	2.5	2.5	2.5
Slovakia	:	:	:	2.4	2.3	2.2	2.2	2.4
Slovenia	0.9	1.4	1.7	1.9	2.0	2.0	2.1	2.0
Sweden	:	:	:	6.7	7.5	8.0	8.8	9.3
Hungary	3.8	4.1	4.6	4.3	3.7	1.5	0.1	0.2
Great Britain	4.5	4.5	4.6	4.6	5.1	5.0	4.8	4.7
Italy	7.9	8.4	8.3	8.2	8.1	8.5	8.6	8.4
UE-28	:	:	:	5.9	6.1	6.2	6.1	5.9

* Data according to ESA 2010.

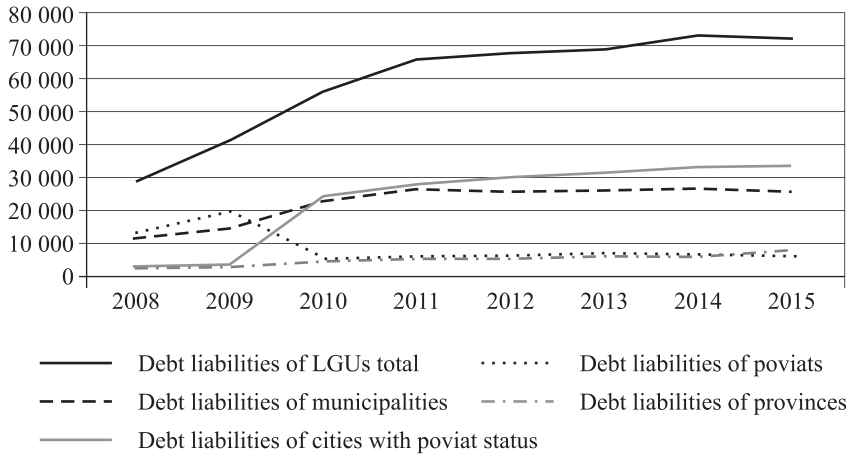
Source: Eurostat Database, http://ec.europa.eu/eurostat/data/database [access: 5.08.2016].

in the group of new EU Member States (the presented data shows that their larger amounts were observed only in case of Latvian local self-government).

Chart 1 illustrates the changes in the amount of debt of the local self-government units (LGUs) in Poland, taking into account individual types of self-government units (municipalities, cities with poviat status, poviats, and provinces).

The presented data shows that the largest growth rate of the self-government's debt occurred during the years 2009-2011 (the years 2009 and 2010 proved to be

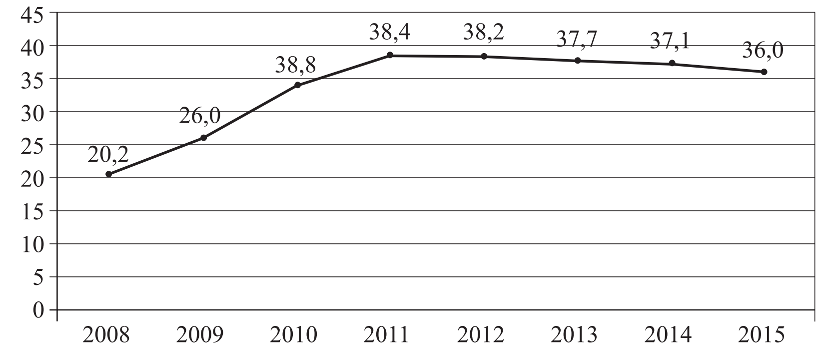
Chart 1. Debt liabilities of local self-government in Poland during the years 2008-2015 broken down into individual types of local self-government units (in millions of PLN)



Source: author's own work based on information from the Ministry of Finance on the implementation of local self-government units' budgets during the years 2008-2015.

the record ones in this respect, when nearly 40-percent increases were recorded in self-government debt). One should note that these were also the years of a record number of investment activities of LGUs (the value of self-government investments exceeded the level of 40 billion PLN per year in the analyzed period), which allows to put forward a thesis on the pro-development (investment) nature of self-government debt. On the other hand, the analysis of the debt's subjective

Chart 2. Debt liabilities as a % of the LGUs' budget revenues in Poland during the years 2008-2015 (including obligations related to the implementation of EU programs and projects)



Source: author's own work based on information from the Ministry of Finance on the implementation of local self-government units' budgets during the years 2008-2015.

structure shows that the accumulation of self-government debt takes place primarily in cities with poviat status and municipalities. For instance, in 2015, these units concentrated over 80% of the total debt of LGUs.

Chart 2 illustrates the changes in the value of the ratio of the liabilities share included in self-government debt (i.e. under the credits incurred by LGUs, loans, issued securities, and the so-called, outstanding liabilities, namely those whose required date of payment has already passed) in LGUs' total revenues. The presented data shows that since 2012 the value of this ratio, calculated as the average value for all LGUs in total, has been steadily dropping.

2. The most important issues and challenges related to the national self-government debt

Given the legal and economic changes and conditions currently taking place in Poland (related to the issue of self-government debt), it is possible to identify some of the key issues having a significant impact on the LGUs' debt policy.

Firstly, self-government debt is largely induced centrally, i.e. when the state imposes additional tasks on local self-government, without adequate financial compensation. In literature, there is the opinion that the national debt of the self-government sector is split onto the LGUs in "small portions". According to M. Słodowa-Hełpa, it takes place in the aforementioned method of transferring additional tasks without simultaneous provision of financial resources for their implementation. It has a significant impact on the growth of self-government debt. Słodowa-Hełpa cites that the mechanism of transferring, from the government to the local self-government, the financial liabilities generated by the educational system, which in conjunction with the current provisions of the Teacher's Chart and the demographic decline, negatively affects the financial situation of municipalities [Słodowa-Hełpa 2013: 37]. A similar scheme applies to the self-government national health care facilities. The medical activity Act[1] has transferred the responsibility for covering their negative financial results to the founding body, that is, the local self-government unit. However, no new sources of funding were indicated of which LGUs, as the founding body, could cover their financial losses associated with this process.

Secondly, dysfunctions occurring in the area of fiscal rules that limit the LGUs' debt are an important issue. Taking into account the fact that the self-government sub-sector is an important component of the entire public finance sector, and that its finance imbalance and debt has an impact on the condition of this sector, the process of the intensification of using fiscal rules at a local level, especially the

[1] Ustawa z dnia 15 kwietnia 2011 r. o działalności leczniczej, t.j. Dz.U. 2015, poz. 618 [Act dated April 15, 2011 on medical activity, consolidated text: Journal of Laws of 2015, item 618].

ones that limit debt (next to the rules that limit budgetary deficits, budget incomes, and expenditure), has somewhat become a natural consequence observed in all EU Member States, including Poland.

The fiscal framework applicable in Poland, associated with national debt, is based on several fiscal rules. Some of them are of a national nature, and some of a local nature. From a legal point of view, the most important rule in the set of national fiscal rules is undoubtedly the debt rule, included in two Acts, i.e. the Polish Constitution[2] and the Public Finance Act.[3] According to the constitutional rule, national debt (self-government debt is its integral component) should not exceed 3/5 of the annual gross domestic product (Art. 216 section 5). However in the Public Finance Act, prudence thresholds are defined and associated with exceeding the specified relation to GDP by the national state debt (55% of GDP – I prudence threshold; 60% of GDP – II prudence threshold). The Public Finance Act also specifies the necessary sanction procedures regarding both of the threshold situations (Art. 86-88).

Table 2 presents fiscal rules directly related to the Polish self-government subsector; national rules are also associated with it, but in an indirect way.

Table 2. Fiscal rules regarding local debt in Poland

Rule Type Category	2009	2010	2011	2012	2013	2014	2015	2016
Debt amount rule	60% of the realized budgetary revenue of the local government unit					none		
Debt servicing costs rule	15% (12%)* of the revenue of the local government unit planned in the given financial year					Individual Debt Ratio (IDR)		
The rule of at least balanced current budget outcome	none		yes					

*12% limit is applied to a hypothetical situation of the state public debt exceeding the prudence threshold of 55% of the GDP.

Source: author's own study.

The data presented in the table shows that the most important solutions that currently secure LGUs against liquidity buffers and excessive debt may include the following: the rule for at least a balanced current outcome of the self-government budget, i.e. the golden rule; and the Individual Debt Ratio (IDR), which since 2014 has replaced the previously applicable limits on debt and its servicing

[2] Konstytucja RP z dnia 2 kwietnia 1997 r., Dz.U. nr 78, poz. 483 [The Constitution of the Republic of Poland dated 2 April 1997, Journal of Laws No. 78, item 483].

[3] Ustawa z dnia 27 sierpnia 2009 r. o finansach publicznych, Dz.U. 2013, poz. 885 [Act dated August 27, 2009 on public finances, consolidated text: Journal of Laws of 2013, item 885].

costs, i.e. limits of 60% and 15%. The first of these rules has been in force in the Polish legal system for a relatively short period of time – only since 2011. According to this rule, local self-government units cannot adopt the budget in which running expenses are not covered by current revenue plus the budget surplus from previous years and the available funds stemming from settlements of issued securities, credits, and loans from previous years. This means the prohibition of an operating (current) deficit of the budget in the local self-government unit (Art. 242 section 1 of the Public Finance Act). Thus, in 2011, a very reasonable and desirable distinction of the local self-government budget in the current and capital section was sanctioned in Poland by introducing the rule of financing through budget deficits only for capital (investment) spending, and not running expenditures.

Individual Debt Ratios, on the other hand, were put into force in the Polish local finance system in the year 2014 (Art. 243 of the Public Finance Act). Their structure is based on the value of the operating surplus of individual local self-government units, calculated for the three years preceding the financial year in which debt obligations will be incurred.[4] In accordance with the fiscal rule in question, the ratio of debt servicing costs in a given year to revenues in the same year cannot exceed the average operational surplus calculated for the three previous years (plus revenues from the sale of assets). The rule formula is determined according to the following formula (Art. 243):

$$\left(\frac{R+O}{D}\right)_n \leq \frac{1}{3} \times \frac{Db_{n-1}+Sm_{n-1}-Wb_{n-1}}{D_{n-1}} + \frac{Db_{n-2}+Sm_{n-2}-Wb_{n-2}}{D_{n-2}} + \frac{Db_{n-3}+Sm_{n-3}-Wb_{n-3}}{D_{n-3}}$$

where:

R – total amount planned for a given year from payment of credit and loan installments of LGUs,
O – interest on loans and credits planned for a given financial year,
D – total revenue of the LGUs' budget in a given financial year that the fiscal rule relates to,
Db – current revenues of the LGUs,
Sm – revenues from the sale of assets of the LGUs,
Wb – current expenditures of the LGUs,
n – the financial year for which the ratio is determined,
n – 1 – the year preceding the financial year for which the ratio is determined,
n – 2 – the year two years before the financial year,
n – 3 – the year three years before the financial year,

[4] In this context, the rule in question, although it entered into force in 2014, has had a significant impact on the operating results of local government units in Poland since 2011.

While the idea, individualized for each LGU, of limiting debt servicing costs referring to the amount of earned operating surplus, seems right and much more reasonable than the idea of the previously applicable, universal for all units, debt servicing cost limits of 15% of the budget revenue*,* the fact remains that the analyzed fiscal rule has some structural flaws. The rule is based on "historical" data, and thus contains harmful mechanism in "transferring to the future" the results from a period of economic slowdown. Secondly, the rule has a defective structure consisting of double counting the debt servicing amount (both on the left side of the formula and on the right side – in the running expenses), which in turn distorts and reduces the real creditworthiness of the local government unit. Apart from that, the rule in question, through its specific structure, puts the self-government policymakers under clear pressure to sell municipal assets (component *Sm* in the formula), and thus, create short-term improvement in the local self-government unit's ability to service debt. In the long term it can be a harmful and even dangerous trend from the point of view of the local government's financial stability. In addition, the rule's structure encourages LGUs to use specific planning manipulations carried out in multiannual financial forecasts (MFF), i.e. in forecast documents that LGUs must obligatorily attach to the budget each year (more on this subject – later in the elaboration). This all means that one should, as soon as possible, review the analyzed rule in terms of eliminating the dysfunctions described.

Thirdly, the debt in the area of local finances is an absorption tool associated with the use of European funds by the local self government and financing their, so-called, own contribution. By means of repayable instruments (obtained from credits, loans, and municipal bonds) an LGU, as a beneficiary of EU aid funds, can supplement the aforementioned own contribution, required in the implementation of financial projects with EU subsidies. In this context, all the debt-rationing mechanisms are also mechanisms that ration absorption capacities of LGUs as the self-government beneficiary.

It should be added that new ratios limiting self-government debt (IDR) are more difficult to fill for LGUs than the previously applicable debt limits. M. Dylewski simply formulates a thesis on limiting the access to the EU aid founds due to individual debt limitations [Dylewski 2014: 133]. In this situation, it is very likely that some LGUs may have a hindered opportunity to apply for funding from the EU, mainly due to a lack of ability to incur liabilities that allow the supplementation of the so-called, own contribution. This was one of the reasons that in 2013, amendments to the Public Finance Act were made[5] that changed the scope of exclusions applicable to determine the IDR ratio. Under the new regulations, the liabilities

[5] Ustawa z dnia 8 listopada 2013 r. o zmianie ustawy o finansach publicznych oraz niektórych innych ustaw, Dz.U. poz. 1646 ze zm. [Act dated November 8, 2013 on amending the Public Finance Act and some other acts, Journal of Laws of 2013, item 1646, as amended].

incurred to finance the project in the part being subject to refund by the European Union and the liabilities incurred in order to provide the own contribution are both subjected to exclusions. These exclusions are extremely important for determining the level of the LGUs. According to them, the loan taken out on the own contribution is excluded from the debt ratio plus interest throughout the period of repayment, provided that the level of partial funding will be at least 60%. In the case of smaller partial funding, exclusion from the debt ratio of a credit granted for the own contribution is applicable for no longer than 90 days after the completion of the project and receipt of the refund.

It seems however, that from the point of view of the analysis of the LGUs' financial situation, total debt should be taken into account, i.e. inclusive of the "EU debt", and excluding the aforementioned exclusions. It is hard not to agree with the opinion of P. Swianiewicz and J. Łukomska [2014: 5] that the economic essence of the self-government debt should be treated equally in this aspect, irrespective of its purpose. One evidence of this is the fact that in the majority of LGUs with serious financial problems in which the so-called rectification proceedings take place (more on this subject – further in the study), one of the primary causes of these problems is an excessive investment momentum funded from repayable revenues associated with the desire to use financing from the EU budget [KRRIO 2016a: 117].

Fourthly, a serious problem is the increasing use by LGUs of customized sources of financing budget needs, which creates obligations with the features of a credit or loan. The causes of such local policy-makers' decisions are as follows: a high level of local debt, new limits on debt that are more difficult than the previous ones to be met by the LGUs, pressure regarding the need to supplement the own contribution in the context of the absorption of European funds in the new EU financial perspective, etc. On the other hand, examples of such custom instruments can be as follows: equity financing, sale back, leaseback, payment by installments, etc. As a result of using these instruments by self-government authorities, a new category of financial liabilities is created with effects similar to that of credit or loan agreements. Thus, there is a specific allocation of the self-government debt beyond the area of the previously known debt instruments, subject to the legal regime of the Public Finance Act and the debt rules contained in it [KRRIO 2016b]. Consequently, it means a risk of a real loss of the ability to monitor the actual level of local debt in Poland, which in turn, can have a negative impact on the balance and financial security in the self-government sub-sector.

In this aspect, a wider expansion is required, especially related to capital financing, for the problem of municipal company debt and the *de facto* problem of self-government debt remaining outside the formal records of public debt. Recently, there are increasing voices that some LGUs (applies to the largest cities) intentionally, that is purposefully, use creative accounting and do not show the true state of their finances by hiding the debt in utility companies, thus creating a kind of "gray zone of local debt".[6] Among others, in this context, P. Swianiewicz and J. Łukomska emphasize that "one needs to look at the debt of local self-government holistically, taking into account the financial situation of other municipal entities, primarily companies performing local tasks" [Swianiewicz & Łukomska 2014: 3].

The scale of the problem is illustrated by the A. Babczuk's studies relating to the years 2009-2010 [Babczuk 2012]. They show that in the analyzed period, the debt of municipal companies in Poland increased from 11.3 billion PLN to 13.2 billion PLN. In 2010, it accounted for approx. 18% of the total debt of LGUs. As much as 22% of the value of this debt fell on the capital city of Warsaw and 55% on other cities with poviat status, which means that 65 of the biggest urban centers in Poland were responsible for 77% of the debt of municipal companies. Given the scale and scope of the analyzed phenomenon, the cited author concludes that the debt of self-government companies is relatively high and can significantly (albeit indirectly) affect the financial situation of local self-government in Poland.

Underestimation of the process of "crowding out" of the debt beyond the LGUs' budgets may turn out to be so dangerous that in a situation of potential insolvency of a company, the self-government is not actually liable for its debts, only formally. Self-government authorities will usually be forced to do anything to avoid bankruptcy and auction off the company's assets, even for the prosaic reason of the implementation of its public tasks being strategic for the local economy. Possible consequences of the described phenomena are the uncontrolled growth of the local self-government's debt, as well as, a significant distortion of data illustrating its actual financial situation. Changes in regulations are needed as soon as possible, determining the legal regime for limiting and monitoring the LGUs' debt, in the formula of introducing additional mechanisms allowing ongoing monitoring of the obligations arising from non-standard instruments of financing the budgetary needs in the self-government sub-sector.

Fifthly, a relatively new but very important issue, from the point of view of the risk of the LGUs' debt, is the phenomenon of the LGUs increasingly taking out financial obligations in the non-bank lending institutions namely in, the so-called, quasi-banks. The reason for such non-standard financial operations is usually the inability to obtain a credit or a loan at the bank, due to achieving a high debt ratio. Quasi-bank institutions do not usually require LGUs to submit the opinion of the Regional Chamber of Audit (RIO) on the possibility of repayment of the obligation, but also the instruments offered by these institutions are much more expen-

[6] Municipal commercial law companies, not belonging to the public sector, are subject to a separate regulation in terms of financial management than the public finance sector. Consequently, their financial liabilities are not recorded in official statistics regarding national debt.

sive than conventional loans and credits, which will undoubtedly have a negative impact on the finances of individuals using their services.[7] The Supreme Chamber of Control warned about these problems in 2015, pointing to specific examples of municipalities using such practices (municipalities in the area of operation of the Regional Chamber of Audit (RIO) in Szczecin: Rewal, Recz, Ostrowice, and Przybiernów; Regional Chamber of Audit (RIO) in Łódź: Zadzim and Pątnów; Regional Chamber of Audit (RIO) in Kielce: District of Piekoszów; Regional Chamber of Audit (RIO) in Białystok: District of Nowy Dwór; Regional Chamber of Audit (RIO) in Poznań: District of Łęka and Opatowska; Regional Chamber of Audit (RIO) in Rzeszów: District of Dubiecko) [NIK 2015: 22]. The fact of ongoing current prosecutions in cases of several districts of the West Pomeranian Province (Ostrowice, Białogard Manowo, Rewal, Bielice, Przybiernów, and Brojce), having serious financial problems in connection with using the services of institutions outside the banking sector, may serve as justification of the seriousness of the problem. In the context of the described examples, one should consider changing the law so that LGUs cannot incur liabilities in institutions other than those subject to the supervision of the Financial Supervision Authority.

Sixthly, an important issue in the area of interest of local finances is a limited realism, and thus, the usefulness of long-term financial forecasts (WPF) as instruments of debt management and debt risk.[8] Experience shows that LGUs, in order to increase the operating surplus, either artificially inflate the budget revenue projected in documents or lowers the estimated spending. The described practices ultimately undermine the realism of long-term financial forecasts (WPF) as a tool for effective management of local debt. It is true that in the Ministry of Finance certain activities are conducted on a new IT tool which is supposed to make long-term financial forecasts (WPF) real, but the question is whether the information improvements themselves are enough. Perhaps more radical changes to the provisions of the Public Finance Act will be needed. In the current legal form, long-term financial forecasts (WPF) are used primarily for information purposes for the state, while being a tool of the central government for "keeping a tight rein" on local debt, and not for the management purposes of LGUs.

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[7] According to the interpretation of the Ministry of Finance [the MF Letter to the Chairmen of the Regional Chamber of Audit (RIO), 22.04.2016] contrary to the following provisions of the Public Finance Act: 1) Art. 91, which sets out the obligation to obtain the opinion of the Regional Chamber of Audit (RIO) by LGUs on the possibility of repayment of the taken out loan; 2) Art. 44 of the Act dated 27 August 2009 on Public Finance, i.e. the principle of effective management of public funds, pursuant to which public expenditure should be borne in a purposeful and frugal way while observing the principle of obtaining the best results from the given outlays (it is hard to talk about savings when debt instruments offered by quasi-banks are much more expensive than those offered by the banking sector).

[8] The statutory order of realism of the long-term financial forecasts (WPF) was formulated in Art. 226 of the Public Finance Act.

Seventhly, in the Polish legal system, there is no formal and legal possibility of bankruptcy for the LGUs. Bankruptcy and composition law[9] defines public entities which are excluded from the insolvency proceedings. They include LGUs (art. 6 item 2), which means that in the strictly legal understanding of a district, poviats and provinces cannot go bankrupt. Of course, the inability to declare bankruptcy by LGUs does not mean that in the case of clear financial problems of these entities, including difficulties associated with the settlement of their obligations, no rehabilitation procedures are started.[10] For example, in 2014 the Regional Chamber of Audit (RIO) sent letters for the development of rehabilitation proceedings to 34 LGUs and in 2015 sent it – to 18 of them [KRRIO 2016a: 116-117].

In this context, one can ask a legitimate question whether the rehabilitation program is a sufficient and effective instrument to improve the financial situation in territorial units with large financial problems. According to the authors cited earlier (P. Swianiewicz and J. Łukomska), one should consider the possibility of regulatory approval of LGUs' bankruptcy in Poland. They state: "the current legal void in this regard means that the only ones injured, as a result of taking out excessive loans, are the local community and self-government authorities. And the blame for excessive debt breaks down into two parties – the borrower, but also the bank, which without due consideration lentmoney without taking into account the risk of insolvency. The risk should therefore be similar for both parties, and not to burden the borrower as a whole" [Swianiewicz & Łukomska 2014].

Conclusion

The analysis carried out in this study showed that national self-government debt is an extremely dynamic category of local finances. There is a number of new challenges and issues of legal and economic nature, determining local debt policies of self-government authorities. The stability of the local/regional finance system, but also the stability of the entire public finance sector, of which an integral component is the self-government sub-sector, will depend on the manner of solving these challenges.

[9] Ustawa z dnia 28 lutego 2003 r. Prawo upadłościowe i naprawcze, t.j. Dz.U. 2015, poz. 233 [Act dated February 28, 2003 Bankruptcy and composition law, consolidated text: Journal of Laws of 2015, item 233].

[10] According to Art. 240a of the Public Finance Act, in the absence of the possibility of adopting long-term financial forecast or budget of the local self-government unit, pursuant to the principles set out in Art. 242-244, and the threats to implementation of public tasks by LGUs, the Body of the Regional Chamber of Auditors calls this unit to develop and adopt the rehabilitation program. The body constituting LGU adopts such a program for a period not exceeding three consecutive financial years. On the other hand, the consequence of failure to adopt the rehabilitation program or a negative review by the Regional Chambers of Accounts is to determine the unit's budget by the chamber, whereas the budget can be fixed without maintaining the relation referred to in Art. 242-244.

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Samorządowy dług publiczny w Polsce – aktualne problemy i wyzwania

Streszczenie. *Jedną z najbardziej dynamicznych kategorii finansów lokalnych w Polsce jest dług samorządowy. Owa dynamika niesie za sobą określone ryzyko nie tylko dla systemu finansów lokalnych/regionalnych, ale również dla całego sektora finansów publicznych, którego integralnym komponentem jest podsektor samorządowy. Podstawowy cel opracowania to identyfikacja najważniejszych i jednocześnie najbardziej aktualnych problemów prawno-ekonomicznych dotyczących samorządowego długu publicznego w Polsce, z jednoczesnym wskazaniem możliwych sposobów ich* *rozwiązania lub przynajmniej złagodzenia negatywnych ich skutków. Od podjętych działań w tym zakresie będzie zależała nie tylko stabilność systemu finansów samorządowych, ale także całego sektora finansów publicznych.*

Słowa kluczowe: *samorząd terytorialny, dług lokalny, problemy zadłużeniowe*

Zeszyty Naukowe
Wyższej Szkoły Bankowej w Poznaniu
2016, t. 70, nr 5

Marcin Kalinowski

The Gdańsk School of Banking
Faculty of Finance and Management
e-mail: mkalinowski@wsb.gda.pl
phone: 58 522 75 16

Municipal Bonds as a Financing Tool for Polish Local Government Units – The State of the Market and Development Prospects

Abstract. *Municipal bonds are an interesting alternative financing tool for local government units. These are a cheaper and more flexible tool than traditional capital acquisition forms out on the market. Between the years 2007-2015, the debt resulting from municipal bond issuance for local governments in Poland increased fivefold (from 4 to 20 billion PLN). This article presents a Polish municipal bond market assessment and outlines the market development prospects based on an analysis of opportunities and constraints.Analyses carried out in the article show that the municipal bond market in Poland should develop dynamically in the next few years. This market, among others, needs to develop to be able to secure local government unit contributions for the implementation of project that are co-financed by the European Union during the years 2016-2020.*

Keywords: *municipal bond, local government unit financing*

Introduction

Local government units are financing not only different ongoing activities, but also, an abundance of infrastructure investments. They are supporting regional development, as well as, enhancing the local economy's competitiveness; however this often leads to excessive expenses over the revenue in their budgets. Local government budgets being imbalanced force these units to use external financing sources.

When using external financing sources, local governments primarily perform infrastructure investments to allow local companies to develop business in other markets. This type of investment has become an important element of regional development [Kozak 2015: 87]. It is worthy to note that a significant source of financing infrastructure investments in Poland is EU funds. However, they require the local government units also have their own contribution to the project. The local government's own contribution is often financed by external sources. One of the external financing sources for local government units are municipal bonds. This is not currently the most important source of funding for local governments, but there is a continuous development in the Polish municipal bonds market. Still, the most important and most popular external source of financing local governments are loans, but municipal bonds have become an increasingly important financial tool in recent years [Szewczuk, Kogut-Jaworska & Zioło 2011: 28]. Thus, municipal bonds may be an interesting alternative to traditional financing for municipalities in the future, instead of, for example, traditional financing in the form of loans.

The aim of the study is to assess the state of the Polish municipal bond market and to outline the development prospects pointing out the opportunities and limitations.

The research is conducted with the use of data from the Ministry of Finance (MF), the European Central Bank (ECB), the Eurostat, the securities exchange platform CATALYST, periodical reports of the National Bank of Poland (NBP), the National Council of Regional Chambers of Audit (KR RIO), Fitch Polish, and economic literature.

1. Financing sources for local government units

In order to meet the collective needs of the community, local government units receive funding guaranteed by law; this includes their own revenues, subsidies, and grants. Their own sources of revenue are often insufficient to finance local government tasks, in particular, investments. Among external sources, local governments may use financial instruments that are:

– non-refundable (like grants, subsidies, or funds from the European Union),
– refundable (like credits, loans, securities – municipal bonds) [Rosa 2011: 367].

According to Art. 89 § 1 of the Public Finance Act of August 27th 2009[1] the local authority can take out loans and issue securities in order to:

– cover the budget deficits occurring during the transitional year,
– finance planned budget deficits,

[1] Ustawa z dnia 27 sierpnia 2009 r. o fnansach publicznych, Dz.U. nr 157, poz. 1240 [Public Finance Act of 27th August 2009, i.e. Journal of Laws no. 157, item 1240].

– repay earlier obligations, such as repayment of securities, loans, and other borrowings,

– finance activities also financed by the European Union budget.

An important element for local government units in financing their deficit is the selection of appropriate financial tools. Factors determining the choice of the financial tool used by local governments can be classified in different ways. Among them are:

– internal factors – related to the conditions of the community, including its ability to incur liabilities, and the scale of the needs and nature of the planned investment projects,

– external factors – determined by the sources of financing themselves, including in particular, the availability and cost of capital acquisition [Zioło 2011: 294].

Among the criteria that guide local authorities in choosing an external financing source are:

– financial criterion,

– non-financial criterion (social, political, formal, legal, and organizational) [Rosa 2011: 367].

The financial criterion, which is one of the key factors determining the choice of financial instrument, can determine the source of capital return with minimal debt servicing costs. The cost of acquiring the funding raises capital costs and current debt service costs. An important factor is the flexibility of a debt instrument and the possibility to adapt it to the specific tasks. Moreover, this group of factors include: the availability of capital, the rate of capital, the payback period of the capital, the collateral required for its return, as well as, the risks associated with raising the capital [Zawora 2014: 207].

Selecting the sources of budget deficit financing should always be preceded by a comprehensive economic analysis. Also important, as an institution under public law, are the established local government specifics to meet local community needs, where economic calculation must go hand in hand with social benefits [Zawora 2014: 206-207]. The main source of deficit financing by Polish local governments, according to data at the end of 2015, are loans. They account for ap-

Table 1. The structure of liabilities for local government debt in 2015
(in billions of PLN)

Structure of liabilities	Billions of PLN	%
Issuing securities	4.15	5.9
Loans	67.3	94.0
Other liabilities	0.15	0.1
Total liabilities	71.6	100.0

Source: own elaboration based on *Sprawozdania z działalności...* 2009, 2010, 2011, 2012, 2013, 2014, 2015.

prox. 94% of debt. The issuing of securities (municipal bonds) represents almost 6% of liabilities (Table 1).

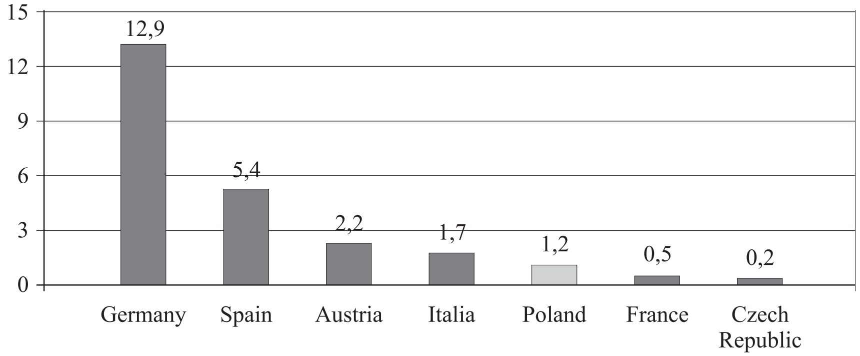
2. Municipal bonds as an example of a debt financial instrument

Municipal bonds are an instrument for balancing the budget and ensuring the liquidity of government in the long run. The Polish municipal bonds market analysis shows that governments issue bonds frequently to finance investment projects [Kozuń-Cieślak 2008: 111].

Legal issues related to the issuance of municipal bonds in Poland are regulated by the Bonds Act of January 15th 2015.[2] However, it neglects to introduce a definition of municipal bonds. This term is consistent with the general bonds term contained in Art. 4 § 1 of the Bonds Act.

Art. 4 indicates a bond as a security issued in series, in which the issuer states that they are indebted to the bond owner (bondholder) and is committed to him and the outlined performance. Moreover, Article 2 indicates that bonds can be issued by, among others, municipalities, districts, provinces, and the associations of these units and regional units or local authorities, other than the Republic of Poland, as long as it is an EU country. Typically municipal bonds have long-term maturities in the range of 1 to 15 years, with the average usually between 5 and 10 years. Final payment resulting from the bond contract is preceded by periodic coupon payments based on the interest rate dependent on the interbank rate.

Chart 1. The debt of local government units from the issuance of debt securities in relation to GDP in selected countries of the European Union selected in 2014



Source: own elaboration based on NBP 2015: 247, prepared on the basis of the ECB and Eurostat.

[2] Ustawa z dnia 15 stycznia 2015 r. o obligacjach, Dz.U. poz. 238 [Bonds Act of January 15th 2015, Journal of Laws item 238].

The municipal bond market is a minor part of the capital market in Poland. These instruments accounted for over 3% of the outstanding long-term debt securities of domestic entities at the end of 2014. The local government unit's (LGU's) debt from the issue of bonds in 2014, represents approximately 1.2% of the GDP. The municipal bonds market development level in other EU countries varied widely and, to a large extent, depend on the degree of autonomy of the administrative system of the state and territorial units (Chart 1). The biggest market for these instruments operates in Germany [NBP 2015].

3. Municipal bond market in Poland

Municipal bonds are in a dematerialized form and are payable to the bearer. Such legal characteristics allow them to be traded publicly. This increases the number of potential investors. A significant part of bonds issued are publicly offered through the electronic platforms operated by the stock exchange. Despite some advantages of these debt securities they are not in use very often in Poland.

Apart from a public offering, municipalities also issue bonds using a private engagement. A private offer may be addressed to a maximum of 149 people without the use of announcements in the media. This is a much simpler procedure than the public offering. Its main advantages are lower execution costs and a shorter period of the implementation process. The disadvantage is the limited number of investors, which reduces the potential of attracting external investment funds.

A large increase in the municipal bonds market value was observed after Poland's accession into the European Union in 2004.

Debt resulting from local government units increased fivefold from 2007 to 2015, from 4 to 20 billion PLN. There is an increase during the analysed period

Table 2. Municipal debt due to issue of municipal bonds and its share in total municipal debt in Poland during the years 2007-2015

Year	Municipal debt due to the issue of bonds (in billions of PLN)	The share of debt from the bonds issued in local government debt (in %)
2007	4.1	15.9
2008	4.5	15.4
2009	6.9	17.0
2010	10.9	19.6
2011	14.4	21.7
2012	15.6	22.9
2013	18.6	26.7
2014	19.1	26.4
2015	20.02	N/A

Source: own elaboration based on the Ministry of Finance, Fitch Polska, and NBP data.

of the issuance of municipal bonds by local government units resulting in debt. Currently, more than a quarter of debt stems from the issue of bonds.

Among the local government units, the issuing of bonds most often occurs in cities and towns. According to Ministry of Finance data at the end of 2014, the amount of debt instruments used by these units accounted for 85.3% of the outstanding value of municipal bonds.

The funds from the issue of local government bonds were basically spent to refinance other obligations, manage early repayments, and to finance infrastructure projects. According to Fitch Poland, local government unit debt securities amounted to 2.1 billion PLN during 2014 in the primary market, and this was less than in 2013, when the value was about 2.4 billion PLN. The reduction in the issue of municipal bonds is connected with the introduction of new debt limits. In addition, there was a decrease in demand for financial resources for the implementation of projects that were co-financed from EU funds resulting from the completion of applications for funding under the EU financial perspective for 2007-2013, and also failing to start new operational programs for new prospects for 2014-2020.

In 2014, municipal bonds were made exclusively private. The primary market was lacking in value security sales. In addition to the relatively low borrowing needs of small local government units, there was a problem of sharing bonds issued in a number of series. The average value of a single series issued was only 1.3 million PLN in 2014; this was about 0.5 million PLN less than in 2013.

More than 60% of municipal bonds issued by local governments in 2014 were instruments with an original maturity from 5 to 10 years. The ones with a greater value of issues mostly had a longer original maturity. Variable interest rates still dominate as a key debt security issue. The amount of municipal bond coupons basically depend on WIBOR reference rates. The only fixed-rate bond instruments were issues in Warsaw between 2009-2011.

The organizers of the issue of local government bonds were mainly banks. The brokerage houses had a very limited activity in this area. As a result, when PKO BP completed its acquisition of Nordea Bank Poland on October 31st 2014, it gained the largest market share of issued municipal bond.

Local government debt securities traded on the Over the Counter (OTC) market at the end of 2014 were approximately 83% of all municipal bonds. Domestic banks still dominated among the investors in the OTC market. Their share in the municipal bonds buyer structure was approximately 90%. It was an alternative tool to lending money. A small amount of municipal bonds trading on the secondary market OTC was also the result of strong market fragmentation resulting from the low borrowing needs of small local government units and dividing up the issue of a number of series. Low market liquidity was one of the main reasons for the minor interest in municipal bonds among other entities, like in particular,

Table 3. Municipal bonds quoted on the Catalyst platform between the years 2009-2015

Years	Electronic Order Booked Trades (daily)		Non-Electronic Order Booked Trades (daily)		Number of Series	Emission Value (in millions of PLN)
	Turvover Value (in millions of PLN)	Number of Trades	Turvover Value (in millions of PLN)	Number of Trades		
2009	62.68	181	14.00	1	9	930
2010	124.21	621	69.60	9	27	1753
2011	41.76	432	1.59	2	24	2222
2012	10.83	279	0.00	0	31	2374
2013	7.23	169	12.33	13	57	3088
2014	17.48	204	0.56	1	60	3187
2015	10.25	69	1.74	1	58	3189

Source: CATALYST Statistic Bulletin, Catalyst 2009, 2010, 2011, 2012, 2013, 2014, 2015.

non-bank financial institutions. Shares of investment funds and pension funds do not exceed 5% in the structure of buyers in this market.

Municipal bonds trading is present on the Catalyst platform – the regulated markets of the Warsaw Stock Exchange (WSE), BondSpot, and retail ASO organized by WSE. There were 65 municipal bond series traded, worth 3.2 billion PLN at the end of 2014; 65% of those were Warsaw bonds. In the analyzed period, the regulated market trading on the Warsaw Stock Exchange introduced municipal bonds with a total value of 113 million PLN (399.5 million PLN in 2013), which was issued by five local government units. At the same time, we observe a drop in interest for issuers on the alternative trading system and less active investors in this segment of the market (Table 3). There was a small liquidity on the secondary market Catalyst platform for municipal bonds in 2014. Approximately 90% of the net sales in this market were transactions for Warsaw bonds.

4. Polish municipal bond market development prospects

A local government's economic development depends on, among other things, on building sustainable competitive advantages within their own region or country. In the constant shortage of investment capital, municipal bonds seem to be the cheapest and most convenient external capital source. They are particularly important and valuable in a case when the value of necessary capital significantly exceeds the municipality's capacity in taking on a bank loan.

On the other hand, factors beyond local government control that determine the most efficient indebtedness level should be considered: current and projected national socio-economic developments, the market mechanism development level and privatization process, changes in GDP, inflation, unemployment, market interest rates, foreign exchange rates, the public finance state of the country and limits on municipal debt, state regulations on debt instruments available to municipalities on the domestic financial market, changes in domestic and global economic conditions, the risk aversion level among international investors and their attitude towards countries with emerging markets.

The fact that bonds are a much cheaper source of funding for regional development compared to bank loans is one of the most frequently emphasized advantages of municipal bonds. The cost of funding could even be reduced by purchasing a guarantee of repayment for the bonds, which lifts the issuer creditworthiness and, consequently, forces investors to accept bonds with lower interest rate coupons.

Another features, positive for the municipality market development, is the flexibility of selecting repayment terms, including coupon payment schedule, the term of capital repayment, or the rolling over bond issue possibility. The possibility of dividing total issues into many branches with varied values and maturities provide municipalities with the ability to match the incoming cash flow to the investment project's individual needs.

In addition, by issuing bonds municipalities obtain credit ratings from independent rating agencies and become more transparent and attractive to potential new investors. This increases their credibility, as well as, their chances for participation in projects co-financed with EU structural funds.

A new opportunity for the development of the municipal bond market are perpetual bonds. The new Bonds Law from January 15th 2015, introduces a new category of bonds called perpetual bonds. In this type of bond, there is no redemption date specified and the interest is only paid. If the maturity date is not specified, the debt ratio of the local count will only be interest. It will be very encouraging for many municipalities, because it will allow them to incur greater commitments for greater investments; this was probably the intention of the government. There is only one problem: the risk for investors will be higher – as in the case of revenue bonds – than ordinary bonds, which will mean higher interest rates. Increased costs due to higher interests rates can contribute to subsequent financial problems. Therefore, governments should be very cautious, making use of this instrument.

From July 2015, local government units in Poland can issue perpetual bonds. Through perpetual bond issuance, issuers of these securities receive a reliable and stable source of capital, which – as a rule – you do not have to pay. It is the duty of the issuer to ensure the timely payment of benefits from the bonds and to keep other commitments made by the issuer in terms of the bonds issued.

Perpetual bonds may be an interesting tool for potential investors. The purchase of such securities can be an excellent way to provide current and specific financial receipts for them and, in the future, for their heirs. In addition, the bondholder does not need to make a reinvestment of the funds received from the redemption of bonds, as is the case with the purchase of other bonds types.

The advantage of such funding tools like municipal bonds is that investment funds mostly come from domestic investors and do not generate foreign exchange risk. Additionally, municipal bonds provide a save and flexible tool for long-term domestic investments.

The matter of the use of municipal bonds in the funding regional development has been frequently discussed in economic literature. On one hand, researchers point to the numerous advantages for the bond issuers, including debt management flexibility, or the possibility of applying for EU structural funds. On the other hand, the development prospects for the municipal bond market in Poland is, very much, limited.

The limitation for the development of the municipal bond market in the coming years may be new regulations on local government debt limits. New debt limits determine the upper limit of the allowed expenses related to the redemption of local government and service obligations in relation to their income. According to regulations, having first applied to the resolutions of the budget of local government units for 2014, the ratio of the local government unit's repayment obligations annual value and service charges to the planned total income does not exceed the rate corresponding to the arithmetic average of the calculated value for the last three years, the relationship of current revenue plus proceeds from the sale of assets and the net current expenditures to total revenue.

For many local government units, primarily those with low-income, new debt limits may be more restrictive than those applied in the end of 2013. A possible decrease in the ability of local governments to assume new obligations in the coming years may translate into a slowdown in their municipal bonds debt growth.

Conclusion

Municipal bonds are an interesting financing tool for local government units. For municipalities, bonds are a convenient form for collecting investment funds. They are much cheaper than banking loans and provide a broad range of flexibility in the repayment schedule. Municipalities can effectively adjust bond repayment plans with payments stemming from the development projects they are used for.

At the end of 2014, these instruments accounted for over 3% of the outstanding long-term debt securities of domestic entities. The local government unit's (LGU's) debt represented approximately 1.2% of GDP from the issue of bonds in 2014. Debt resulting from the issue of bonds by local government units increased fivefold from 2007 to 2015, from 4 to 20 billion PLN. Larger cities are leaders in the issuance of municipal bonds.

The perspective of co-financing regional economic and infrastructural projects with EU structural funds and limits in indebtedness have the most impact on municipalities in organizing new issues of bonds. Recently, to limit the level of debt and to connect external capital with the profits from particular economic projects, local governments will probably force municipal enterprises to issue revenue bonds. Similarly like in developed countries, such bonds will help fund utility and infrastructure projects in large Polish cities.

From the municipal, national, and provincial point of view, municipal bonds are an advantage over traditional credit. This arguments shows that the municipal bond market should develop dynamically in the coming years.

It is important that the years 2015-2020 be a period of inflow of EU funds in the new financial perspective. Projects funded in part by the European Union require local government's own contribution; this means that they will need to start borrowing capital through, for example, the issue of municipal bonds.

In addition, since 2015 local governments can use a new type of bond – perpetual bonds. They can also become a popular tool for financing the deficit in local government units.

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Obligacje komunalne jako narzędzie finansowania jednostek samorządu terytorialnego w Polsce – stan rynku i perspektywy jego rozwoju

Streszczenie. *Obligacje komunalne stanowią w ostatnich latach interesującą alternatywę finansowania dla jednostek samorządu terytorialnego. Są to narzędzia tańsze i bardziej elastyczne od tradycyjnych form pozyskiwania kapitału na rynku. W latach 2007-2015 dług wynikający z emisji obligacji komunalnych przez jednostki samorządu terytorialnego w Polsce wzrósł pięciokrotnie (z 4 do 20 miliardów PLN). W artykule zostaje dokonana ocena rozwoju rynku obligacji komunalnych w Polsce i nakreślone zostają możliwości rozwoju tego rynku w oparciu o analizę szans i ograniczeń. Przeprowadzona w pracy analiza wskazuje, że rynek obligacji komunalnych w Polsce powinien się w kolejnych latach dynamicznie rozwijać. Wynika to m.in. z przyszłych potrzeb uzyskania przez jednostki samorządu terytorialnego wkładu własnego do realizacji projektów współfinansowanych w ramach środków Unii Europejskiej w latach 2016-2020.*

Słowa kluczowe: *obligacje komunalne, finansowanie jednostek samorządu terytorialnego*

Zeszyty Naukowe
Wyższej Szkoły Bankowej w Poznaniu
2016, t. 70, nr 5

Marek Dylewski

The WSB University in Poznan
Faculty of Finance and Banking
e-mail: marek.dylewski@wsb.poznan.pl
phone: 61 655 32 46

The Financing of Public Tasks Delegated to Local Governments – An Unresolved Systemic Problem

Abstract. *The paper addresses problems relating to dysfunctions observed in the performance of public tasks delegated to local governments by the state's central authorities. The paper aims, in the first place, to investigate the factors behind these dysfunctions and to suggest recommendations for systemic improvements. In addition, an attempt is made to identify elements that should be taken into account in determining the costs of tasks delegated to local government units. The discussion is based primarily on a review of relevant regulations and a critical reading of topical literature, but also includes practical insights.*

Keywords: *delegated tasks, devolved resposibilities, local governments, public finance*

Introduction

Under the Constitution of the Republic of Poland, public tasks geared to satisfy the needs of the local population are designated as local government's statutory tasks and are therefore to be performed by a specific local government unit (LGU). However, if need arises on the part of the state's central authorities, LGUs may be mandated, through a parliamentary bill, to perform public tasks other than statutory ones. Methods and procedures for the delegation and performance of such tasks should be laid down by the relevant bill. The absence of specific regulations has been raising disputes between the central government and LGUs, since LGUs may not refuse to perform delegated public tasks but, at the same time, expect to be provided with commensurate funding to cover the expenses involved in pursuing these. The problem has not yet been adequately addressed and leads to clashes between central and local government bodies. Many of such disputes have to be resolved by courts, which is not only time-consuming but also incurs additional costs for taxpayers.

The main strand of discussion in the paper aims to investigate the factors behind dysfunctions in task delegation to local government units and to suggest recommendations for systemic improvements. Further, the author attempts to identify elements that should be taken into account in determining the costs of tasks delegated to LGUs.

1. Delegated Tasks and Their Funding Schemes

LGUs are responsible for all public affairs with local, supra-local and regional implications that are not expressly assigned by relevant legislation to other government bodies. Unless a law stipulates otherwise, local affairs are handled by municipalities, while supra-local and regional ones are tackled by the other respective levels of local government. Tasks involving the satisfaction of the needs of a local community are considered the LGU's basic, or statutory, responsibilities. A specification of these tasks can be found in laws laying down the rules for the formation and operation of local governments at respective levels: that of municipality (*gmina*), district (*poviat*), and region/province (*voivodeship*). These laws allow the state's central authorities to devolve, under other applicable laws, specific public tasks, such as e.g. the preparation and administration of general elections or referenda, to local governments.

LGUs are intrinsically vested with the execution of public tasks that are not explicitly assigned by the Constitution or parliamentary bills to other public bodies. An LGU will typically have all the responsibilities of local government that are not expressly assigned to other LGUs. Public tasks focused on the needs of a specific local community are designated as an LGU's basic, or statutory, tasks. At the same time, the Constitution of the Republic of Poland allows for parliamentary bills, if deemed necessary for the good of the state, to delegate the performance of public tasks from outside the list of statutory responsibilities to specific local government units. Relevant legislation then specifies how such tasks shall be delegated and executed, at the same time providing LGUs with a share in public revenues commensurate with the tasks devolved. Local government revenues are composed of an LGU's own income alongside open-end and closed-end subsidies from the state budget (or other public sector units). The sources of NGU's income are clearly defined in legislation, primarily by the 2003 Law on Local Government Revenues[1] (further referred to as LGU Revenue Law). Importantly enough, any shifts in the powers and responsibilities, and hence in the statutory tasks, of local government units are to be followed by parallel changes in the distribution of public sector revenues.[2]

Aside from parliamentary bills, public tasks may be delegated to LGUs via agreements with central governmental institutions and agencies or other LGUs [Moll 2012: 213]. In carrying out a delegated task, a given LGU acts on behalf of central government and under its responsibility. This is because a public task that has been delegated to an LGU does not immediately among its statutory responsibilities but it remains a responsibility of central government. Therefore, the rule whereby an LGU shall perform public tasks on its own behalf and bear responsibility for these does not apply.[3]

Although LGUs themselves have never objected to the need of attending to public tasks devolved from central government, there is a lot of controversy around the funding scheme, notably around the method for determining financial allocations to specific delegated tasks. K. Wójtowicz cogently observes that the greatest threats to the financial stability of LGUs arise from persistent non-compliance with the constitutional rule of adequacy [Wójtowicz 2014: 306]. What makes it even more difficult to abide by the rule of adequacy is the fact that the relevant laws are not very accurate in defining the methods for establishing the funding requirements associated with the performance of public tasks devolved to local government [Kornberger-Sokołowska 2013: 142].

General provisions for the financing of delegated tasks can be found in the LGU Revenue Law. Namely, an LGU that is entrusted with the performance of public tasks devolved from the central government level, or other tasks delegated to it under relevant laws, is entitled to receiving closed-end subsidies that should cover the expenses involved in performing these tasks. What the Law further stipulates is that the amounts of closed-end subsidies granted toward the execution of public tasks devolved from central government or other public tasks delegated under specific laws should be determined by the same method that would be applied in determining similar expenses under the state budgeting process (Art. 49 of Law on Local Government Revenues).[4]

[1] Ustawa z dnia 13 listopada 2003 r. o dochodach jednostek samorządu terytorialnego, Dz.U. nr 203, poz. 1966 [Law of November 13, 2003 on Local Government Revenues, Journal of Laws No. 203, item 1966].

[2] Konstytucja Rzeczypospolitej Polskiej z dnia 2 kwietnia 1997 r., Dz.U. nr 78, poz. 483 ze zm. [The Constitution of the Republic of Poland of April 2, 1997, Journal of Laws No. 78, item 483 as amended].

[3] Wyrok Sądu Najwyższego z dnia 21 listopada 2003 r., sygn. akt II CK 267/02, Legalis [Supreme Court Ruling of November 21, 2003, file ref. no. II CK 267/02, Legalis].

[4] It should be noted that the state budget procedure hardly provides any useful information on methods for determining financial allocations to similar tasks, as the state budget process operates

Unless another law stipulates otherwise, closed-end subsidies toward public tasks devolved from central government or other public tasks delegated under specific laws are distributed by regional representatives of central government known as governors or *voivodes*, on terms and conditions set forth in relevant regulations. Importantly, subsidies should be made available to LGUs within such time frames as to enable them to complete the delegated tasks to an acceptable standard and in a timely manner. If this condition is not met, an LGU may claim the amount due, plus interest at the default rate applicable to tax arrears, in court. Unless other applicable laws stipulate otherwise, closed-end subsidies toward the performance of public tasks devolved from central government or other public tasks delegated under specific laws are distributed among specific LGUs, at municipality and poviat level, by centrally appointed governors of regions/provinces known as *voivodes* (Art. 49 of Law on Local Government Revenues).

An LGU is to be provided with commensurate funding to ensure that it is capable of completing a specific public task assigned to it. Nevertheless, the terms and conditions on which the funds should be transferred to an LGU are only defined under laws delegating specific tasks or under intra-governmental agreements. As a result, an LGU does not have a say about how such tasks are determined and what amount of funding is allotted to these. In case funds are not available to an LGU in time to enable it to attend to a devolved public task, the LGU is entitled to a penalty payment based on the default interest rate applicable to tax arrears.

It is therefore easy to see that LGUs have hardly any influence on the making of laws that delegate public tasks from the central to the regional (province or district) or local (municipality) level. The only way they can engage in the law-making process is through the consultative body called the Joint Committee of Central and Local Government (Komisja Wspólna Rządu i Samorządu Terytorialnego). The Committee is a forum that has been created to enable central government and local government to develop a consensus on vital issues relating to the functioning of local government. It is also where national policies toward local government are discussed and attention can be given to local government matters involving, or falling within the jurisdiction of, the European Union or other international organizations of which Poland is a member state. The Committee is composed of representatives of both central and local government. The central government is represented by the minister for public administration and 11 other members appointed and recalled by the Prime Minister on a recommendation from the minister for public administration. Local governments are represented by appointees of national associations of local government units. Representatives of both sides are proportionately assigned, on appointment by the Committee's plenary assembly,

at a much higher level and, hence, central government bodies are not at all engaged in performing tasks similar to those pursued by LGUs.

to 12 task forces and 3 workgroups whose work is widely supported by domain experts.[5]

2. The Rule of Adequacy in the Costing of Delegated Tasks

In democratic and decentralized European states, the principle of adequacy between the tasks performed by LGUs and the resources available to it is seen as a cornerstone of local government finance [Ostrowska 2014: 59-78]. The European Charter of Local Self-government demands that local authorities be entitled to adequate financial resources of their own that they can use freely at their discretion, and that these financial resources be commensurate with the responsibilities assigned to local government units by the constitution and the law.[6] This right is also enshrined in Poland's Constitution that guarantees LGUs a share of public income in proportion to their burden of tasks and responsibilities and insists that any modifications to the powers and responsibilities of local government be accompanied by corresponding shifts in the distribution of public income (Art. 167 of the Cobnstitution).

A. Ostrowska notes that, in line with the Constitution, the distribution of income between state (i.e. central government) and local government must be based on a fixed mechanism for dynamic adjustment and compensation rather than on gradual, ad-hoc "devolvement" of the expenses incurred in the performance of public tasks delegated from central to local government. The principle of adequacy also implies that LGU income, both in terms of structure and fiscal efficiency, should correspond to the nature as well as to the expected quality and quantity of public tasks to be carried out.[7] If so interpreted, the principle would postulate that, whilst LGU revenues should be in proportion to its responsibilities, LGUs are to carry out solely those tasks that are set out explicitly in legislative acts providing for the transfer of specific powers and responsibilities to them, rather than those tasks that local authorities themselves perceive as local and public [Ostrowska 2014: 59-78; Dębowska-Romanowska 2010: 239].

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[5] The work of the Joint Committee is currently regulated by the provisions of the "ustawa z dnia 6 maja 2005 r. o Komisji Wspólnej Rządu i Samorządu Terytorialnego oraz o przedstawicielach Rzeczypospolitej Polskiej w Komitecie Regionów Unii Europejskiej", Dz.U. nr 90, poz. 759 [Law of May 6, 2005 on the Joint Committee of Central and Local Government and on Representatives of the Republic of Poland in the Committee of the Regions of the European Union, Journal of Laws No. 90, item 759].

[6] Europejska Karta Samorządu Lokalnego z dnia 15 października 1985 r., Dz.U. 1994 nr 124, poz. 607 [The European Charter of Local Self-government of October 15, 1985, Journal of Laws No. 124/1994, item 607].

[7] Cost vs. output and outcome.

Despite the constitutional guarantee, it is for many years that we have seen the costs of public tasks repeatedly underestimated in delegating responsibilities from central to local government. As a matter of fact, the problem has not been addressed properly until today. LGUs have been reacting differently – by petitioning and appealing on one hand and, ultimately, by filing lawsuits in courts of law on the other. Attention was brought to the unresolved problem by the Polish National Association of Local Government Organizations in its statement of January 26, 2016, underscoring the fact that, over recent years, the state government has continued to impose an increasing burden on local governments while at the same time failing to provide them with adequate funding. The Association argued that, under the Law on Local Government Revenues, an LGU that is obliged to carry out public tasks devolved from central government or delegated under other legislative acts should be provided with closed-end subsidies from the state budget covering the full cost of such tasks. The actual practice is, however, that many LGUs need to earmark a significant part of their own revenues to support the performance of non-statutory duties. Importantly enough, this extra spending is not reported in the Rb-50 form (the one for reporting expenditure relating to the performance of public tasks delegated from central government or devolved under other specific laws), as it is simply not allowed under the current government regulation concerning the preparation and submission of these forms.

The problem seems to be chiefly attributable to the lack of established standards in two key areas:

– quality, concerning the expected outcomes of delegated tasks,

– methodologies for costing a delegated task in terms of its deliverables (output) and their value [NIK 2014].

Although the absence of costing methodology appears to be crucial, one should realize that without quality standards for output and outcome it would be extremely difficult to come up with a universal solution, i.e. one suitable and applicable to all types of LGUs.

The difficulties with costing methodology stem, to a large extent, from a mistaken perception of cost whereby the costs of public tasks devolved from central government are effectively identified with government spending. Insofar as the economic category of cost is known to the public finance sector and used widely in its budget recording and reporting system, it is not found at all within the public task planning and execution process. The reasons for this are manifold. Firstly, it is the so-called cash method that is adhered to in recording government revenues and expenditures. This means that it is the date of payment that matters in recording expenses rather than the actual date on which the underlying event occurred. As a result, reporting on public tasks is based on annual budget entries, and hence on the related expenditures, instead of on costs incurred (Art. 40 § 2(1) of Law on Public Finance).[8]

It should be emphasized, however, that cost is an economic category that relates to product or service. In the sales process, the cost of each product is linked to the revenue from its sales.

Under the Accounting Law, the cost of a product (service) comprises both costs directly related to the making of this product and a reasonable proportion of indirect costs that are attributable to it (Art. 28 § 3 of Accounting Law).[9] The broad definition of cost, on the other hand, includes:

a) costs and losses – denoting likely and measurable decreases in economic benefits over a given reporting period, such as a decrease in the value of assets or an in increase in the value of liabilities such that will reduce equity or increase its shortage in any manner except through withdrawal of funds by the owners or shareholders.

b) other operating expenses – construed of as expenses related indirectly to the operating activities of a business, such as in particular:

– social (aid) activity,

– sale of fixed assets, capital work in progress, intangible assets as well as of real property and intangible assets that are accounted for as investments,

– expenses involved in the upkeep of real property and intangible assets accounted for as investments, including adjustments to the value of such investments or their conversion to, respectively, fixed assets or intangible assets, provided that their appraisal is based on market value or, otherwise determined, fair value,

– costs arising from the writing-off of time-barred, discharged or unrecoverable debts and receivables, except for non-cost-bearing debt toward the state,

– expenses related to the creation and release of provisions for liabilities, except for provisions associated with financial transactions,

– fixed asset impairment or revaluation write-downs, as well as adjustments to these, except revaluation charges bearing on financial costs,

– costs incurred due to compensation and penalty payments,

– costs related to the transfer or acquisition of assets, including cash, wherever the assets are transferred or acquired at no charge, through donation or otherwise, for use other than to subsidize sale price or to purchase or build capital goods, capital work in progress or intangible assets (Art. 3 Accounting Law).

An important ingredient of any business activity is cost accounting. It is the designation given to the ongoing process of determining the cost of production or

[8] Ustawa z dnia 27 sierpnia 2009 r. o finansach publicznych, Dz.U. 2013 poz. 885 ze zm., art. 40 ust. 2 pkt 1 [Law of August 27, 2009 on Public Finance, Journal of Laws of 2013, item 885, as amended].

[9] Ustawa z dnia 29 września 1994 r. o rachunkowości, Dz.U. 2013 poz. 330 ze zm., art. 28 ust. 3 [Accounting Law of September 29, 1994, Journal of Laws of 2013, item 330, as amended].

service activities. It is the cost accounting system that processes information on the value of resources used by the business in running its daily operations. The gathering of data on the costs of business operations is governed by principles allowing for the requirements of specific users of cost accounting information [Nowak et al. 2004: 13-18].

The classical and most common costing system is that of full-cost accounting, as it complies with the requirements of compulsory financial reporting. Full-cost accounting makes it possible to arrange costs by type, grouping them e.g. either by contractor or by product/service. Under this system, the key criterion for cost classification is the possibility to assign costs to products or services that are hence viewed as basic cost drivers. Using this criterion, two basic categories of cost are distinguished [Sobańska 2009: 101-102]:

– direct costs – that can be directly and individually linked to a specific product or service,

– indirect costs – that are perceived as costs shared by a number of different products or services.

A major issue involved in assigning indirect costs to products or services is that of adopting certain factors – auxiliary values representing a sort of technical-economic parameters characterized by real or conventional linkage to the costs that are to be captured for accounting purposes [Sobańska 2009: 101-102; Drury 1998: 37-54].

If the simplest available solution is adopted – that of full-cost accounting – the cost of delegated public tasks should be determined by looking at direct as well as indirect costs. Such a costing model for public tasks delegated from central to local government is shown in Fig. 1.

It should be at the same time stressed that LGUs may not opt out and, with a vast majority of delegated tasks, have to be willing and prepared to carry them out regardless of whether there is demand for a particular public service at the moment or not[10]. It seems to be wrong, too, to advocate an approach whereby a universal measure is sought, such as a unit cost or a factor based on the number of full-time hires, that could be applied in costing all public delegated tasks. In most cases, the method will be inappropriate to estimating the cost of a delegated public task, as it will not be able to capture all the costs, particularly indirect ones, involved in carrying it out. Cost estimation based on a linear function depending on the number of activities or the outcomes of such activities is an over-simplistic and inadequate approach, since it is oblivious of the so called fixed costs, incurred in sustaining preparedness to provide public services to an unknown number of customers and hence perform a hardly predictable number of activities, or of in-

[10] This can be illustrated with the example of registry offices: whether or not there are any residents wishing to get married, municipalities may not close down any of these institutions.

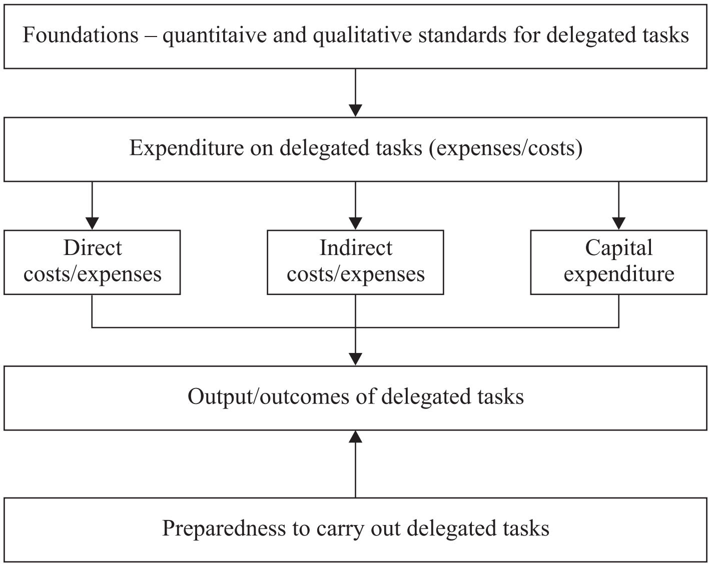

Figure 1. A costing model for delegated public tasks

Source: own elaboration.

direct costs associated with institutional management, financial and accounting services, rent, electricity, office space maintenance and utilities, etc.

Another question that arises is that of capital investments, i.e. when and how much it is reasonable to spend on capital goods. This is directly dependent on the desirable quality of output and outcome to be delivered by a delegated task. Unless output and its qualitative properties are defined, alongside the definition of outcome vis-à-vis social expectations, any estimate of required capital outlay is bound to be characterized by a large margin of error, i.e. the expenditure is going to be considerably overestimated or underestimated.[11]

Given the above, it seems advisable to take the following steps in order to address the issue of adequate funding for public tasks delegated from central government to LGUs:

– a review of delegated public tasks to verify the rationale for their devolvement to local government along with a proportion of local government revenues (share in tax revenues, computation of open-end subsidy, etc.),

– delineating standards for the output and outcome of delegated public tasks to inform estimates of funding required to carry out these tasks (relevant models

[11] There is no such approach. If this approach were adopted, it would not matter where and how a citizen is provided with a public service, which means, for example, that a municipality could organize weddings in hallways or wherever in their office space, as this would be a neutral factor in terms of capital investment.

can be derived from the implementation experience with task budgeting in central government institutions),

– determining the costing methodology, where the full-cost accounting method seems to be, arguably, the simplest and therefore best suited to relevant requirements,

– amending the reporting requirements to capture the full cost of delegated tasks. including any necessary capital investment.

Unless these steps are taken, it will be impossible to produce any fair estimate of the costs involved in the performance of delegated public tasks. Nevertheless, considering the fact that the state budget has been running a deficit for a number of years, the government cannot be expected to be ready to make easy concessions. On the contrary, it should be supposed that the awareness of the enormous amounts that need to be diverted to support the performance of delegated tasks will hamper the process of their correct and adequate estimation.

Summary

The processes of delegation and performance of public tasks devolved from central to local government are characterized by a number of dysfunctions in organization and funding. In theory (and in law as well), closed-end subsidies that are awarded to local government units ought to fully cover the costs involved in carrying out these tasks. It is therefore hard to understand why that they do not and why the problem has not yet been addressed by implementing an appropriate costing method and establishing quantitative and qualitative standards for desirable output and outcome, i.e. for what and how should be expected from LGUs carrying out such tasks.

It is high time the deadlock were broken and efforts were initiated to adopt a single methodology for standardizing the quantity and quality requirements for public tasks devolved from central to local government as well as for costing such tasks in a way that will embrace the rule of adequacy. In market settings, a service that is provided at no charge would be unthinkable. Of course, what is at stake with public delegated tasks is not a charge *per se* but mere compensation or reimbursement for the expenses reasonably borne in performing these tasks. In a developed democracy, the fact that LGUs are unable to recover these expenses otherwise than by bringing their claims before the court cannot be regarded as something to be proud of and, obviously enough, brings no benefits to the state and its citizens.

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Finansowanie zadań zleconych jednostkom samorządu terytorialnego – nierozwiązany problem systemowy

Streszczenie. *Poruszone w artykule problemy dotyczą dysfunkcyjnych obszarów w zakresie realizacji zadań zleconych jednostkom samorządu terytorialnego z zakresu administracji rządowej. Celem artykułu jest identyfikacja przyczyn tych dysfunkcji. Na podstawie prowadzonych rozważań zaproponowano systemowe zmiany w tym zakresie. Ponadto podjęto próbę identyfikacji tych elementów, które powinny być brane pod uwagę w procesie kalkulacji kosztów realizacji zadań zleconych z zakresu administracji rządowej. Rozważania oparto głównie na analizie rozwiązań prawnych, krytycznej analizie literatury przedmiotu i zakończono je elementami aplikacyjnymi.*

Słowa kluczowe: *zadania zlecone, jednostki samorządu terytorialnego, finanse publiczne*

Zeszyty Naukowe
Wyższej Szkoły Bankowej w Poznaniu
2016, t. 70, nr 5

Beata Zofia Filipiak

University of Szczecin
Faculty of Economics and Management
e-mail: bfilipiak@wneiz.pl
phone: 91 444 19 60

Changes in the Direction of Financing Tasks of Local Government Units

Abstract. *The existing financial situation forces local government units to seek alternative financing possibilities for tasks. The aim of the study is to indicate the two basic options, which allow for the financing of investment projects in a way that is not a burden on the local government budget. The paper presents the financial reasons for the changes in the directions of financing tasks. They point to a public-private partnership (PPP) and the creation of municipal companies as the two basic alternatives for financing local government tasks.*

Keywords: *local government, financing, PPP*

Introduction

Local government units (LGUs) carrying out public tasks at the same time compete for citizens or an investor. This competition is reflected in increasing the quality and/or quantity of the tasks. These decisions affect both sides of the situation, the income and expenditure. LGUs undertake investment projects that are related to maintaining current standards of provided services and benefits, as well as, deciding to invest for growth.

These decisions relate to capital expenditure, taking out debt liabilities, or the acquisition of foreign funds, including those of the EU. The existing fiscal rules on one hand, are aimed at stabilizing the financial management of local government; but on the other hand, limit the possibility of taking out debt liabilities (especially in the case of the debt rule), which allow an increase in the standards of the performed tasks through investments.

The presented situation forces many local governments to seek alternatives that will stimulate an increase in those standards, extend the task force, and will constitute an important aspect of enhancing the quality of services provided to the public. The aim of the study is to indicate the two basic possibilities that allow the financing of investment projects.

1. Evaluation of financing tasks of local government units

Though LGUs have been appointed to realize their own specific tasks, they are also entrusted with the execution of the tasks of a government administration under the applicable laws, and to carry out tasks arising from agreements with other local governments; however, they do not always realize them in the expected or required standards of both a qualitative or quantitative nature. Reducing the standard tasks can result from reduced quantitative and qualitative requirements. The most common reason for a reduction of requirements in relation to ongoing tasks is the scarcity of budgetary resources. Reducing the quantitative requirements, LGUs bear a lower cost and thus, the expenses for the local government unit budgets are smaller. This operation may, however, not be accepted by the recipients of the services, or the local community of the LGU. Reducing quality requirements would also lead to a reduction in the cost of providing the service and the local government would reduce the cost of its implementation. Nevertheless, in this case the change would also not be accepted by customers [Fornalczyk 2013: 97-98; McConnell 1987: 93-100; Schiller 1989: 57-60; Blaug 1994: 600-610; Samuelson & Marks 1998: 445, 599; Baumol & Blinder 1988: 646-648; Begg, Fischer & Dornbusch 2007: 130-159; Stiglitz 2004: 184-217]. It is essential to find answers to the question of how to provide a high number and better quality of tasks for the local community using the means of available funds, which includes the LGUs budget for a given year.

The current financial situation of LGUs (presented in Table 1), as well as, the scope of tasks and the necessity to improve the quality and quantity of goods for society, make it necessary to seek alternatives outside the local government unit budget; especially alternatives capable of achieving a greater efficiency with distribution of allocated funds, at a certain level of budgetary expenditure.

The period of increasing absorption of EU funds from different programs (as seen in Table 2), as well as, operating aid mechanisms (like the Norwegian mechanism) have limitations that are related to the necessity to sustain their own contribution. Furthermore, the existing rules limiting debt further restrict the possibility of obtaining alternative funding.

Table 1. The structure and dynamics of LGU budget revenues in Poland during the years 2013-2015

	2013	2014	2015	2013	2014	2015	2013/14	2014/15
	In thousands of PLN			Structure (%)			Dynamics (%)	
Total income (current and property)	183,458,281	194,337,188	199,018,949	100.00	100.00	100.00	94.40	97.65
Current income	163,168,725	171,721,544	176,067,029	88.94	88.36	88.47	95.02	97.53
Own revenues, including:	85,794,504	92,656,211	97,915,012	52.58	56.79	60.01	92.59	94.63
Own revenues in narrow terms (whithout PIT and CIT)	47,033,594	51,110,327	52,738,765	54.82	59.57	61.47	92.02	96.91
PIT, CIT only	38,760,910	41,545,884	45,176,246	45.18	48.42	52.66	93.30	91.96
Targeted subsidies	26,408,864	28,160,787	27,103,200	16.19	17.26	16.61	93.78	103.90
General subsidy	50,965,357	50,904,546	51,048,817	31.23	31.20	31.29	100.12	99.72
Property income	20,289,556	22,615,644	22,951,920	11.06	11.64	11.53	89.71	98.53
Own revenues, including:	6,004,165	5,934,846	5,524,318	29.59	29.25	27.23	101.17	107.43
Revenues from the sale of assets	3,785,992	3,872,597	3,515,749	63.06	64.50	58.56	97.76	110.15
Targeted subsidies	13,993,081	16,381,771	17,133,121	68.97	80.74	84.44	85.42	95.61
General subsidy	291,731	299,028	294,486	1.44	1.47	1.45	97.56	101.54

Source: own calculations based on *Sprawozdania z działalności...* 2014-2016.

Table 2. The structure and dynamics of income in Poland separating projects financed with foreign funds including those financed by the EU, between the years 2013-2015

	2013	2014	2015	2013	2014	2015	2013/14	2014/15
	In thousands of PLN			Structure (%)			Dynamics (%)	
Total income (current and property)	183,458,281	194,337,188	199,018,949	100.00	100.00	100.00	94.40	97.65
Expenses for the implementation of projects financed from EU funds	16,385,716	171,721,544	17,412,763	8.93	9.47	8.75	89.06	105.66
Current income	163,168,725	18,397,523	176,067,029	88.94	88.36	88.47	95.02	97.53
Grants and appropriations to finance expenditures for projects given EU funding	3,959,556	171,721,544	2,545,638	2.43	2.31	1.45	99.60	156.15
Property income	20,289,556	22,615,644	22,951,920	11.06	11.64	11.53	89.71	98.53
Grants and appropriations to finance expenditures for projects given EU funding	12,426,655	14,422,479	14,867,125	61.25	63.77	64.78	86.16	97.01

Source: own calculations based on *Sprawozdania z działalności*... 2014-2016.

Table 3. The structure and dynamics of expenditures of local government units in Poland separating expenditures on projects implemented by foreign funds from the EU between the years 2013-2015

	2013	2014	2015	2013	2014	2015	2013/14	2014/15
	In thousands of PLN			Structure (%)			Dynamics (%)	
Total expenditure	183,838,643	196,754,150	196,415,300	100.00	100.00	100.00	93.44	100.17
Current expenditure	148,831,937	155,403,934	157,839,415	80.96	78.98	80.36	95.77	98.46
Expenses related to projects co-financed from EU funds	3,968,059	4,164,102	2,631,773	2.67	2.68	1.67	95.29	158.22
Capital expenditure	35,006,707	41,350,216	38,575,885	19.04	21.02	19.64	84.66	107.19
Investment expenditures, including:	33,497,403	39,922,753	37,219,959	95.69	96.55	96.49	83.91	107.26
Expenses related to projects co-financed from EU funds	16,870,533	19,734,506	16,712,840	50.36	49.43	44.90	85.49	118.08

Source: own calculations based on *Sprawozdania z działalności*... 2014-2016.

Table 4. Revenues, expenditures, and outcomes for local government budgets between the years 2013-2015

	2013	2014	2015	2013	2014	2015	2013/14	2014/15
	In thousands of PLN			Structure (%)			Dynamics (%)	
Total revenues	24,062,022	22,893,508	20,257,746	100.00	100.00	100.00	105.10	113.01
Contracted debt, including:	12,959,196	11,234,006	8,090,976	53.90	49.10	39.90	115.36	138.85
Debt connected with projects co-financed from EU funds	1,862,807	2,101,554	1,427,542	7.70	9.20	7.00	88.64	147.21
Free resources and surplus	10,890,869	11,456,270	11,996,644	45,30	59.20	59.20	95.06	95.50
Total expenditures	13,753,153	9,304,310	11,332,133	100.00	100.00	100.00	147.81	82.11
Repayment of debt, including:	11,838,719	8,000,696	8,291,576	86.08	85.99	73.17	147.97	96.49
Debt connected with projects co-financed from EU funds	1,551,731	2,006,500	1,538,735	11.28	21.57	13.58	77.34	130.49
Budget outcome	–380,363	–2,416,962	2,603,649				15.74	–92.83
Surplus	3,782,249	3,655,713	6,317,898		x		103.46	57.86
Deficit	–4,162,612	–6,072,675	–3,714,249				68.55	163.50

Source: own calculations based on *Sprawozdania z działalności*... 2014-2016.

The current financial situation of local governments shows significant capital expenditure (at approx. 20% in the analyzed period), as well as, a high level of debt (as seen in Table 4).

It should be noted that the amount of capital expenditures decreased in 2015. In addition, expenditures related to projects co-financed from foreign funds, which include the EU, also decreased. It is worth emphasizing that the trend discovered is that of the reduction of debt incurred in the period, as well as, a decrease in the amount of expenditures related to the repayment of debt.

In the presented data, an investment insufficiency becomes apparent for local government units in relation to existing fiscal rules. They restrict the possibility of borrowing, as well as, reduce expenditures. The analyzed data shows the need to consider alternatives outside the system of local government finances. This possibility can be created by the legislator as legal solution and includes public-private partnerships and municipal companies.

2. A public-private partnership (PPP) as an alternative for the realization of public tasks

It is commonly stressed that the PPP (a public-private partnership) formula may constitute an effective tool for public purposes by combining different forms of public and private funds. The subject of public-private partnership is a common implementation of the project based on the division of tasks and risks between the public entity and the private partner.[1]

Considering the division of tasks, usually the task of local government is restricted to the preparation of the project, the creation of conditions for formal and legal functioning of the partnership, the development of assumptions for the project (often project documentation, obtaining necessary permits, etc.), and the determination of the criteria for partner selection. After which, the local government must supply the partner with the design assumptions and supervise the process of the construction or renovation (renovation or revitalization) of the project specified in the contract. The private partner is engaged in designing or redesigning, afterwards, the process of building, and in many cases, the operation and/or management of the project (building, structure, or roads). One must remember that the PPP agreement must specify the formal and legal situation concerning the resulting partnership assets (often an object). After the end of the contract, the private partner can pass the object to the owner, in this case, the LGU. The private partner may also rent the object. Another variation is the passing of the

[1] Definitions on the subject of partnership: Art. 1 § 2 of the Act of December 19th 2008 pertaining to public-private partnerships, Journal of Laws 2009, no. 19, item 100 as amended.

object to the owner (the LGU) and signing a concession contract of service. The private partner may also purchase the object from the public partner in exchange for the opportunity to use it. The private partner can, after the completion of the investment phase, decide to end cooperation with the LGU. In this situation, the public partner pays appropriate remuneration to the private partner and takes over the exploitation of the object or may delegate the task to another entity selected in a new proceeding.

The PPP thus divides the obligations of the parties to the activities related to the preparation and the execution of the project in a clear manner. The PPP sets out the commitment of the private partner for the implementation of the action, task, or project, for which he receives remuneration from the public partner. Remuneration can also be rewarded in the form of benefits that can be derived from the completed project (for example, in the form of fees for its use). The purpose of the public partner is to control the execution of the agreement and the creation of conditions for its implementation during its duration.

The second condition for the use of the PPP is an issue of risk sharing. This risk arises from the contract itself, but is also primarily associated with burdening the local government budget with debt or with the inability to go into debt for the realization of a project that the local government is not able to cover financially within their budget.

This last point applies to both current and future financial situations of the local government, but also the possibility of obtaining funds from the European Union. PPP also gives an undeniable chance to co-finance investments from EU funds through the use of hybrid financing, which is acceptable in these types of projects.

It should be emphasized that in previous programming periods LGUs have often taken on substantial debt obligations, which currently significantly reduce the ability to incur new debt obligations (Art. 243 of the Act on Public Finance[2]). An important limitation is the phase of the operation, because art. 242 of the Act on Public Finance indicates an obligatory balancing of the current budget. LGUs do not always take into account newly transferred investments in their ongoing operation of investment projects.

There are often high costs that exceed the previously incurred and budgeted funds for the indicated purpose. This means that the "new" investments cost more than the implementation of the task which is based on the existing infrastructure. This fact points to the occurrence of internal risk on the side of the public partner, which is related to refinancing risk and financial risk [Filipiak 2011: 77-78; Poniatowicz 2014: 158-160; Filipiak & Guranowski 2016: 14-26].

[2] Ustawa z dnia 27 sierpnia 2009 r. o finansach publicznych, Dz.U. nr 157, poz. 1240, ze zm. [Act of August 27th 2009 on Public Finance, Journal of Laws no. 157, item 1240 as amended].

The same problem of risk in PPP projects is extremely important. Art. 18a paragraph 1 of the Act on Public-Private Partnership identified three categories of risk, which the evaluation of the project (or projects) should be focused on from the point of view of the initial classification of assets covered by the agreement of the PPP, namely: the risk of construction, the availability risk, and the demand risk.

The scope of risk has been identified in the Regulations of the Minister of Economics from February 11th 2015, concerning the risks and factors taken into account in the assessment of risk.[3] The indicated classification is undoubtedly crucial from the point of view of the LGUs.

Debts arising from contracts of a public-private partnership do not affect the level of public debt and the deficit of public finances in a situation where the private partner bears most of the risks of building and most of the risk of the availability or demand risk (including the impact on these risk factors, such as guarantees and financing by the public partner and asset allocation at the end of the agreement). This means that taking a risk by the private partner will not affect the level of debt obligations and will not burden the individual debt ratio (as defined in Art. 243 of the Act on Public Finance). These reasons highlight the attractiveness of PPP solutions for local governments, which will be able to develop a project that will allow the safe transfer of risk to the private partner, in addition to transferring to them the cost of operation and management of the property, allowing for the implementation of goals for the public.

The premise that will determine the success of the PPP is the establishment of the remuneration for the private partner. This factor is a condition of the effectiveness of the public task, because it is not always possible to accomplish the task at acceptable costs for its implementation. For the private partner to take on the PPP project it is necessary to indicate a satisfying compensation. It must ensure the stability of the income of the project after its completion, or return on the investment, and a satisfactory remuneration for the private partner. This means that the interest of the private party is associated with the acceptance of the relative durability of the PPP contract (terms of withdrawal must be set out therein), as well as, the economic efficacy of the project to a certain level [Filipiak & Guranowski 2016].

The projects implemented in PPP are mainly about reconciling socially acceptable costs, which the local government has to pay in relation to the performance of the PPP (this cost is spread out over many years) with the need to ensure a stable remuneration to the private partner, which will be able to cover the incurred time costs (outlays) and enable them to meet profit margins. In particular,

[3] Rozporządzenie Ministra Gospodarki z dnia 11 lutego 2015 r. w sprawie rodzajów ryzyka oraz czynników uwzględnianych przy ich ocenie, Dz.U. poz. 284 [Regulations of the Minister of Economics from February 11th 2015, Journal of Laws item 284].

the latter often raises issues of opposition from the local community, perceiving a negative amount of staggered expenditure. This is undoubtedly a mental issue, because the local community does not take into account that they given a standard service much earlier (or even at all) than would be possible to achieve with a traditional budget approach.

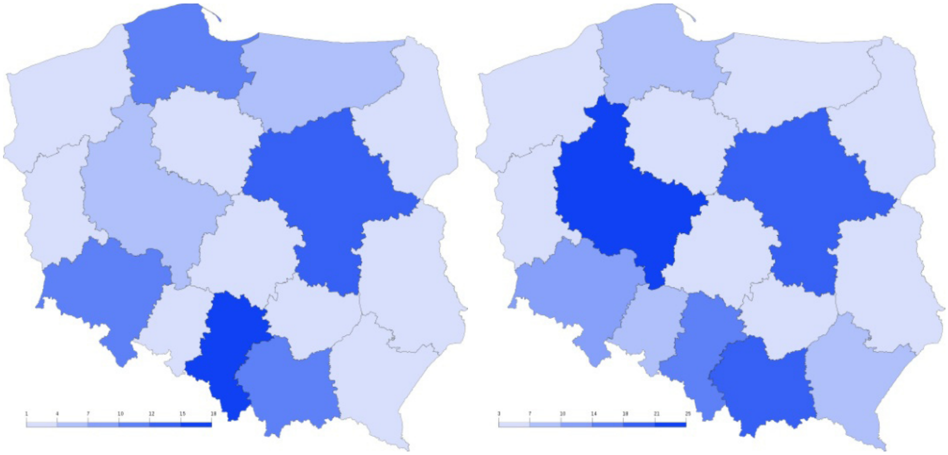
Speaking of opportunities, the functioning of this idea should also be summarized. Agreeably, under the current law, a Database of Public-Private Partnership Projects was created.[4] This database operates in response to an obligation established by the Minister responsible for the economy (the Minister of Development) to distribute and promote public-private partnerships. Its aim is to present analyses and assessments of the functioning of public-private partnerships and the prospects for their financial involvement in the private sector.

The information given to the public indicates that at the end of July 2016, 98 projects were declared as completed and there were 150 ideas for the PPP design.[5] A breakdown of completed and potential ideas between individual regions is illustrated in Figure 1, Part A. The figure indicates that the leaders in the implementation of PPP projects are unquestionably the following regions: Pomerania (10 completed projects), Lower Silesia (11 completed projects) and the Lesser Poland Voivodeship (15 completed projects). The smallest number of completed PPP projects (standing at only two completed projects) are seen in the regions of Podlaskie Voivodeship, Lubusz Voivodeship, Lublin Voivodeship, and with only one project implemented, the Lodz Voivodeship. Part B of Figure 1 shows the breakdown of possible projects for implementation in a PPP project. The most projects submitted to the PPP database have come from these regions: Greater Poland Voivodeship (25 submitted ideas), Masovian Voivodeship (21 submitted ideas), and the Lesser Poland Voivodeship (18 submitted ideas). The least amount of project ideas submitted were in the following regions: Podlaskie Voivodeship (3 submitted ideas), Lubusz Voivodeship (4 submitted ideas), and Lodz (4 submitted ideas).

The presented data is not impressive, considering the fact that the idea of public-private partnership has been legally recognized (by an Act) from 2005. In spite of great distrust and numerous barriers, local governments perceive the possibility of implementing public tasks using PPP in the future because of the lack of own funds for investment, aversion to being an investor, and grappling with investment risk (thus, solving this through transferring risk to the private partner),

[4] New regulations on the PPP impose statutory obligations on the minister responsible for the economy to disseminate and promote public-private partnerships (Art. 3 of Act from December 19th 2008, concerning public-private partnerships). The Database of PPP projects was created to this end, and accessible at www.bazappp.gov.pl.

[5] www.bazappp.gov.pl [access: 30.07.2016].



A. Projects Implemented B. Projects Submitted (Ideas)

Figure 1. Completed and potential (ideas submitted) PPP projects in Poland

Source: own work based on: https://bazappp.gov.pl/project_base/ and the use of the program found at: http://mapy.easysoftware.pl/ [access: 30.07.2016].

and the possibility of the realization of other investments, which cannot be implemented through a PPP due to their nature.

3. Municipal companies as contractors of current and investment tasks

Each local government unit in the municipality is obliged to realize the tasks of running economy utilities. This includes, in particular, the tasks of a public utility, whose aim is ongoing and uninterrupted satisfaction of the collective needs of the population through the provision of a universal service. Municipal services can be carried out by local government units, particularly in the form of local government budgetary establishments or commercial companies. The law allows the transfer of tasks to entities that can more flexibly, more efficiently (especially in cost) achieve them, in addition to having the appropriate competence and necessary equipment for the implementation of infrastructure. This idea was developed alongside privatization and has both supporters and opponents at present. It gives undeniable possibilities for future use of instruments and sources of financing, which are reserved for local government units. They do not fall under restrictions contained in the law, as is the case for local government units.

The legislator introduces a limit to the types of companies that LGUs may create. On the subject of activity, it is important that outside of public utilities, the municipality can establish commercial companies and join them. In particular, the legislator indicates that the LGU can utilize the companies when there are community government needs that are not met, or unemployment significantly affects the standards of living, or the use of other activities and existing provisions of the law have not resulted in the revival of the economy; especially if there is not a significant revival of the local market or a permanent reduction of unemployment. In addition, it allows for the creation of special purpose companies for the implementation of PPP projects.[6]

It is crucial for a municipal company to be both effective and efficient. It becomes a market entity, which may (but does not need to) seek potential customers for its services in the commercial market and to local government, which is the owner (based on public procurement law), it can contract public services "in-house". The Act from June 10th 1994 on public procurement does not apply to cases of entrusting a municipality's organizational unit the tasks of public road creation. The completing of "in-house" tasks through the created municipal organizational unit does not necessarily require an agreement to be created. The basis of performing these types of tasks is, in fact, the very reason for its creation and the appointing authorities specify the objectives for its activity. Within the relationship between the municipality and its organizational entity, there is a possibility for a contract to be created to service a public contract for the municipality. This contract may happen provided that the contracted task does not fit into the range of tasks for which the entity was created for by the municipality.[7]

According with the intentions of the legislator, entrusting the service to the entity should allow for both the functioning of the company, ie the revenue will cover the costs of the services entrusted at that time, as well as, to ensure the profitability at a sufficient level for development based on asset replacement ("Reasonable profit" should serve this purpose). Public services are not always correctly estimated, which makes it necessary to incur increased expenditures by the local governments to raise more capital, usually in the form of a contribution.

The entity created by the government, in addition to pursuing public tasks in the form of public service, may also take on commercial services. As indicated in the NIK report, municipal companies appointed by the local government focus too much on commercial activities rather than completing public tasks. This situation results in a relief for local governments, but limits the objectives for which these

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[6] Broader indications for the creation of companies by LGUs can be found in Art 10 § 2-4 of Act from December 20th 1996, relating to municipal economy, Journal of Laws 1997 no. 9, item 43.

[7] The position of the Supreme Administrative Court stated its judgement August 11th 2005, sygn. akt II GSK 105/05.

entities were established, namely to focus on public services. Moreover, the NIK indicates that local governments provide unreliable supervision over the entities they create, resulting in almost half of them bringing losses. Ultimately, the financial consequences of these projects are felt by the people living in these regions (according to the NIK report). This means that when deciding on the creation of entities, local governments have to make a decision to increase the efficiency of their management, their organization, and the financial execution of specific tasks.

There is another benefit associated with the appointment of a municipal entity when considering the potential to increase the efficiency of completing public tasks by local governments. LGUs can flip the implementation of investment projects on the municipal entity, which would make it the investor, but it would also be financing the project. To finance the work, the entity may incur a debt obligation that (as long as local government is not a guarantor or guaranteeing repayment of the debt) will not burden the budget and will not affect the individual debt ratio. Running the company will source repayment of the debt obligation from the investment.

The cited report indicates that only half of the established companies are actually not in financial difficulty. Those with companies that have financial difficulties will undoubtedly be looking for solutions to their financial problems in the local government unit budget. Others will be directed and managed based on market principles, in addition to their objective statute, they will be guided by cost-oriented attention to the efficiency of its activities.

Conclusions

The two indicated alternatives for financing tasks ensure both financing investment, as well as, current projects. Public-private partnerships allow for ensuring quality standards throughout the duration of the contract, as opposed to the use of a public utility company which does not always guarantee proper execution of the task. Utility companies may have financial problems, which would translate into the need for recapitalization by the owner, or in this case, the local government. Public-private partnerships, although based on a market approach towards the project, will always have the fear that the private partner will no longer comply with the contract in an unexpected way.

The advantages and disadvantages of both solutions lead the author to conclude that the effects of transferring out specific tasks should always be considered. LGUs must guard against bad implementation of contract provisions, but also need to shape the structure of its tasks so that in the future there are guaranteed standards of a quantitative and qualitative nature and are adequate to the current financial situation and the needs of its society.

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Przemiany w kierunkach finansowania zadań jednostek samorządu terytorialnego

Streszczenie. *Istniejąca sytuacja finansowe wymusza na jednostkach samorządu terytorialnego poszukiwanie alternatywnych możliwości finansowania zadań. Celem opracowania jest wskazanie na podstawowe dwie możliwości, które pozwalają na finansowanie zadań inwestycyjnych w sposób nieobciążający budżetu JST. W opracowaniu przedstawiono przesłanki finansowe zmiany w kierunkach finansowania zadań. Wskazano na partnerstwo publiczno-prywatne oraz tworzenie spółek komunalnych jako dwie podstawowe alternatywy finansowania zadań JST.*

Słowa kluczowe: *samorząd terytorialny, finansowanie, PPP*

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  - ♦ praca zbiorowa:

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  [1] K. Strzyżewska, *Zarządzanie dostawami*, „Logistyka a Jakość” 2008, nr 3-4, s. 31-32.

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  [1] J. Bughin, J. Doogan, O. Vetvik, *A new way to measure word--of-mouth marketing*, "McKinsey Quarterly" 2010, No. 2, p. 113-116.

  [2] P. Spenner, K. Freeman, *To keep your customers, keep it simple*, "Harvard Business Review" May 2012, p. 108-114.
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