

# FINANCING LOCAL SELF GOVERNMENT A CHALLENGE FOR A DEMOCRATIC STATE IN POLAND

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*Abstract: The specific character of the self- government revenues sources implies difficulty in the distinction of the participation of the self- government own revenues in the general structure of the self- government budget. There are many factors which have impact on amount and structure of the self- government own revenues (e.g. structure of population or industrialization).*

*Keywords: local revenues, local self government, democratic state.*

## **1. The Local Revenues of Local Self Government**

“According to the Constitution of 1997 Poland is a unitary, decentralized state. No state organisms and no autonomous structures exist within the state. The Constitution of 1997 does not determine the model of the territorial division of the state which, in turn, determines the division of competencies of the basic units of public power acting locally, i.e. central government, general purpose administration acting locally and the bodies of the territorial self-government (such division should not be mistaken with the administrative division of the state made not only to establish territorial competencies of public administration, but also of the courts, prosecutors and legal entities)<sup>1</sup>. The Constitution delegates the regulation of the territorial division of the state in the way of an Act. It only says, in Art. 15 (2), that such division should take into account "social, economic or cultural ties" and assure "the territorial units the ability to perform their public duties". In 1998 a three-tier territorial division of the country was introduced. “The local self-government units took all over the organizational tasks related to meeting the collective need of the inhabitants. The central and local government administration agencies have mainly supervision functions. All units of the self-government have a legal personality. The community of people constituting the unit has an obligatory character and the unit may not, by way of its own act, dissolve itself”.<sup>2</sup>

Art. 165 (1) of the Polish Constitution grants the self-government the ownership rights and other property rights (usufruct, easement, pledge). The Act on the commune self-government says that the property of a given commune includes the ownership and other property rights of such commune, associations of communes and other municipal legal entities.

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<sup>1</sup> B. Banaszak, *Unitary State in:* B. Banaszak and others, *Constitutional Law in Poland. Inrenational Encyclopeadia of Laws. Constitutional Law*, Kluwer Law International 2012, p. 195.

<sup>2</sup> *Ibidem* p. 197.

Art. 167 (1) of the Constitution assures the funds for units of local self-government required for their activities by assuring their share in public funds accordingly to their tasks. It indicates the sources of funding for the self-government: own revenues, general subsidies and specific grants (purpose subsidies) from the state budget. Those sources are to be indicated closer by a relevant act. The Act on the commune self-government in the Art. 54 says that the steady sources of income for the communes are the following: taxes, fees and other revenue described in other statutes as the commune's income, income from the commune property and general subsidies from the state budget. Moreover, the income of the commune may be: budget surpluses from previous years, purpose subsidies for the execution of specified tasks, income from self-taxation of the residents, funds the commune inherited, bequests and donations and other income. The Act on the district self-government, in Art. 56 in the similar way describes the sources of income of districts. The income of provinces was described in the equally detailed way in Arts. 67 and 68 of the Act on the district self-government.

Revenues of local authorities in Poland are regulated also in the Act Income of Local Self- Government Entities of 23th November 2003. According to this Act other Acts of local self- governments, local revenues are:

- 1) Receipts from taxes established and collected on the basis of separate acts, i.e. the tax on real estate, the agricultural tax, the forest tax, the tax on means of transportation, shares in receipts from personal income taxes- receipts from lump sum taxation, taxes on inheritance and gifts, tax on civil law transactions.
- 2) Receipts from fees established and collected on the basis of separate acts, e.g. the Financial Statue, the Service Act and the Marketplace Act, dog's owners fee, local fee, health resort fee and others determined in separated acts.
- 3) Revenues from property of local self- governments entities.
- 4) Revenues from state administrative entities.
- 5) Inheritance and gifts in the aid of local self- government .
- 6) Duties and fines determined in separated acts.
- 7) 5.0% of revenues for the state budget in the implementation of the tasks of central government. and other tasks determined in other acts (e.g., the fee for issuing identity card).
- 8) Others, e.g. administrative fees, interest on founds deposited in bank accounts, interest on late payments.
- 9) Revenues from shares in receipts from corporate and personal income taxes:
  - a) municipality: personal income tax- 39, 34%, corporate tax- 6,71;
  - b) county: personal income tax- 10,25%, corporate tax- 1,40%;
  - c) voivodeship: personal income tax- 1,60%, corporate tax- 14,75%.

Local self- government revenues in 2011 accounted for 45.5% of all self- government's revenues in the country.

The specific character of the self- government revenues sources implies difficulty in the distinction of the participation of the self- government own revenues in the general structure of the self- government budget<sup>3</sup>. There are many factors which have impact on amount and structure of the self- government own revenues (e.g. structure of population or industrialization).

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<sup>3</sup> More about the notion self- government revenues see: B. Banaszak,, *Poland – Local government in Poland: Towards consolidation ?* w; C. Panara. M. Varney (ed.), *Local government in Europe. The 'fourth level' in the EU multilayered system of governance*, London – New York 2013, p.27o.

The examples show that the differences turn up also in the structure of a given voivodeship. In 2011 in the voivodeship of Lower Silesia (Wrocław is the capital) only 51 of 166 municipalities reached the level of the self-governments' own revenue above the average (55,6%). The average comes out of the calculation of the extreme values, because on the one hand the richest municipalities- Polkowice and Koberzyce reached their own revenues adequately 86% and 84,8%, on the other hand the poorest one- Stara Kamienica reached only 17% of this source to its budget.

## **2. The Scope of Freedom of Local Authorities to Use Their 'Own' Resources.**

The Constitution, in Art. 165 (2), establishes a very important rule concerning the position of the local self-government within the political system; it states that its independence is protected by courts. That should protect the self-government from the intrusions of executive bodies supervising its activities. The competence disputes between the bodies of the self-government and bodies of the government administration are settled by administrative courts. Yet, there is a question whether only those courts provide the protection for the self-government. There are two views on that issue among law scholars. The first one says that the protection is exercised only by administrative courts and only based on special regulations<sup>4</sup>. The other one, presently commonly accepted, was formulated in the beginning of 90s. It says that the constitutional provision granting the court protection of the independence of the self-government is an autonomous one and may constitute the base for the claims of the self-government which may be settled by the common or administrative courts<sup>5</sup> and also by the Constitutional Tribunal. In the light of the present Constitution such a view should be regarded as the correct one.

For a real independence of the self-government, it is important that it has proper funds and material base. The Polish Constitutional Tribunal states that guaranteeing a source of revenue plays an instrumental role when confronted with the significance of a legal norm formulated in art. 167(3) as a provision guaranteeing that territorial self-government units will receive sufficient revenue to implement constitutionally delegated tasks. Art. 167(3) may also be interpreted as an expression of a more general principle, guaranteeing that the units "will not only have [...] at their disposal certain financial means (by guaranteeing the sources from which they are transferred) but they will also be guaranteed independence in their use, i.e. expenditure and adoption of relevant tasks".<sup>6</sup> The Tribunal emphasizes that it does not mean that financial independence of local self-government units may be interpreted as "full autonomy in allocating financial means [...]". Both doctrine and jurisprudence unequivocally maintain that independence in planning expenditure [...] must respect statutory limits, which impose e.g. absolute priority of financing own obligatory tasks".<sup>7</sup>

Any changes concerning tasks and competences of territorial self-government units entail respective changes in the division of public revenue, which may assume various forms – from creating by the legislator a possibility of increasing units' own revenue to providing means in the form of an appropriate specific grant. In the case of dispute whether the changes in the division of public revenue are adequate to the changes concerning tasks and competences of territorial self-government units, the matter should be adjudicated by the Constitutional Tribunal if the changes are made by the legislator.

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<sup>4</sup> Sec M. Armata, *Ustawa samorządowa a zakres kognicji NSA*, Samorząd terytorialny 5/1991, p. 10.

<sup>5</sup> See A. Agopszowicz, *Zarys prawa samorządu terytorialnego*. Katowice 1991, p. 77-79.

<sup>6</sup> OTK ZU 2/A/2003, pos. 11.

<sup>7</sup> ibidem

Self- governments conduct the management of their finance independently. The basis for it is the resolution of the entitled entity. Self- governments' own revenues are determined by the separated acts and not by the constitutional law. Self- governments are free to manage their finance, but first of all they have to realize tasks given to them by law. Self- governments have financial freedom in managing the rest of the sum of money. Apart from the most general rules of the management of public finance, there are no legal restrictions on how local authorities should use their own revenues. The only binding rule is that the implementation of the voluntary tasks cannot endanger the fulfilment of the mandatory ones. Notwithstanding some legal regulations affect the financial management of local authorities in an indirect way.

According to article 15 of the Polish Constitution, territorial system ensures the decentralization of public power. The territorial division of the state and local self government's activity are regulated by the ordinary law. Statues are the main source of law when it comes to the local government. Although statutes create local self government structures and regulate its tasks, it is permissible to impose further obligations by new acts. The decentralization of public authority, expansion of social self-government, spreading autonomy of local governments is a complicated process which leads to local government's tasks.

That process might be funded either with local self government's own revenues or grants from state budget.

Due to the fact that these new tasks involve funding, Article 167 of the Constitution assures public funds adequate to the performance of the duties assigned to local self governments. The funds include: own revenues, appropriated allocations, general subsidies from the state budget.

The order of the income sources indicates that the primary role should have the local self governments' own revenues.

The legislator is aware of the fact that the process of decentralization creates a number of tasks assigned to the local governments ( most of them are imposed to municipalities as a result of the principle of the presumption of competence). Therefore, it is permissible to provide the local governments' with grants or subsidies from the state budget.

It is worth mentioning that, the socio-political reality may cause changes in the legal regulatory framework and affect shifting powers between the different local government units or LGU's and government.

Recognizing this fact legislator declared rightly that changes in the scope of duties and competences of local governments' units are tightly connected with appropriate changes in the share of public revenues. Therefore, it is unacceptable imposing new tasks without the proper transfer of measures for their implementation.

The Constitution should prevent the situations from previous years when the self-government was assigned the tasks of the government administration for execution of which there were no funds in the state budget and the self-government had to pay for them from its own funds.

It is to mention that the Act on the commune self-government in Art. 48 (3) guarantees the inhabitants of villages all of their up-to-date ownership rights, usufruct rights and other property rights, called the commune property.

### **3. Local Self Government Units Budget**

Local self government units budget is an annual, financial plan of the intended revenues and expenditures. The budget is passed for one financial year, which is identical with a calendar year. The budget becomes a footing of a financial economy. All the financial decisions must be made in accordance with the budget. Considering the annual character of the budget, it is comprehensible that local government's financial planning is designed on an annual basis. Due to annual calculations and modifications of basic variables it can be difficult to evaluate the adequacy between the financial measures and local authorities activities. In 2009 The New Public Finances Act implies on local governments the responsibility of preparing financial forecast for a few years in advance. Long-term financial forecast should be realistic and defined for each year inter alia:

1. current revenue and current expenditure from the local government budget, including debt service, guarantees and sureties;
2. income from property, including income from the sale of property;
3. the amount of local government debt.

Long-term financial forecast is created not only for one financial year, but at least for three fiscal years.

#### **4. The Procedure of Calculating the Revenues of Units of Local Self Government**

According to article 3 of the Act of revenues of units of local self governments, the revenues of units of local governments are composed, except of their own revenues, of general subventions and expedient grants, both provided from the state budget.

General subsidies and specific grants as well as their amount should be determined according to statutorily defined, objective criteria. General subsidy is the statutorily defined grant constituting local self-government unit's revenue transferred from the state's central budget to finance implementation of unit's own tasks. General subsidy is regulated in detail by the act of 13 November 2003 on the revenue of local self-government units, which further develops the provisions of the Constitution. The revenue is diversified and at all self-government levels it consists of compensatory and educational components. The former compensates for disproportions in revenue between local self-government units, while the latter enables to implement educational tasks delegated to the units of a given level. Additionally, general subsidy for communes and districts also includes an equalizing component, complementing their revenue in connection with the change in task financing regulations. Provinces do not receive this component of subsidy, yet they are entitled to a regional component consisting of several lump sums, each of which is determined on the basis of different, statutorily defined criteria. General subsidy is determined by a minister responsible for public finances. Territorial self-government units' councils decide how financial means received through general subsidy are spent.

General subvention consists of two parts for municipality: leveling and balancing for counties, leveling and balancing for voivodeships, leveling and regional balancing for all of them (municipalities, counties and voivodeships) but general subvention consists also of an educational part. Presenting organ of the unit of the local government decides about allocation of a received center from the title of general subvention.

Specific (expedient) grant is the statutorily defined grant constituting local self-government unit's revenue transferred from the state's central budget to finance, in whole or partially, the tasks delegated by government administration, other tasks statutorily

delegated to territorial self-government units, their current own tasks or investments as well as to maintain law, public order and implement national defence tasks.

The revenues of units of local governments can present specific (expedient) grants from the state budget on:

- 1) tasks within the range of government administration and other tasks commissioned by acts;
- 2) tasks realized by units of local governments on force of agreement included with organs of government administrations;
- 3) deletion of direct threat for safety and public order, results of floods and earth landslips and results of other acts;
- 4) sponsorship or extra funding of their own tasks;
- 5) realization of tasks which are the result of international agreements.

The revenues of county are specific (expedient) grants from the state budget on realization of tasks of guards and inspections. The revenues of units of local governments can be also satisfied by means from earmarked funds. Besides, the revenues of units of local governments can be constituted by grants assured by National Fund of Environmental Protection and Water Economies and provincial funds of environmental protection and water economies on base of separate regulation.

Budgetary act defines amounts assigned on part of general subvention for units of local governments (municipalities, counties and voivodeships). The details of the application of an amount of subventions for individual units of local government are defined by the act of revenues of units of local government.

It is important to remember that units of local governments participate in an individual income tax and corporate tax. The amount of participation of municipality with incomes provided by individual income tax is established by increasing general amount of incomes from this tax by 0,3934 and by equal index in the year previous in relation to the baseline year of an individual income tax in this municipality in general amount of due tax in same year.

The amount of the participation of a county with income provided by individual income tax is established by increasing general amount of income of this tax by 0,1025 and by equal index in the previous year than baseline year of an individual income tax in this county, in a general amount of due tax in the same year.

The amount of the participation of voivodeship with income provided by individual income tax is established by increasing general amount of income of this tax by 0,0160 and by equal index in the previous year than baseline year of an individual income tax in this voivodeship, in a general amount of due tax in the same year.

## **5. The Financing of the Delegated Tasks**

The accepted rule associated with the transfer of further responsibilities to the local self government is to guarantee funds for their implementation. Such guarantee can be implemented in two ways – either by an increment of their new income source or the participation in the assets of the central budget.

However, there is a risk that an own income as well as resources guaranteed by the central budget will not be sufficient to meet the expenditure of the local self government. Therefore, local self governments can count on their reserves. The calculations carried out in the previous years can be helpful viewing the calculations for the next years which can be based on them.

Revenues of the local self-government units were made up, on average - own revenues – less than 60% and general subsidies and specific grants from the state budget over 40%.

## **6. The Taxation Power of Local Self Government Authorities.**

The Polish Constitution determines :

### **Article 168**

*To the extent established by statute, units of local self government shall have the right to set the level of local taxes and charges.*

### **Article 217**

*The imposition of taxes as well as other public imposts, the specification of those subject to the tax and the rates of taxation, as well as the principles for granting tax reliefs and remissions, along with categories of taxpayers exempt from taxation, shall be made by means of statute.*

These articles determine that taxes and public fees can be levied only if the statutes allow that.

Thus self- governments have right to levy taxes and public fees which are given not only by the Constitution, but also by the *European Charter of Local Self-government*. It is also determined by a special legal status of self- governments which creates self- government legal independence. Local governments have freedom of determining which taxes and to what extent they wish to levy but they should of course comply with the limits determined by law.

The Act Income of Local Self- Government Entities local revenues are receipts from taxes established and collected on the basis of separate acts, i.e. the tax on real estate, the agricultural tax, the forest tax, the tax on means of transportation, shares in receipts from personal income taxes- receipts from lump sum taxation, taxes on inheritance and gifts, tax on civil law transactions.

Local taxes are the main source of municipalities' revenues. There is a strong tendency that local revenue system would aim at reducing subsidies and grants instead of increasing the participation of local governments in taxes. In 2004 these tendencies introduced changes in the rules which determine revenues for municipalities and counties.

One of the major problem for the municipal budgets is lack of payment by some payers in the payment of amounts due to local taxes (especially in property tax and agricultural taxes).

In the group of local taxes and charges there are two of them which are most relevant - taxes on real estate and agricultural tax.

It is worth mentioning that in 2006 taxes generated nearly 90% of income within this group.

In the analyzed period there was observed a gradual reduction in the share of agricultural tax ( from 46.7% to 39.2%), but the property tax increase (from 40.7% to 48.1%).

An upward trend was observed also on the tax on means of transportation. The presented tendencies reflect general situation not only in the central Polish financial economy but also in the local governments' income.

Local government units run municipal economy on terms and forms prescribed by law, involving the exercise of the LGU's own tasks in order to meet collective needs of the local community. Municipal economy included in particular tasks of public utility, aims at meeting current and collective needs of the population through the provision of widely available service. Municipal economy can be carried out by local government units in

particular in the form of local government budgetary establishment or commercial companies. Local government units may form limited liability companies or joint stock companies as well as access to such companies.

Legislature made it possible for municipalities to take an activity from an outside public utilities zone. In such situations a municipality may establish commercial companies and join them if the following conditions are fulfilled:

- 1) there are needs of local community in the local market;
- 2) occurring in the municipality unemployment significantly affect the quality of life of local community, and the use of other activities and arising from existing regulations legal measures did not lead to economic activation, in particular to significant revival of the local market or permanent reduction of unemployment.

Apart from the income earned by municipalities through municipal economic activities, local government units are provided with other taxes, such as: a stamp duty, a marketplace fee, a local fee, a health resort fee or a dog owners' fee. These rates and taxes supply only municipal budget. The remaining LGUs do not earn such an income.

The most popular theory assumes that local authorities could increase the LUG's revenues by increasing taxes or levy new fees or charges. Nowadays the economic crisis made it clear that a local population should not be charged with more fees and higher taxes.

The best way to increase the revenues for local governments is not only efficient using of available resources but also using of the existing opportunities to increase their own income.

A good idea for local governments to increase their own revenues is creating special economic zones which can attract the investors to the region.

## **7. Conclusions**

The very constitutional construction of decentralization of public authority complies with the standards of the Council of Europe. The matter of absolutely important meaning for the realization of the decentralization principle within the member states of the Council of Europe is including to the decision process wide perceived local communities.

The European integration do not affect directly the local government in Poland. It stimulates the implementation of EU law and the international cooperation of local self-governments units. This is well revealed by the following example. Poland is one of the major recipients of regional funds and EU regional policy promotes the same trends towards political decentralisation and regionalism in Poland that it is claimed to have been promoted in other member states. Another example - the EU access highlights the need to develop systems of external audit of the local self-government and to restrict their indebtedness.

Law-defined sources of income of local government units would not be sufficient to cover the expenses of these units, which in consequence would lead to the impossibility of realization of tasks imposed on them. Due to the above issues, statutory implemented additional possibilities of transferring funds, especially grants and subsidies, should be positively evaluated. The significance of the participation of the income tax cannot be underestimated. It should also be a matter of positive evaluation that local government units have been given a possibility of income raising by using non-recoverable funds from other sources, e.g. other funds enlisted in specific regulations or else funds from the EU.

On the basis of the value of self-income of local government units in the structure of the total income – exemplified in the section 1, presumably they would not be able to fulfill their numerous statutory duties without any additional sources of income. Therefore the decision of the Polish legislator to implement a catalogue of various income sources should be considered most favorably. It was obvious during the legislation process that self-income of specific self government units cannot be considered equal. They depend on many various factors and that forced creation of a system that would allow to even the inequalities and support less wealthy units in the realization of their duties.

Unfortunately a large number of tasks which are imposed on the local government units are imposed without any guarantee of funding including funding from the state budget. In the situation when local governments lack subsidies or grants they are forced to realize these imposed tasks by means of their own income. It can cause not only the inequality in revenues but also may cause differences on the level of realization of the local governments' tasks.

„Finally, it would be desirable if the state administration would transfer more authority and resources to the local government structures. However, this will not be feasible until the social insurance, education and health care systems in Poland are stabilized and heavy industry—mainly coal mining, iron and steel industries—and agriculture are restructured”<sup>8</sup>.

The organization, functioning, competencies and forms of activities of local self-government units and their bodies were regulated prior to the access of Poland to the EU but the European integration process played a significant role in recently discussed reforms of the local government. As M.Brusic<sup>9</sup> observed the EU Commission's interest in regional self-governments with a substantial fiscal and legal autonomy has provided an additional rationale and an incentive to re-create regional self-governments. Advocates of regional self-government and an institutionalization of regions in the accession countries have referred to European trends and (perceived) EU expectations of regionalization. Thus, the Commission and the pre-accession framework have become catalysts for a process in which most CEE regions have already enhanced and will further increase their political salience. However, the trajectories and outcomes of regional-level reforms can be better explained by a combination of domestic institutional legacies, policy approaches of reformers and their adversaries, and the influence of ethnic/historical regionalism.

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<sup>8</sup> A. Kowalczyk, *Local Government in Poland*, w: *Local Government in Central and Eastern Europe*, 2000, p. 245.

<sup>9</sup> Governance 4/2003.