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## THE FINANCIAL CONDITION OF LOCAL GOVERNMENT UNITS IN POLAND IN THE LIGHT OF THE CHANGES IN THE ECONOMIC SITUATION

This article aims to assess the magnitude of the impact of the changing economic situation, related to the COVID-19 pandemic, on the financial situation of local government units (LGUs) in Poland. It employs an indicator analysis, along with a comparative analysis of measures of the financial condition of LGUs. It assesses the extent of financial self-reliance, development opportunities, budget results and operating results, as well as debt. Polish LGUs covered by the comparative analysis are categorized by their respective types. The analysis covers the years 2018–2021. In describing the condition of local government finances, it can be ascertained that the role of self-revenue decreased in 2020; this indicates a reduction in LGUs' financial self-reliance. The deterioration of the financial situation can be further evidenced by falls in LGUs' operating surpluses and investment expenditures. Cities with powiat (municipal) rights find themselves in the most disadvantaged situation.

**Keywords:** financial situation, COVID-19 pandemic, economic crisis

### 1. INTRODUCTION

The situation of public finances, including those of local government units (LGUs), depends on macroeconomic conditions shaping the economy throughout the whole country. The state of the Polish economy in 2020 was significantly affected by the COVID-19 pandemic. The introduction of a number of restrictions on economic activity as well as changes in social behavior contributed to the decrease in the activity of the national economy. As a result, in 2020 there was a decrease in gross domestic product (GDP) compared to the previous year (by 2.0%).

Both the government and local administration had to shoulder additional expenditures in order to prevent the spread of the pandemic and to overcome its effects. The increase in ongoing expenditures, concurrent with a decline in overall income, had an impact on the financial situation of local governments.

The economic and social problems caused by the pandemic raised many concerns about the deterioration of the financial situation of local government units and the limitation of their ability to carry out their tasks. The research already carried out during 2020 on the

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expected effects of the pandemic and the socio-economic crisis caused by it showed that the prevailing expectation was that of a significant negative impact of the pandemic on local government finances. Such conclusions were formulated in a report prepared by the Organisation for Economic Co-operation and Development (OECD) and the European Committee of the Regions (CoR). The report was prepared on the basis of a survey conducted in mid-2020 among representatives of local government authorities at various levels in 24 Member States of the European Union. In the short and medium term, most local and regional authorities expected the pandemic to have a negative impact on local government finances by causing a widening disparity between declining incomes and rising expenditures (OECD, 2020).

Similar conclusions were drawn from a survey conducted in mid-2020 by the Bank of Domestic Economy (Bank Gospodarstwa Krajowego). It aimed to assess the financial situation and investment plans of local government units in Poland in the context of the crisis caused by the COVID-19 pandemic. Most local governments predicted a significant decrease in tax revenues, mainly due to PIT and CIT. Cities with powiat rights<sup>2</sup> and gminas were expected to bear the greatest negative financial consequences of the pandemic. Furthermore, due to declining revenues and increasing expenditures related to the pandemic's impact, local governments declared reductions in other budgetary expenditures (BGK, 2020).

The legal solutions introduced in 2020, affecting the financial economy of local governments (Ustawa..., 2020), were intended to mitigate the effects of the pandemic. The implemented changes included: the possibility of earlier transfer of state subsidies to local governments, softened requirements for keeping a LGU's balanced budget and made it easier to incur liabilities.

The state financial support of LGUs was possible due to the creation of the Government Fund for Local Initiatives (RFIL), which was a program supporting the implementation of local government investments. The Fund was created by a resolution of the Council of Ministers of 23 July 2020 on support for the implementation of investments by local government units (Council of Ministers, 2020).

In view of the aforementioned concerns regarding the negative impact of the pandemic on local government finances, the aim of the article was to assess the scale of the impact of changes in the economic situation related to the COVID-19 pandemic on the Polish LGU's financial situation. Likewise, it was necessary to take into account the pandemic's impact on the economy of local governments at each level. In order to achieve the stated goal, changes in revenues and expenditures of local government budgets were assessed against the backdrop of the changes in the public revenues and expenditures and GDP in Poland. An indicator analysis was used to assess the financial situation of local government units. It enabled specifying the state of finances in relation to the most important areas of local government activity. A comparative analysis of measures of the financial condition of LGUs was applied. It assessed: the extent of financial self-reliance, development opportunities, budget result and operating profit (gross and net) as well as debt. Polish LGUs covered by the comparative analysis were categorized by their respective types.

The analysis covered the years: 2018 and 2019 (a period of stable macroeconomic situation and good economic situation in Poland), 2020 (a period of crisis caused by the

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<sup>2</sup> Powiat is the second level unit of local government, a part of voivodeship. While most powiats consist of multiple gminas (smallest type of local government), major cities are exempt from such subdivision. These cities are the cities with powiat rights.

pandemic), and 2021 (a period of recovery from the crisis and improvement of the economic situation). The time period chosen for the study will enable the verification of the previous predictions of a significant deterioration of LGUs' financial situation. It will allow one to specify the finite extent of local government financial problems in 2020. In addition, based on the state of local government finances in 2021, it will make it possible to specify the extent to which the difficulties were overcome. In 2021, the Polish economy recovered from the crisis caused by the pandemic – GDP increased by 6.8%. However during the year there was a gradual increase in inflation, which had an impact on the rising operating costs of local authorities.

The article contributes to existing studies about the pandemic's impact on the finances of LGUs in Poland. The time and scope of the research make it possible to assess the impact of economic changes on the financial situation of LGUs, as well as to determine the scale of the economic crisis impact on the finances of the various levels of local government. The conclusions of the analysis will specify the baseline position of local governments in the face of new problems affecting their finances in the coming years. These problems include the acquisition of funds in the new EU financial perspective, changes in tax law introduced as a part of the Polish Order, or the more difficult situation of the Polish economy in the wake of the Russian aggression against Ukraine.

In order for local authorities to continue to actively participate in development processes, they should first and foremost maximize their self-revenues, the use of which they themselves decide. Moreover, they should invest in a development-oriented manner so that investments generate long-term income that will allow them to repay the liabilities incurred for the implementation of key development projects.

The empirical material comes from the Local Data Bank of the Central Statistical Office, studies of the Ministry of Finance and reports of the National Council of Regional Chambers of Accounts.

## **2. ASSESSMENT OF THE FINANCIAL CONDITION OF LOCAL GOVERNMENT UNITS – THEORETICAL APPROACH**

Meeting the collective needs of the community and increasing the investment attractiveness of the local government unit depends to a large extent on its income. The desired features of local government income include, above all, efficiency and stability (Bartle, Ebdon, Krane, 2003; Musgrave, 1983; Poniawicz, 2015). The financial resources at the LGUs disposal constitute the foundation for the functioning of the local government unit and determine the implementation of tasks, including those of investment nature (Grzebyk, Stec, Hejdukova, 2022).

Financial condition is a measure which shows the state of local government finances. It is a complex concept, multidimensional in nature. The level of financial condition cannot be described by one indicator (Bieniasz, Gołaś, 2015; Groves, Godsey, Shulman, 1981; Hendrick, 2004). In order to describe it a number of attributes of the given entity's finances is selected. The financial condition of local government units is shaped, among others, by: the level of income, financial independence, the amount of investment expenditure, the ability to raise non-budgetary funds, achieving budgetary balance. Financial condition is also reflected by solvency. It is understood as the financial capacity of local government to meet its obligations (short-term and long-term) in a timely manner and to ensure continuity in the provision of services to the local community (Ritonga, Clark, Wickremasinghe, 2012; Rivenbark, Roenigk, Allison, 2009; Wang, Dennis, Tu, 2007).

When defining the financial health of LGUs, it is most common to emphasize the local government's capacity to ensure its financial security, understood as its ability to fulfill its basic tasks and to maintain its financial credibility related to the repayment of current and future financial obligations. Continuity of the provision of local government services is a result of the balanced budget, financial independence, independence from transfers, financial liquidity and long-term solvency, as well as rational spending of public funds (Stanny, Strzelczyk, 2018).

An important tool for assessing the financial situation of a local government unit is financial analysis. The scope of financial analysis includes: the efficiency of the management of the public money resources, the ability to settle obligations in a timely manner combined with the level of indebtedness, financial self-reliance and the development capacity. The analysis of the financial condition of the entity provides information about its current and future assets and financial situation. Moreover, it also determines the development opportunities of local government (Zawora, 2018). It is also important to obtain data on potential threats that may lead to a deterioration of the financial situation of the local government. The development and use of appropriate tools for assessing the financial situation of local government units and the ability to interpret the information flowing from them form the basis for determining the development opportunities of a given unit and, on a broader level, for comparing the differences occurring in the financial situation of particular units (Filipiak, 2009). The analysis conducted for selected groups of local government units indicates trends at the national, regional or local level. The conclusions of such analysis should lead to the improvement of the entire system of local government finances, as well as to the improvement of the efficiency of the functioning of individual units.

One of the basic methods of assessing the LGU financial condition is an indicator analysis. It makes it possible to assess the performance of local authorities on an on-going basis and, by identifying trends in a given unit, provides a basis for formulating predictions for the future. The use of indicator analysis should provide a meaningful understanding of the processes and conditions affecting financial potential. The sets of indicators used in the analysis of the financial situation of local governments most often concern the assessment of: financial liquidity, understood as the ability to meet short-term obligations; the level of indebtedness and the ability to manage it; financial self-reliance (revenue and expenditure); the ability to develop the entity, understood as the ability to finance the investment expenditures of a given local government unit; and the attractiveness of LGU, which indicates the wealth and development capacity per capita of a given local government unit (Łukomska-Szarek, Zawora, Kawecki, 2018). The indicators recommended by the Ministry of Finance include: budget per capita and liabilities based on debt instruments (Ministerstwo Finansów, 2021).

### **3. CHANGES IN GDP, PUBLIC REVENUE AND EXPENDITURE IN 2018–2021**

One of the desirable characteristics of a well-functioning local government financial system is ability to ensure stability and efficiency in the long term. The stability and reliability of funding sources significantly influence the scope and quality of public services provided by LGUs (Kata, Czudec, Zajac, Zawora, 2022). Currently, the Polish LGUs finance nearly 30% of public tasks (NIK, 2022). Income of LGUs depends to a large extent on the state budget, while the latter's situation depends on macroeconomic conditions and the state of the economy. Public revenues, including those of local

governments, are largely reliant on public levies, which in periods of economic slowdown results in fluctuations in the budget revenues of both the state and local governments. The volatility of public revenues at particular periods is connected to the problem of ensuring the continuity of funding for public services provided to society as a whole as well as at the local level (Owsiak, 2011).

In 2020, after years of stable economic growth, the economic downturn caused by the COVID-19 epidemic took place in Poland. Numerous restrictions related to the epidemic had serious economic and social consequences, resulting in a decrease in GDP by 2.0% compared to the previous year, when the economic growth rate was 4.5% (Table 1). In 2021, Poland, like most European Union countries, recorded a high rate of economic growth. Although temporary restrictions related to the need to counteract the epidemic were still in force, they were much milder than a year earlier. As a result, Poland's GDP grew by 6.8% and was one of the most dynamic increases since 2007, when it exceeded 7%. Thus, in 2021, Poland maintained an economic growth rate exceeding the average growth rate in the European Union, which was 6.1% (NIK, 2022). Household consumption was the main contributor to Poland's GDP growth. It rose to 6.2% after falling to 3.0% in 2020. When assessing the rate of economic growth in 2021, it is also important to remember how low the 2020's baseline was. Additionally a gradual intensification of inflation was observed throughout 2021. The average annual increase in the prices of consumer goods and services was 5.1% (3.4% a year earlier).

Table 1. Changes in GDP as well as government revenue and expenditure between 2018 and 2021 (%)

Years	2018	2019	2020	2021
Previous year = 100				
Gross Domestic Product	105.9	104.5	98.0	106.8
Public income	110.7	107.4	102.7	114.9
Public expenditures	107.3	108.7	117.7	102.8
National debt	102.3	100.7	112.1	103.3
GDP = 100				
Public income	41.3	41.0	41.3	42.3
Public expenditures	41.5	41.8	48.2	44.2
Result	-0.2	-0.7	-6.9	-1.9
National debt	46.5	43.2	47.5	43.8

Source: Own study based on (NIK, 2022; GUS, 2022; Ministerstwo Finansów, 2023).

In 2018–2021, the increase in public revenues was maintained. However, there was recorded a much lower growth rate, as compared to previous years, in 2020 (102.7%). In 2021, the increase in public revenues compared to the previous year was much higher – by 14.9%. Revenues in relation to GDP increased from 41.3% in 2020 to 42.3% in 2021. Such a high increase in public income, as well as its level in relation to GDP, has not been observed in Poland in the last ten years. At the same time, public spending was at an increased level, compared to the period before the COVID-19 epidemic, which in 2021 amounted to 44.2% of the gross domestic product. In recent years, public spending was higher in relation to GDP only in 2020, when it amounted to 48.2%.

The consequence of the high dynamics of revenues and the decrease in public spending in 2021 was a significant reduction in the general government deficit compared to 2020, when it amounted to as much as 6.9% of gross domestic product, but it still remained significantly higher compared to 2018–2019, when it accounted for 0.2% and 0.7% of GDP, respectively. The government institutions were primarily responsible for the deepening of the deficit of this sector in 2020–2021. The local government institutions generated a surplus in 2020–2021, which accounted for 0.2% and 0.6% of gross domestic product, respectively.

In 2020, public sector debt increased significantly (by 12.1% compared to the previous year), constituting 47.5% of gross domestic product. At the end of 2021, the ratio of public debt to GDP decreased to 43.8%, and there was also a lower increase in debt compared to the previous year – by 3.3%. The size of the national debt was primarily influenced by the increase in government debt, while the local government debt increased by 9.4% in 2020 compared to the previous year, and by 1.8% in 2021. It is also worth noting that the share of LGUs debt in the public finance sector debt remained stable, fluctuating from 7.4% to 8.1% in 2018–2021.

#### **4. FINANCIAL SITUATION OF LOCAL GOVERNMENT UNITS IN POLAND IN 2018–2021**

In addition to the recession caused by the pandemic, the financial situation of local governments in the analyzed period was significantly affected by changes in the provisions on personal income tax introduced in 2019 (including, among others, a reduction in the tax rate and exemption from income tax for people under 26 years of age), affecting the level of tax revenues of local governments (Ustawa..., 2019). Along with the economic situation, legislative changes were an important factor negatively affecting the level of revenues of local governments, especially in terms of their share of PIT and CIT taxes (Kwiatkowski, Tyszkiewicz, Wójcik, 2021).

In 2018–2021, the budget revenues of local government units increased steadily. Their highest increase – by 10.6% – compared to the revenues of the previous year was recorded by the local government sector in 2019 (Table 2). This was slightly higher than the dynamics of 2017 and 2018, amounting to 107.6% and 109.6%, respectively (Krajowa Rada RIO, 2020, 2021). In 2020–2021, the dynamics of income growth decreased slightly, amounting to 109.5% and 109.3% respectively, which was mainly influenced by a decrease in self-revenue lower than in 2018–2019. Particularly unfavourable changes occurred in 2020, when the income of LGUs from income taxes (CIT and PIT) decreased compared to the previous year. The negative trend in this income group was influenced by a 1.9% decrease in LGUs income from the personal income tax. An unfavourable change in the financing structure of local governments is also indicated by the increase in revenues obtained from the general subsidy, received by local governments in 2021 to supplement their revenues (among others, due to partial compensation for the loss of income from PIT). It should be noted, however, that in 2021 the growth rate of own revenue was higher than in 2020, with a significant increase in personal and corporate tax revenue – CIT revenue increased by 26.3%, while PIT revenue increased by 12.7%, and this was similar to the growth rate observed before the pandemic (the average growth rate in 2017–2019 was 11.0%) (Krajowa Rada RIO, 2022).

The expenditures of LGUs increased to a lesser extent than revenues in the period under review. On-going expenditure grew at a similar rate to total expenditure. However, the

growth was higher in 2019–2020. What was worrying, though, was the decline in local government property expenditure – by 3.5% in 2019 and by 4.5% in 2020. The year 2021 saw an increase in property expenditure (by 6.3%), but its level (PLN 48.1 billion) was still lower than in the year before the pandemic (PLN 49.0 billion). Also noteworthy is the low level of implementation of local government investment plans in 2021 (77%), related, among other things, to the delayed disbursement of funds under the new financial perspective of the EU 2021–2027 and the National Reconstruction Plan (NRP). However, it is important to reverse the downward trend in LGU investments. The boost to local government investment activity in 2021 was facilitated, among other things, by funds from the Government's Local Investment Fund (GLIF), allocated from the COVID-19 Countermeasure Fund (Departament Analiz Ekonomicznych, 2022). The total target value of funds addressed to local government units under the Fund in the years 2020–2021 was over PLN 13 billion (Rada Ministrów, 2020).

The decrease in the operating surplus (the difference between current income and current expenditure) proves the smaller development opportunities of local government units in 2020. After the surplus level increased by 9.5% in 2018 and by 4.5% in 2019, the operating surplus decreased by 11.5% in 2020. However, in 2021 there was a significant increase in the surplus – by 71.2%.

The trend of an increase in the amount of LGU debt continued between 2018 and 2021. In 2020, there was a higher increase in debt compared to the previous year – the growth rate was 109.5%. This was due to an increase in liabilities due to credits and loans and issued bonds by 9.5%. In 2021, the pace of debt growth slowed.

Table 2. |Changes in budgetary revenue and expenditure of local government from 2018 to 2021 (previous year = 100%)

Years	2018	2019	2020	2021
Total revenue	109.6	110.6	109.5	109.3
Self-revenue	109.5	109.5	107.8	108.4
Corporate income tax	115.7	112.4	103.9	126.3
Personal income tax	113.4	110.3	98.1	112.7
General subsidy	104.0	109.4	108.6	122.8
Targeted subsidies	114.5	113.5	113.0	101.0
Total expenditure	112.7	108.0	106.8	105.6
On-going expenditure	105.9	111.0	109.3	105.4
Property expenses	150.2	96.5	95.5	106.3
Operating surplus	109.5	104.5	88.5	171.2
Total debt	110.4	107.8	109.5	101.4

Source: Own study based on (Ministerstwo Finansów, 2022; Krajowa Rada RIO 2022; NIK, 2022).

It is noticeable, when observing the diversification of changes in the level of income of each level of local government units, that the least favourable changes, visible in 2020, concern cities with powiat rights. They achieved relatively the lowest growth in total income (amounted to 6.8%) and self-revenue (1.8%). These entities rely heavily on tax revenues, especially income tax, which together account for around half of their self-

-revenue, while being particularly vulnerable to the economic crisis. In 2020, the income from PIT and CIT decreased in most local governments. However, the decline was greatest in cities with powiat rights (Table 3).

Only voivodeship governments recorded an increase in the operating surplus (by 14.7% compared to the previous year). At the powiat and gmina level, the surplus was lower by nearly 2%, while the highest decrease in operating surplus was recorded in cities with powiat rights. There the surplus of ongoing income over on-going expenditure decreased by almost half in comparison with the previous year.

The lower development capacity of the local governments is also evidenced by the decrease in investment expenditure seen in 2020 in all categories of LGUs. The highest decrease compared to the previous year was recorded in gminas and cities with powiat rights. It is worrying because these units are very important local government investors.

The economic crisis related to the pandemic to the least affected the finances of the voivodeship government, which in 2020 maintained a trend of income growth, including self-revenue, comparable to previous years. In addition, they recorded a high increase in the operating surplus, while the investment expenditures of voivodeship governments were inhibited.

In 2021, the income situation of local governments at all levels improved, primarily in terms of self-revenue. Revenues from PIT and CIT increased at a rate similar to the years preceding the pandemic. In gminas and cities with powiat rights, subvention flow significantly increased, which resulted from a large increase in funds complementing the general subvention (compensation for the loss of revenue due to the PIT changes in the Polish Order) (Departament Analiz Ekonomicznych, 2022). The development opportunities of local governments also increased, in units of all levels there was a significant increase in the operating surplus. In most local governments, the level of investment expenditure also increased (after decreases recorded in 2019–2020).

Table 3. Changes in budget revenues and expenditures in 2020–2021 – by LGU category (previous year = 100%).

Specification	Gminas		Cities with powiat rights		Powiats		Voivodeships	
	2020	2021	2020	2021	2020	2021	2020	2021
Total revenue	110.3	109.7	106.8	110.7	112.6	104.3	111.7	108.9
Self-revenue	112.2	111.0	101.8	112.2	113.7	102.1	107.6	120.2
CIT, PIT	99.6	113.7	98.1	105.7	99.1	113.5	102.5	124.0
Targeted subsidies	112.1	96.0	117.2	102.4	106.2	95.1	112.7	89.4
General subsidy	103.9	129.4	109.8	121.3	115.2	111.5	125.3	114.5
Total expenditure	106.2	106.3	106.8	104.5	109.0	105.8	107.2	105.6
On-going expenditure	108.9	105.8	109.0	104.8	111.0	106.4	111.5	104.5
Investment expenditure	92.4	105.2	95.9	98.8	99.6	102.5	99.9	106.5
Operating surplus	98.1	147.5	52.1	321.8	98.1	137.0	114.7	137.7

Source: Own study based on (Ministerstwo Finansów, 2022; Krajowa Rada RIO, 2022; NIK, 2022).



An analysis of the changes in the budget revenues of local governments between 2018 and 2021 shows that in the first year of the pandemic the revenues of local governments not only did not decrease, but also maintained the rate of their growth, which was similar to the one in years preceding the pandemic. It can be concluded that the effects of the pandemic did not affect the overall income potential of LGUs. It is therefore reasonable to ask about the sources of the increase in budget revenues and their impact on the level of income autonomy of local government units. Income independence, understood as local government units being vested with their own sources of income and freedom of distribution of these funds, is measured by the percentage of own income in the total amount of budget income (Dziemianowicz, Kargol-Wasiluk, Bołtromiuk, 2018). The high share of own income in total income also affects the development opportunities of local governments, which provides the basis for shaping local development policy, supports long-term decisions regarding the level of investments and impacts loans taking. Simultaneously, the amount of generated self-revenue is connected to the activity of the residents and their assets, as well as the area development. For this reason, this indicator indirectly allows the assessment of the development potential of the gmina. On the other hand, external provision of budgets in the form of subsidies and grants is a form of direct influence by the state on local government finances (Szołno-Koguc, 2021). At the same time, the autonomy of the local government's expenditure policy is most strongly reduced by targeted subsidies (Swianiewicz, Łukomska, 2020).

Table 4. Structure of LGUs income by main sources in 2018–2021 (%)

Years	Total LGUs	Gminas	Cities with powiat rights	Powiats	Voivodeships
Self-revenue					
2018	49.2	43.3	61.3	36.0	53.2
2019	48.7	43.3	58.6	40.1	52.8
2020	48.0	44.0	55.9	40.5	50.9
2021	49.0	44.5	56.7	39.6	56.2
General subsidy					
2018	22.4	23.4	18.0	37.6	12.9
2019	22.2	22.5	18.2	37.9	13.7
2020	22.0	21.2	18.7	38.8	15.3
2021	24.7	25.0	20.5	41.5	16.1
Targeted subsidies					
2018	28.3	33.4	20.7	26.4	33.9
2019	29.1	34.2	23.2	22.0	33.5
2020	30.0	34.8	25.4	20.7	33.8
2021	26.3	30.5	22.8	18.9	27.7

Source: Own study based on (Krajowa Rada RIO, 2022).

The data presented in table 4 shows the impact of the effects of the pandemic on the income self-reliance of local government units. In 2019–2020, there was a visible downward trend in the share of LGUs' self-revenues in the total amount of budget revenues. The reason was the decline in the role of tax revenues, including income tax revenues. In

2020, LGUs in each voivodeship in Poland recorded a decrease in the share of personal and corporate income tax in budget revenues (Czudec, 2021). It can be assumed that this was the result of the economic crisis caused by the restrictions related to the pandemic. It should also be remembered that the decrease in tax revenues was also caused by legislative changes regarding tax law introduced in July 2019. The reduction in financial self-reliance in income aspects was also evidenced by an increase in the contribution of transfer income (subsidies and grants).

It can be noted that in 2021 the increase in the share of subsidies in the financing structure of LGUs, visible in all types of local governments, with a simultaneous increase in the share of own revenues, was inhibited.

In local government practice, the superiority of income independence over expenditure independence is often indicated, because the actual financial independence of a local government is determined by the level of income that it can freely dispose of to cover its expenses. Although the expenditure aspect of local government's financial independence is as important as its income aspect, the degree of expenditure independence is largely determined by the level and structure of budget revenues (Dziemianowicz et al., 2018). Income is crucial for determining the ability of local government units to carry out their tasks, including the financing the LGU's investments, which determine the development opportunities of these units, determining their expenditure.

The development opportunities of local government units – in addition to self-revenues – are also indicated by the size of investment expenditure. The indicator of the share of development expenditure in total expenditure reflects the investment activity of the local government and at the same time indicates the extent of the local government's spending autonomy. For investment expenditures are the type of expenditures which the local government units themselves decide to undertake (Surówka, 2013). Their size reflects the amount of funds that the local government unit can allocate to the implementation of development projects after funding ongoing (predominantly obligatory) tasks.

Table 5. Structure of LGU expenditure in 2018–2021 (%)

Years	LGUs' total	Gminas	Cities with powiat rights	Powiats	Voivodeships
On-going expenditures					
2018	79.6	79.4	83.1	79.1	64.1
2019	81.8	83.1	83.6	82.1	62.1
2020	83.7	85.2	85.3	83.6	64.5
2021	83.6	84.8	85.5	84.1	63.9
Investment expenditures					
2018	19.7	20.3	15.7	20.7	33.9
2019	17.5	16.6	15.1	17.6	36.3
2020	15.6	14.4	13.6	16.1	33.8
2021	15.2	14.3	12.8	15.6	34.1

Source: Own study based on (Krajowa Rada RIO, 2022).

In 2020, the structure of expenditures of local governments of all types continued the trend of an increase in on-going expenditures and a decrease in investment expenditures in relation to budget expenditures (Table 5). The increase in the share of on-going expenditure

of local government units was associated with an increase in the operating costs of local governments, including those related to the pandemic. Special pandemic-related expenditures aimed at ensuring epidemic safety, including meeting special sanitary conditions, were introduced in 2020 by legislation, which imposed obligations on local governments and their organizational units to counteract the pandemic and to counteract the effects of the pandemic (Ustawa..., 2020). However, the financial effects of these expenditures are difficult to determine due to the lack of supplementation of the budgetary classification, which would enable the identification of this type of expenditure (Nelicki, 2020).

All categories of LGUs also recorded a decrease in the share of investment expenditure in total expenditure, which indicates a decrease in the development opportunities of local governments and their independence in terms of expenditure. It is worth noting that 2021 brought a further decrease in the share of LGUs' investment expenditure in their total expenditure.

Table 6. LGUs budget outturn vs. debt

Years	Operating result in relation to total income (%)	Budget outturn (PLN thousand)	Liabilities in relation to total income (%)
2018	9.2	-7 539 849.0	30.2
2019	8.7	-1,706,179.7	29.5
2020	7.0	5,689,482.7	29.5
2021	11.0	17,441,838.0	27.3

Source: Own study based on (Krajowa Rada RIO, 2019–2022).

In 2018–2019, the budgetary expenditures of LGUs exceeded revenues, which resulted in a deficit at the end of the year (Table 6). In 2020, local government budgets closed with a surplus of PLN 5.69 billion, despite the fact that local governments originally planned a deficit of PLN 21.17 billion, which indicates that local authorities are being very cautious when implementing their budgets under pandemic conditions. This was associated with a significant reduction in local government investment activity. It was connected to the deteriorating economic situation in Poland and the increasing uncertainty about the implementation of the revenue plan by local authorities. In 2021, the implementation of LGUs' budgets brought a surplus for the second year in a row (PLN 17.4 billion, with a planned deficit of PLN -19.4 billion). In addition to further reductions in local government investment, the PLN 8 billion funding that local governments received in December 2021 as a supplement to the general subvention (Ustawa..., 2021) contributed to the net positive budget result. The budget surplus was recorded at the level of all types of LGUs.

In 2018–2020, LGUs' debt systematically increased (on average by 10% per year). The period of the pandemic did not significantly increase the growth of debt (mainly due to postponement of the investments). However, in 2021, the liabilities of the local government sector increased by only 1.4% compared to the previous year. At the same time, the relationship between liabilities and income stabilized. The debt-to-income ratio in the entire local government sector decreased in this period from 30.2% to 27.3%. As in previous years, in 2021 the highest debt-to-income ratio occurred in cities with powiat rights (40.6%). The lowest share of debt-to-income ratio occurred powiats (17.2%), and the

highest decrease in the value of said ratio was achieved by voivodships (to 24.9%). It should be noted that local government debt constituted a small part of the debt of the entire public finance sector (7.9%).

The difficult financial situation of LGUs in 2020 is evidenced by the reported decrease in the operating surplus. The ratio of operating surplus to total income shows the investment opportunities of LGUs and the ability to increase current expenditure (Satoła, 2015). Voivodships had the highest value of this indicator, while cities with powiat rights had the lowest. In most local governments, the operating surplus in relation to income decreased in 2020, with the largest decrease visible in cities with powiat rights. The voivodships were characterized by a high and stable level of surplus. In 2021, the financial situation of local governments improved. In all types of units there was a significant increase in the operating surplus (Table 7).

Table 7. The operational outturn (gross and net) to total revenue (%)

Years	Gminas		Cities with powiat rights		Powiats		Voivodships	
	Operational outturn in relation to total income (%)							
	gross	net	gross	net	gross	net	gross	net
2018	8.9	5.6	8.4	4.8	7.4	4.7	18.2	12.6
2019	8.4	4.9	6.8	3.2	9.0	5.7	19.6	14.6
2020	7.5	4.4	3.3	1.0	7.8	5.4	20.1	16.0
2021	10.1	7.3	9.6	6.5	10.3	8.0%	25.4	21.1

Source: Own study based on (Krajowa Rada RIO, 2022).

Obtaining an operating surplus is necessary for the local government finances, but the gross operating surplus does not include expenses intended for repayment of loans and borrowings (expenses). Therefore, the assessment of the financial situation of local governments should also take into account the net operating surplus indicator, which reflects their investment opportunities (Swianiewicz, Łukomska, 2021). The (gross) operating surplus is calculated in accordance with the methodology used by the Ministry of Finance by deducting the LGUs debt repayment. The use of the net operating surplus is justified due to the persistently high indebtedness of local governments. Significant differences in the gross and net surplus values indicate a high burden of debt repayment on the budgets of local government units. Cities with powiat rights faced the most difficult situation among all types of local governments. In 2020, they generated a very low net operating surplus. They also had the highest indebtedness ratio among the different types of local governments.

## 5. CONCLUSIONS

The economic downturn in Poland caused by the COVID-19 epidemic was reflected in the financial health of the state budget and consequently also had negative consequences for local government finances. The economic crisis affected the functioning of local government units at all levels. It can be noted, however, that the crisis affected local governments unevenly. The effects of the pandemic, visible in 2020, had the least impact on the financial situation of voivodeship. These units mainly maintained a high and stable

level of operating surplus. They also reduced the liability ratio and their investment capacity decreased to the smallest extent.

The economic downturn had a negative impact primarily on cities with powiat rights, where the surplus of on-going income over current expenditure almost halved compared to 2019, while the net operating surplus was barely over PLN 0. The development opportunities of these units decreased, which was reflected by the large decrease in investment expenditure. Self-revenues from taxes, which in cities have a significant position in total revenues, also fell.

It should be emphasized that the actual severity of local government financial problems in 2020 turned out to be less than anticipated. In fact, local governments maintained their overall revenue potential comparable to their planned level as well as that of the previous year. However, the structure of local government revenues has deteriorated as the role of revenues transferred from the state budget has increased. This led to a diminution of financial independence, which is the basis for the operation of local governments. The deterioration of the financial condition is also evidenced by the decrease both in the operating surplus and investment expenditure recorded in local governments in 2020. The deterioration of the operating result not only reduced the development opportunities of local governments, it also increased the risk of a loss of liquidity and could lead to a situation where the day-to-day operations of local governments would be at risk.

The deterioration of the financial situation of LGUs in 2020 is primarily a result of income factors influenced by both the economic situation and the direction of legislative changes of tax policy. In addition to the economic situation, legislative changes were an important factor negatively affecting the profitability of local governments. Therefore, national-level policies resulted in a reduction of the financial independence of local governments. The dependence of local government finances on external factors, including economic fluctuations, and the related volatility of local government revenues pose a threat to the stability of financing public services, which are provided by local governments in Poland.

In the crisis situation, the unfavorable phenomena present in recent years in Polish LGUs finances became more visible (among other things, limiting the financial independence of LGUs by the state, imposing additional tasks on LGUs without adequate financial compensation, or introducing new debt limits). Given this, changes in legal regulations should focus on the search for and implementation of such solutions that will stabilize the financial management of local governments to strengthen their financial independence, which is the basis of LGUs autonomy.

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## LEGAL ACTS

- Ustawa z dnia 14 października 2021 r. o zmianie ustawy o dochodach jednostek samorządu terytorialnego oraz innych ustaw (Dz.U. z 2021 r., poz. 1927; Journal of Laws. 2021, item 1927).
- Ustawa z dnia 31 marca 2020 r. o zmianie ustawy o szczególnych rozwiązaniach związanych z zapobieganiem, przeciwdziałaniem i zwalczaniem COVID-19, innych chorób zakaźnych oraz wywołanych nimi sytuacji kryzysowych oraz niektórych innych ustaw (Dz.U. z 2020 r., poz. 568; Journal of Laws. 2020, item 568).
- Ustawa z dnia 30 sierpnia 2019 r. o zmianie ustawy o podatku dochodowym od osób fizycznych oraz ustawy o zmianie ustawy o podatku dochodowym od osób fizycznych oraz niektórych innych ustaw (Dz.U. z 2019 r., poz. 1835; Journal of Laws. 2019, item 1835).
- Uchwała nr 102 Rady Ministrów z dnia 23 lipca 2020 r. w sprawie wsparcia na realizację zadań inwestycyjnych przez jednostki samorządu terytorialnego (M.P. z 2020 r., poz. 662; M.P. 2020 item 662).

