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Normative formation of the system of revenues and expenditures of local government as a  
factor creating indebtedness

#### SUMMARY

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The dissertation focuses on an analysis of the normative determinants of the system of revenues and expenditures of local government units that can potentially create indebtedness of local communities. The research includes both the issue of creation and application of legal regulations shaping the system of revenues and expenditures, as well as the consideration of the relationship between the normative shaping of revenues and expenditures of local government and the existing excessive indebtedness of local communities. It should be stressed that the dissertation focuses on the analysis of legal regulations and not on the statistical study of these relationships.

In the thesis, as an obvious consequence of the existence of the needs of local communities, the obligation to create such a system of incomes, the amount of which would allow their realization, and at the same time such a system of expenditure and financial management, which would secure the realization of these needs, was assumed. In other words, the main purpose of the proper shaping of the system of revenues and expenditures of local government units is to meet the needs of local communities in a continuous and effective manner.

However, this is not the only objective that is pursued through the normative shaping of the system of revenues and expenditures of the local government. This system should reflect the systemic assumptions of the role of the self-government in the state, i.e. be a guarantee of the possibility of performing the tasks entrusted to the self-government in a manner adequate to its nature - a political and territorial community. This second objective of shaping the system of revenues and expenditures of the local government is as important as the first.

It would seem, therefore, that the factors and institutions of indebtedness of local communities should not be rooted in the normative system of shaping the system of revenues and expenditures of local government, i.e. this system by its very nature, as regards the material and legal construction of sources of revenues, the procedure of their realisation and the effectiveness of enforcement, should not by itself create the need for indebtedness and increase the risk of such indebtedness for reasons completely beyond the control of local government authorities and bodies. However, the risk of the appearance of factors generating debt, which can be found in the normatively shaped system of revenues and expenditures of local government, does exist. It should be noted that in countries where local government was established as a result of decentralisation processes, i.e. by central government, it is the central government that shapes

the system of local finance. This entails the risk that the legislature may take decisions that undermine the budgetary balance of local government units.

These are factors external to local communities - independent of the actions of their authorities and bodies. Factors creating the need for indebtedness of local authorities, related to the nature of legal institutions shaped externally to local authorities by the state, or resulting from random or economic phenomena arising on a national scale, i.e. also external to local authorities, pose the problem of responsibility for the scope of indebtedness and the limits of indebtedness caused by these external factors.

As regards the responsibility for the creation of external factors of local government indebtedness, which are inherent in the legal system itself, it is the responsibility of the legislative authority to remove from the legal system such institutional solutions that in themselves create and force the incurrence of repayable liabilities. This type of responsibility forces either the removal of these external normative factors of indebtedness or the introduction of appropriate corrective institutions that remove the responsibility of local government.

The second type of responsibility relating to the actions of local government bodies themselves, taken within the framework of political freedom, should be limited to the responsibility for excessive indebtedness.

As it follows, the aim of this dissertation is to present the normative system of revenues and expenditures of local government as a potential source of local government indebtedness. This concerns both external and internal factors creating local debt. The subject of the dissertation and its title, by referring to "normative shaping", indicate that the aim of the analysis will be primarily normative external factors of indebtedness, but also internal factors, dependent on the local government, "but shaped" by the general legal order in the state, such as the legal system of civil law transactions or EU directives forcing the activity of the local government in the field of environmental protection.

The dissertation could not, however, completely omit pointing to the extra-legal determinants of the indebtedness of local communities. However, they do not constitute the main problem of the dissertation, but are indicated as a methodological supplement.

The key task set by the author was, consequently, to seek an answer to the question whether the legislature's "responsibility" for failing to fulfil its systemic duty, i.e. shaping the

system of local finance in such a way as to effectively protect local governments from excessive indebtedness, has been properly shaped.

The subject of the dissertation and the outlined research goals have influenced the construction of its layout and scope. The dissertation consists of an introduction, four chapters, and a conclusion.

The first chapter of the dissertation is devoted to considerations on the constitutionally established concept of local government, which influences the formula adopted by the legislator for the division of revenues and expenditures between the state and the local government, and determines the position of the local government in the state structure. An evolutionary approach to this issue makes it possible to examine the possible relationship between the adoption of the concept of territorial self-government, as defined in successive constitutions, and the indebtedness of local communities. These considerations have been accompanied by a definition of most of the basic processes, principles and notions of the political system related to local government. The issues raised constitute the starting point for the deliberations conducted in the subsequent parts of the dissertation.

The second chapter describes issues related to the debt of the local government. The basic concepts related to this phenomenon, i.e. the concept of deficit, national public debt, local debt, are explained. The relationship between local debt and national public debt is shown, as well as the permissible limits of indebtedness of local government and their impact on the financial management of municipalities. Above all, the potential factors for the emergence or aggravation of the indebtedness of local communities, which existed in the interwar period and are emerging today, are indicated.

The third chapter is devoted to the discussion of methods of revenue allocation between the state and local government, which may be applied in a state based on the principle of decentralisation of public authority. In addition, the criteria for the correct equipping of local government with revenues are indicated, the respect or omission of which affects the emergence of returnable liabilities of local communities. Then, the system of revenues of local government units is analysed and the extent to which it respects the systemic and economic criteria of correctness of the division of revenues between the state and local government is assessed.

The fourth chapter describes the system of expenditures of local government units and the influence of particular types of expenditures on the emergence of deficit or local debt. Within this chapter, the structure of total expenditure of local government units is analysed. By

analysing the structure of total expenditure, not only the category of expenditure prevailing in the budgets of local government units was established. First of all, examination of the structure of total expenditures made it possible to indicate which of the public-law unions, i.e. the state or the local government, has a real impact on meeting the balancing rule under Article 242 of the Public Finance Act of 27 August 2009<sup>1</sup> and on not exceeding by local government units the Individual Debt Ratio stipulated in Article 243 of the Public Finance Act. Finally, in this part of the paper considerations are given to the way of dividing tasks between the state and the local government in the context of the systemic principles currently in force.

As it results from the final conclusions of the dissertation, the currently functioning, normatively determined, system of revenues and expenditures of the local government may be regarded as a potential factor of local government indebtedness. The consequence of such recognition should be that the state, i.e. the public-law entity whose action or omission led to the occurrence of the causes of excessive indebtedness, bears responsibility. The responsibility of the central government (legislature) for such a manner of structuring the system of revenues and expenditures of local government units that generates excessive debt cannot be understood in a traditional way. The responsibility of the state should be understood in this case as the necessity to apply institutional solutions, which are a consequence of the lack of adequate revenues for local government units in relation to the tasks entrusted to them, in a way that implies excessive indebtedness, which was established on the basis of analysis and assessment of revealed effects of functioning of the normatively formed system of revenues and expenditures of local governments. The responsibility of the legislator for normative factors of indebtedness is of a special nature, as it encompasses protection of the systemic essence of local government, which is a political and territorial community, just as such a community is the state. Thus it is a responsibility of a special kind, of a systemic nature, ensuring preservation of the essence of local government in Poland.

The fact that the central authority bears this special responsibility points to the need to introduce changes to the Public Finance Act, as, for example, it forces the addition of Article 243b.1 to the Public Finance Act, which would impose an obligation on the central authority to remove identified external normative debt factors. The removal of external normative debt factors can be a lengthy activity. Therefore, one of the *de lege ferenda* proposals is also to add to the Public Finance Act Article 243b, paragraph 2, which would introduce compensation for the effects of these factors, in order to restore balanced budgets of local government units. A compensation function could be performed by a compensation subvention.

It also seemed reasonable to propose an addition of Article 243c to the Public Finance Act and amendment of Article 25a paragraph 1 of the Act on Regional Chambers of Audit of 7 October 1992, which would enable monitoring of potential occurrence of normative debt factors in self-governments.

It was also considered a justified postulate to amend Articles 243 and 242 of the Public Finance Act, so as to distinguish three levels of responsibility for local government indebtedness, which arise from the basic law:

- the first is the plane of exclusive responsibility of the central authority,
- the second is the sphere of exclusive responsibility of local communities
- The third is the sphere of co-responsibility of the central government and local governments.

The study uses primarily the dogmatic and legal method. It included the analysis of legal regulations and statements of doctrine and judicature representatives. The applied dogmatic-legal method had to take into account the aspect of law application relating to the constitutionally guaranteed decision-making freedom of self-government representative bodies. To a limited extent, referring to the issue of the constitutional role of local communities, the comparative legal method has also been used. The historical method has been applied in order to examine the systemic solutions, not only concerning the place of self-government in the state structure, but also determining the shape of the system of revenues and expenditures of local communities.

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