*Teka Komisji Prawniczej PAN Oddział w Lublinie, vol. XIV, 2021, no. 1, pp. 515-527*
*https://doi.org/10.32084/tekapr.2021.14.1-42*

# THE LAW REGULATIONS OF INDIVIDUAL DEBT RATIO IN THE TIME OF THE COVID-19 PANDEMIC

Dr. habil. Tomasz Wołowiec, University Professor
Institute of Public Administration and Business, Faculty of Administration and Social Sciences, University of Economy and Innovation in Lublin, Poland
e-mail: tomasz.wolowiec@wsei.lublin.pl; https://orcid.org/0000-0002-7688-4231

**Abstract.** The new rules governing debt limits were introduced in 2014 (Articles 242–244 of the Act on Public Finance) and immediately became a major difficulty in planning and managing local finances in territorial self-government units. The next four years proved many defects and inconveniences in implementing new norms, while "creativity" of the financial sector of local authority units demonstrated that they were quite easy to evade. The structure of the maximum ratio limiting obligations due to titles specified by the lawmaker, due in a particular year, is closely related to the provisions of the Act on Public Finance. For the first time it was used in evaluating the budgets passed for 2014. The essence of this legal regulation consists in comparing two ratios, presented in form of an equation (formula). In order to pass the budget local authorities need to obtain a relation in which the left side of the formula (annual debt repayment ratio) is lower than or equal to the right side (maximum debt repayment ratio). The ratio of the annual repayment ratio to the maximum repayment ratio (the debt repayment ratio) is presented in the debt forecast, which constitutes part of Long-Term Financial Forecast (LFF). This is justified by the requirement derived from APF that the board of a territorial self-government unit simultaneously present the draft of the budget and the draft of the resolution on LFF, and then both these documents are passed simultaneously.

**Keywords:** public finance act, public debt, individual debt ratio, public sector

## INTRODUCTION

Since 2020 every territorial self-government unit planning an amendment to the budget can exceed the relation specified in Article 242 of the Act on Public Finance[1] by the amount of planned deficit in income due to the COVID-19 pandemic.[2] This means that current expenditure can exceed current income by the expenses incurred when performing tasks related to prevention of COVID-19 in a part in which they were financed with own means. This relation concerns rules of limiting debt – at present planned expenditure cannot exceed planned current income increased by revenues from surpluses from previous years, repayment of loans granted in the past and unused cash on the current account. A similar overdraft of the budget was allowed at the end of the year, after the unit makes a bud-

---

[1] Act of 27 August 2009 on Public Finance, Journal of Laws of 2019, item 869 as amended [hereinafter: APF].
[2] Act of 2 March 2020 on specific solutions related to prevention, counteracting and fighting COVID-19, other infectious diseases and crisis situations they cause, Journal of Laws of 2020, item 374 [hereinafter: AC].

get report. The law clearly defines the deficit of income. This stands for decrease in income calculated as a difference between tax income of the unit, increased by the health resort and local fee and incomes showed by the unit in its financial report for the first quarter of 2020 planned in the budget amendment due to COVID-19. This decrease is decreased when the unit receives income supplement amounts from the general subvention reserve. The mitigation of the fiscal rule consists in excluding from the limitation concerning debt repayment specified in Article 243(1) APF (individual debt ratio) the amounts for buyout of securities, repayment of loan and credit installments together with due interest and discount, respectively issued or contracted in 2020 to the amount of the actual decrease in income of the unit resulting from COVID-19. These obligations, contracted in connection with decreased income, need an opinion of Regional Audit Chamber, concerning the possibility of their repayment and effect on performance of public tasks. The contraction of an obligation cannot threaten the performance of public tasks by a local self-government unit in a particular budget year and in the next years. In addition, when establishing – for 2021 and next years – the relation limiting the amount of debt repayment, the local authority will decrease current expenditure in its budget by detracting current expenditure incurred in 2020 for the performance of tasks related to fighting COVID-19. This solution widens the options local authorities have in debt repayment. Due to the necessity of maintaining financial security of a local authority unit, an additional mechanism was introduced, in the shape of a one-year limit of the local self-government debt at the level of 80% of the unit's income. The limit concerned only 2020, and as an exception it does not have to be achieved by units which observe the limitation concerning repayment of debt specified in Article 243(1) APF, not taking into account the exclusion specified in the Act on specific solutions related to prevention, counteracting and fighting COVID-19, other infectious diseases and crisis situations they cause on specific solutions related to prevention, counteracting and fighting COVID-19, other infectious diseases and crisis situations they cause [Wołowiec 2019].

## 1. METHODS AND METHODOLOGY

Legal sciences use typical methods found in the field of social sciences and humanities, i.e. examination of documents (legal acts and judgments of administrative courts), comparative methods (examination of expert opinions, legal opinions, analyzes resulting from linguistic, grammatical and historical interpretations) and case studies. New statements or theories are the result of cognitive research. On the other hand, the result of research for the purposes of economic practice is to determine whether and if the existing theories and theories regarding the functioning of the individual debt ratio are useful to support investment processes of local government units.

Induction was used as the main research method. It consists in drawing general conclusions or establishing regularities based on the analysis of empirically established phenomena and processes. It is a type of inference based on details about the general properties of a phenomenon or object. The use of this method requires the assumption that only facts can form the basis of scientific inference. These facts are real legal situations. Inductive methods include various types of legal acts, analyzes, expert opinions and scientific documents used in social research.

## 2. THE FINANCIAL SITUATION OF POLISH LOCAL AUTHORITIES IN 2013–2019

In 2019 the local self-government sector witnessed a dynamic growth of capital expenditure. This was due to the implementation of numerous projects co-financed with the European Union funds. Since there were many commercial projects implemented by construction companies, many investments planned by local authorities for 2018 were put off until 2019 or 2020.[3] In 2020 we can see a significant decrease in budgets of local authorities compared to 2019 as far as capital expenditure and total amount of new debt are concerned. This is the result of formal requirements related to creating planning documents in self-government units. Another problem (burden) is the education subvention received by self-government units, which allowed in 2019 to cover, on average, only 60% of expenses on education (there are no signs that in 2020 the funds for education will be increased). It is also worth emphasizing that some of incurred and planned costs resulted from the implemented reform of the education system. The growing disproportion shows that the costs of financing the reform were shifted to the municipalities, which is particularly visible in municipalities with the smallest budgets. Another challenge faced by some self-government units is the necessity to settle obligations contracted in the current year, related mostly to the implementation of numerous capital investments. Since 2013 we have been observing the improving terms of debt repayments for units of all levels. In 2013 the average period of debt repayment, assuming that local authorities allocate their whole operational surplus, was 4.8 years. In 2017 the value of this ratio fell to 3.25 years. Taking into account the acceleration of the implementation of expenses co-financed with the EU funds, a significant growth of debt was planned for 2019–2023. The value of the analyzed ratio will increase to 6.61 years due to this reason.[4]

Current income of self-government units grew from PLN 163 billion in 2013 to PLN 239.5 billion in 2019, which shows that the compound annual growth rate CAGR[5] reached 5.64%. The difference between current income and current expe-

---

[3] See *Raport roczny 2019 (syntetyczny skrót analizy). Sytuacja finansowa jednostek samorządu terytorialnego*. Raport INC Rating Sp. z o.o. i Związku Banków Polskich, Poznań 2019, p. 4–10.
[4] Ibid.
[5] CAGR is the average annual growth rate, or put differently, compound annual growth rate. It is a measure which reflects the average annual growth of a particular value, over a given period. The

nditure (operational margin) ranged from 5.47% to 10.35% of current income, reaching the average value of 9.17% for the period. It should be noted that the lowest value was in 2019, the year which is still burdened with the requirement of careful planning. The lowest actually achieved average value was 8.79% from 2013. Total debt of all self-government units in 2013–2019 grew from PLN 69.2 billion to PLN 86.6 billion and at the end of 2019 accounted for approximately 36.15% of their current income. Since 2013 the average annual debt repayment level was PLN 9.5 billion. The decreasing operational surplus that we saw in 2019 results from careful planning in the 3rd quarter, but on the other hand, changes in the personal income tax and growing financial burden connected with financing education and the statutory rise of salaries led to difficulties in generating own capital for further investments. From the point of view of the banking sector it might, therefore, be necessary to change the repayment schedules which are offered as a standard to local authorities, from 8–12 years to 15–20 years, for debt contracted in 2020–2023. There is no doubt that in 2013–2018 the operational surplus was quite a stable item, showing some growth trends and that plans included in Long-Term Financial Forecasts (LFF) were often formulated too optimistically.

To conclude: the most important sources of income for self-government units are general subventions from the country budget and share in personal income tax. Both these sources accounted for 63% of average income local authorities had in 2013–2018. Local taxes, purpose subsidies for commissioned tasks and subsidies for investment tasks along with share in corporate income tax accounted for over 78% of average income in the analyzed period. In 2014 and in 2018–2019 local authorities' obligations were growing, which was connected with the noticeable investment cycle related to obtaining funds from the EU. In 2015–2017 debt decreased. The real picture, reflecting indirect obligations, not included in reports (concerning debt of related companies or contracts of support[6]) shows much greater dynamics of obligations in the self-government sector. This is a negative signal, and at present the average growth rate equals 5%, exceeding average GDP in the analyzed period (4.3%).

---

Polish name of this method is not very accurate. It does not reflect the essence of CAGR, which stems from applying the theory of the value of money in time, and more precisely, the principle of compound interest. The formula used for calculating the compound annual growth rate is presented in a number of ways. Regardless of the presentation, CAGR is calculated in each case in a very similar way. Possible differences in calculation are due to the choice of data, not due to the fact that in specific cases a different formula is used.

[6] Non-standard financial operations – other than credit, bank loan, issuance of bonds – operations aimed at obtaining external returnable financing are especially: lease-back, reverse sale, payment in installments, forfaiting, factoring and restructuring operations (subrogation, assignment of liabilities, debt restructuring contract, agreement on debt). Non-standard operations generating debt are in particular: lease-back contracts, reverse real estate sale contracts, liabilities assignment contracts, subrogation contracts, forfaiting contracts, payment in installments. See Supreme Chamber of Control, information on results of control number 25/2016/P/15/014/KBF, 2016; Gonet 2011.

Budgets of municipalities. Current incomes of communes in 2013–2019 grew from PLN 73.61 billion in 2013 to PLN 115.24 billion in 2019, which means that the compound annual growth rate (CAGR)[7] was at the level of 7.8%. The operational margin ranged from 5.16% to 10.89%, with average value of 9.51% for the period. The lowest value was burdened with reserves and careful planning in 2019 – excluding the current year the lowest value was reached in 2017 – 9.68%. Tax income of municipalities accounted for 34.2% to 39.5% of current income. On average 47.9% of tax income was local tax. The most important elements in municipality income were current transfers and income from personal income tax (66% of average income that municipalities had in 2013–2019). Total debt of municipalities in 2014–2017 was falling (to the level of PLN 23.9 billion in 2016), but in 2018 it grew to the level of PLN 30.1 billion and in 2019 – PLN 34.8 billion. The ratio of direct debt to own income fell from 68.67% in 2013 to 62.3% in 2019 (58.5% in 2018). Expenditure on servicing direct debt in 2019 accounted for 9.25% of own income and were 4% higher than in 2018. The average cost of debt for municipalities in 2019 was 3.0%.

Budgets of cities with district rights. Current income of cities with district rights grew from PLN 56.69 billion in 2013 to PLN 83.05 billion in 2019, which means that the compound annual growth rate (CAGR) was at the level of 6.57%. The operational margin ranged from 4.17% to 9.32%, with average value of 7.97% for the period. Tax income of cities with district rights accounted for 43.51% to 45.60% of their current income. On average 32.42% of tax income was from local taxes. Total debt of cities with district rights in 2013–2019 was PLN 33.2 billion, reaching the level of 43% of current income. A significant increase of PLN 5 billion is planned in 2020. Expenditure on servicing direct debt in 2019 accounted for 8.20% of own income and was 5% lower than in 2013. The average cost of debt for cities with district rights in 2019 was 3.03%.

Budgets of districts. Current income of districts grew from PLN 21.32 billion in 2013 to PLN 26.5 billion in 2019, with compound annual growth rate (CAGR) of 3.7%. The operational margin oscillated from 5.29% to 9.23%, with average value of 7.42% for the analyzed period. Tax incomes of districts accounted for 17.2% to 23.3% of their current income and has demonstrated a growing trend. Total debt of districts in 2013–2019 grew from PLN 5.6 billion in 2015 to PLN 6.5 billion in 2018. In 2019 we observed a slight increase to the value of PLN 6.8 billion. This accounts for 25.6% of planned current income. The ratio of total debt to own income was decreasing from the level of 90.06% in 2013 to 67.45% in 2019. Expenditure on servicing direct debt in 2019 was 12.6 of own income and was 2.5% higher than in 2018. Average cost of district debt in 2019 was 3.15%.

[7] Compound Annual Growth rate (CAGR) – an indicator used in calculating average annual growth of some value over a given period, for example average growth of profits, capital value or level of employment in an enterprise in a period of time divided into years. When calculating the value of growth using the CAGR model we assume that average annual growths in an analyzed period are added to the base value in the next year.

Budgets of province self-governments**.** Current income of provinces in the analyzed period increased from PLN 11.55 billion in 2013 to PLN 14.68 billion in 2019 – compound annual growth rate (CAGR) reached 4.08%. Operational margin was between 13.1% and 22.50%, with average value of 16.98% for the period. Tax income provinces obtained ranged from 44.3% to 57.51% of current income. Average capital expenditure was 37.27% of total expenditure (the biggest share of all self-government units). Therefore we can describe budgets of province authorities as flow-investment ones. The most important elements of province income were the money from corporate income tax, current transfers, subsidies for investment tasks and money from personal income tax. Total debt of provinces in 2013–2019 grew from PLN 6.6 billion to PLN 7 billion in 2019, which accounts for 47.65% of current income (the highest percentage of all self-government units). The ratio of total debt to own income fell from 110.99% in 2013 to 77.31% in 2019. Expenditure on servicing direct dent in 2019 reached 15.23% of own income. The average cost of province debt is 2.6%.

A major and quantifiable threat to the finances of self-government units (including the calculation of Individual Debt Ratio – problem with own income) can be seen in amendments to the Act on Personal Income Tax, which generate the decline of own income for the whole sector of public finance at the level of PLN 13.3 billion annually, with self-government units losing as much as PLN 6.6 billion. Lowering tax progression in personal income tax from 18% to 17% will result in annual loss of PLN 7.3 billion in income of the whole sector of public finance. The total share of all levels of self-government in personal income tax is 49.93%. This means that local authorities in Poland will experience a decrease of PLN 3.6 billion in their income. Moreover, increased costs of obtaining revenue will result in lower income of the whole sector of public finance obtained from personal income tax. The loss will equal PLN 3.9 billion. The total share of all levels of self-government in personal income tax is 49.93% (the loss of income in self-government units in Poland will reach PLN 2.0 billion). Additionally, exempting persons under 26 from the income tax obligation will generate an annual loss of PLN 2.1 billion. The total share of all levels of self-government in personal income tax is 49.93%, therefore the income of self-government units will decrease by PLN 1.0 billion.

## 3. LAW REGULATIONS OF OPERATIONAL SURPLUS AND ITS CRITICISM

In 2014 the lawmakers introduced a structure limiting the level of repayment of financial obligations, expressed in Article 243 APF, thus abandoning the fixed ratio formula which had been used by self-government units for many years. The current formula establishes the limit of repayments that can be planned in the budget year, for obligations indicated in Article 243 APF. The lawmakers based it on the category of operational surplus, which – in their opinion – honestly characterizes the financial situation of a self-government unit. In order to obtain greater reliability of the result, the lawmakers decided that when calculating the self-government unit's ability to repay debt (maximum repayment ratio) data is taken for a few years preceding the budget year for which we determine the maximum repayment ratio. For relations determined for 2019–2025 this is a three-year period, and for those for 2026 and the next years financial values will be related to seven previous budget years (2019–2025). It should be remembered that in the relation specified in Article 243(1) APF the lawmakers excluded the possibility of adding to current income in a given year revenues from previous years (for example due to budget surplus), which is contrary to the solution adopted in Article 242 APF. Therefore it is possible that the passed budget will maintain the relation described in Article 242 APF, but the annual value of the ratio used in calculating the maximum repayment ratio will be negative [Wołowiec 2020, 25–40].

**The current regulations – the formula**

According to the current valid regulation, included in Article 243(1) APF, the decision-making body of the self-government unit cannot pass the budget whose execution will cause that in the budget year and in each year following the budget year the relation of total amount due in the budget year of: 1) repayment of installments of credits and loans specified in Article 89(1)(2–4) and Article 90 APF, along with interests on credits and loans due in a given year, as specified in Article 89(1) and Article 90 APF; 2) buyout of securities issued for purposes specified in Article 89(1)(2–4) and Article 90 APF, along with due interests and discount on securities issued for purposes specified in Article 89(1) and Article 90 APF; 3) potential repayment of amounts resulting from granted guaranties and warranties to planned total budget income will exceed an arithmetic mean from calculated for the past three years relations of its current income increased by income from sale of assets and decreased by current expenditure, to total budget income, calculated according to the following formula:

$$\left(\frac{R+O}{D}\right)_n \leq \frac{1}{3} \times \left(\frac{Db_{n-1}+Sm_{n-1}-Wb_{n-1}}{D_{n-1}} + \frac{Db_{n-2}+Sm_{n-2}-Wb_{n-2}}{D_{n-2}} + \frac{Db_{n-3}+Sm_{n-3}-Wb_{n-3}}{D_{n-3}}\right)$$

where:

**R** – planned for a budget year total amount for repayment of credit and loan installments, specified in Article 89(1)(2–4) and Article 90 APF, and buyout of securities issued for purposes determined in Article 89(1)(2–4) and Article 90 APF.

**O** – planned for a budget year interest on credit and loans specified in Article 89(1) and Article 90 APF, interest and discount on securities issued for purposes specified in Article 89(1) and Article 90 APF, and repayments of amounts due to guarantees and warranties.

**D** – total income of the budget in a given budget year.

**Db** – current income.

**Sm** – income from selling capital (assets).

**Wb** – current expenditure.

**n** – budget year for which the relation is determined.
**n – 1** – year preceding the budget year for which the relation is established.
**n – 2** – year preceding the budget year by 2 years.
**n – 3** – year preceding the budget year by 3 years.

The relation expressed in Article 243(1) APF assumes that we compare two values – annual debt repayment ratio (left side of the equation) and maximum debt repayment ratio (right side of the equation). Debt repayment covers both expenses and disbursements. The latter include: repayment of credit, loans and buy-out of bonds, expenditure comprises payment of interest and discount on the above obligations and additionally interest and discount on credit, loans and securities which finance the transitional budget deficit of self-government units. Credit, loans and securities as money claims are debt titles. Potential expenses due to guaranties and warranties granted by self-government units are different, because these obligations do not constitute a component of state public debt, but, as intended by the lawmakers, they are reflected in the subject relation on the left side. Expenses due to guaranties and warranties granted by self-government units must be included in the plan of current expenditure in the budget resolution, according to Article 122(1)(7) APF. It should be remembered that budget planning does not comprise the whole amount that was covered with guaranty or warranty, but only expenses to be paid in a given budget year, as in the concluded contract. If the contract of the credit (loan) guaranteed by the self-government unit stipulates that in the situation when the client stops repaying their debt, the sum of unpaid credit or loan becomes due immediately and the self-government unit should secure in its budget the whole amount of guarantee (in the plan of expenditure). This amount of guarantee must be taken into consideration when calculating annual debt repayment ratio [Walczak 2019].

## 4. CHANGES IN THE SCOPE OF THE MAXIMUM DEBT REPAYMENT RATIO SINCE 2020 – THE FORMULA MODIFICATION

Beginning with budgets and LFF passed for 2020 the maximum debt repayment rate forecasted for 2026 and further years will be established as arithmetic mean (from the past 7 years) from the calculated relation of its current income (Dbei), decreased by current expenses (Wbei) to the current income of the budget. In addition to prolonging the period for which the arithmetic mean is determined (from 3 to 7 years), the lawmakers modified the formula by eliminating income from sales of property and total income replaced the category of current income (as well as on the left side). Moreover, all parameters on the right side of the relation are subject to the following modifications [Wołowiec 2018, 129–40]: 1) the amount of current income – Dbi (the denominator of the formula on the right side of the relation) – to which the difference between current income and current expenditure is referred, is subject to decrease by subsidies and means allocated to current goals (the amount of current income defined in this way is used in calculation, beginning from 2020); 2) the amount of current income decreased by current expenditure – Dbei (the numerator of the formula on the right side of the relation) – is decreased by subsidies and current means for implementation of a program, project or task financed with participation of means specified in Article 5(1)(2) APF (the amount of current income defined in this way is used in calculation, beginning from 2020); 3) the amount of current expenditure – Wbei (the numerator of the formula on the right side of the relation) – is decreased by: current expenses due to repayment of obligations contracted in connection with the debt title, other than credits and loans (Article 243(2)(3a) APF), current expenditure on servicing debt and current expenditure on implementation of a program, project or task financed with participation of means specified in Article 5(1)(2) APF. The amount of current income defined in this way is used in calculation, beginning from 2020, but decreasing current expenditure by amounts of current expenditure due to repayment of installments of obligations included in the debt title, other than credits and loans, concerns exclusively obligations contracted after 1st January 2019. The amounts of current expenditure when calculating the relation for 2020–2025 is not decreased by current expenditure on servicing debt (decreasing by current expenses on servicing debt will take place when determining the relation beginning from 2026).

When preparing LFF for 2020 and the next years, each self-government unit must establish the relation of the repayment of obligations applying two methodologies. According to the content of Article 9(1) APF, for the 2020–2025 period the determined relation of total amount of repayments and buyouts due in a given budget year to planned current budget income cannot exceed the arithmetic means for the relations between current income, increased by income from sale of property and decreased by current expenditure to current income of the budget, calculated for the past 3 years.

Therefore, it should be emphasized that ultimately self-government units will determine the relation of the repayment of obligations following the formula below:

$$\frac{(R+O)}{Db} \leq \frac{1}{7} \times \sum_{i=1}^{7} \frac{(Dbei - Wbei)}{Dbi}$$

where:

**R** – planned for a budget year total amount for repayment of installments of obligations included in the debt title, as specified in Article 72(1)(2) APF, and buyouts of issued securities, excluding amounts of repayment of credits and loans and buyouts of securities contracted or issued for the purpose specified in Article 89(1)(1) APF and obligations defined in Article 91(3)(1) APF.

**O** – planned for a budget year current expenditure on servicing debt, including interest on obligations included in the debt title, as specified in Article 72(1)(2) APF, interest and discount on securities and repayment of the amounts resulting from granted guaranties and warranties.

**Db** – planned for the year for which the relation is determined, current income of the budget, decreased by subsidies and means allocated to current goals.

**Dbei** – current income in the year preceding by i-years the year for which the relation is determined, decreased by subsidies and current means for the implementation of a program, project or task financed with participation of the means specified in Article 5(1)(2) APF.

**Dbi** – current income in a year preceding by i-years the year for which the relation is determined, decreased by subsidies and means allocated to current goals.

**Wbei** – current expenditure in a year preceding by i-years the year for which the relation is determined, decreased by current expenditure due to repayment of the installments of obligations included in the debt title, as specified in Article 72(1)(2) APF, current expenditure on servicing debt and current expenditure on the implementation of a program, project or task financed with participation of means defined in Article 5(1)(2) APF.

When designing the budget for 2020 and LFF for 2020 and the next years we need to establish the relation of the repayment of obligations using two methodologies. According to the content of Article 9(1) APF, for the 2020–2025 period the determined relation of total amount of repayments and buyouts specified in Article 243(1) APF in the wording given in the amended APF, to planned current budget income cannot exceed the arithmetic means for the relations between current income, increased by income from sale of property and decreased by current expenditure to current income of the budget. This means that: 1) the amount of repayments (left side of the relation) does not include the amounts connected with repayment of installments and servicing other obligations classified as credit and loans on the basis of Article 72(1a) APF if these obligations were contracted before the implementation of the new provisions (from 1st January 2019); 2) the amount of current income, to which the amount of repayments is referred (the annual repayment rate – left side of the relation) will be decreased by the amounts of subsidies and means for current goals; 3) the amount of current income (the denominator of the formula on the right side of the relation), to which the result of the calculation from the numerator (Dbei – Wbei) is referred, will be decreased by the amounts of subsidies and means for current goals; 4) the amount of current income, increased by the amount of income from selling property, from which the amount of current expenditure is deducted (the numerator of the formula on the right side of the relation) will be decreased by the amounts of subsidies and current means for the implementation of a program, project or task financed with means specified in Article 5(1)(2) APF; 5) the amount of current expenditure deducted from the amount of current income, increased by the amount of income from selling property (the numerator of the formula on the right side of the relation), will be decreased by: a) current expenditure on the implementation of a program, project, or task financed with the means specified in Article 5(1)(2) APF, b) current expenditure due to repayment of installments classified as credit and loans, as far as they are obligations contracted after the implementation of the Act on Public Finance; 6) for the year preceding the budget year for which the relation is determined, we adopt the planned values shown in the report for three quarters on the execution of the budget of a self-government unit, and after the annual report is made – the values for this year, provided that in order to calculate the relations for the previous two years we adopt the values obtained, as given in the annual reports.

When determining the relation of repayment of obligations for 2020–2025, self-government units still use budget values for three years preceding the budget year for which the relation is determined. Moreover, in the formula, on the right side (the numerator) income from property is still reflected. Starting from 2020, when determining the relation of repayment of obligations for 2026 and the next years, self-government units will use a completely new method of calculating this relation, in the subject relation (on the left and right sides) there will also be amounts related to other obligations classified as credit and loans on the basis of Article 72(1a) APF only as far as the obligations contracted after the implementtation of the APF are concerned (since 1st January 2019). At the same time, provisions concerning exemptions from limiting repayment of debts (Article 243(3) and (3a) APF) will remain unchanged.

## CONCLUSIONS

According to Article 31, when determining the relation limiting the amount of debt repayment in 2020–2025, current expenditure of the self-government unit's budget will be decreased by current expenditure on servicing the debt. The adoption of this solution is connected with increasing the possibilities of contracting and repayment of obligations by local authorities. However, it seems that this change will not result in significant support for finances of self-government units and increasing financial potential of municipalities. This is because only current expenditure on servicing debt is exempted. This will, in most cases, be interest on credit and loans. A more effective solution for 'loosening' the individual debt ratio seems to lie in excluding – while determining this ratio – the amounts resulting from repayment of installments of the credit and loans contracted by self-government units or repayment of installments of other obligations of self-government units classified as debt titles, which were contracted out of the necessity to finance activities aimed at counteracting COVID-19.

Therefore it is possible to make an earlier repayment of the debt if the local authorities have financial means from repayment of a loan granted earlier, free cash, income from privatization or surplus from previous years. The Act states that we can exclude from the ratio only earlier repayments, that is repayments which have been originally planned for the future budget years. Repayments planned for the budget year must meet the limitation requirement.

It is possible to restructure the debt, that is to replace one debt with the new one, provided the costs of the new debt are lower than the costs of the restructured debt. The biggest disadvantage of the ratio specified in Article 243 APF has been eliminated since 2020. Now the creditworthiness is calculated as an arithmetic mean of three annual ratios, which are made up from sums of current surplus and sale of property related to total income. This structure accounts for the fact that the higher property subsidies (an element of total income, which is the denominator of the fraction), the lower creditworthiness (that is the value of the percentage constituting the allowable repayment in a particular year). This is in spite of the fact that subsidies should not in any way affect creditworthiness of self-government units. Beginning with budgets for 2020, the right side of the formula is calculated as average from 3 last years of annual ratios, which constitute a ratio of the sum of current surplus and sale of property to current income for a given year, decreased by current subsidies from the EU. In addition, current surplus in the numerator of this fraction will be corrected to reflect both income and expenditure due to current subsidies of the EU. After this change, EU subsidies (both current and capital ones) will have no influence on creditworthiness. The left side of the formula is calculated as a relation to current income decreased by current subsidies from the EU.

In 2020–2025 the sum of current surplus and property sale will be referred to current income. In 2022 a significant amendment will be made in Article 242 APF – so far the requirement of this Article that current income should be higher than or equal to current expenditure could be met by adding any free means at the disposal of the self-government unit. Free means, according to the Act, denote means from credit that were contracted earlier and have not been spent.

In 2026 major changes will take place. Firstly, the period on the basis of which the average operational surplus is calculated, will be prolonged to 7 years, while the arithmetic mean will be replaced with weighted mean, secondly, the numerator on the right side will be deprived of capital income from selling property and expenditure on servicing debt will be excluded from current expenditure on the right. Since 2026 the ratio will be calculated on the basis of weighted mean from the past 7 years, while the first 4 years will have the weight of 40% and the last three – 60%. Budget results for 2019 will be entered into the ratio for 2026 with the weight of 6%, and the consecutive ones with weights of 9%, 11%, 14%, 17%, 20% and 23%.[8]

Taking into account the needs of self-government units and the anticipated effects of the pandemic, it seems necessary to pass further legislative changes. Lawmakers should consider modifying the method of determining the individual debt ratio of self-government units. What is needed in this scope is to exclude those debt titles which increase the individual debt ratio of self-government units, contracted in order to finance the deficit caused by expenditure caused by the virus or expenditure for which there are no means in the budget due to the virus. The necessity to contract further debt obligations is connected, *inter alia*, with lower income from personal tax. Municipalities have lower incomes also due to the activities taken with the aim of supporting local entrepreneurs, for example, redemption of real estate tax or rents.

The current structure of the ratio does not fully meet the challenges posed by current problems. Many municipalities will not have the possibility of contracting a new credit or another debt obligation. It seems that these obligations should be temporarily neutral for Individual Debt ratio (IDR), firstly, due to specific circumstances and role of municipalities in fighting the effects of the epidemic, and

[8] Quoted after Gołaszewski 2018, 57–58.

secondly, due to the purpose for which they are contracted. This postulate could be fulfilled as in the content of Article 243a APF, according to which revenue bonds are not included in the calculation of IDR.

It also seems necessary to implement changes in income of self-government units by increasing it (especially as far as vertical transfers from the state budget are concerned). The problem of insufficient financing of public tasks could be partially relieved by increasing the share of transfers from the state budget (for example general subventions) in self-government unit's income, especially in these areas of expenditure which require specific financing (for example education – by increasing the education part of the general subvention).

It seems that it would also be helpful to create a complex system of refinancing the already contracted obligations in order to finance the deficit of self-government units. Such a system could be created by state financial institutions (state-owned corporate bodies, funds which have capital ties with the Treasury, BGK, etc.).

## REFERENCES

Gołaszewski, Marek. 2018. "Nowe reguły limitacji zadłużenia. Rewolucja czy ewolucja?" *Wspólnota* 11:6–13.

Gonet, Wojciech. 2011. *Zakres swobody zawierania umów przez jednostki samorządu terytorialnego*. Warsaw: LEX.

Walczak, Piotr. 2019. *Zmiany w finansach publicznych 2019*. Warsaw: C.H. Beck. Legalis.

Wołowiec, Tomasz. 2018. "Pozabankowe finansowanie inwestycji gminnych." *International Journal of Legal Studies* 2 (4):129–40.

Wołowiec, Tomasz. 2019. "Legal conditions for the financing of local government units investments by parabanking financial instruments in Poland." *International Journal of New Economics and Social Sciences* 1 (9):45–54.

Wołowiec, Tomasz. 2020. "Modyfikacja indywidualnego wskaźnika zadłużenia od 1 stycznia 2019 r. a reguły limitacji zadłużenia jednostek samorządu terytorialnego." *Finanse Komunalne* 2:25–40.