

Intergovernmental Transfers in Poland¹

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Paper for the Copenhagen Workshop: 17-18 September 2009

1. An Overview of Local Governments Organisation and Finance in Poland

With area of almost 313.7 thousand km², population of over 38.1 million inhabitants Poland is the sixth largest country among 27 UE member countries but still lagging behind with only 57.5% of UE average GDP per capita according to Eurostat. This is 3rd lowest result in UE. Considerable disparities in GDP among regions are evident. In 2006 the best result was 83.6% of average of UE. At the same time 5 regions have the result of little below 40%.

Poland is a unitary state with three-tier local government. There are 16 regions, 314 counties, 65 cities with county status (municipalities exercising also county tasks) among them Capital City of Warsaw and 2478 municipalities. Average municipality has a population of about 14.5 thousand (figure for 2007). Only 624 municipalities are less than 5 thousand inhabitants. There are 1427 municipalities between 5 thousand but less than 20 thousand.

While consolidated public sector expenditures accounted for 42.0% of GDP its consolidated revenues have reached level of 40.4% of GDP. After deducting intergovernmental transfers local governments collected revenue of 6.1% of GDP (the State budget – 19.6% of GDP)². Local governments spent 9.9% of GDP with quiet inconsiderable deficit of -0.2% of GDP.

Current transfers to local governments accounted for 44.8% of all current transfers from the State budget making this the single biggest spending item. These transfers constituted 21.1% of the State budget expenditures equivalent to 4.6% of GDP. Figures for 2007 are quiet similar – respectively 21.2% and 4.6% of GDP. Capital transfers to local governments accounted for almost 0.8% of the State budget expenditure³.

Local governments own-source revenue which constitutes about 55.0% of their total revenue relies – quiet typically for CEE Countries (Council of Europe) - on shared taxation, namely proceeds from personal income tax and corporate income tax (respectively 36.4% and 9.5% of own-source revenue). Property tax (17.2%) and tax on legal transactions (2.9%) are most important local taxes. Within the group of own-source revenue there are also some of taxes of less importance (3.4%), numerous fees and asset-based revenue (revenue from property, leasing and sales).

¹ The views expressed in this paper are the views of the author and do not necessarily reflect the views or policies of Polish Ministry of Finance. Figures in the paper refer to 2008, unless otherwise stated.

² Note: From now on all figures are referring to local government budgets so all off-budgetary public entities are excluded.

³ Note: Except intergovernmental transfers the central government may give loans to local authorities experiencing financial difficulties. Amount of these loans is insignificant.

Table 1. Share of respective type of local government in total local governments revenue and expenditure

	Share in:	
	total LGs revenue	total LGs expenditure
Municipalities	43.7%	43.3%
Counties	12.7%	12.5%
Cities with County Status	34.7%	35.2%
Regions	8.9%	9.0%

Source: Rada Ministrów 2009b.

Highest share in local governments expenditure has education (30.0%) followed by transportation and communication (16.0%), social protection (13.6%), general public services (9.2%)⁴. Capital expenditure accounted for 22.0% of total local governments expenditure.

It should be noted that there is no separate financing system for cities with county status, i.e. cities are included respectively in both municipal and county financial system. There are only few minor exceptions with respect to transfers.

2. Grants system

Actual transfers and own-source revenue system has been designed in 2003 and implemented from the beginning of 2004 with Act of 13 November 2003 on Local Governments Revenue. Many earmarked grants have been replaced with the parallel increase of own-source revenue and general grants⁵. Up to the end of 2003 only municipalities have been obliged to make equalization payments. From 2004 the payments are also in place for counties and regions.

Since its introduction the system remains quiet intact except for the fact that level of equalization with general grants has been strengthened for all types of local governments at the expense of one of the reserve within these grants. As for earmarked state transfers, in the last years new provisions in the Act allowed more own local governments responsibilities to be co-financed by the central government. The same might be noted with the regard to other acts.

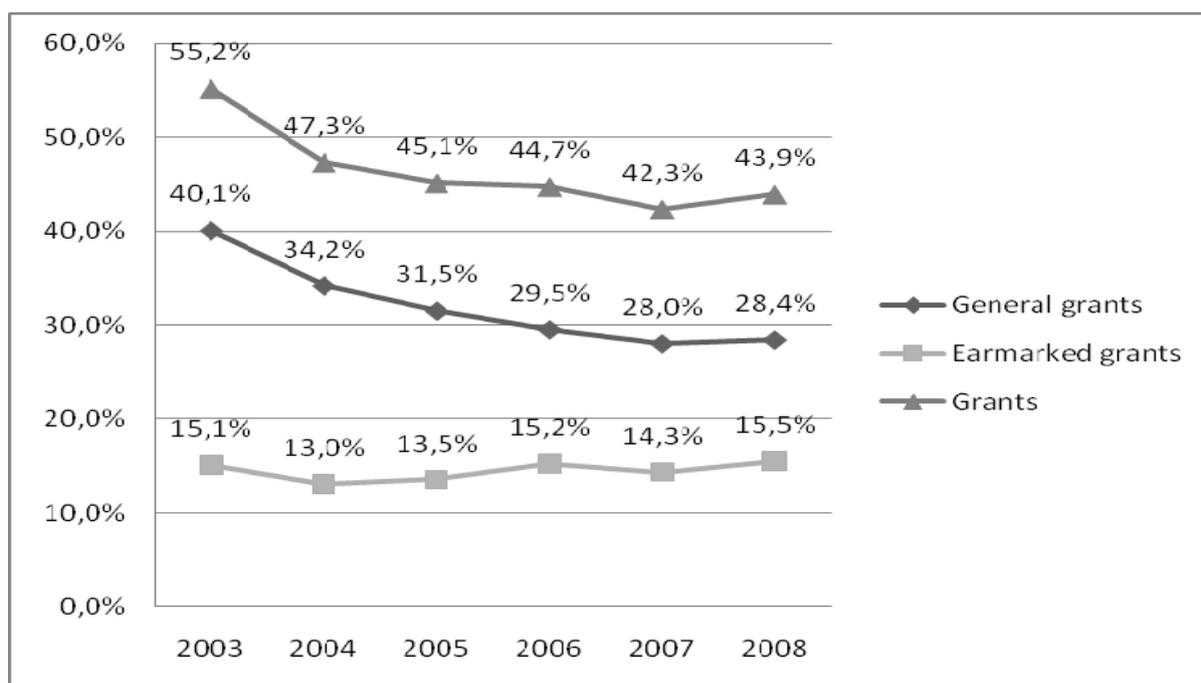
While own-source revenue contributes to slightly less than 55.0% of local governments income, transfers from the State budget represents 43.9% of local governments revenue. General grants are as high as 28.4% and earmarked grants contributing to 15.5% of sub-national revenue. Transfers from the State budget are main source of revenue for both counties (52.9%) and municipalities (49.6%).

Remaining financial resources to local governments come from transfers between local governments and from other public bodies.

⁴ Functions according to the national methodology.

⁵ According to Polish terminology there are "General grants" item in the State budget which are composed of various "parts". Term "grant" would be used instead "part" while explaining each component of the "General grants".

Diagram 1. State transfers share in local governments revenue



Source: Ministry of Finance

Table 2. State transfers to local governments in current prices (in billion PLN)

2003	2004	2005	2006	2007	2008	
31.7	31.3	32.5	34.5	36.7	40.5	General grants
12.0	11.9	13.9	17.8	18.8	22.1	Earmarked grants

Source: Ministry of Finance

In current prices and proportion amount of transfers from the State budget to local governments dropped in 2004 – a year of the introduction of the new financial system, comparing to 2003. But from 2005 in current prices both general and earmarked grants have showed steadily increase. In current prices amount of transfers increased inconsiderably in 2007. Starting from 2005 but except for 2007 rise in volume of earmarked grants is evident while in the period of 2004-2007 proportion of general grants in revenue has been decreasing.

2.1. General grants

Local governments may spend general grants at their own discretion so the funds disbursed from the State budget are not tied to any specific purpose or activity.

The biggest and by far the most significant grant received by local governments is **education grant** which contributes to 22.7% of total local governments revenue and has 76% share in total amount of general grants. Although education grant is not earmarked

for education the functional and historical references are apparent (Herbst, 97).

This grant is allocated according to regulation issued by the minister responsible for education. There are multiple factors⁶ included in mechanism (based on algorithm) of distributing funds between recipients, including:

- number of pupils in schools and other educational institutions run by local governments; different significance is given according to the type of a school and pupils category;
- share of employed teachers according to their professional status;
- share of pupils in schools situated in small localities in total number of pupils;
- additional 20% of employed teachers salaries to provide funds for other current spending, cost of administration and service (Mackiewicz-Lyziak, 36-37).

Inside the grant there is 0.6% reserve disbursed by the Minister of Finance.

Act on Local Governments Revenue requires that the total amount of education grant in the State budget cannot be lower than in previous year, corrected by the amount of other expenditures resulting from the shift in educational responsibilities. Mechanism of financing primary and secondary education, amount of education grant and its distribution is source of disputes between three parties: teachers' trade unions, local governments' representatives and the central government.

The grant has not escaped criticism. It's argued that the grant is based on simplified estimated current cost approach. At the same time it doesn't include revenue capacity of each local government. There is no rationale for economic interpretation of this transfer as the amount of the grant is not linked to actual costs of providing educational services by local governments (Mackiewicz-Lyziak, 151-152). Ambiguity of purposes which are to be achieved with the grant is shared by others (see for example: Herbst, 129-130)

Although there are some preferences for rural and small town municipalities mechanism of the grant lacks effective support to weaker local governments (Malinowska-Misiąg, 98-99). Some suggest that revenue equalization give a strong reinforcement to municipalities with weak revenue base (Herbst, 129-130) but clearly this occurs thanks to other general grants.

Majority of municipalities and counties have higher current expenditure on education than received in form of the grant and earmarked transfers for this activity. Only one city with county rights has spent on education less than received from the State. In average municipality ratio of current expenditure to current transfers for education is 120.0%. For counties and cities with count rights this ratio is 102.1% and 133.4% respectively. Financing of education is improving which is reflected in lower share of salaries in overall spending of local governments for this activity. However an issue is that in some municipalities, especially rural units, education grant doesn't even cover costs of salaries.

Equalization grant contributes to 5.1% of local governments revenue (17.9% share in volume of general grants). This grant intends to equalize differences in tax capacity among each tier of local government and is entirely financed from the State budget, i.e. with no local governments financial input. Average tax capacity per capita is calculated for municipalities, counties and regions. According to Act on Local Governments Revenue

⁶ Number of factors is around 40 which makes a rational debate on advantages and disadvantages of this grant virtually very tough (see: Herbst, 163).

for tax capacity computation lowering of tax rates or any relief applied or granted by local government are neutral. For municipalities one tax is not accounted for the purpose of calculating tax capacity; meanwhile two fees are included.

Regarding municipalities with tax capacity below 92% of national average for all municipalities are entitled to receive equalization part. Brackets for tax capacity equalization for municipalities are as follows.

Table 3. Level of equalization for municipalities

Tax capacity of municipality (G) as % of national average for municipalities (GG)	Equalization within the bracket
$G \leq 40\% GG$	99.0%
$40\% GG < G \leq 75\% GG$	83.0%
$75\% GG < G < 92\% GG$	76.0%

Source: Own elaboration based on Act on Local Governments Revenue

Tax capacity equalization concerns also counties and regions. Some amount of equalization grant is allocated to municipalities with low population density (and tax capacity below 150% of national average) and regions with less than 3 millions inhabitants.

Balancing grant (municipalities, counties) and **regional grant** (regions) amounted to 1.5% of total local governments revenue (5.3% of share in general grants). Balancing grant is mainly focused on distributing funds according to the social expenditure. In case of dividing regional grant several factors are taken into the account: unemployment rate, GDP per capita, surface of public roads per capita, expenditure on regional railways. Entitlement to these funds is also conditioned.

Balancing part and regional part is financed with equalization payments. Obligation and amount of the payments depend on tax capacity. Municipalities with tax capacity higher than 150% of national average for all municipalities are supposed to contribute to the mechanism. In case of counties and regions it's 110% of national average for their respective level.

Some municipalities are recipients of **compensating grant**. Entitlement to this grant is due to revenue decrease affected by the statutory exemptions in property tax in so-called Special Economic Zones.

Within the general grants there are also some reserve funds.

2.2. Earmarked grants

Among earmarked transfers from the State, grants to carry out State delegated responsibilities play most significant role as they contribute to almost 10.3% of local governments revenue. These transfers have features of non-matching grants. According to

law local government shall receive funds necessary to carry out State delegated tasks, so no contribution from local governments is required. Majority of funds is targeted for social assistance (mostly social benefits) representing 2/3 of these transfers in vast part being disbursed on tasks at the municipal level (municipalities and cities with county status).

Next group of earmarked grants consists of funds earmarked to exercise own specific responsibilities of local governments and represent slightly less than 5.1% of local governments revenue being in many cases matching close-ended grants. Capital transfers within this group contribute to 1.4% of local governments revenue which can be explained by the fact that these funds in large part are disbursements under the national and regional development policy schemes. Largest portion of grants for own specific responsibilities is allocated for social assistance (2.2% of local governments revenue) exclusively at municipal and county levels. As a general rule respective local government carrying out a State delegated task is entitled to 5% of proceeds from the exercised task.

Recently newly introduced exemptions in local property taxes are being compensated with grants categorized as current transfers for local governments own tasks. Volume of these transfers is relatively small and unimportant for local governments revenue. It's of some difficulty to qualify "compensation" grants using accepted theoretical concepts.

The last group of earmarked grants making less than 0.2% of local governments revenue are transfers resulting from agreements with the State bodies to carry out certain State tasks. Regarding type of transfer law allows for flexibility while concluding a contract.

Developments in earmarked transfers policy

The majority of central government earmarked transfers still follows "traditional" pattern of grants for mentioned earlier State delegated responsibilities. This is due to division of tasks provided in law specifying Polish political system⁷. With the regard to own local tasks, often if State co-financing is allowed law also stipulates upper level of national co-financing. This is for example the case of Act of 12 March 2004 on Social Assistance.

In conformity with Council of Europe observations in recent years new national multi-annual schemes are being launched for local governments to follow the national priorities and provide support in managing certain local issues. This reinforcement assumes the form of earmarked grants, mostly matching close-ended grants. Sometimes the equalization aspect can be observed as build-in measures to reinforce similar standards of services or infrastructure. The table allows for brief review of some of the latest programs.

⁷ Scientific circles have already several times expressed proposal for changing State delegated responsibilities into compulsory local government own tasks with increase of own-source revenue or/and general grants (see for example: Mackiewicz-Łyziak, 40-41).

Table 4. Examples of recent earmarked grants schemes

Scheme	Purpose	Preferences	Type of grant and level of co-financing	Notices
<i>National Local Roads Rebuilding Program 2008-2011</i>	Building, rebuilding and repairing municipal and county roads	<ol style="list-style-type: none"> 1) Short and small projects, 2) safety and environmental considerations, 3) roads joining the network of higher status roads, 4) LGs partnerships projects 	Matching close-ended grant from central government up to 1/2 (but no more than 3 million PLN)	Yearly each municipality can apply with only one project; each county with no more than 2 projects.
<i>My Playground – Orlik 2012</i>	Building 1600 playgrounds in municipalities and counties	<ol style="list-style-type: none"> 1) Municipalities: <ul style="list-style-type: none"> - with average tax capacity per capita (G) ≤ 40% of national average (GG), - special needs of revitalization in urban areas, - with large housing estate, - possessing playgrounds without artificial surface 2) Municipalities and counties with positive opinion on placement of playground and prepared construction site 	Matching close-ended grant from central government and respective region, each grant up to 1/3 (but no more than 333 thousand PLN); scheme allows for non-financial input of beneficiary	<ol style="list-style-type: none"> 1) beneficiaries have unrestricted and free of charge access to the typical investment project documentation 2) additional state financial support associated with project in form of providing salary for so-called sports animator
<i>Assistance to Local Governments in Stabilization of Health Care System (2009-2011)</i>	Reinforcement to LGs efforts in the process of liquidation of outdated organizational public sector hospitals and replacing them with companies aimed at improvement of health care functioning	LG with restructuring projects giving a high probability of success of hospital reorganized as company	Non-matching open-ended grant from central government disbursed after liquidation of old organizational form, taking over its debt by LG and creating a company	<p>Level of disbursement:</p> <ol style="list-style-type: none"> 1) allows the repayment of public liabilities (e.g. tax arrears) of “old” hospital and its debt loans, 2) prizes successful effort for compromise with private debtors (e.g. extinction of invoices debt), 3) is taking into the account other costs.
<i>State Support in Nutrition (2006-2009)</i>	Supporting municipalities responsible for nutrition policy with regard to children and people deprived of nourishment, improvement children and teenagers health, rising living standards of people and families with low income, development of nutrition institutions	<ol style="list-style-type: none"> 1) Rural areas and areas subjected to the high level of unemployment, 2) emphasis on the amount of service provided, 3) financial position of municipality has to be taken into the account when dividing grants between municipalities 	Matching open-ended grant from central government generally up to 60% up estimated costs with some exceptions	Individuals eligibility for benefits depends on their income with the reference to income criteria fixed in Act on Social Assistance (150% of income criteria).

Source: Own elaboration based on acts, regulations and governmental documents.

Funding of new competencies

Certain safeguards against unfunded mandates are stipulated in common statutes not mentioning the “principle of adequacy” laid down in the Constitution⁸.

Essentially recently a trend might be observed of funding new local authorities competencies (either newly created or transferred from the State) in form of non-matching earmarked grants; rarely a new kind of local fee is introduced to cover expenditures associated with new mandate and number of local taxes remains unchanged for years. Usually law transferring new responsibilities doesn't establish restricted period for financing local government with earmarked grants. This is also the case of the act which has come into a force on 1 August 2009. However generally the volume of competencies transferred to local governments is rather of less importance (with exception of above-mentioned act). Most prominent responsibilities in terms of spending have already been allocated to them during the Nineties of previous century (i.e. primary and secondary education, social assistance).

Despite this it has been practiced in past (mentioned earlier Act on Local Governments Revenue) to replace after some time earmarked grants with own-source revenue and compose required financial resources into general grant system to allow local governments for more flexibility.

No simple explanation for choosing rather earmarked grants instead of increasing general grant or own revenue could be given. There are several circumstances influencing this practice. It might be difficult to find good indicator of distributing funds among local governments and earmarked grants emerge as most suitable form of financing mandates. Sometimes the burden of including new task in local governments own-revenue and general grants system is too high as additional state input into equalization mechanism is required. The process of changing revenue system is a long-lasting one. Finally, also an issue of central government review of transferred responsibilities can't be forgotten.

3. Prospects for intergovernmental transfers policy

Framework for discussing possible changes is undoubtedly confined by crucial decisions regarding not only local authorities' tax system but model of taxation as whole⁹ while others refer to substantial circumstances surrounding the responsibilities of local governments¹⁰.

Recently most notable proposition of change of local governments revenue system, simplifying, suggest cancellation of education grant, strengthening equalization role of general grants and increase in own-source revenue (see: Malinowska-Misiąg, 101). This concept is furthermore developed (see: Mackiewicz-Łyziak, 27-28 and 170). Authors are supportive to the idea of equalizing with unconditional transfers to local governments and

⁸ Units of local government shall be assured public funds adequate for the performance of the duties assigned to them (art. 167 par. 1).

⁹ Framers are not liable to personal income tax. For individuals property tax is not a genuine real estate tax.

¹⁰ E.g. disbursement of salaries is a competence of local governments. Policy in this area is formulated at the national level.

virtually exclude earmarked grants as a measure of funds redistribution. Idea of using the earmarked grants in the capacity of equalization tool is outside the mainstream of thinking.

However there are some grounds for changing the paradigm. First step is improving coordination of overall transfer policy also with the regard to equalization purposes, linking earmarked grants policy to the being implemented idea of performance budgeting. Some steps have already been made with more program oriented budgeting. Redesigned targeted grants could be seen as more versatile than general grants as seen from the central government standpoint. Nevertheless this attractive idea might have been difficult to implement even because of technical reasons.

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