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## POLISH LOCAL GOVERNMENT DEBT REFINANCE\*

### I. INTRODUCTION

It would be difficult to disagree with the view that an economy without access to debt instruments is a fiction.<sup>1</sup> The use of such instruments by public authorities opens up new opportunities, but it can create serious economic and social problems.

Over-indebtedness is among the interests of the most eminent contemporary economists. According to Elżbieta Mączyńska one of the most severe dysfunctions of the contemporary economy is the risk resulting from over-indebtedness.<sup>2</sup> Robert J. Shiller points out that over-indebtedness, which is a situation in which the relation of the debt to one's own resources becomes too high, may even disable any positive action. Over-indebtedness is referred to as debt overhang.<sup>3</sup> Jerzy Hausner also warns that without a long-term development perspective, it is easy to fall into the trap—just as everyone does if he becomes overly indebted by financing his activities from transitional funds.<sup>4</sup> The causes of over-indebtedness and deficit have different reasons but their common denominator is the lack of moderation in spending in relation to income.<sup>5</sup>

A long-term analysis of the budgetary balances of developed market economies indicates that a deficit and the public debts resulting from it are a permanent feature of the financial structure of the economy.<sup>6</sup> Budget deficits, which are one of the tools of State interventionism, have led to a significant

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<sup>1</sup> M. Poniatowicz et al., *Efektywne zarządzanie długiem w jednostce samorządu terytorialnego*, Warszawa: Oficyna Wolters Kluwer business, 2010: 11.

<sup>2</sup> E. Mączyńska, Wybrane globalne i makroekonomiczne czynniki kształtujące w Polsce dochodzenie praw z umów, *Biuletyn PTE* 2015, no. 1(68): 21.

<sup>3</sup> R.J. Shiller, *Finance and the Good Society*, Princeton: Princeton University Press, 2012: 151–159.

<sup>4</sup> M. Słodowa-Hełpa, *Rozwój zintegrowany. Warunki, wymiary, wyzwania*, Warszawa: CeDeWu, 2013: 202.

<sup>5</sup> J. Pach, Umiar w finansach publicznych w świetle kryteriów budżetowych z Maastricht, in: J. Pach et al. (eds.), *Ekonomia umiaru. Realna perspektywa? Nowy paradygmat Grzegorza W. Kołodki*, Warszawa: PWN, 2016: 168.

<sup>6</sup> S. Owsiak, *Finanse*, Warszawa: Polskie WE, 2015: 320.

increase in public debt. This leads in turn, in the future, to a necessity to allocate public funds to its repayment or to take out another debt. The latter is referred to as rollover of debt, which may end up with a risk of falling into the debt trap.<sup>7</sup>

The authors of the report 'The State and Us. Eight deadly sins of the Republic of Poland' noted this problem and pointed out that any economic slowdown, which is unavoidable in the market economy, leads to a rapid increase in the indebtedness level, and after each subsequent slowdown its volume remains at a much higher level and is impossible to reduce noticeably. This may lead to a situation where Poland falls into the debt trap, which may even threaten its solvency.<sup>8</sup>

Although the nature of local government debt and the reasons for its emergence are significantly different from national debt, the problem also concerns indebtedness at regional and local levels. This debt is inextricably linked to development processes and is primarily an effect of increased investment effort resulting from the absorption of aid funds.<sup>9</sup> And yet, issues concerning debt refinancing (commonly known as debt roll-over) apply at regional and local levels as well.

The choice of the topic of local government debt refinancing has been determined by the author's conviction that this issue is insufficiently covered in the relevant literature, or frequently underestimated in relation to debt at the local and regional level, and that there are significant gaps in this field of research.

The aims of this paper are both cognitive and application-oriented. The author's intention was to systematise information on the refinancing of public debt, especially local government debt, to study the scale of this phenomenon in Polish municipalities, and on this basis to present proposals for supplementing the indicators assessing the financial condition of local governments with indicators that take into account the phenomena analysed.

The structure of this study was subordinated to the objectives outlined above. The concept of the refinancing of debt, with reference to local government debt, is presented against the background of difficulties in measuring public debt. Issues related to debt restructuring, sometimes confused with its refinancing, have also been highlighted. Further in the study, the scale of the refinancing of Polish municipalities between 2003 and 2015 is presented, along with proposals for indicators of this phenomenon. The summary provides the main conclusions and identifies the issues that require further research.

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<sup>7</sup> Ibidem: 83.

<sup>8</sup> J. Hausner, S. Mazur (eds.), *Państwo i My. Osiem grzechów głównych Rzeczypospolitej*, Kraków: Fundacja Gospodarki i Administracji Publicznej, 2015: 71.

<sup>9</sup> In each subsequent year between 2007 and 2012 local government investments exceeded 50% of the investment spending of the Polish public sector. Cf. K.S. Cichocki, *Zarządzanie finansami i długiem samorządu terytorialnego w perspektywie wieloletniej*, Warszawa: PAN, IBN, 2013: 15.

## II. DIFFICULTIES RELATED TO THE MEASUREMENT OF PUBLIC DEBT

When analysing public debt issues, it should be borne in mind that a significant part of this debt does not appear in public statistics. There are two main reasons for this. One is that under the current legal regime, only the liabilities of public finance entities are recognised as public debt. Obligations of entities which are not part of the sector, even if fully owned by public entities, do not constitute public debt. Such an interpretation is grounded in the literal wording of Article 72 of the Act on public finance (AoP)<sup>10</sup> as well as the secondary regulation issued based on this Act.<sup>11</sup> The other reason is that entities in the public finance sector make use of repayable liabilities which, sometimes rightly and sometimes wrongly, are not classified as public debt.

Wojciech Gonet points out that the actual public debt consists of the official debt and the remaining debt, and the latter is greater in the local than in the government sector.<sup>12</sup> The frequent attempts to circumvent the statutory restrictions by using unnamed contracts that produce economic effects similar to a loan or credit agreement prompted the Minister of Finance to issue a regulation in September 2010 on the detailed classification of debt classified as State public debt, including Treasury debt, in order to eliminate attempts to circumvent the applicable law.<sup>13</sup> This problem is still topical as shown, among others, by the results of the audit conducted by regional clearing houses.<sup>14</sup> The methods of circumventing the statutory regulations on the use of repayable liabilities include in particular: equity financing, repayable sale, leaseback, hire purchase and subrogation. It should be added that the changing environment gives rise to completely new doubts. It is enough to mention, for example, the recording of liabilities arising from the issuance of income bonds by local government units in the event that the issuer's liability is not limited exclusively to certain revenues and assets.<sup>15</sup>

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<sup>10</sup> Act of 27 August 2009 on Public Finance, Journal of Laws of the Republic of Poland [JL RP] 2016, item 1870 as later amended (hereinafter referred to as the AoPF).

<sup>11</sup> Ordinance of the Minister of Finance of 28 December 2011 on the detailed manner of classifying debts accounted as State's public debts, JL RP No. 298, item 1767.

<sup>12</sup> W. Gonet, Zapis dyskusji panelowej na temat „Pożądane kierunki i scenariusze naprawy finansów publicznych w Polsce”, in: J. Szolno-Koguc, A. Pomorska (eds.), *Ekonomiczne i prawne uwarunkowania i bariery redukcji deficytu i długu publicznego*, Warszawa: Wolters Kluwer business, 2011: 39.

<sup>13</sup> For more on this see: M. Bitner, M. Kulesza, Nowa definicja państwowego długu publicznego? Problemy związane z interpretacją przepisów rozporządzenia Ministra Finansów z 23.12.2010 r. w sprawie szczegółowego sposobu klasyfikacji tytułów dłużnych zaliczanych do państwowego długu publicznego, w tym do długu Skarbu Państwa, *Samorząd Terytorialny* 21(7–8), 2011: 15–30; W. Miemieć, Kategoria kredytu i pożyczki jako tytułów zaliczanych do państwowego długu publicznego w ustawie o finansach publicznych i w rozporządzeniu wydanym na jej podstawie, in: J. Szolno-Koguc, A. Pomorska (eds.), op. cit.: 183–196.

<sup>14</sup> T. Zółcik, *Kreatywna księgowość kwitnie w samorządach. Nowe reguły zadłużania się nie zdają egzaminu*. 2016 <serwis.gazeta.prawna.pl/samorząd.artyki/925758.html> [accessed 22 February 2017].

<sup>15</sup> M. Wiśniewski, Obligacje podporządkowane, wieczyste i przychodowe w Polsce—próba oceny ekonomicznych skutków nowelizacji ustawy o obligacjach, *Ruch Prawniczy, Ekonomiczny i Socjologiczny* 77(1), 2016: 192.

In recent years, public debt related to units of local government (herein-after referred to as ULG) has consisted predominantly of liabilities of these units and their associations, which accounted for over 95% of the total debt payable by ULGs. A large portion of this debt (but the bad news is that it is feared that nobody knows how large<sup>16</sup>) connected with local government-run hospitals, has been transferred by special purpose units outside the public finance sector.<sup>17</sup> One should also remember debts related to territorial self-government units which do not constitute public debt. These debts constitute municipal companies' debt. Under the current legal regulations, the allowable level of debt of municipal companies is not limited by statute and attempts to determine its size or structure are clearly hindered. There are no reliable data either regarding these obligations. Although certain estimates can be found,<sup>18</sup> the actual size or extent of municipal companies' debt is not known, and there are concerns that the volume of that debt is constantly growing. Additionally, the more stringent regulations regarding local governments debt that have been on the increase recently may only lead to a situation where territorial self-government units will be transferring their debt to municipal companies,<sup>19</sup> and as a result this debt will be excluded from the official statistics. While no regulation at all in this respect constitutes a serious threat for the financial security of self-governing units.

Debt that is outside the official statistics is not only a problem at the local government level. In recent years, Poland's official public debt has been slightly above 50% of GDP. However, there are publications indicating that it is much higher. According to Paweł Dobrowolski, it accounts for over 200% of GDP,<sup>20</sup> which is also due to the particular way of recording economic events by the public sector. The posting of its liabilities only in the year of cash disbursement, rather than at the moment when the liability arises, significantly falsifies the data of the government debt. Leszek Balcerowicz goes even further in the estimates of this debt. Taking into account the legislative obligations not covered by Treasury securities, he estimates that Poland's total debt is as much as 250% of the GDP.<sup>21</sup> These estimates may be too pessimistic, nev-

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<sup>16</sup> A. Kamela-Sowińska, Sekurytyzacja jako metoda oddłużenia polskich szpitali, *Zeszyty Naukowe Uniwersytetu Szczecińskiego. Finanse, Rynki Finansowe, Ubezpieczenia* 2014, no. 67: 911.

<sup>17</sup> An example here may be the operation performed by the City of Grudziądz in December 2016.

<sup>18</sup> A study by A. Babczuk shows that at the end of 2010 only a little under 76% of the debt related to self-governments was the debt of territorial self-government units while a little more than 18% constituted the debt incurred by municipal companies. See A. Babczuk, *Zadłużenie spółek komunalnych w Polsce. Próba oceny skali i zróżnicowania regionalnego*, *Finanse Komunalne* 2012, no. 9: 5–16.

<sup>19</sup> For more on the process of transferring debt to municipal companies see: M. Bitner, *Spółki prawa handlowego—przeniesienie zadłużenia poza JST*, in: P. Walczak (ed.), *Zadłużenie jednostek samorządu terytorialnego*, Warszawa: C.H. Beck: 2014: 235–260.

<sup>20</sup> P. Dobrowolski, *Prawdziwy dług publiczny Polski wynosi ponad 200% PKB*, Instytut Sobieskiego, Warszawa 2009, <[sobieski.org.pl/wp-content/uploads/raport\\_dobrowolski\\_e\\_book.pdf](http://sobieski.org.pl/wp-content/uploads/raport_dobrowolski_e_book.pdf)> [accessed 6 February 2017].

<sup>21</sup> A. Koziński, *Balcerowicz pokazuje prawdziwy dług Polski*, 2013, <[polskatimes.pl/artykul.1005111.html](http://polskatimes.pl/artykul.1005111.html)> [accessed 6 February 2017].

ertheless, there is no doubt that some of the obligations of public entities are not included in official statistics, which may involve potential threats to both individual entities and the Polish economy.

### III. DEBT REFINANCING

The term refinancing refers to a monetary operation that involves acquiring external sources of financing to replace one's own resources which have been spent for some purpose.<sup>22</sup> According to Kamilla Marchewka-Bartkowiak the refinancing of the debt means a repurchase of a debt falling due (maturing) and payable in a given year by means of taking out another debt; it may be of a one-off type or be of an ongoing character.<sup>23</sup> This concept does not have a formal legal definition, but in the case of public debt it is almost exclusively attributable to the Treasury. In the opinion of Przemysław Wielgosz, the problem of Polish debt is not its size or real burden, but the problem of political decisions promoting the interests of the financial elite rather than satisfying social needs and economic development.<sup>24</sup> Most of the debt is used to pay off old debts. The Ministry of Finance's statistics show that between half and two thirds of Poland's borrowing needs are related to the need to service the Treasury debt. However, it should be added that debt roll-over is common and concerns the vast majority of countries.

Although for several years now the indebtedness of local government entities, which is part of the state public debt,<sup>25</sup> has been the subject of numerous publications, the issues related to the refinancing of this debt are beyond the field of interest of researchers. The lack of publicly available data, inadequate reporting and budget classification require extensive knowledge of practical issues related to local government finances in order to investigate these phenomena. The refinancing process, also called debt rollover, is sometimes related to local government debt, but these references are usually laconic. Taking out loans in order to repay existing ones (rollover of debt) proves the current inability to pay the existing liabilities from the existing funds, which may lead to falling into what is known as the debt trap,<sup>26</sup> also referred to as a spiral of

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<sup>22</sup> *Refinansowanie*, Portal Narodowego Banku Polskiego, <[www.nbportal.pl/sloownik/pozycje-sloownika/refinansowanie](http://www.nbportal.pl/sloownik/pozycje-sloownika/refinansowanie)> [accessed 8 February 2017].

<sup>23</sup> K. Marchewka-Bartkowiak, *Refinansowanie (rolowanie) długu*, 2012, <[sejm.gov.pl/sejm7.nsf/BAS\\_Leksykon](http://sejm.gov.pl/sejm7.nsf/BAS_Leksykon)> [accessed 8 February 2017].

<sup>24</sup> P. Wielgosz (ed.), *Kryzys długów publicznych. Przewodnik dla początkujących*, official site of the Polish Economic Society, 2012, <[issuu.com/lmdpl/docs/dlug](http://issuu.com/lmdpl/docs/dlug)> [accessed 22 February 2017].

<sup>25</sup> The indebtedness of the territorial self-governing units has for the last several years accounted for about 8% of the State public debt. Its level is markedly lower than that in other EU Member States. For more on that see: B. Filipiak, *Przesłanki dokonania oceny samorządowego długu publicznego na tle podejścia badawczego*, in: E. Denek, M. Dylewski (eds.), *Szacowanie poziomu zadłużenia jednostek samorządu terytorialnego w warunkach zwiększonego ryzyka utraty płynności finansowej*, Warszawa: Difin, 2013: 176–177.

<sup>26</sup> M. Ciałak, *Instrumenty wspierania rozwoju gospodarczego stosowane przez samorząd terytorialny. Problematyka prawnofinansowa*, Toruń: TNOiK, Dom Organizatora, 2013: 205.

indebtedness.<sup>27</sup> The notion of rollover of debt has much more pejorative connotations, but it is nonetheless indicated that it may also have positive economic effects. This may be the case when a more expensive debt is refinanced with a cheaper one. However, repeated rollover of debt may lead to an inability to repay debts from an entity's own funds.<sup>28</sup>

A day before accession to European Union structures, local self-governments in Poland were granted the opportunity to take out loans and other commitments intended for repayment of their existing liabilities arising from earlier issues of securities, loans and credits. By virtue of the Law of 17 October 2003 amending the Act<sup>29</sup> on public finance the catalogue of purposes for which refinancing loans could be taken out was broadened. According to Wojciech Gonet<sup>30</sup> the legalisation of borrowing to repay existing debts may lead to the rollover of debt that will then go on for many years or even continuously. On the other hand, in some situations, it may be beneficial to incur a debt to pay existing debts. This will be the case if the new debt is made available on more favourable terms. Despite numerous significant changes in the legal status of public debt issues, the possibility of refinancing local government debt has remained unchanged until today.

One of the main types of risk attached to government public debt is the risk of refinancing.<sup>31</sup> Its measure is often considered to be the average time to maturity (ATM). It is the average length of the period after which the borrowing is repaid expressed in years.<sup>32</sup> What is interesting is that among the many types of risk indicted in various publications on the local governments' management of public debt, the risk of refinancing is not mentioned.<sup>33</sup>

The concept of debt refinancing is also tied to the notion of the borrowing needs of the budget, as defined in the Act on Public Finance and related to the State budget. The borrowing needs of the State budget are the demand for funds necessary to finance the State budget deficits, the budget of the European funds and the outgoings of the State budget. The Minister of Finance publishes the data on these needs on a regular basis, but they only provide information on the State budget. Unfortunately, other entities in the public

<sup>27</sup> M. Jastrzębska, Nadmierne zadłużanie się jednostek samorządu terytorialnego—przyczyny, skutki, przeciwdziałanie, *Finanse Komunalne* 2016, no. 6: 18.

<sup>28</sup> M. Tyniewicki, Ogólne zasady zaciągania zobowiązań przez inne niż Skarb Państwa jednostki sektora finansów publicznych, in: E. Ruśkowski, J.M. Salachna (eds.), *Finanse publiczne. Komentarz praktyczny*, Gdańsk: ODDK, 2014: 420–421.

<sup>29</sup> JL RP 2003, No 189, item 1851.

<sup>30</sup> W. Gonet, *Kredyty, pożyczki, obligacje w gospodarce finansowej samorządu terytorialnego*, Warszawa: Szkoła Główna Handlowa w Warszawie—Oficyna Wydawnicza, 2006: 83–84.

<sup>31</sup> Such a view is shared by for example K. Marchewka-Bartkowiak and T. Uryszek in works referred to in this paper.

<sup>32</sup> T. Uryszek, *Ryzyko refinansowania długu Skarbu Państwa w Polsce*, *Finanse i Prawo Finansowe* 2, Łódź 2014, <finanseiprawofinansowe.uni.lodz.pl/Publikacje/2/Dodatek\_Kwartalny.pdf?> [accessed 8 February 2017].

<sup>33</sup> See: M. Poniatowicz, *Dług publiczny w systemie finansowym jednostek samorządu terytorialnego (na przykładzie miast na prawach powiatu)*, Białystok: Wyd. UwB, 2005: 253-259; M. Poniatowicz et al., *Efektywne zarządzanie długiem w jednostce samorządu terytorialnego*, Wolters Kluwer business, Warszawa 2010: 118-148.



finance sector do not publish such data. Although there are postulates claiming the need of an indicator summing up the total of the borrowing needs of the entire Polish public finance sector<sup>34</sup> their presence in the public space is still inadequate.

#### IV. DEBT RESTRUCTURING

Like refinancing, debt restructuring also lacks legal regulation and is confused with both, public debt management and its refinancing.<sup>35</sup>

In specialist<sup>36</sup> as well as semi scientific<sup>37</sup> publications one finds opinions claiming that neither of these processes may be considered or treated as taking a refinancing loan. The catalogue mentioned in the Act on public finance, identifying the purposes for which local governments may incur debt obligations, is a closed catalogue. The conclusion of consolidating credit agreements is not an off-balance sheet debt operation, but constitutes a circumvention of the regulations on the limitation of territorial self-government units' debt. The debt consolidating operation does not constitute a separate right to take up a debt. As a consequence, in most cases consolidating processes are impossible owing to the existing legislation. An attempt to consolidate even a small part of the debt results in failure to meet the existing quantitative limits. The admissibility of the solutions referred to above is not a subject of much discussion, but there are also views that such solutions are not only acceptable but they do not need to be recorded as debt. Such a view is also expressed by Józef Stęplowski.<sup>38</sup> In his opinion the acceptance of a different point of view leads to equalising the loan creating a debt the purpose of which is to repay an old one, while in reality they are two separate economic categories. It should be pointed out that such equalising was carried out by the Minister of Finance in the preparation of a classification of revenues, expenditures, income and budgetary outgoings, in which income on loans and borrowings is recorded in the same division of the budget classification, both for those taken in order to finance the planned budget deficit and those used to repay liabilities arising from loans and borrowings taken in previous years. Attention should also be given to the draft of amendments to the provisions regulating the financial

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<sup>34</sup> K. Marchewka-Bartkowiak, *Potrzeby pożyczkowe jednostek sektora finansów publicznych*, INFOS, Biuro Analiz Sejmowych, 2012, <[orka.sejm.gov.pl/Infos\\_131.pdf](http://orka.sejm.gov.pl/Infos_131.pdf)> [accessed 6 February 2017].

<sup>35</sup> *Artykuł 243. Ze skarbnikiem o ustawie o finansach publicznych*, 2013, Serwis Samorządowy PAP, <[samorząd.pap.pl/depesze/wiadomości\\_centralne/125229](http://samorząd.pap.pl/depesze/wiadomości_centralne/125229)> [accessed 22 February 2017].

<sup>36</sup> M. Tyniewicki, *Ogólne zasady zaciągania zobowiązań przez inne niż Skarb Państwa jednostki sektora finansów publicznych*, in: E. Ruśkowski, J.M. Salachna (eds.), op. cit.: 418–419.

<sup>37</sup> P. Walczak, *Zasady zaciągania zobowiązań z tytułu kredytów, pożyczek i papierów wartościowych przez zarządy JST*, in: P. Walczak (ed.), *Zadłużenie jednostek samorządu terytorialnego*, Warszawa: C.H. Beck, 2014: 154–156.

<sup>38</sup> J. Stęplowski, *Czy kredyt konsolidacyjny wymaga zmiany budżetu jednostki samorządu terytorialnego?*, *Finanse Komunalne* 2016, no. 6: 62.

management of self-governments, as proposed by Polskie Stronnictwo Ludowe in 2014.<sup>39</sup> The project envisaged, among other things, the opportunity for territorial self-government units of taking out consolidation loans. Importantly, this parliamentary project, proposed by the party forming the government coalition, failed to obtain the approval of the Minister of Finance, who prevented it from proceeding further. This does not however confirm in any way the view that the restructuring processes of local government debt are absolutely, always, acceptable and that liabilities that arise in these processes do not need to be recorded as debt.

The problem presented here has its origin in the existing legal regime which lacks provisions that would regulate to which transactions concerning their debt the local governments are entitled. A *de lege ferenda* conclusion urging the regulation of issues connected with the restructuring of local government debt<sup>40</sup> has recently been formulated more frequently.

## V. REFINANCING OF THE DEBT OF POLISH MUNICIPALITIES BETWEEN 2003 AND 2015

The subject of the studies presented in the text is the repayable liabilities incurred by Polish municipalities in connection with previously generated operating surpluses. On this basis, the extent of the debt roll-over phenomenon has been assessed and indicators for measuring it have been proposed. All Polish municipalities were included in the survey, which constituted a permanent group of 2,478 research subjects. In a globalised world, the local context does not lose its relevance. According to discerning researchers of development issues, paradoxically it becomes even more important.<sup>41</sup>

According to their specific circumstances, the municipalities were divided into two groups: towns with poviats rights (66 research subjects) and other/remaining municipalities (*gminas*) (2,412 subjects). There were three main reasons for separating a group of towns with poviats rights: much higher income potential, a significantly higher number of realised investments and much higher debt at the moment when the research commenced. It should be added that during the whole period covered by the survey, there were no changes as regards the number of *gminas* belonging to groups of towns with poviats rights or other *gminas*.

The research covered the period from 2002 to 2015. There were two basic arguments which determined the choice of time frame. Firstly, it was the availability of data. The research required access to very detailed and extensive

<sup>39</sup> A. Gniadkowski, Poprawianie artykułu 243: samorzady pod mniejszą presją, *Wspólnota* 2014, no. 19: 38–39.

<sup>40</sup> R.P. Krawczyk, Problem skuteczności rozwiązań prawnych zapobiegających nadmiernemu zadłużaniu się samorządu terytorialnego, *Finanse Komunalne* 2016, no. 12: 18; D. Jurewicz, Dług samorządu—bodziec czy bariera absorpcji środków europejskich?, *Ruch Prawniczy, Ekonomiczny i Socjologiczny* 78(2), 2016: 247.

<sup>41</sup> M. Słodowa-Helpa, op. cit.: 22.



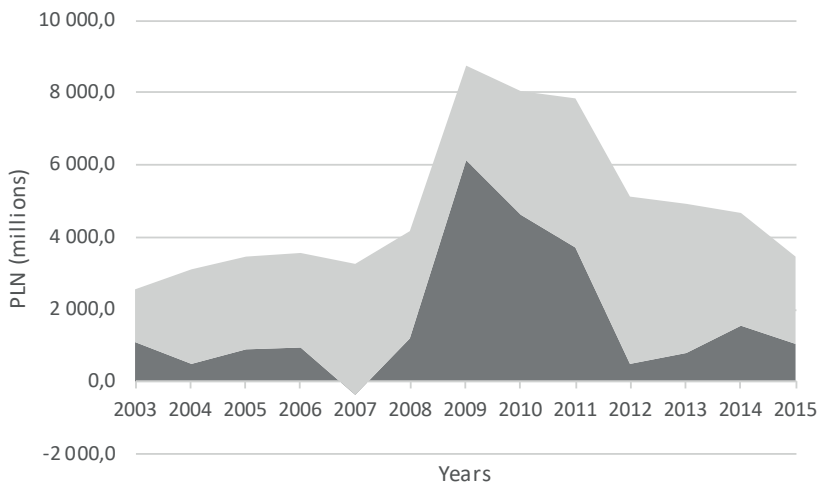
data, and the electronic version<sup>42</sup> of the database has been available since 2002. Additionally, in the time frame covered by the study, there are shown selected elements related to the huge investment effort which Polish municipalities made in terms of absorption of funds from the European Union budget. This effort would not have been possible without multiplying the debt. This paper presents the results for the years 2003–2015. However, this is not a manifestation of the author's failure to observe the unity of the time frame. Indeed, in order to present some data for 2003 (concerning changes in the level of debt as compared to the previous year), it was necessary to use the 2002 figures.

In order to eliminate the change in time of the value of money the variables were adjusted by inflation<sup>43</sup> and were all brought down to the price level applicable in 2015.

Graphs 1 and 2 present the scale of refinancing the debt of towns with poviats rights and of the remaining municipalities.

### Graph 1

Repayable liabilities incurred in individual years and changes in the level of indebtedness of towns with poviats rights in the years 2003–2015 (in PLN mln)



Source: own calculations based on the data extracted from the budget reports prepared by Polish municipalities.

Graphs 1 and 2 in darker colour indicate a change in the debt level and represent the data available to the general public and presented in numerous scientific publications as well as media reports. The figures presented in

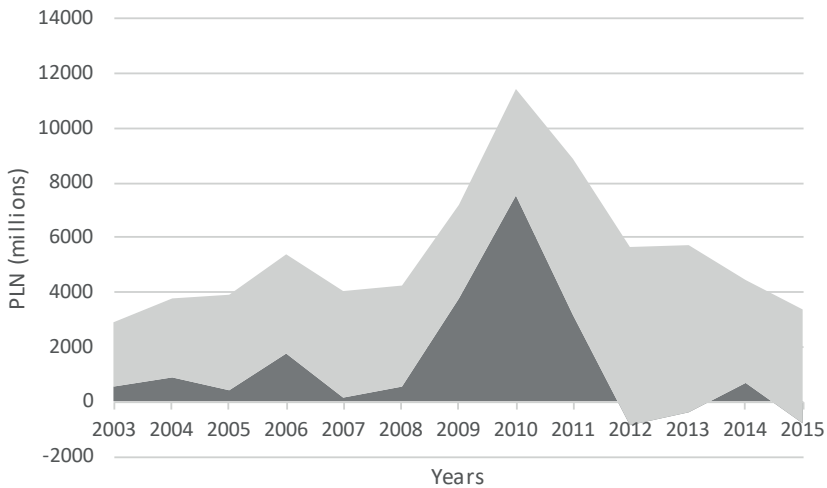
<sup>42</sup> The data come from a programme under the name Besti@ of the relevant minister of public finance. It contains information on the reports prepared by territorial self-government units.

<sup>43</sup> Data on inflation were extracted from the information announced by the main Statistical Office <<http://stat.gov.pl>>.

a lighter colour identify the scale of refinancing of Polish municipalities' debt. This graphic presentation shows that the debt incurred to repay the existing debts of Polish municipalities is substantial. Debt roll-over is not incidental, but a mass phenomenon. This phenomenon is evidently much faster in the case of cities with poviát rights, which may indicate a strong correlation of debt rollover with the level of debt held. In both groups of municipalities, the debt roll-over is the greatest after the period of strong debt growth that occurred between 2009 and 2011, but is nevertheless the strongest after about two years after this growth. Debt effects (including undesirable ones) often occur with a considerable delay. The data also indicate the need to look for new measures related to debt—as can be seen, the taking out of repayable liabilities for the repayment of the existing debt increased the most when the debt in nominal values stabilised (and even started to decrease in the group of municipalities, excluding towns with poviát rights). The exclusion of data on the refinancing of local government debt may significantly distort the results of the research conducted.<sup>44</sup>

## Graph 2

Repayable liabilities incurred in individual years and changes in the level of indebtedness of municipalities with the exclusion of towns with poviát rights in the years 2003–2015 (in PLN mln)



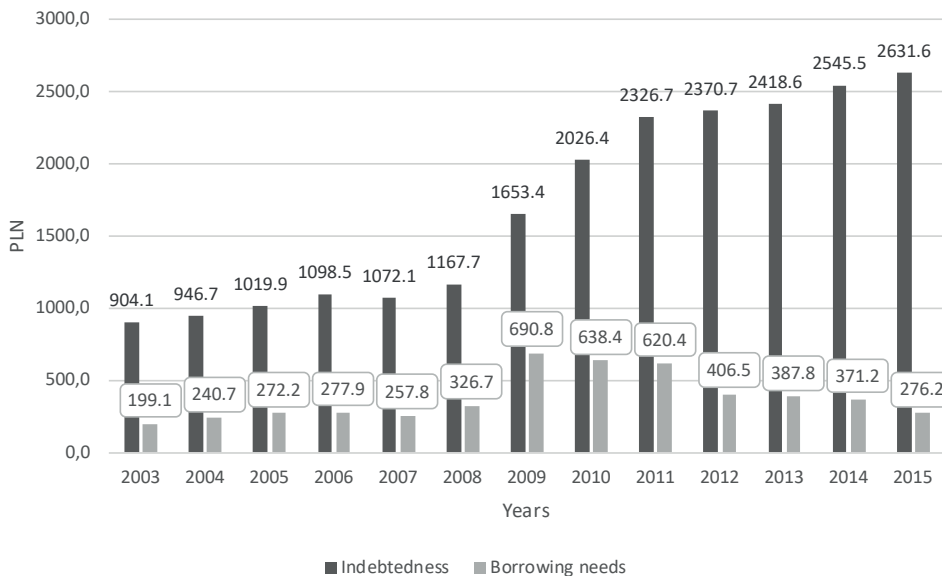
Source: own calculations based on the data extracted from the budget reports prepared by Polish municipalities.

<sup>44</sup> The author conducted research into the impact of municipalities' indebtedness on their development and based the research on the municipalities from the Kujawy-Pomerania region in years 2003–2013. When loans taken by the municipalities to repay their existing loans were taken into account, the correlation between repayable liabilities and investment spending of these municipalities was found to be decidedly lower than reported by other researchers. More on this see: D. Jurewicz, *op. cit.*: 231–249.

The indicator illustrating debt refinancing well is the borrowing needs of the budget. A measure which, in the author's opinion, illustrates this phenomenon best and can be used widely, is the borrowing needs of the budget per capita.<sup>45</sup> It can be presented for individual self-governments as well as for groups of self-governments. Graphs 3 and 4 present the value of this indicator for all towns with poviatic rights and for the remaining Polish municipalities in comparison with the indicator of indebtedness per capita shown in most publications.

### Graph 3

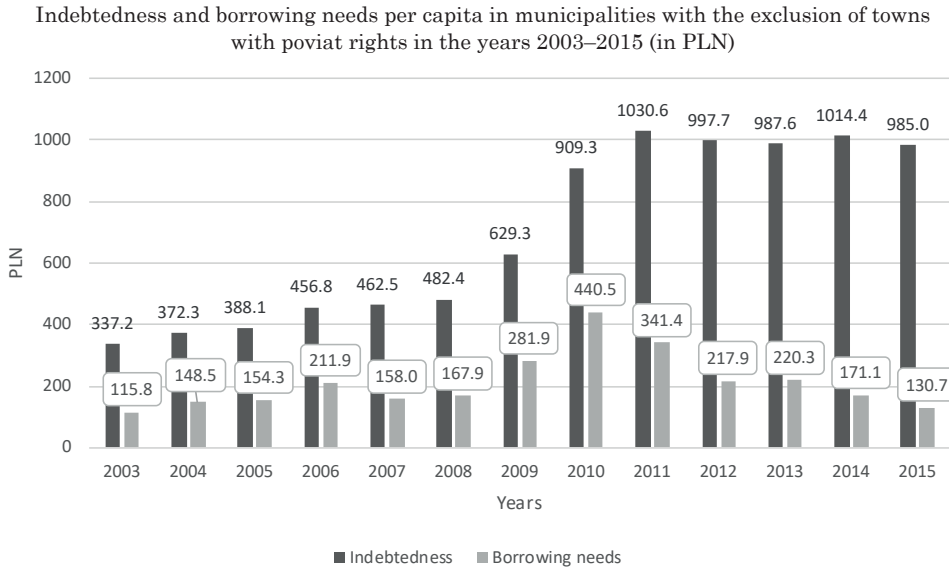
Indebtedness and borrowing needs of towns with poviatic rights *per capita* in the years 2003–2015 (in PLN)



Source: own computations based on the data extracted from the budget reports prepared by Polish municipalities.

Even only a superficial analysis of the two indicators presented above allows us to conclude that, firstly, the borrowing needs of the budget are significant and, secondly, that in particular years their relationship to debt differed significantly. For example, in 2010, in a group of municipalities with the exclusion of towns with poviatic rights, the debt calculated per capita was slightly more than twice as high as the borrowing needs per capita, and in 2015 it was more than seven and a half times higher. This confirms the necessity of adding to the analysis the borrowing needs.

<sup>45</sup> In order to obtain the value of the indicator, the number of liabilities of repayable character (loans, credits, issued securities) taken out in a given period must be divided by the number of inhabitants.

**Graph 4**

Source: own calculations based on the data extracted from the budget reports prepared by Polish municipalities.

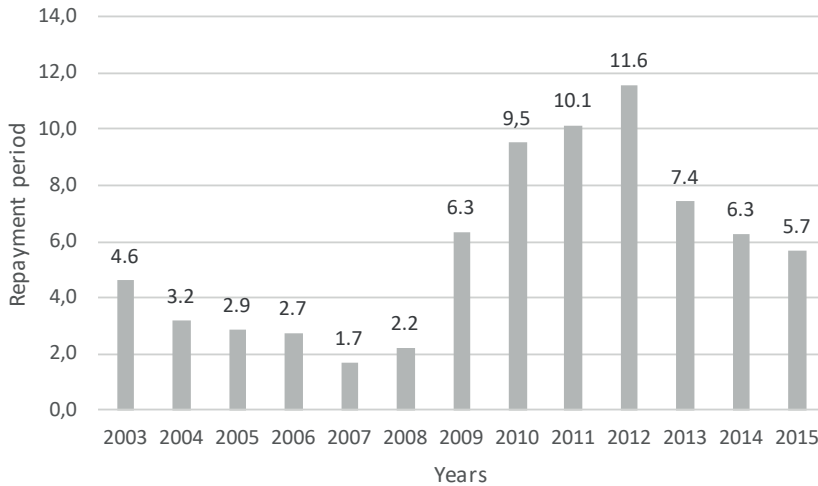
It was demonstrated earlier that state debt is analysed taking into account the average maturity of the debt. The longer the loan period, the higher the debt refinancing risk. The methodology of computation of this indicator is only possible to apply in respect of individual self-governments, but it is not possible to apply to the group as a whole. The following period of repayment of operating surplus presented below is a proposal with a universal scope of potential use, as one of the most important determinants of local governments' financial condition being the difference between the current income realised and current expenditure. This figure indicates how much of the financial resources generated by a given local government remains after financing its day-to-day operation. The current Act on public finance has made Polish self-governments concentrate their activities on achieving the highest possible level of operating surpluses. The latter is the most important factor in determining the permissible level of indebtedness of local governments. It is, after all, from the operating surplus that local governments can finance investment operations or repay their debt.

A good measure for assessing the indebtedness of local governments may be the above mentioned repayment period with operating surplus. The length of this period can be obtained by dividing the debt outstanding at the year-end by the operating surplus generated in that year. It indicates how much time (calculated in years) it would take a territorial self-government unit to repay the debt with the assumption that the entire operating surplus it generated would be used for this purpose. Likewise as in the case of the indicator of the borrowing needs per capita, the proposed measure is of a universal charac-

ter—it may be used both with respect to individual self-governments, as well as to any groups of self-governments. Graph 5 presents the value of the above mentioned period for Polish towns with poviatic rights, whereas Graph 6 presents the value for the remaining municipalities.

**Graph 5**

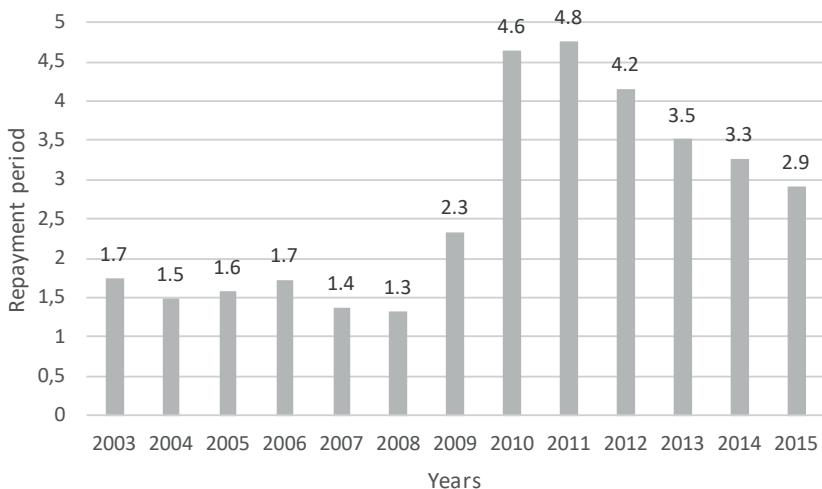
Periods of debt repayment using the operational surplus by towns with poviatic rights in the years 2003–2015 (in PLN)



Source: own calculations based on the data extracted from the budget reports prepared by Polish municipalities.

**Graph 6**

Periods of debt repayment using the operational surplus by municipalities with the exclusion of towns with poviatic rights in the years 2003–2015 (in PLN)



Source: own calculations based on the data extracted from the budget reports prepared by Polish municipalities.

The data presented in Graphs 5 and 6 show that in the time-frame analysed, the repayment period of liabilities was characterised by significant variability, after initially low values: in the years 2009–2010 there was a rapid increase, followed by another decrease. This rapid increase was influenced by a substantial increase in the volume of debt, combined with a declining tendency of operating surpluses. After 2010, the level of debt stabilised, but the level of operating surpluses generated by Polish municipalities started to increase. As mentioned above, the permissible level of indebtedness of local governments depends to a large extent on the levels of operating surpluses generated; the above provision is included in the Act on public finance of 2009. The subsequent increase in these surpluses seems to be a positive consequence of the change in the legislation.

The data presented in all the graphs above lead to some important conclusions. Firstly, the phenomenon of debt refinancing has become visible much faster in the group of towns with poviát rights, which is undoubtedly caused by the much higher initial level of debt. Graphs 1 and 2 also show that the debt roll-over rate increases markedly after periods of significant debt increases.

Secondly, an analysis of local government debt should take into account borrowing needs. The values presented in Graphs 3 and 4 indicate that these needs are very high and their value in comparison with the total indebtedness of municipalities is highly variable in particular years. Omitting these data may make it difficult to draw proper conclusions from the analysis carried out.

Thirdly, the analysis of local government debt should include the period of repayment of debt liabilities using the operating surplus, in particular when it comes to issues related to the broadly understood financial security of self-governments.

In addition, local government debt is also associated with the refinancing risk. A good measure of this risk is the period of repayment with operating surplus as presented here. The growing level of indebtedness of local governments increases the risk of its refinancing.

## VI. CONCLUSIONS

In the vast majority of cases, debt refinancing is a conscious, sovereign decision by local authorities. As long as Polish self-governments continue to make an increased financial effort related to the absorption of funds from the European Union budget, the scale of this phenomenon will remain unchanged. In such cases, the refinancing of local government debt, commonly referred to as debt rollover, should not be a cause for serious concern. However, the scale of the phenomenon should be monitored, for example by using among other things the proposals presented in this text.

Although the existing local government debt level should not yet be regarded as preventing positive action, it may increasingly often hinder these actions. A problem arises in a situation where refinancing of the debt becomes



a necessity, because it is impossible to repay the debt otherwise. The next European Union budgetary perspective and the ensuing projected increase in local government debt may make these difficulties more strongly felt.

A general conclusion which results from this study is that the data on Polish public debt are not precise. This is because not all debt liabilities connected with public entities are included in the general debt statistics, and the amount of unrecognised debt may vary significantly over time. Entities attempting to hide debt should take into account the risk of a change in the regulatory provisions—a good example of this is the change in the catalogue of debt instruments made in December 2010. An unavoidable reaction of the legislator may entail negative consequences for individual local self-governments.

Marchewka-Bartkowiak is fully right in her proposal that data on the borrowing needs of Polish self-governments ought to be made public. An analysis of the financial condition of Polish self-governments should be carried out taking into account some additional indicators depicting debt refinancing issues. It would be hard to disagree with Dorota Jegorow's proposal that the reporting practice based on a selective presentation of quantitative data be eliminated from the public space.<sup>46</sup> An example of such new indicators could be the budgetary borrowing needs proposed in this text and the repayment period of the loan with the operating surplus. At the same

time the refinancing risk should be added to the group of risks associated with local government debt.

The perspective of debt-related phenomena changes with the changing environment. It should be pointed out that even the International Monetary Fund, considered by many to be the backbone of the views of the economic orthodoxy, recommends that debt repayment should not be at the expense of development processes.<sup>47</sup> A reduction of public debt should not be a goal in its own right and ought to be conducted keeping in mind a number of factors of a social character.

Among the numerous problems faced by Polish self-governments at all levels, a low degree of financial independence is worthy of note. The vast majority of municipalities point to the need to increase local government budgets, however, only one in three of them sees local taxes as a source of increased income.<sup>48</sup> This fact may also explain the popularity of local government debt refinancing. However, 'easy money' is not always a development factor, and the example of the major beneficiaries of the cohesion policy, namely Greece, Ireland, Spain and Portugal, should be a warning.<sup>49</sup>

Obviously, this study cannot aspire to be a comprehensive proposal to resolve the emerging dilemmas and doubts. However, the author hopes that the

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<sup>46</sup> D. Jegorow, Falsyfikacja rozwoju społeczno-gospodarczego w skwantyfikowanym systemie sprawozdawczym w układzie regionalnym, in: J. Pach et al. (eds.), *Ekonomia umiaru. Realna perspektywa? Nowy paradygmat Grzegorza W. Kołodki*, Warszawa: PWN, 2016: 441.

<sup>47</sup> *Public debt. How much is too much*, 2015, <[economist.com/blogs/freecharge/2015/06/publicdebt](http://economist.com/blogs/freecharge/2015/06/publicdebt)> [accessed 22 February 2017]

<sup>48</sup> G. Gorzelak, B. Jałowiecki, Koniunktura w Polsce lokalnej 2013, *Studia Regionalne i Lokalne* 2014, no. 4(58): 18–19.

<sup>49</sup> M. Słodowa-Helpa, op. cit.: 202.

text can inspire many researchers focusing on public finance issues. A detailed analysis of the issues raised here exceeds the framework of this publication. Further research is undoubtedly needed. Analyses of the differentiation of debt refinancing carried out from different perspectives may be extremely interesting, both in terms of the wealth of self-government units and their geographical location. Historical conditions, even the legacy of partitions, can still be seen, among other things with regard to the wealth of Polish self-governments as well as their development potential,<sup>50</sup> and too great inequalities may weaken development tendencies significantly.<sup>51</sup>

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## POLSH LOCAL GOVERNMENT DEBT REFINACE

### Summary

The choice of the subject of this paper: the refinancing of local government debt, was determined by the conviction that this field of research has not yet been sufficiently explored. The literature downplays this issue at the regional and local level. Thus the main aim of this work is the systematisation of information on the refinancing of public debt, including local government debt, and examination of the scale of this phenomenon (existing) throughout Polish municipalities. Debt indicators have been proposed to add to the array of tools used for assessing the financial condition of local governments so that the objectives defined in the paper have both a theoretical as well as a practical application. Problems and difficulties associated with the measurement of public debt have been identified, the concept of debt refinancing explained in more detail and reference has been made of (a) public debt in relation to (the) local government debt. Issues indicated in the article relate to debt restructuring and are sometimes confused with refinancing. The refinancing of Polish municipalities in the years 2003–2015 has been presented, followed by some proposals for measures applicable to the issues under discussion. The paper ends with a summary containing the main findings, and indicates issues that still require further research.

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<sup>50</sup> G. Gorzelak, B. Jałowicki, op. cit.: 23–24.

<sup>51</sup> G.W. Kołodko, Społeczne i przestrzenne aspekty zróżnicowania dochodów we współczesnym świecie, *Nierówności Społeczne a Wzrost Gospodarczy* 2014, no. 39(3): 32.