

Zbigniew OFIARSKI*

PREREQUISITES AND METHODS OF BUDGET BALANCING FOR TERRITORIAL SELF-GOVERNMENT UNITS

1. Reasons for the Income Equalization System

The differentiated level of development of territorial self-government units and their endowing with sources of income whose amount depends on many factors (e.g. the number of inhabitants in a given area, the scale of economic activity carried out, value of property, investments, etc.) justify the necessity of using various equalization mechanisms to level the disproportions in civilizational development. Two basic equalization (compensating) mechanisms can be discriminated: horizontal and vertical. The first one is based on pecuniary resources transferred from the central level to the self-governmental (local and regional) level, whereas the second mechanism assumes the form of redistribution of resources between territorial self-government units – from units with higher income to units with lower income. Also a mixed system may be applied, in which part of the pecuniary resources are transferred from the central level whereas the rest comes from payments made by other territorial self-government units (such an equalization system has been applied in Poland in relation to municipalities (*gmina*)). However, the equalization of the revenues of districts (*powiat*) and provinces (*voivodeship*) is based on transfers of pecuniary resources from the central level. The equalization mechanism is applied by using the existing budgetary system, because the resources are appropriated from the state budget and they constitute a final expenditure from that budget to municipality budgets, district budgets or provincial budgets. Therefore, it is a form of non-re-

* Prof. Zbigniew Ofiarski, University of Silesia, Faculty of Law and Administration.

turnable financial subsidy of such units from the state budget. The equalization part of the general mechanism is a form of increasing the income of a unit, above all from tax sources, with which the territorial self-government unit is endowed. Balancing the budgets of territorial self-government units is recognized by this doctrine as one of the most important tasks of the budgetary system. Appropriate legal solutions within such a scope are a requisite of both the efficient and effective functioning of the budgets and the real standing and activities of local and regional bodies and agencies [Nykiel, 1993, 28].

Legal grounds for the use of income equalization mechanisms for territorial self-government units result from articles of international law, constitutional law, as well as common law of individual countries. According to the provisions of Art. 9 Items 5 & 7 of the European Charter of Territorial Self-Government [Dziennik Ustaw, 1994], the protection of local communities with a weaker financial position requires the use of compensating (equalizing) procedures or balancing actions aimed at the correction of effects caused by unequal distribution of potential sources of income and the compensation of expenses borne by such communities. Procedures or actions of such a type should not place limits on decision making by local communities within the scope of their own rights. If it is possible, the subventions granted to local communities should not be assigned to the financing of specific projects. The granting of a subvention cannot constitute a threat to the basic liberty of a local authority to following its own policy within the scope of rights it is vested with. Similar solutions are presented in Art. 14 Item 4 of the European Charter of Territorial Self-Government¹, where the principle of solidarity requires the introduction, within every country, of a financial equalization mechanism which takes into consideration both the potential resources and needs of regions and is aimed at the harmonization of the standard of living in various regions.

The income equalization system for territorial self-government units is not a solution peculiar to the financial system of Polish territorial self-governments. In the constitutions of many countries, either an order to use an income equalization system or the possibility of transferring pecuniary resources to territorial self-government units of low own income has been directly expressed without specifying the aims of the funds transferred. Art. 35 of the Constitution for the Federal Swiss Con-

¹ This act formulates the basic principles with which the legislation of its signatories has to comply. ECTS is not binding on the Republic of Poland, because the procedures aimed at giving it the character of an international convention have not yet been completed [Kieres, 1999, 141ff.]..

federation dated 18th April 1999 may be indicated as an example [The Constitution of Switzerland, 2000], where it is stipulated that the Federation supports financial equalization between the cantons and when analyzing the performance of the federation, it takes into consideration the financial abilities of cantons and alpine regions. The adoption of such constitutional rule is justified by the great differences between cantons in many respects (such as area, population, industrial development), which does not create the same financial resources for solving problems. The Berno canton is almost thirty times as large as the Appenzell Innerhoden canton and has a population almost ninety times as great. Considerable differences also exist in the level of national income per capita (this is twice as high in the canton of Basel city as in the Jura canton) [Czeszejko, 2002, 42].

The duty to undertake actions at the level of the Confederation aimed at ensuring the balanced development of the economic situation in individual regions of the country appear in the provisions in Art. 100 of the Swiss Constitution. It is possible in economically threatened regions of the country to support individual branches of the economy and professions from the central arrangement level and even to suspend the use of the principle of economic liberty (Art. 103 of the Constitution). The system of economic equalization between the cantons is based, *inter alia*, on direct assessment and collection of the receipts from taxes by the cantons. At least one sixth of the receipts falling to the cantons should be appropriated for the purpose of financial equalization between the cantons (Art. 128, Item 4 of the Constitution).

Also Art. 238 in the Constitution of the Republic of Portugal dated 2nd April 1976 [The Constitution of Portugal, 2000] stipulates that the system of local finance has as its objective, *inter alia*, a fair distribution of public revenue by the state and territorial self-government units, including the equalization of such a scope as is necessary, of the differences between territorial self-government units at the same level. Such a principle is extended in some further provisions of the Portuguese Constitution. The provisions of Art. 81, which quotes the chief tasks of state, can be mentioned as an example. One of these tasks is the laying out of goal for economic and social development aimed at obtaining of balanced growth in all branches and regions and the gradual removal of social and economic differences existing between towns and villages. It has been stipulated in Art. 90 of the Portuguese Constitution that the plans of economic and social development do not have only the economic and social development as their objective, but also harmonious and uniform development of branches and regions, fair distribution of the national product between units and regions and protection of rural areas. According

to the provisions of Art. 91, it is permissible to apply special programs in relation to a specific territory or branch. The financial bases supporting the uniform development of regions are contained first of all in the state budget, from which resources are transferred to the autonomous regions (*i.e.* the archipelagos of Azores and Madera) and local authorities (Art. 106, Item 3 of the Constitution). Moreover, the national system of taxation should be adapted to the specific feature of regions, whereas taxation, monetary, financial and currency policies should support investments necessary to the development of the relevant region (Art. 227 of the Portuguese Constitution).

Constitutional guarantees for the equalization of revenues have also been introduced in several other states: Art. 119 in the Constitution of the Republic of Italy stipulates that the government shall grant special subsidies to accelerate the development of the south and islands; Art. 1007 in the Constitution of Germany imposes on the Federal Council the duty to ensure appropriate financial balancing between richer and poorer provinces (lands). Municipalities in Denmark have also enjoyed such an equalization system. Taxes are differentiated using various tax bases according to the municipality. Such compensating subventions are granted in Denmark, above all, to municipalities characterized by a low population and thus having low revenues [Drwiłło and Gliniecka, 1997, 198]. Art. 142 in the Constitution of the Republic of Slovenia introduces a principle according to which municipalities draw income from their own sources, but in the event where a municipality owing to its low level of economic development cannot fully fulfil its tasks and duties, the state – in the manner set forth by the relevant law – transfers additional resources to the municipality [The Constitution of the Republic of Slovenia, 1994]. Similar solutions have been applied in the Constitution of the Republic of Macedonia [The Constitution of the Republic of Macedonia, 1999]. Municipalities and the city of Skopje are financed, above all, from their own sources of income, but at the same time it is permissible to finance them from state resources (Art. 114 and 117 of the Constitution). Also Art. 36 in the Constitution of Canada imposes upon its Parliament, legislative bodies, the government of Canada and the governments of provinces an obligation to support equal opportunities as well as the process of equalizing the differences in economic development of individual provinces [The Constitution of Canada, 1998]. The level of development of territorial self-government units in the Scandinavian countries is very differentiated and has a direct influence on the level of funds to be distributed among local units. In connection with the need to observe the principle of equal treatment of all citizens, various forms of central administration intervention have been introduced,

which subsidize municipalities and districts with a weak economy in particular. However, such a system has been criticized due to self-government agencies being dependent on decisions, mainly financial ones, made by the government within the framework of budgetary arrangements and on decisions reached by the central administration [Grzybowski, 1998, 131]. However, irrespective of the options proclaimed on the need of decentralization or simply de-concentration of the local economy and irrespective of the level of state economic development, various forms of compensating income for territorial self-government units are necessary on account of the necessity to eliminate the situation in which the revenue of such units are not sufficient [Gajl, 1993, 294].

Arguments substantiating the need for creating the various balancing mechanisms which are most often mentioned in this approach include: territorial differentiation of the revenue generated by local authority caused by the dissimilarity of natural, economic and infrastructural conditions; the necessity of satisfying the social needs of local communities; barriers to the commercialization of municipal and social services; a tendency to limit separate features of the technical infrastructure; the need to balance the consequences of central economic decisions [Piotrowska-Marczak, 1997].

As a rule, balancing the budget of territorial self-government units takes place by using external funds, *i.e.* coming from outside the self-governmental sector of public finance, in particular transfers from the state budget. The Constitution of the Republic of Poland dated 2nd April 1997 [Dziennik Ustaw, 1997] simply generally defines that territorial self-government units have a share in the public revenue relevant to the tasks entrusted to them, whereas their revenues consist of the income they themselves generate, general subventions and earmarked subsidies from the state budget (Art. 167, Item 1 and 2 of the Constitution). However, it is not directly stated anywhere that income equalization mechanisms in the case of differentiation between individual territorial self-government units should be applied. On the other hand, such principles are set forth by common law, *i.e.* the Law of 26 November 1998 on Revenues of Territorial Self-government Units in the Years 1999–2002 [Dziennik Ustaw, 1998]. This income equalization system is different for each individual category of territorial self-government units (municipalities, districts, provinces). A mixed system has been adapted in relation to municipalities because part of the pecuniary resources appropriated in order to pay the compensating amount for municipalities comes from contributions collected from municipalities, which are characterized by basic tax revenues at a higher level than a specified threshold. However, in relation to the districts and provinces the funds

appropriated in order to pay the compensating part of the general subvention are transferred from the state budget. Hence, this constitutes a uniform system of equalizing the revenue of districts and provinces.

2. Principles of Balancing the Income Potential of Municipalities in Poland

According to Art. 55 of the Law on Municipal Self-Government from 8 March 1990 [Dziennik Ustaw, 2001b], general subventions are to be determined under objectivized criteria, which are set forth by a separate law (the Law on Revenues of Territorial Self-government Units). A division of general subvention to municipalities into three parts: basic, educational and compensating, has been introduced on Art. 19 of the Law on Revenues of Territorial Self-government Units. However, the objectivity of criteria for determining and dividing individual components of general subventions payable to the municipalities has not been fully or consistently regulated. By virtue of statutory delegations, authorization has been given to set forth detailed principles and procedures of distributing certain components of general subventions in implementation acts to that Law.

A compensating component is included in the basic part of general subventions to municipalities. However, different criteria of ascertaining a municipality's right a given amount and the large variation of these amounts between municipalities justify the separation of the compensating component from the remaining pecuniary resources making up the basic part of general subvention to municipalities. The criteria enabling the singling out of the municipalities authorized to the compensating payments have been set forth in the Law on Revenues of Territorial Self-government Units. According to the provisions of Art. 21 Item 1 of that Law, the municipalities in which the ratio of basic tax revenues per capita (G-ratio) is lower than the standard one set forth under such principles (P-ratio – calculated jointly for all municipalities in the country) receive a compensating payment. Basic tax revenues comprise the income obtained by the municipalities by way of such taxes as real estate tax, agriculture tax, forest tax, conveyance tax, self-employment business tax paid in the form of a lump sum, tax on civil law transactions and by way of such charges as stamp duty and operating fees, as well as from their share in income tax receipts (5% revenue from organizations with legal identities and 27.6% of revenue from individuals, in coal mining areas this proportion is 32.6%) and from the compensating component of the general subvention.

The G-Ratio is calculated by dividing the amount of a municipality's basic tax revenues in the first half-year of the base year (*i.e.* the year preceding the year for which the budget is planned) by the population of the municipality. The revenue which is obtained by a given municipality from agriculture tax is adopted to determine the compensating fund by applying the average purchase price of rye set forth by the President of the Central Statistical Office. In the case of other taxes the maximum rate is assumed, without any exemptions, deferrals, relief and consequences of abandoning the municipality's revenue collection except for the conveyance tax for which revenue is calculated by the application of the rates set forth in resolutions of the municipality board. This applies to real estate tax, agriculture tax, forest tax, self-employment business tax paid in the form of a lump sum, tax on civil law transactions, as well as such charges as stamp duty and fees on business activities. Only for municipalities with a population of up to 15,000 the revenue from real estate tax resulting from the rates of tax passed by the board of such a municipality is adopted in calculating the compensating fund for the basic part of the general subvention. Hence, such rates may be lower than the maximum rates set forth in the Law on Local Taxes and Fees of 12 January 1991 [Dziennik Ustaw, 2002]. The basis for calculation of the G-ratio and P-ratio is constituted by the revenue shown in the municipality's financial accounts [Dziennik Ustaw, 2001] and the data on its population.

Such municipalities in which the G-ratio is lower than 85% of the P-ratio are entitled to a compensating fund. According to the provisions of Art. 21, Item 3 of that law, the compensating fund due to the municipality is calculated by multiplying the number equal to 90% of the difference between the G-ratio and 85% of P-ratio by the population of the municipality and by the ratio for the base year defining the relation between planned state budget revenue and such revenue obtained in the first half-year. It follows from the adopted method of compensation for budget shortages that a part of the deficit should be financed by the municipality within its own scope, *e.g.* by obtaining credit or a loan, obtaining revenue in the capital market or otherwise. It is regarded that such a balancing mechanism can have an adverse (anti-motivational) influence, *i.e.* it does not encourage municipalities with a weak economy to develop their own sources of income. In connection with this the full compensation of municipality tax potential by means of the compensating fund would not be justified [Borodo, 2000, 143].

According to Appendix 2 to the budget law for the year 2002 [Dziennik Ustaw, 2002a], the amount of 2,112,300,000 PLN, of which the compensation for municipalities amounts to 2,093,960,000 PLN, has been set

aside for the basic part of the general subvention to municipalities. Such an amount is designated to in total 1789 municipalities, comprising 88 towns, 387 towns and municipalities, as well as 1314 municipalities. In considering the compensating amount in relation to the remainder (18,340,000 PLN set aside in the year 2002) within the framework of the basic part of the general subvention to municipalities, it can be stated that the compensating amount makes up an essential component of the basic part. One should note not only the annual increase in the amount set aside for distribution within the framework of the compensating amount for municipalities, but most of all the increase in the number of municipalities eligible for such an equalization mechanism. In the year 2000 1750 municipalities were eligible, whereas in 2002 39 municipalities more were eligible.

The municipalities in which the level of basic tax revenue per capita (G-ratio) exceeds 150% of the P-ratio are under an obligation to make annual contributions set aside to increase the basic part of the general subvention. The amount of this annual contribution is calculated as the product of the population of the municipality and the ratio defining the relation between planned state budget revenue and such revenue obtained in the first half-year of the base year, taking into account a progressive ratio which depends on how much the G-ratio exceeds the P-ratio. These progressive ratios have been set in the following way:

- G does not exceed 200% of P – 20% of the surplus of G over 150% of P;
- G exceeds 200% of P, but does not exceed 300% of P – 10% of P and 25% of the surplus of G over 200% of P;
- G exceeds 300% of P – 35% of P and 30% of the surplus of G over 300% of P.

The total amount of contributions is set forth every year in the budgetary law. In Art. 40 of the budgetary law for the year 2002 it was planned that municipalities would make a total contribution amounting to 247,000,000 PLN. Municipalities should pay the due amounts into the account of the state budget revenue in twelve equal instalments by the 15th day of each month. Interest will be calculated at the same rate as for tax arrears on the sums not paid on time. In relation to sums not paid on time, the provisions of the law dated 17 June 1966 on Administrative Enforcement Proceedings [Dziennik Ustaw, 1991] will apply. On the basis of Art. 39 Item 2 of the Law dated 26 November 1998 on the Adaptation of Coal Mining to the Functioning of the Market Economy and on Special Rights and Tasks of Mining Municipalities [Dziennik Ustaw, 1998a], mining municipalities under this law do not make any contributions earmarked for increasing the total amount of the general

subvention to all municipalities. By virtue of the provisions of Art. 49 mining municipalities are exempted from such contributions.

Contributions made by municipalities with higher than average tax income are a form of horizontal distribution of revenue between municipalities. Therefore, the increase in the amount destined for the basic part of the general subvention to municipalities influences both the compensating amount set aside for municipalities with a weak economy and the remainder of the basic part of the general subvention distributed between all municipalities in proportion to the population of individual municipalities. Such contributions may be treated as a specific type of rate capping on obtaining above average tax income. On the other hand, opinions have been expressed that such tax income may be, in specific situations, the consequence of circumstances independent of the decisions taken by the municipal self-government and that the concept of relatively equal living conditions throughout the country and relatively equal funding with the pecuniary resources necessary to carry out statutory tasks should be observed [Borodo, 2000, 149]. Thus, the present mechanism of equalizing the income of districts is of a mixed nature, because it is based on both the pecuniary resources set aside in the state budget and the means coming from the contributions made by municipalities.

3. Balancing the Income of Districts

There is a crucial lack of coherence between the provisions of the Law on District Self-government [Dziennik Ustaw, 2001b] and the provisions of the Law on the Revenue of Territorial Self-government Units within the scope of classifying the compensating resources set aside for districts. Such incoherence concerns the identical names of such resources, because the Law on District Self-government uses the phrase „the compensating subvention”, which is not mentioned in Art. 167 Item 2 of the Constitution. This might suggest that there exists a separate category of subventions different from the general subvention. On the other hand, the Law on the Revenue of Territorial Self-government Units mentions the compensating part of the general subvention, thus in this case the compensating resources are only a structural element of the general subvention set aside for districts.

The manner of qualifying compensating resources is also different in these two Laws. Under the provisions of Art. 56 Item 2 Point 1 of the Law on District Self-Government the compensating subvention from the state budget is a type of extraordinary revenue of a district. This is not compatible with the classification set forth in Art. 167 Item 2 of the

constitution, according to which subventions constitute a category of regular income of territorial self-government units, while under the provisions of Art. 8 Item 2 in connection with Art. 28 Item 1 Point 3 of the Law on the Revenue of Territorial Self-government Units the compensating part of the general subvention to districts constitutes a type of regular income. However, when the manner of establishing a district's right to the compensating part of the general subvention and the assumption that not all districts are entitled to such compensating resources are adopted as basic criteria, then such resources are classified as facultative income of a district. Furthermore, a different manner of classifying equalizing resources, in comparison to the solutions regarding municipalities, has been adopted for districts. The compensating part is a separate part of the general subvention for districts, whereas the compensating amount constitutes a component of the basic part of a general subvention set aside for municipalities.

According to Art. 29 of the Law on the Revenue of Territorial Self-government Units, the amount set aside for the compensating part of the general subvention to districts is determined for every budgetary year in the budget. The annual determination of amounts set aside for the functioning of the mechanism of equalizing district income potential in the budget law may lead to a lack of stability of such income in the districts. In particular, no minimum statutory guaranteed level of pecuniary resources earmarked each year in the state budget for such a purpose has been specified. This means that the legislator may set aside different sums for such a purpose in particular budgetary years. Therefore, their level may depend on the current level of revenue in the state budget and on the priorities adopted within the scope of state expenditure. The compensating part of the general subvention to districts is classified in the light of the provisions of the Polish Constitution and the Law on the Revenue of Territorial Self-government Units as regular income of districts, while in practice it may be of a very variable nature and depend on the means for setting aside an appropriate amount of pecuniary resources designated in each budgetary year for this purpose in the state budget. Thus, it can be said that the legislator, by departing from the principle of setting an amount for the general subvention to districts as a proportion of state budgetary income, has violated the principle of the objectivity of subventions resulting from the provisions of Art. 57 Item 1 of the Law on District Self-government [Chojna, 1999, 139 ff.]. The budget for 2002 earmarked 435,453,000 PLN for the compensating part of the general subvention to districts.

The statement that the budget specifies an amount earmarked for the compensating part of the general subvention to all districts is too ge-

neral, because not all the districts are eligible to receive such a part of the general subvention. According to the provisions of Art. 30 of the Law on the Revenue of Territorial Self-government Units, the compensating part of the general subvention is to be received by districts in which the ratio of the basic tax revenue per capita (S-ratio) is lower than S_w -ratio which constitutes the basis for calculating the compensating part of the general subvention to all districts (this was the highest S-ratio for 1999). The S_w -ratio is revalorized each year by means of the corrective ratio for personal income tax, determined as the ratio of the total amount of receipts planned from personal income tax adopted in the budget for that budgetary year and the amount of receipts planned from such a tax adopted in the budget for the base year *i.e.* the preceding year. The S-ratio for a given district is calculated by dividing the amount of income planned in a given budgetary year by that district from its share in the receipts from personal income tax, which constitutes income to the state budget, by the number of people living in the district.

In order to establish which districts are eligible to receive the compensating subvention, it is necessary to calculate and compare two ratios: the S-ratio and S_w -ratio. District, in which the basic tax revenue per capita (the S-ratio is related to the share in personal income tax) are lower than such revenue of the district obtaining the highest level of such income (S_w -ratio), are eligible for the compensating part. Thus, the compensating part of the general subvention is received by all districts and towns with the district status, except for the district (or town) with the highest S-ratio. This amount is transferred in twelve equal monthly instalments by the 15th day of each month.

The amount of the compensating part of the general subvention is calculated as the product of 85% of the difference between the S_w -ratio and S-ratio for a given district and the population of a given district. To guarantee the real value of district revenue from the compensating part of the general subvention, a specific valorization mechanism has been introduced, as mentioned above, based on increasing the S_w -ratio every year by the ratio obtained by dividing the total amount of receipts planned from personal income tax adopted in the budget for that budgetary year by the planned amount of receipts from such a tax adopted in the budget for the preceding year. However, it is difficult to acknowledge that this mechanism of compensating the differences in the basic revenues of districts will fulfil the objectives of the legislator, because districts have not been endowed with a developed system of their own sources of income from specified local taxes [Izdebski, 2001, 183] and their share in income tax receipts is negligible. According to Art. 8 Item 1 and Art. 10 of the Law on the Revenue of Territorial Self-government

Units, the income of a district comes from its the share in personal income tax, which constitutes income to the state budget, and amounts to 1% of the receipts from people residing in the district. This is considered as one of the basic threats to the effective functioning of districts, resulting from a lack of any influence on shaping the level of their revenue and the unstable structure of such revenue [Saługa, 2001, 105].

It had already been indicated before the revival of districts that funding from basic tax sources in district revenue should be considerable, *i.e.* amounting to approx. 5% of the share in receipts from personal income tax and a similar share in receipts from corporate income tax. A general subvention of a balancing nature was also assumed to be crucial. Its objective and main function was supposed to be the approximate equalization of income potential for districts with a weak economy. At the same time it was pointed out that no full equalization of this shortfall would be possible, because that would lead to weakening the activity carried out by district agencies with a view to developing its own sources of revenue [Borodo, 1996, 85-6].

4. Balancing the Level of Income of Provinces

The objectives and functions of the compensating part of the general subvention to provinces can be defined based on the provisions of Art. 14 Item 4 of the European Charter on Territorial Self-Government, according to which the principle of solidarity requires the introduction, in every country, of a financial equalization (compensation) mechanism taking into account both the potential resources and needs of regions and aiming at the harmonization of the standard of living in various regions. The distinctive feature here is a lack of coherence between the provisions of the Law on Provincial Self-government [Dziennik Ustaw, 2001a] and the provisions of the Law on the Revenue of Territorial Self-government Units within the scope of classifying compensating resources coming from the compensating part of the general subvention. Art. 68 Item 1 of the first law classifies the compensating subvention from the state budget as an income of extraordinary nature [Zięba-Załużka, 1999, 131], whereas it clearly appears from the provisions of Art. 11 Item 2 in connection with Art. 31 Item 1 Point 3 of the Law on the Revenue of Territorial Self-government Units that this constitutes regular income of a province. One can also note the lack of co-ordination within the vocabulary in the laws quoted above. The Law on Provincial Self-government uses the term „compensating subvention”, whereas the Law on the Revenue of Territorial Self-government Units refers to „the compensating part of general subvention”. The latter is more adequate in the light of

the arrangements resulting from the Polish Constitution, because the term „general subvention” is used in the Constitution. The Law on the Revenue of Territorial Self-government Units simply divides the general subvention into parts, therefore the compensating part is not a the separate category of subvention, but only a component of the general part. However, it might appear from the provisions of the Law on Provincial Self-government that the compensating subvention is a separate category of subvention, but one cannot find conformation of this in the provisions of the Polish Constitution. Theory criticizes the division of the general subvention into individual parts. It is considered that the introduction of separate principles for the calculation and division of each such part renders the assessment of their functioning more difficult and does not constitute a proper basis for the analysis the level of of financial security as regards the performance of tasks imposed upon a province [Glumińska-Pawlic, 2000, 262]. At the same time, such a system is too complex and insufficiently clear [Gilowska and Misiąg, 2000, 34 ff.].

No arrangements have been adopted to guarantee the specification of definite amounts in the state budget set aside for distribution between provinces by way of compensation resources. According to the provisions of Art. 32 of the Law on the Revenue of Territorial Self-government Units, the amount set aside for the compensating part of the general subvention to all provinces is determined for each budgetary year by the budget. These provisions apply to two decisions, namely „the determination by the budget of the amount set aside for the compensating payment to provinces” and the statement that this amount is earmarked „for all provinces”. The annual determination of amounts set aside for the functioning of the mechanism equalizing province income potential in the budget may lead to the lack of stability of such income in the provinces. This is due to the fact that the legislator may set aside different sums for such a purpose in particular budgetary years. Therefore, their level may depend on the current level of revenue in the state budget and on the priorities adopted within the scope of state expenditure.

After the ratification of the European Charter on Territorial Self-government (ECTS) there is also a problem of the lack of coherence between this legal deed and both provisions of the Law on Provincial Self-government and the provisions of the Law on the Revenue of Territorial Self-government Units, because under Art. 14 Item 1 of the ECTS the appropriate system of funding regions should ensure them **predictable** amounts of public revenue, appropriate to their competencies and enabling them to pursue their own policies. Equalizing resources transferred in the form of subventions are sources of public revenue to provinces, therefore they should be predictable *i.e.* it is justifiable to adopt

such legal regulations which guarantee a specified parity of resources in relation to the planned revenue of the state budget, because the compensating part of the general subvention to provinces is just transferred from the state budget. Art. 14 Item 5 of the ECTS states that financial transfers should be based on **previously** specified principles using a small number of objective criteria connected with the real needs of regions.

Under Art. 69 of the Law on Provincial Self-government the total value of the compensating subvention for provinces, as well as the principles and criteria of its distribution, are set forth by separate regulation. However, there is no provision included in the Law on Provincial Self-government (as provided in Art. 57 Item 1 of the Law on District Self-government) which meets the aim of objectivizing the subvention, *i.e.* a rule on the necessity of setting a fixed relation between the compensating part of the general subvention to provinces and state budget revenue. Such arrangements should also be submitted to critical examination, because they introduce unreasonable differentiation between individual categories of territorial self-government units within the scope of the mechanism used to compensate the shortage of basic tax revenue. Thus, the annually adopted budget makes separate provisions mentioned in Art. 69 of the Law on Provincial Self-government.

The statement that the budget stipulates the amount set aside for the compensating part of the general subvention to **all** provinces is inaccurate, because not all provinces are eligible to receive such a part of the general subvention [Sokolewicz, 2000, 157]. According to the provisions of Art. 33 of the Law on the Revenue of Territorial Self-government Units, the compensating part of the general subvention is received by such provinces in which the ratio of basic tax revenue per capita (the W -ratio) is lower than the W_w -ratio which constitutes the basis for calculating the compensating part of the general subvention (this was the highest W -ratio for 1999). The W_w -ratio is revalorized: for the revenue of provinces coming from their share in receipts from personal income tax constituting state budget income by means of a corrective ratio for personal income tax (this is the ratio of the total amount of receipts planned from personal income tax adopted in the budget for that budgetary year to the amount of receipts planned from such a tax adopted in the budget for the base year) and for the revenue of provinces from their share in receipts from corporate income tax constituting state budget income by means of a corrective ratio for corporate income tax (*i.e.* the ratio of the total value of receipts planned from corporate income tax adopted in the budget for that budgetary year and the value of receipts planned from such a tax adopted in the budget for the base year).

The W-ratio for a given province is calculated by dividing the amount of planned revenue (from its share amounting to 1.5% of the receipts from personal income tax on inhabitants of the province and amounting to 0.5% of the receipts from corporate income tax on organizations having their principal place of business in that province) by its population. The level of provincial revenue planned for a budgetary year from its share in receipts from personal income tax constituting state budget income is determined by multiplying the value of receipts planned from that tax, adopted in the budget for that budgetary year, by 0.015 and by the share of income tax due in the year preceding the base year from people living in municipalities within the province in the total amount of tax due in that same year, determined on the basis of tax returns on income obtained and yearly calculations of tax made by tax payers and filed by 30th June of the base year. On the other hand, the level of provincial revenue planned for the budgetary year from its share in the receipts from corporate income tax constituting state budget income is determined by multiplying the total value of receipts planned from that tax, adopted in the budget for that budgetary year, by 0.005 and the share of receipts from corporate tax in the year preceding the base year, from the territory of that province in the total value of receipts from that tax in that year. The basis for calculating an individual province's share in the total amount of provincial revenue from its share in receipts from corporate income tax in the year preceding the base year constitute revenue shown in the financial accounts.

In order to establish which provinces are eligible to receive the compensating part of the general subvention, it is necessary to calculate and compare two ratios: the W-ratio and W_w -ratio. Provinces in which the basic tax revenue per capita (the W-ratio is related to the share in personal income tax and corporate income tax) is lower than the appropriate revenue of the provinces which have obtained the highest level of such income (the W_w -ratio) are eligible for the compensating part. Thus, the compensating part of the general subvention is received by all provinces, except for the province with the highest W-ratio, in twelve equal monthly instalments by the 15th day of each month.

This shortfall of basic tax revenue is only partly compensated to provinces, because the amount of the compensating part of the general subvention due to a province is calculated by multiplying 70% of the difference between the W_w -ratio and W-ratio for the given province by the population of such province. The manner of compensating the differences in the basic revenues of provinces fulfils the objectives of the legislator only to a small extent. The provinces have not been endowed with any developed system of their own sources of income from specified regional

taxes and their share in income tax receipts is rather negligible. Various studies have demonstrated the strong dependence of the provinces on transfers from the state budget. The ability of provincial self-governments to pursue their own policies of provincial development is assessed critically due to the low level of their financial means and the highly discretionary nature of transferring subsidies and certain components of the general subvention from the state budget [Gilowska, 2001, 88].

The value of the compensating part of the general subvention to provinces has been stipulated in the budget for 2002 as 242,154,000 PLN.

5. Conclusions

The mechanism of equalizing territorial self-government units' income in force in Poland uses some solutions applied in other countries with a much longer tradition of local self-government, *e.g.* in Germany, Sweden, Denmark, Austria, France, Italy and Greece. In the majority of these cases the legal institution of subvention or subsidy is applied, while a share in receipts from specific taxes is only rarely used [Comparative analysis..., 2000, 39]. Apart from transferred resources from the state budget, resources coming from territorial self-government units are also utilized, *e.g.* the equalization fund at the level of lands in Germany, which enables the distribution of resources between municipalities in accordance with their financial ability and requirements [Tegler, 1997, 32].

A comprehensive assessment of the mechanism of equalizing income level is difficult, but it should be emphasized that it enables granting financial assistance to local communities in carrying out their tasks and satisfying their needs while retaining a specified standard. This can lead to the elimination of differences caused by geographic conditions, different management conditions, demographic structure and professional qualifications of the labour force. When applying various balancing mechanisms some dangers may also appear, *e.g.* the formation of permanent financial dependence of territorial self-government on the state budget [Zakrzewski, 2000, 184], deficits in the budgets of territorial self-government units, a gradual decline in activity related to the development of one's own sources of revenues. The total elimination of such negative phenomena does not seem to be possible. However, they can be limited, above all, by applying objective and stable rules for determining and distributing pecuniary resources within the framework of a binding system for equalizing the income potential of territorial self-government units. This balancing mechanism should constitute a conscious, comprehensive compromise between the independence of territorial self-government units and the justified needs of guaranteeing the coverage of ex-

penses in units with a weak economy, in order to achieve a specified standard of performing various services on behalf of local communities enjoying the right to adequate welfare.

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