

# The impact of income sources on the financial independence and development activities of municipalities in Poland

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**Abstract**— The independence of local government is complex and multi-faceted. It should be considered taking into account many aspects, including the financial aspect. It is financial independence, especially its income approach, that plays an important role from the point of view of the current functioning of local government units. The aim of the article is to analyze the level of financial independence and development activities of municipalities in Poland. The data used for the analysis come from the Statistics Poland and Regional chambers of audit databases. The time taken for analysis is 2014-2022. The study used the following methods to assess the degree of financial independence and development activities of municipalities: an analysis of the level of communes' income from individual sources, an analysis of the level of operating surplus in municipalities and an analysis of the level of debt.

**Keywords**— financial independence, income of municipalities, operating surplus, debt of municipalities.

## I. ENTRY

The financial independence of local government is limited to the use of financial resources from the "cutting" of primary income intended for public purposes. Therefore, an important feature of local government should be the adequacy of its revenues to the scope of tasks performed. This is due to the fact that own, obligatory tasks, just like tasks assigned by law, result from acts and must be performed (provided) for as long as required by legal provisions. Importantly, they do not depend on the income of local government units. At the same time, the essence of local government results in the independence of local authorities to decide on the directions of development. This is related to having financial independence.

## II. THE ESSENCE AND SCOPE OF FINANCIAL INDEPENDENCE OF LOCAL GOVERNMENT

When performing its tasks, local government is guaranteed independence and in this respect it is subject to judicial protection. An important element of local government independence is financial independence.

The concept of financial independence includes income independence, i.e. the right of local government units to have and shape their own income, and expenditure independence, i.e. independence in the implementation of their own tasks.

In the opinion of the direct implementers of the budget economy, income independence is more important than expenditure independence. Therefore, it is often identified with independence in general (Piotrowska-Marczak 1997).

The concept of income independence of local government units should be understood as the right of local government authorities to dispose of financial resources, but also to determine and obtain them. However, this right is not unconditional for at least two reasons.

Firstly, because in the economic sense, local government means decentralization of tasks and financial resources by the state to public-law associations, although not hierarchically subordinated to the state, but established at the will of the state. Therefore, since these associations are independent, but not autonomous (they cannot exist without the state, they are subject to the jurisdiction of the state, etc.), the competences of local government authorities in terms of profitable activities are reduced.

Secondly, income independence is also limited by the fact



that local government cannot maximize its income in an unlimited manner. If he has excess of them in relation to the scope of tasks performed, he is forced to redistribute them.

The above restrictions define the framework for the financial independence of local government authorities. They also mean that income independence cannot be considered separately from the tasks performed by local government units. Considering the obligatory nature of most tasks performed by local government and their usefulness (e.g. educational services or social assistance services), relying on stable sources of income, although established by the central authorities, may be a much better solution than allocating them own income, but dependent, for example, on the economic situation. On the other hand, it should be remembered that without income independence it is impossible to conduct investment activities. This prevents the development of local government.

### III. FINANCIAL INDEPENDENCE OF LOCAL GOVERNMENT IN THE EUROPEAN CHARTER OF LOCAL SELF-GOVERNMENT

The legal act defining the idea of local self-government is the European Charter of Local Self-Government, drawn up in Strasbourg in 1985. It was ratified by Poland on April 26, 1993. According to this legal act, local government means the right and ability of local communities, within the limits set by law, to direct and manage a significant part of public affairs under their own responsibility and in the interest of their residents. The right to manage public affairs should be exercised by electing decision-making bodies in free, secret, direct and universal elections, which in turn may appoint their executive bodies. An important statement of the ECSL is the provision that: "responsibility for public affairs should be borne by those authorities that are closest to the citizens." This provision fully refers to the idea of subsidiarity. The Charter also emphasizes that local authorities have full freedom to act in any matter that is not excluded from their competences or does not fall within the competence of other authorities. These competences may be questioned or limited by another authority (central or regional) only to the extent provided for by law, in the manner and in cases specified in the Constitution or laws.

The European Charter of Local Self-Government also refers to the principles of financing the tasks carried out. Its provisions indicate that the amount of financial resources of local communities should be adjusted to the scope of powers and at least part of these resources should come from fees and local taxes specified by law. The Charter also takes into account the use of compensatory procedures or balancing activities aimed at correcting the effects of unequal distribution of potential sources of income and expenses incurred by individual local government units. Another important provision of the ECSL is that the financial systems on which the resources at the disposal of local communities are based should be sufficiently diversified and flexible so that they can, as far as possible, correspond to actual changes in the level of costs related to the exercise of rights (Filipak 2011). This provision is extremely important because it guarantees local governments access to

financial resources even if their own income is limited as a result of the economic downturn. In turn, in order to enable local government units to finance investment tasks, EKSL guarantees them access to the domestic capital market.

The European Charter of Local Self-Government reflects the essence of local self-government, becoming the basis for the functioning of local self-government in modern countries and securing the interests of local communities in relation to government administration. It is also a guarantee of ensuring two principles, i.e. decentralization and subsidiarity, on which modern local government is based.

This approach to local government is consistent with the concept of localism, which includes the view that the fundamental feature of local government is the diffusion of power. Thanks to local government, power is fragmented, which becomes more accessible and more flexible, and by getting closer to society, it can also make more rational decisions

### IV. SOURCES OF INCOME OF LOCAL GOVERNMENT UNITS IN POLAND AND THEIR FINANCIAL INDEPENDENCE

The scope of income independence of local government units varies depending on the type of budget revenues. It is highest in the case of local taxes and fees and income from property. Much smaller in the case of percentage shares in central taxes, general subsidies and targeted subsidies.

An important source of income for local governments is income from taxes and fees.

By classifying taxes contributing to the budgets of local governments, they can be divided into (Surówka 1999):

- spontaneous taxes, introduced independently by local authorities,
- local taxes and fees determined by law but placed entirely at the disposal of the local government.

Revenues from residents' self-taxation are an example of the most far-reaching autonomy of local governments in shaping their own sources of income. Local authorities, based on their own local legislation, decide to charge natural or legal persons an additional public levy, which will finance important tasks of local government units, most often of a development nature. The competence to impose it remains in the decision of all residents, through a referendum.

The basic source of tax revenues, especially for local budgets, are local taxes and fees. Due to the fact that they were handed over entirely to the local government, local authorities receive specific tax powers from the legislator (Dylewski et al 2014). It consists in the fact that these authorities determine the level of tax rates, the amount of fees, may apply reliefs and exemptions, and may also write off debts, divide them into installments, etc. However, the maximum rates are set by law, uniformly at the country level.

However, there is a certain danger associated with local tax authorities, consisting in the possibility of reducing budget revenues by local authorities lowering tax rates (well below the maximum rates), applying a wide range of reliefs, tax write-offs

and even numerous exemptions. Local governments also generally have greater problems with the effectiveness of tax enforcement than central tax authorities. It must also take into account numerous statutory reliefs in local taxes, which limits the financial independence of local government authorities. This is particularly visible in Polish legal regulations.

The low efficiency of local taxes means that local governments also have access to central taxes from a given area. It should be emphasized that the revenues from these taxes constitute an important source of financial support, enabling local governments to carry out their basic tasks. In many cases, state tax revenues exceed local tax revenues.

The budgets of individual levels of local government are generally not financed by all central taxes. They rarely have access to indirect taxes, participating only in the division of income taxes. This is justified by the fact that local authorities do not have much influence on the formation of income, e.g. from excise taxes.

The amount of income tax revenues from both natural and legal persons is a symptom of the economic development of a given area. Local government units should participate in the division of national income generated in a given area. However, the question arises what form this redistribution of funds should take.

In practice, local governments participate in the distribution of central taxes, either by establishing local government supplements to income taxes or through percentage shares in income taxes. The meaning of both forms is varied.

The main difference between tax participation and tax supplement is that in the case of participation, local authorities do not have much influence on the amount of budget revenues. Funds due to local government authorities are calculated automatically. The amount of share is decided by the legislator. All this means that tax shares are treated as complementary, and not their own, sources of financial support for local governments. Their nature is similar to general subsidies. Unfortunately, in Poland, local government participates in the division of PIT and CIT by establishing percentage shares in these taxes (Borodo 2019).

Tax allowances differ fundamentally in their economic nature from tax shares. While the share in the tax has only a fiscal significance, the allowance, in addition to its fiscal function, may also have a significant stimulating effect, influencing the behavior of entities operating in a given area (Borodo 2019).

The local government is the owner of the majority of public property in its territory. These are buildings, land, as well as

economic entities whose founding body is, or in which local government authorities own shares. This property brings various incomes to local government units in the form of rents from leases, dividends from municipal companies, payments from surpluses of local government budgetary entities, income for services provided and income from the sale of property. Most often, the revenues obtained from the services provided do not cover the expenses incurred for this purpose. By definition, local government should make property available to the local community not to generate profits, but to provide residents with appropriate living conditions.

The basic source of budget revenues for the majority of local government units in Poland remain grants and compensatory subsidies (Alińska, Woźniak 2019). The need for external power supply is indispensable because revenues from taxes and assets of local government communities in no country are sufficient to finance budget expenditure.

Grants and subsidies are intended to counteract development disproportions between individual local government units. The main difference between subsidies and targeted grants is that the former are of a general nature, are allocated on the basis of objective criteria and these funds do not have to be accounted for. In turn, targeted subsidies are planned for a precisely defined purpose, based on criteria established by the ordering party, and after the end of the financial year, the unused part is refunded. Of course, the mechanism for calculating them does not have to limit the principles of self-government. However, for this to happen, two basic conditions must be met:

- firstly, subsidy funds should be determined based on objective criteria and local governments should know what revenues they are entitled to,
- secondly, targeted subsidies should be adjusted to the costs of assigned tasks carried out by local government units.

Only in such a way will the system of supplying local government units with transfers from the state budget be able to ensure compliance with the principle of adequacy of revenues to the scope of current expenses.

#### V. THE STRUCTURE OF MUNICIPALITIES' INCOME IN POLAND IN SELECTED YEARS OF THE PERIOD 2014 - 2022 AND THEIR IMPACT ON THE AMOUNT OF OPERATING SURPLUSES AND DEVELOPMENT ACTIVITIES

Tables 1-2 present the income structure of communes and cities with poviats rights in 2014-2022. These amounts are presented in zlotys, not percentages, to show the overlapping phenomena taking place during this period.

TABLE 1. THE STRUCTURE OF MUNICIPALITIES' INCOME IN 2014-2022 (IN PLN BILLION)

Type of income	2014	2015	2016	2017	2018	2019	2020	2021	2022
Total income	84.5	87.7	101.8	111.2	121.1	135.2	149.1	163.5	171.8
Own income	27.0	27.5	30.0	31.0	30.7	34.4	41.6	41.7	47.8
PIT and CIT	14.7	16.1	17.4	19.2	21.6	24.2	24.1	27.6	31.6
Subsidy	24.6	25.4	26.4	27.0	28.3	30.4	31.6	40.9	34.9
Targeted subsidies	18.2	18.7	28.0	34.0	40.5	46.2	51.8	53.3	57.5

Source: Own study based on GUS and RIO data

TABLE 2. REVENUE STRUCTURE OF CITIES WITH POWIAT RIGHTS IN 2014-2022 (IN PLN BILLION)

Type of income	2014	2015	2016	2017	2018	2019	2020	2021	2022
Total income	68.3	70.6	74.4	78.7	85.5	93.9	100.3	111.0	110.2
Own income	25.2	25.8	26.3	28.1	27.3	27.6	29.3	31.9	35.7
PIT and CIT	17.7	19.0	20.2	20.3	25.0	27.5	26.8	30.2	30.7
Subsidy	13.6	13.9	14.3	14.8	15.4	17.1	18.8	22.8	21.2
Targeted subsidies	11.8	11.9	13.6	15.5	17.8	21.7	25.4	25.3	22.6

Source: Own study based on GUS and RIO data.

In the years 2014-2022, the share of own revenues (together with PIT and CIT) in the structure of total revenues of both municipalities and cities with rights is decreasing. In the case of communes, within 8 years this share decreased from 50% to approximately 45%, and in the case of cities with poviats rights from 63% to 54%. These changes after 2019 were caused by the economic slowdown due to Covid, and after 2020 by the implementation of the Polish Economic Order.

The Polish Economic Order consists primarily in the reform of personal income tax, and in particular in the introduction of numerous tax reliefs. They concern a significant increase in the tax-free amount, a reduction of the tax rate in the first tax bracket by 5 percentage points, an increase in the first tax bracket from PLN 85,528 to PLN 120,000 thousand. PLN, introduction of relief for seniors, for families 500+, as well as relief for "young" taxpayers who are under 26 years of age. The changes introduced in 2021 in the lump sum tax on recorded income also contributed to an additional decline in PIT income. Until the end of 2020, the "lump sum" was a form of taxation for small entrepreneurs whose revenues did not exceed PLN 250,000. EUR per year, while in 2021 the revenue limit was increased to EUR 2 million. However, local government units do not have a share in this tax. Due to the fact that many business entities changed the form of taxation from general principles to "lump sum", the state budget gained additional revenues, and the local government lost income from shares in PIT.

In the analyzed period, the share of earmarked subsidies in the income structure of communes and cities with poviats rights increases (in the case of communes from 21% to 33% and in the case of cities with poviats rights from 18% to 21%). This was caused by an increase in the share of earmarked subsidies for the implementation of commissioned tasks, especially for the payment of 500+ benefits (currently 800+), starting from 2016. This resulted in the share of targeted subsidies in the income structure of municipalities increasing by over 10% and in the case of cities with poviats rights by over 3%.

The increase in targeted subsidies after 2016 was accompanied by a decline in operating surpluses. This is due to the fact that targeted subsidies for tasks commissioned in Poland do not cover 100% of the costs of implementing these tasks. Municipalities subsidize most of the commissioned tasks from their own revenues. This, in turn, limits the amount of operating surpluses and the development possibilities of local government units. The level of funds that can be allocated to servicing incurred liabilities is decreasing.

An additional reduction in operating surpluses is the failure to adjust the educational part of the general subsidy to the expenditure on financing education. The amount of subsidies in most local government units does not even cover the expenses for salaries and wage derivatives.

Tables 3 - 4 present the current income and current expenses of municipalities and cities with county rights in the years 2014-2022.

TABLE 3. OPERATING SURPLUSES OF MUNICIPALITIES IN POLAND IN 2014-2022 (IN PLN BILLION)

Municipalities	2014	2015	2016	2017	2018	2019	2020	2021	2022
Current income	78.2	84.2	100.9	106.0	111.4	123.8	133.6	145.0	156.9
Current expenses	69.6	71.5	87.2	95.6	100.9	112.4	122.4	129.5	143.5
Operating surplus	8.6	12.7	13.7	10.4	10.5	11.4	11.2	16.0	13.4

Source: Own study based on GUS and RIO data.

TABLE 4. OPERATING SURPLUSES OF CITIES WITH COUNTY RIGHTS IN POLAND IN 2014-2022 (IN PLN BILLION)

Municipal counties	2014	2015	2016	2017	2018	2019	2020	2021	2022
Current income	58.3	63.6	70.2	74.4	85.5	93.9	91.5	103.1	102.5
Current expenses	55.1	56.9	63.4	68.1	72.3	81.0	88.3	92.5	97.3
Operating surplus	3.2	6.7	6.8	6.3	13.2	12.9	3.2	10.6	5.2

Source: Own study based on GUS and RIO data.

In the years 2018-2022, in communes and cities with poviats rights, operating surpluses fluctuate, with a clear tendency to decrease, especially after 2019. In the case of communes, in the years 2014-2022, operating surpluses to current income amounted to approximately 10%. . 2015 was an exceptional year, when the operating surplus exceeded 15% of current income.

In the case of cities with county rights, large fluctuations in this respect can also be observed. For example, in 2015-2017 they amounted to approximately 10% of current income, in 2018-2019 they increased to 15%, and after 2019 they

decreased to approximately 5%. In the case of this group of local government units, this is not a favorable phenomenon due to their development needs. These are large cities with developed technical and social infrastructure that requires constant modernization and further investments. The lack of funds for debt servicing (this is the role of operating surpluses) makes it impossible to obtain returnable revenues. If the increase in investment expenditure is not accompanied by a proportional increase in operating surpluses, the indebtedness of local government units increases

Such a situation occurred in Polish local government in the

years 2007–2011, where within 6 years the liabilities of local government units increased from PLN 25.9 billion to PLN 65.8 billion, including cities with poviats rights from PLN 11.3 billion to PLN 28. PLN 1 billion (GUS, RIO) . Currently, this group of local government units (66 cities) is more indebted than all other municipalities.

Table 5 shows the amount of liabilities of communes and cities with county rights in Poland in 2014-2022.

The high debt of local government units is a significant reason for the decline in investment expenditures in communes and cities with county rights. For example, in 2011 the share of investments in the total expenditure of municipalities was 23% and in 2016 it dropped to 12.5%. In the case of cities with county rights, the decline was also large (from 21% in 2011 to 12% in 2016).

In the years 2017-2022, investment expenditure in the case of municipalities stabilized at the level of 16% and in cities with poviats rights at the level of 15%. This limitation is primarily due to the debt of this group of local government units, but also for political reasons related to the blocking of Poland's access to EU funds in connection with the policy pursued by the ruling authority regarding compliance with legislation in the years 2016-2023. This deprived Poland, including also local government units, access to EU funds.

In the years 2014-2022, communes and cities with district rights will stabilize their debt by limiting the taking out of credits and loans.

Tables 8 - 9 present credits and loans taken out and repaid by communes and cities with poviats rights in the years 2011–2018 (without free funds).

TABLE 5. LIABILITIES OF COMMUNES AND CITIES WITH COUNTY RIGHTS IN 2014-2022 (IN PLN BILLION)

Commitments	2014	2015	2016	2017	2018	2019	2020	2021	2022
Municipalities	26.4	25.4	23.9	24.8	30.1	32.4	34.2	34.2	34.1
Municipal counties	32.4	33.2	32.8	32.4	33.6	37.1	43.0	45.0	45.6

Source Own study based on data from the Central Statistical Office and the Central Statistical Office.

TABLE 8. CREDITS AND LOANS TAKEN OUT BY MUNICIPALITIES AND THEIR REPAYMENT IN 2014-2022 (PLN BILLION)

Municipalities	2014	2015	2016	2017	2018	2019	2020	2021	2022
Loans taken out	4.5	3.4	2.5	4.7	9.3	6.9	6.5	4.3	4.4
Repayment of loans	3.7	4.3	3.9	3.7	4.0	4.9	4.8	4.6	4.8

Source: Own study based on GUS and RIO data.

TABLE 9. CREDITS AND LOANS TAKEN OUT BY CITIES WITH DISTRICT RIGHTS AND THEIR REPAYMENT IN 2014-2022 (PLN BILLION)

Municipal counties	2014	2015	2016	2017	2018	2019	2020	2021	2022
Loans taken out	4.8	3.5	1.9	2.6	4.5	5.6	8.2	5.4	3.4
Repayment of loans	3.2	2.6	2.6	3.0	3.1	3.4	3.3	3.1	3.0

Source: Own study based on GUS and RIO data

The numerical data contained in tables 8 - 9 show that in the years 2014-2016, communes and cities with county rights pursue a very prudent investment policy, stabilizing their debt. In the case of communes in 2015-2016, and in cities with county rights in 2016-2017 - repayment of loans and redemption of securities were higher than loans taken out.

Since 2017, investment expenditure in local government budgets has started to increase again. In the case of municipalities, investment expenditure increased by over PLN 100 billion over the last 5 years, and in cities with county rights by approximately PLN 80 billion. The significant increase in investment expenditure after 2017 should be assessed positively, mainly due to the still large needs of local government in the development of municipal and social infrastructure.

## VI. CONCLUSION

The sources of income of local government should, first of all, be adapted to the scope of tasks performed. On the other hand, local government authorities should have an influence on conducting their own policies and deciding on the directions of development. In this case, the guarantee is your own income,

and in particular the ability to pursue your own tax policy. However, this carries certain risks, especially in the event of an economic downturn. Therefore, own revenues should not dominate in the structure of local government revenues.

In Poland, local government at the commune level is largely concerned with "administration" rather than deciding on the directions of its development. This means that tasks financed by targeted grants and educational subsidies constitute over 65% of total expenses.

This unfavorable situation can be counteracted by planning subsidies in the state budget to finance the development activities of municipalities. They would be an own contribution, enabling access to EU funds in the 2020-2026 perspective. Otherwise, during the period of economic recession, municipalities (especially large cities) will have major problems with maintaining and developing social and technical infrastructure. This will limit the quality of the services provided.

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