

THE DEBT LEVEL OF COMMUNES IN LUBELSKIE VOIVODSHIP ANALYSIS IN YEARS 2010-2015

Karolina Leonarcik
Maria curie-Sklodowska University, Poland
leonarcik.karolina@gmail.com

Abstract:

Financial resources owned by local government units in Poland to implement assigned tasks are limited. Due to constantly growing demand for the financial resources, local government units need to attentively analyse their budgets and assess the risk of undertaken investments. Having access to up-to-date and real information about local government units' liabilities and debt amount is essential to execute this tasks. It is extremely important due to the fact, that local government units' debt is a part of the national public debt.

Commune, as a basic local government unit in Poland, received the biggest, unclosed list of tasks, which aim to meet the needs of the commune's inhabitants. There are decisions made about debt limitation to improve the financial safety management of local government units.

The article presents general rules on the polish local government units' debt development. There are acceptable debt limits valid until 2013 described, as well as a new method of limiting debt - the individual debt ratio, which is in force since 2014. In the article there are also debt management methods and possible recovery programs for local government units presented.

The purpose of the article is to analyse the communes from lubelskie voivodship in Poland liabilities in 2010-2015. All communes from the lubelskie voivodship were analysed. The article analyses the formation of income, expenditures and budget deficit/surplus. There is debt dynamics and the debt structure in the analysed period presented, as well as communes' debt to general incomes indicator.

Keywords: commune, debt analysis, individual debt ratio, budget deficit

1. INTRODUCTION

Due to the decentralisation of public tasks in Poland part of the government tasks was transferred to the lower level units. Communes, which are basic local government units, received the biggest and unclosed list of tasks, that aim to meet the needs of this units' inhabitants.

Many aspects of decentralisation resulted in fact, that communes received resources insufficient for the execution of their assigned tasks. The resources are not sufficient to cover expenses, which results in the growth of communes' deficit and liabilities. High demand for the financial resources is becoming the more and more important part of the public funds management. Under conditions of increasing public debt it is important to plan the debt level and to have information about the actual amount of liabilities.

The aim of the article is to analyse the debt level of communes in lubelskie voivodship in Poland in years 2010-2015. The level of budget incomes and expenses was analysed, as well as the formation of budget deficit or surplus. In the article there was the debt amount and its structure analysed.

2. INFORMATION ABOUT LOCAL GOVERNMENT UNITS' DEBT IMPORTANCE

Public debt is defined as nominal debt of all financial sector units after the elimination of cash flows between these sector units. Polish law regulations does not introduce government or local debt concept – these terms are contractual. Local government units' debt subjective scope includes credits and loans taken, emitted securities, accepted deposits and due liabilities (Borodo, 2004, pp. 218-222).

Local government units, including communes, more and more often use repayable financial resources to execute their tasks. This funds are used both to finance investments and current expenses. It is the law in 2009, which introduced a record, that requires the current expenditures to be higher than current revenues increased by surplus from previous years. It caused the separation of the current budget and investment budget, and therefore the realisation of the 'golden rule of a balanced budget' (Parlińska, 2014, pp. 192-193).

2.1. Sources and importance of information about financial phenomenon

Reliable and transparent information about financial phenomenon formation is essential for financial management and financial decision making. It is crucial, that the information capture the actual development of the phenomena and allow their analysis. Because of local government units' specifics and character, the methods used to gather and analyse information and data are different from the ones used in enterprises. The basic source of information in local government units are budgets, which contain information about income and expenses formation. Financial Reporting is another important source of information about local government unit's financial situation. Local governments have a legal obligation to report on the implementation of the processes associated with the accumulation of resources and their distribution. It is caused by the necessity of control, statistics and transparency of public finances. Local government units create the following financial reports:

- the performance of the plan of budget revenues,
- the performance of the plan of budget expenses,
- liabilities,
- receivables,
- budget result.

Information about local government's financial situation is part of the public debt control and its management (Hałaburda, 2011, pp. 157-158).

2.2. Local government units' debt limits to 2013

Lack of resources to finance all planned and realised budget expenses creates the need to use repayable funds by the local government units. Deficiency of own funds may be temporary (short-term) or long term (beyond the budget year) (Poniatowicz, Salachna, Perło, 2010, pp. 93-94). The usage of debt instruments by local authorities is restricted by law regulations, which affect the level of debt of these units, including the amount of liabilities from debt. Categories of debt, which are included in the local government unit's debt are also important (Jastrzębska, 2009, p. 95).

The Public Finance Act allows the use of financial instruments by local authorities in precisely defined cases. They can take loans and issue securities for (Act of 27 August 2009 on public finances, Article 89):

- financing the local government units' planned budget deficit,
- repayment of the previously incurred liabilities from issued securities and taken loans,

- advanced financing of activities funded from the European Union's budget. Specified catalogue of debt titles allows local government units not only to finance the borrowing requirements, but also allows the possibility to conclude agreements for the purposes of refinancing needs associated with the acquisition of European funds. However, this possibility is limited by other law regulations. It is important, that both incomes and expenditures are recognized at the date of their payment, regardless of the annual budget to which they relate (Act of 27 August 2009 on public finances, Article 40). This is budget's cash basis principle, which means that the use of financial debt instruments is possible mainly to cover the budget deficit only with the use of financial instruments, which provide the physical cash flow. It also applies to mentioned in the law regulations repayments of previously contracted loans and issued securities (Dylewski, 2014, p.126).

To 2013 there were uniform and quantitative local government unit's debt limits contained in Act on Public Finances of 2005. This limits were presented as follows:

- loans and credits, and securities buyout with interest receivable and their discount for the budget year to local government income relation limit is 15% (Act of 30 June 2005 on public finances, Article 169),
- total amount of local government unit's debt at the end of the budget year to budget incomes relation limit is 60% (Act of 30 June 2005 on public finances, Article 170).

These regulations have been criticized. The most frequently mentioned disadvantages of such debt limitation system include (Romowicz, 2014, p. 228):

- limitation of possibility to incur debts by the units in good financial condition,
- there is a possibility of excessive indebtedness of the units in bad financial situation,
- the size and income potential of the local government is not taken into account,
- the specifics of each local government unit such as geographical location, area, natural resources is not taken into account.

2.3. Individual debt ratio

Individual debt ratio, effective since 1 January 2014 is one of the most important local government unit's financial activities limitation. New indicator was based on data from 2011-2013, and for the next years it is supposed to be counted with the appropriate time shift. This solution extends from the same limitations for all units to the ratio calculated individually for each local government. Individually calculated ratio is the basis for determining the limit of the amount, that local governments will be able to spend on debt service. This indicator, determined as the relation of the surplus of current revenues over current expenses, increased by the income from the sale of assets to total revenues, can be presented with the following formula (Walczak, Pietrzak, 2011, p. 169):

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

where:

R - the total amount of loans repayment and issued securities buyout planned for the budget year,
O - credits and loans interest, issued securities interests and discount, and the repayment of the amounts resulting from granted guarantees planned for the budget year,
D – total income in the budget year,

Db – current income,

Sm – income from the assets sales,

Wb – current expenses,

n, n - 1, n - 2, n - 3 - the budget year and the years before the budget years.

Limiting the debt with the individual debt ratio is not free from defects. The most important disadvantages of this ratio are (Walczak, Pietrzak, 2011, p. 171):

- Limitation of the usage of the local government units European Union's funds to finance investments (obtaining more resources leads to a decrease of individual debt ratio),
- Ability to improve the ratio by selling local government's assets - even the necessary ones,
- Revenues, which does not increase the debt, such as budget surplus and free financial resources on the 31st December of the year preceding the year of index calculation are not included in the numerator (positive numbers in the numerator increase the ratio),
- The new indicator is based on operating surplus (current income decreased by current expenses), which may be hard to accomplish in the financial crisis,
- The indicator is based only on historical data, what means that it does not take unit's current or future situation into account, which is important for the investments.

3. DEBT MANAGEMENT AND SOLUTIONS FOR THE LOCAL GOVERNMENT UNITS

3.1. Debt management in local government units

Debt management in local government units is a process. It is to determine the abilities of the local government unit to incur debt and to repay it, which means determining the safe level of debt for each unit and the most effective usage of all debt forms.

Debt management standards in general are not strictly regulated by law. They are the effect of the long term process of specific practices in financial management formation, and the assessment of this practices usefulness to fulfil the unit's aims. Good practices often become the common norms, which are respected by the local government units, regardless of legal requirements. Additionally, investors interested in acquiring various forms of local government unit's debt formulate standards and best practices, which decide about the safety of this debt. The decisive role in the promotion of such practices play professional organizations, which in particular are practices in the area of public finance associations, local government associations and the rating agencies. Differences between legal standards and best practices in financial management often have only a formal character.

Debt management policy should include all types of debt incurred by the local government. It should also regulate short-term loans that result from the cash flow needs. It is essential that debt management policy allows to set limits or acceptable debt levels of legal, financial and information type. Legal limits may be specified in the Constitution, laws, local government units' statutes, as well as in the resolutions or internal agreements. Debt management policy should also cover the debt structuring rules, such as determining the maximum maturity period, average maturity period, instalments payment preferences, forms of debt (domestic or foreign), the usage of early redemption options, which take market conditions and the needs of the budget into account, the usage of debt based on floating and fixed rates.

Information about acceptable forms of debt protection is also an important part of debt management policy. In particular, it should contain information on the arrangements for the use of derivatives - rules for disposing derivatives, conditions justifying the derivatives usage, acceptable and unacceptable derivatives, methods of measurement, assessment and risk management (including legal risk, credit risk, the risk of premature termination of the credit agreement, the refinancing risk). Other important elements of the debt management policy include information about acceptable practices in the field of debt issuance, conditions for the rating, rules for any investing income from free resources, reporting obligations, guarantees of compliance with its legal regulations, and rules on informing investors. Local government units should pay particular attention to the information policy pursued in the field of debt management. Limits for information purposes related to public information policy should define (Cichocki, 2013, pp.53-55):

- Tasks that can or cannot be financed with debt (reference to transactions such public-private partnership should also be included),
- types of debts that may or may not be issued,
- The aims associated with the local government units' economic development and the financing of investments with debt,
- Possible intentions related to the increase of fees or taxes in connection with debt incurred to finance specific investments.

3.2. Recovery program

Local government unit which fails to adopt the budget due to not meeting the limit set by the individual debt ratio, should accede to the recovery program. Like the other acts on financial matters, this program is assessed by Regional Chamber of Audit and allows local government units to continue their functioning. Implementation of the recovery program is associated with numerous limitations, which intend to contribute to expenses reduction and not increasing the debt. The result of the recovery program application is to improve the condition of local finances, which enables the correct functioning of local governments and getting possibility to incur new liabilities.

In practice, during the implementation of the recovery program, local government units (Romowicz, 2014, p. 231):

- Raise taxes, especially real estate tax and agricultural tax,
- Increase charges for water supply and sewage disposal,
- Does not provide financial assistance to other units of local government,
- Reduce expenses for salaries,
- Limit the grants and subsidies,

- Freeze growth of expenses of councillors.

4. COMMUNES IN LUBELSKIE VOIVODSHIP DEBT ANALYSIS

A necessary condition to execute tasks assigned to local government is to have adequate financial resources. Financial resources of communes are collected primarily in their budgets. Table 1 presents the level and dynamics of budget expenses of communes in lubelskie voivodship in 2010-2015.

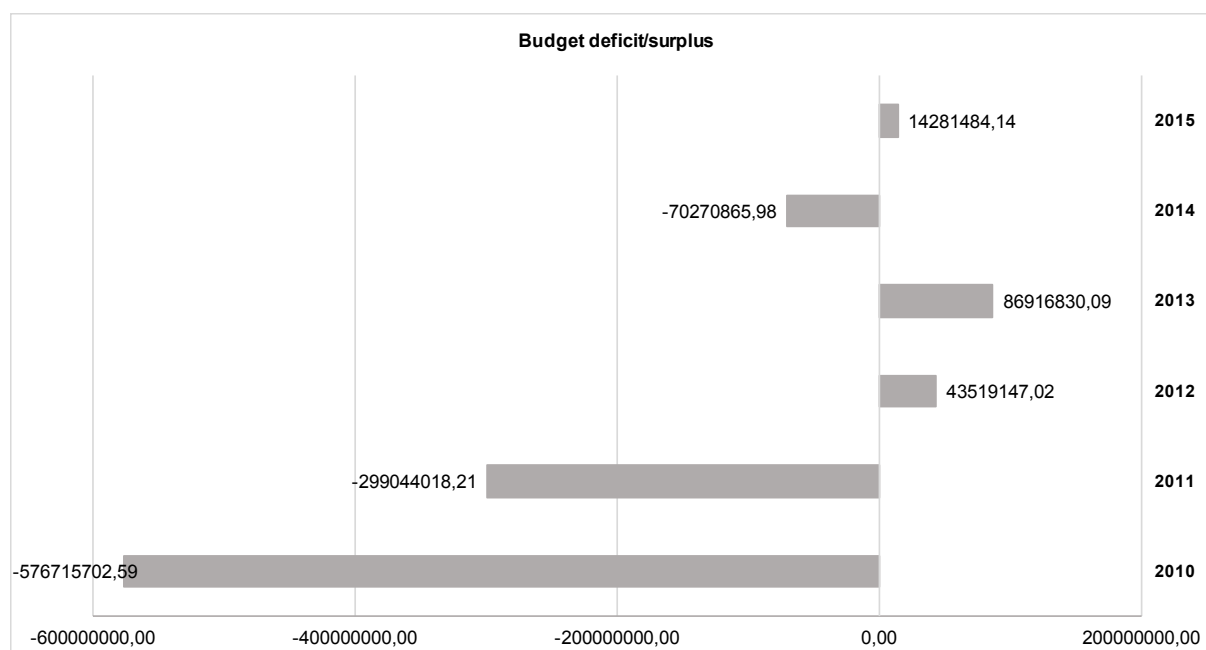
Table 1: The dynamics of income and budget expenses of communes in lubelskie voivodship in 2010-2015

	2010	2011	2012	2013	2014	2015
Total income	4341459316,00	4600754426,64	4768212066,40	4789026054,03	5014366160,33	5150093163,35
Total expenses	4918175018,59	4899798444,85	4724692919,38	4702109223,94	5084637026,31	5135811679,21
Total income dynamics	115,11%	105,97%	103,64%	100,44%	104,71%	102,71%
Total expenses dynamics	123,78%	99,63%	96,43%	99,52%	108,14%	101,01%

Source: Own elaboration based on public data published by Regional Chamber of Audit in Lublin

From the table it is clear that in the analysed period, communes' income continued to grow. The largest increase of 15% occurred in 2010. The smallest increase in income compared to the previous year, took place in 2013, when revenues increased only by 0,44%. A different situation occurs in the case of of communes' in lubelskie voivodship expenses. In the analysed period there was no permanent increase or decrease of expenses. The biggest increase in expenses took place in 2010. In 2011-2013, expenses were lower than in previous years. Since 2014 once again there was an increase of expenses in relation to previous years. The dynamics of communes' budget expenses is lower than the income growth, beyond the year 2010, and 2014, when the increase in expenses was higher than the increase of budget revenues.

Picture 1: Communes' in lubelskie voivodship budget deficit/surplus in 2010-2015

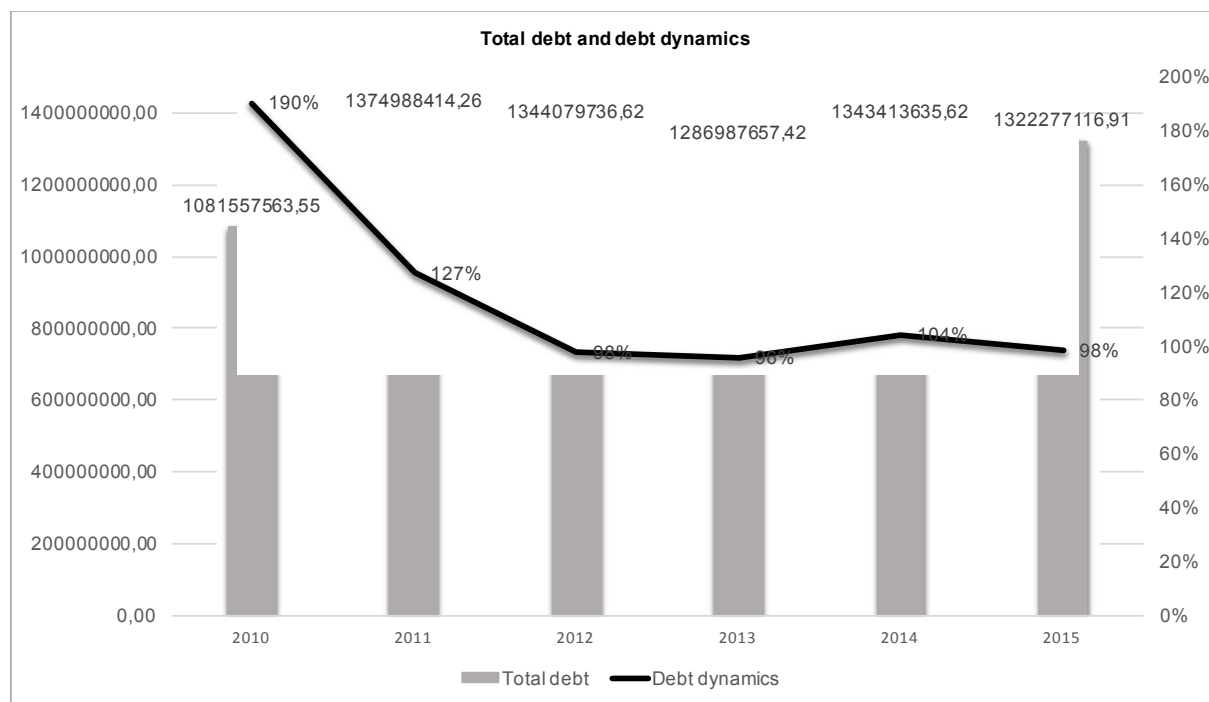


Source: Own elaboration based on public data published by Regional Chamber of Audit in Lublin

Picture 1 shows the development of the deficit and the budget surplus of communes in lubelskie voivodship in 2010-2015. In 2010, the budget deficit was almost twice higher than in 2011. In 2012, 2013 and 2016 communes achieved a budget surplus, which means that their incomes were higher than the expenses incurred. The budget deficit also appeared in 2014, but was a much lower than in previous

years. It can be concluded that the financial situation of communes in the analysed period significantly improved.

Picture 2: Communes in lubelskie voivodship total debt and debt dynamics in 2010-2015



Source: Own elaboration based on public data published by Regional Chamber of Audit in Lublin

In the years 2010-2015 level of communes' total debt increased significantly. Communes' in lubelskie voivodship total debt and its dynamics during the analysed period presents picture 2. The highest increase in relation to the previous was recorded in 2010 year (90%). Rather high debt growth was also recorded in 2011. Debt increased by 27% compared to 2010. In the following years the debt continued to decline marginally, except for 2014, when once again there was a slight increase in debt. The increase in the debt level does not necessarily indicate a deterioration of the financial situation. They can incur debt among other things, for example for investment purposes. This situation is temporary and leads to the economic development of communes.

Table 2: Communes in lubelskie voivodship debt structure in 2010-2015

Year	Debt structure		
	Securities	Credits and loans	Due liabilities
2010	0,00%	99,45%	0,55%
2011	0,00%	99,48%	0,52%
2012	0,00%	99,60%	0,40%
2013	0,00%	99,63%	0,37%
2014	0,00%	99,62%	0,38%
2015	0,00%	99,48%	0,52%

Source: Own elaboration based on public data published by Regional Chamber of Audit in Lublin

Apart from the total level of debt, its structure is also extremely important. The structure of communes' debt in 2010-2015 is presented in table 2. In the years 2010-2015 communes in lubelskie voivodship did not have any liabilities from debt securities. More than 99% of communes' liabilities represent credits and loans. A small part of the debt are due liabilities. These are all indisputable liabilities which payment deadline has passed for the debtor and which have neither been expired or written off.

Table 3: Communes in lubelskie voivodship total debt to total income ratio in 2010-2015

Year	2010	2011	2012	2013	2014	2015
Total debt to total income ratio	25%	30%	28%	27%	27%	26%

Source: Own elaboration based on public data published by Regional Chamber of Audit in Lublin

Table 3 shows the ratio of total debt of to the level of their total income achieved by communes in lubelskie voivodship. This indicator reached Tits highest value of 30% in 2011. According to the applicable debt limits until the end 2013, communes in lubelskie voivodship reached a rate well below the acceptable limit.

5. CONCLUSIONS

In the process of debt management by local authorities, it is important to take the existing legal and economic conditions of contracting liabilities into account. Legal regulations are mainly due to the Public Finance Act and executive regulations. They concern mainly debt limits, definition of the liabilities, as well as connection between local government units' debt and the national public debt. However, there is a problem of the lack of stability in the rules. Frequent changes in regulations make it difficult for local governments to plan liabilities occurred for investments and proper public debt management. Local governments must pursue fundamental objectives of debt management, such as minimizing service costs, reducing risk associated with debt service (including the interest rate, exchange rate risk) or the loss of cash flow in case of excessive debt.

The introduction of new rules of debt limitation by local government units caused that many communes were not able to sufficiently reduce the level of debt. As a consequence, it led to the need to introduce recovery programs. The changes have both his opponents and supporters. However, the dominating opinion is that the aim of reducing the possibility of further indebtedness of units in a difficult financial situation, has been met.

Analysis of the communes' in lubelskie voivodship debt level in 2010-2015 showed improvement in the financial condition of these units. Despite the increase in debt, which main source are incurred credits and loans, lubelskie communes significantly reduced the budget deficit, and in 2012, 2013 and 2015 achieved a budget surplus. Debt to total income ratio shows that the commitments were not the dominant source of income. Further increase in debt would not lead to a deterioration of the units' financial situation.

It is important that the level of communes' debt is constantly and carefully monitored. Individual debt ratio, calculated separately for each local government unit is to check the financial situation of the unit, and it allows to assess whether further debt increase will not cause difficulties in its financial management.

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