eFinanse
financial internet quarterly

RULES OF CONTRACTING DEBT BY TERRITORIAL SELF-GOVERNMENT UNITS

Dariusz Reśko[1], *Tomasz Wołowiec*[2]

Abstract

Self-governments are given new tasks without guaranteeing resources for their completion, an example of which is lowering the school obligation age. There are also some savings of the state budget at the expense of territorial self-government. All these and other changes, including those planned in the near future, take place without compensating for the incomes lost by self-governments or additional costs. All this leads to serious tensions in self-government budgets, limiting their ability to finance investment. The Regulation of the Minister of Finance from 23rd December 2010 on detailed ways of classifying debt titles included in state public debt, also treasury debt (Journal of Law from 2010, No 252, position 1692) was issued on the basis of specially changed article 72, section 2 of the Act of 27th August 2009 on Public Finance (Journal of Law No 157, position 1240 with subsequent amendments).

JEL Classification: H63, H63, H72, H73, H75
Keywords: public finance, public sector, expenditure, income, controlled debt, deficit

Received: 9.12.2011 Accepted: 26.05.2012

Introduction

The notion of "controlled debt" is reflected in Article 216 of the Polish Constitution, according to which "(…) *Contracting loans and offering financial warranties and guarantees by the state is in accordance with the principles and in the mode determine by the act. It is forbidden to contract loans or to offer financial warranties and guarantees as a result of which state public debt will exceed 3/5 of the total gross domestic product (...)"* and in article 86 of the Act on Public Finance, which defines the prudential norms of 50, 55 and 60% of the value of the state public debt to gross domestic product ratio. This means that all investment other than those related to EU projects, will be more difficult to perform, as self-governments will not be allowed to plan deficit for them and to contract debt. The mechanism of limiting public debt defined in the Act seems relatively simple and effective. However, first of all, it means that the self-government debt may still grow, therefore the effectiveness of the limit may be constrained by the loans for the EU needs. Secondly, this limit does not take into account the individual debt abilities of particular self-governments. It may then turn out that the EU project resources and associated loans will appear in self-governments whose borrowing power is limited. This is connected with another problem, which we may face irrespective of whether we exceed the second prudential threshold or not, namely the one related to debt microanalysis. The Act contains two regulations touching upon the issue of deficit and debt of each territorial self-government unit. These are the principle of balancing 'the current bud-

[1] Tomasz Wołowiec PhD, Associate Professor, Vicedirector for Development of the Institute of Financial Research and Analyses, University of Information Technology and Management in Rzeszów, Deputy of the Mayor in Krynica-Zdrój, e-mail: wolowietomek@gmail.com.

[2] Dariusz Reśko PhD, Wyższa Szkoła Biznesu – National-Louis University in Nowy Sącz, Mayor of Krynica-Zdrój, e-mail: dresko@wsb-nlu.edu.pl.

get' (article 242; which will become valid since 2011) and individual debt limit (article 243, which will become valid since 2014). Both these regulations answer the postulates which have long been expressed concerning the present ways of limiting local debt (in previous acts on public finance). The issue of balancing the current budget introduces into Polish legislature the so-called 'golden rule on debt', which clearly states that local debt should only be related to investment expenditure. In case of old debt limits for each unit there is the same limitation – the debt may reach the level of 60% of revenue and debt servicing – 15% of it. This does not reflect the specificity of a particular self-government and its real borrowing power.

The discussion on the expenditure rule for territorial self-government units (TSGU) and about the lowering of the contribution transferred to open pension funds confirms the importance of two basic parameters of public finance (financial result of PFS in relation to GDP and public debt of PFS in relation to GDP), which indicate the economic state of PFS. The financial result of the whole PFS consists of the results obtained by three subsectors: government, self-government and social insurance ones. The fact that the whole PFS is approaching the level of the 55% ratio implies that we have a gap between public income and expenditure, the origins of which can be found in: the global financial crisis, limitation of the fiscal ratio (from 35.1% of GDP in 2007 to 29.3% of GDP in 2011) and increased GDP redistribution ratio (resulting from the growth of sector expenditure on co-financing investment and tasks realized with EU funds – in 2007 this accounted for 41.1% of GDP, while in 2011 it was 48% of GDP). These three factors caused public finance imbalance. The financial crisis led to serious decline of tax income, being the result of lower GDP growth. The amendment of the Budget Act as a consequence of discretionary results brought an increase in the income from non-tax sources of PLN 9.6 billion. In 2010 and 2011 non-tax sources additionally compensated the decrease of tax incomes. Of vital significance here is the payment of the profit made by the National bank of Poland in the amount of PLN 3.9 billion in 2010 and PLN 6.2 billion in 2011. In 2009, as a result of the amendment of the budget, public expenses were cut by PLN 31 billion. It should be noted that TSGU – contrary to the government subsector – do not have sources of income which could be used once only at times of the financial crisis (Lubińska, 2011, p. E13).

The scale of public debt growth to around 55% of GDP process that the balance between the left and right sides of the balance sheet of PFS has been disturbed. The left side has decreased by lost income from reduced pension contribution, lower PIT tax rates (in consequence – a considerable shrinking of TSGU budget income), family relief or elimination of tax fees. On the right side, on the other hand, we have a considerable growth of expenditure items in 2007-2011 from the level of 41.1% of GDP redistribution in 2007 to 46.6% of GDP in 2011. Of this, around 4% of GDP accounts for the tasks financed from EU funds. The redistribution scale for 2011, without the EU funds, equals 42.6% of GDP. It should be remembered that the absorption of EU funds influences the pro-development changes in the structure of public expenses (The share of expenditure on innovation, economic and infrastructure areas has grown considerably). The growth of the VAT rate, combined with lower contribution to open pension funds will not affect the improvement of relations between the fiscal and redistribution levels (Lubińska, 2011, p. E13).

The Regulation of the Minister of Finance from 23rd December 2010

Self-governments are given new tasks without guaranteeing resources for their completion, an example of which is lowering the school obligation age. There are also some savings of the state budget at the expense of territorial self-government. All these and other changes, including those planned in the near future, take place without compensating for the incomes lost by self-governments or additional costs. All this leads to serious tensions in self-government budgets, limiting their ability to finance investment. The Regulation of the Minister of Finance from 23rd December 2010 on detailed ways of classifying debt titles included in state public debt, also treasury debt (Journal of Law from 2010, No 252, position 1692) was issued on the basis of specially changed article 72, section 2 of the Act of 27th August 2009 on Public Finance (Journal of Law No 157, position 1240 with subsequent amendments). Section 1 of article 72 states that state public debt covers the following obligations of the public finance sector:

1. issued securities holding claim to money,
2. contracted debts and loans,
3. accepted deposits,
4. due payables,
   a. resulting from separate acts and valid court judgments or final administrative decisions,
   b. deemed unquestionable by proper unit of public finance sector being the debtor.

By the amendment of the Act of 16.12.2010 (Journal of Law No 257, position 1726) in section 2, article 72 the statutory delegation is contained, allowing the Minister of Finance to issue a regulation determining in detail the method of classifying debt titles included in the state public debt, also types of obligations listed as debt titles as far as basic categories of subject and object debt and maturity dates are concerned. From the regulation of article 72, sections 1 and 2 it turns out that the stipulation from section 2 refers directly to what appears in the valid Act on Public Finance in article 72 section 1 the statutory classification of public obligations constituting state public debt (article 72, sections 1-4) and that *"the detailed way of classifying debt titles included in state public debt",* and that *"types of obligations included in debt titles"* mentioned in the regulation cannot be contradictory to the basic classification of article 72, section 1 of the Act on Public Finance (Mazurkiewicz, 2011, p. 7 and next).

The regulation of article 72 section 2 violates article 92, section 5 of the Polish Constitution, which states that *"the organ entitled to issue a regulation cannot pass its competencies, defined in section 1, to another organ"*, as the entitling norm included in this regulation makes it impossible to precisely determine the allowable scope of the executive order issued on its basis. Statutory delegation to execute the regulation included in article 72 section 2 of the Act on Public Finance (APF) obliges the Minister of Finance to determine detailed ways of classifying debt titles included in state public debt (also types of obligations), taking into account basic object and subject categories of debt and maturity periods. These *"basic subject and object categories of debt*", however, were formulated by the law-maker in article 72 section 1, points 1-4 of the APF and this basic classification was binding for the Minister of Finance when he issued, in accordance with article 92, section 1 of the Constitution, the executive order to the Act (Kulesza and Bitner, 2011, p. B12).

In the meantime, in the published executive order from 23.12.2010, without prior amendment of article 72, section1 of the APF, the Minister of Finance in fact changed the content and scope of article 72, section 1, point 2 of the APF, covering bank credits and loans (normalized in the Civil Code), deciding arbitrarily in § 3 of the regulation that this category also covers PPP contracts, affecting the level of public debt; securities with limited transferability; sale contracts in which payment is made in installments; leasing contracts in which the risk and benefits of ownership are transferred on the user and unnamed agreements with payment term longer than one year, connected with financing services, deliveries, construction work, which cause similar effects to position or credit contracts. The Minister of Finance transferred these titles from their basic category of obligation, determined in article 72, section 1, point 4, where their inclusion

into public debt was restricted by the requirement of their maturity. This has worsened – without statutory regulation – the legal situation of for example TSGUs financing public tasks in order to achieve particular economic goals belonging to their statutory scope of activities[3].
Therefore we can state that article 72, section 2 is in contradiction with article 216 section 5 of the Constitution, according to which "….. *the way of calculating the value of gross domestic product and state public debt is defined by the Act"*. Since the determination of debt titles included into state public debt is of fundamental significance for its calculation, there is no possibility of changing them via the regulation (relevant changes may only take place by virtue of the Act). The Constitutional Tribunal in its rulings indicated that the basic principle of legislative technique is to use the same terms for defining the same phenomena. Giving special significance to some legal terms, defined differently in another legal act, especially the fundamental one, may occur only if we clearly define the term in the act and use this term in the meaning defined by the act. It is unacceptable to construct a definition containing further references[4].
Such drafting of § 3 of the Regulation of 23.12.2010, as the executive regulation to article 72 section 1 of the APF, indicates its non-compliance with article 2 and article 92 section 1 with reference to article 163 and article 216 sections 1 and 5 of the Constitution.

Financial planning and long-term financial forecasts

Within the subject and object scope of obligations included in the public debt the legislator may make changes dictated by the changing economic situation. This, however, has to be consistent with the principles of legislative correctness (Mazurkiewicz, 2011, pp. 8-9). The subject regulation was issued on 23.12, that is when a considerable part of TSGUs had already their budget acts passed. Can the law have retroactive force? Can it surprise us without proper *vacatio legis*? Can it destroy long-term financial planning and assumptions of long-term financial forecasts?
The issued regulation is to lead to the situation in which in 2012 (at the cost of TSGU investment and at the cost of country's GDP) the deficit to GDP ratio falls by 0.4%, which means that in 2012 the government would like the self-government deficit not to exceed 0.6% of GDP (around PLN 9 billion). The Minister of Finance in the subject regulation applied towards self-government units the same severity as to the whole sector of public finance, including the government sector, not taking into consideration constitutionally guaranteed independence of self-government. The government did not make or take into account the forecasts concerning the influence of the new regulation on public debt of self-government subsector or on the level of debt to income ratio, which limits the possibilities of contracting new debt of particular territorial self-government units. We should realize that the share of self-government obligations in consolidated debt of public finance sector is slightly above 5%. Self-governments have nearly PLN 180 billion per annum, of which around 24% is allocated to investment (three times their deficit value); the government has nearly PLN 300 billion at its disposal and invests only PLN 15 billion. The debt to income ratio for self-governments is around 30%, whereas the government (Treasury) debt is nearly 330% of the state budget income (Kulesza and Bitner, 2011, p. B12).

---

[3] Article 163 with reference to article 216 section 1 of the Constitution. Article 163 of the Constitution states that "territorial self-government performs public tasks not reserved by the Constitution or Acts for the organs of other public authorities" and section 1 of article 216 of the Constitution says that "financial means for public purposes are collected and expended in the way defined in the Act".
[4] See the rulings of the Constitutional Tribunal from: 22.05.2002 (K 6/02) OTK-A 2002/3, position 33; 20.02.2000 (K 39/00) OTK-A 2002/1, position 4; 20.11.2002 (K 41/02), OTK-A 2002/6, position 83.

Thus the deficit of the self-government sector clearly serves the purpose of realizing investment projects which are of vital significance for the country development, mostly co-financed from EU funds. The TSGU investment creates new added value in economy, and through the multiplier effect stimulates the business climate in a situation when the company sector withholds its investment. The introduction of the analyzed limits will translate into decline of investment and will lead to increased unemployment (the state transfer expenses will grow) and to lower income from VAT, PIT and CIT taxes. This in practice means a lower rate of GDP growth. Territorial self-government units had the surplus in 2007 and a deficit of 1.8% of their income in 2008. In the next two years this deficit increased nearly fivefold and in 2010 reached approximately PLN 15 billion, which constituted 9% of total income of TSGUs and 1% of GDP. What is interesting, from the analyses of long-term financial forecasts (LFF)[5] we can see that the self-government sector is planning for 2012 total deficit in the amount of PLN 1 billion (which is the deficit below 0.1% of total income) and in 2013 it plans to generate a surplus. TSGUs developed LFF in 2010, when there were no deficit limits and nobody indicated introducing them. Radical lowering of TSGU deficit in LFF is a simple consequence of the necessity of meeting the already existing ratios of self-government ability to pay debt. The act on Public Finance from 2009 obliges the TSGU authorities to balance their current budget from 2011. Also the formula of the debt ratio has changed for the examination of individual borrowing power of a particular TSGU. The new ratio will become valid since 2014. New limits will be calculated individually – in a nutshell – a territorial self-government unit will be able to spend on debt as much as its surplus of current income over current expenditure.
The regulation mixes the issues of public debt statistics (and European Union requirements in this respect - ESA'95) with the means of controlling public debt. The stipulations of ESA'95 are mainly to satisfy the need of availability of comparable, current and reliable information about the structure and dynamics of the economic situation in particular countries and regions. Obviously, the government has to control the level of public debt, but the regulation, trying to measure the economic effects of debt, confuses the reporting approach with the repressive one, the effects of which are already visible in the supervisory actions of Regional Clearing Houses.

The regulation and its effects versus the principle of adequacy

The financial powers of the self-government were guaranteed in article 167 of the Constitution. According to this provision, territorial self-government units are granted share in public income proportionately to their tasks. This provision defines the guarantees for territorial self-government in the form of guaranteeing appropriate level of public income. Performing tasks is associated with the necessity of incurring expenses for the financing of which self-government must obtain particular sources of income, also through the activeness in obtaining external sources of finance (public-private partnership, leasing, funds from the financial market, hybrid financing). According to article 167 section 1 of the Constitution, passing the tasks to territorial self-government units must be accompanies by appropriate provision of these units with financial means from public and legal sources. Therefore we can assume that the basic constitutional guarantee of the income independence of the commune is the obligation of the commune's participation in public income proportionately to the tasks assigned to it. The provision of article 167, section 1 is thus the first manifestation of the adequacy (relevance) principle in the Constitution. The constitutional guarantee of relevance results from article 167 and refers to all three aspects

[5] Data from the Department of Territorial Self-Government Finances, the Ministry of Finance.

of the commune's financial independence, that is the income aspect, expenditure aspect and budget economy aspect. We can assume that each assignment of new tasks for the commune or expansion of the scope of already performed tasks without changes in income repartition, that is without provision of new sources of public income or without increasing the fiscal effectiveness of the already existing sources, should be treated as a violation of the constitutional principle of adequacy (Miemiec, 2005, p. 3).

The consequence of the constitutional principle of adequacy should be to grant self-government the possibility of making claims for providing them with financial resources allowing them to accomplish their tasks and equipping the legal system with provisions related to establishing appropriate level and structure of territorial self-government units income (Miemiec, 2005, p. 42).

The guarantee of financial independence and stability of territorial self-government units

The amended article 72, section 2 of the APF poses the risk of violating the principles of financial independence and stability of TSGUs. Financial guarantees for territorial self-government units constitute one of the fundamental elements of their independence (Miemiec, 2005, p. 42). The term "guarantees" in the legal sense can be understood as a set of institutions and instruments and rules of conduct effectively contributing to securing something or to achieving some goals. These will be legal constructions made directly and indirectly in order to protect the public and legal sources of income of the communes so as to allow them to finance, on their behalf and on their own responsibility, the commune tasks. Of vital importance for the guarantee of the independence of public and legal income in communes are the provisions of article 15, section 1 and article 16, section 2 of the Constitution. According to article 15, section 1 *"the territorial structure of the Republic of Poland provides decentralization of public authority"*. Article 15, section 2, on the other hand, stipulates that *"territorial self-government participates in executing public authority. An essential part of its statutory obligations are performed on its own behalf and on its own responsibility*." TSFUs should then be guaranteed, on one hand, appropriate share of public income, and on the other hand, they should be provided with stable income sources and modifications violating the 'relevance' of this share should not be allowed so as to enable the units to accomplish their tasks (Glumińska-Pawlic, 2003, p. 42). Therefore we should assume that the provision of article 16, section 2 of the Constitution also contains financial guarantee for territorial self-government. It establishes public and legal financial authority of TSGUs.

Article 165 states that *" the independence of territorial self-government units is subject to court protection"*. The regulation issued on 23.12.2010 became valid on 1.01.2011, violating article 2 of the Polish Constitution which states that *"The Republic of Poland is a democratic state of law, implementing the principles of social justice*", as it violated the principle of trust for the state and the principle of protecting the pending interests, through omitting the period of *vacatio legis*. Issuing the subject resolution the Minister of Finance did not take into account that until 1.01 2014, the regulations of article 170 of the Act on Public Finance from 2005 are still valid. This article defines the prudential limits in TSGUs. According to this regulation, total debt of a territorial self-government unit at the end of the budget year cannot exceed 60% of the executed income of this unit in this budget year. During the budget year the total debt of a territorial self-government unit at the end of the quarter cannot exceed 60% of planned income of this unit in the given budget year. Therefore, if – in view of the regulation – these limits are exceeded, the TSGU will not be allowed to contract any new obligations influencing the level of public debt, and it will be forced to withdraw from the already made commitments which at their origin did not violate the prudential procedures of public debt but now contribute to exceeding the valid limits.

Conclusions

The new regulations valid since 1.01.2011 force TSGUs to make sudden and unexpected changes in public finance expenditure and in their budgets, which, due to the change in calculating state public debt and acting on the basis of the law valid until 2013 will exceed the limit defined in article 170 of the Act on Public Finance from 2005. It should be remembered that article 170 was not changed in the amending act, therefore the content of the regulation, through its effects, is in contradiction with the valid regulation of the act rank, which is another violation of article 92 of the Polish Constitution, which states that *"regulations are issued (...) on the basis of detailed authorization include in the act in order to execute it"* (Kulesza and Bitner, 2011, p. B12).

References

Lubińska, T. (2011). Nie rozdęte wydatki są problemem. *Rzeczpospolita.* insert: Ekonomia i Rynek, p. E13.
Mazurkiewicz, M. (2011). Problem zgodności z Konstytucją art. 72 ust. 1 i 2 ustawy o finansach publicznych w zw. z § 3 jej rozporządzenia wykonawczego – zagadnienia dyskusyjne. *Finanse Komunalne*, No 4, p. 7 and next.
Kulesza, M., Bitner, M. (2011). Zatapianie zielonej wyspy. *Rzeczpospolita*, p. B12.
Miemiec, W. (2005). *Prawne gwarancje samodzielności finansowej gminy w zakresie dochodów publicznoprawnych*. Wrocław: Kolonia Limited.
Glumińska – Pawlic, J. (2003). *Samodzielność finansowa jednostek samorządu terytorialnego w Polsce*. Katowice: Wydawnictwo Uniwersytetu Śląskiego.