

*Projekt finansowany w ramach umowy 857/P–DUN/2016
ze środków Ministra Nauki i Szkolnictwa Wyższego
przeznaczonych na działalność
upowszechniającą naukę.*

Nazwa zadania:

Stworzenie anglojęzycznej wersji publikacji



Ministerstwo Nauki
i Szkolnictwa Wyższego

Zeszyty Naukowe
Wyższej Szkoły Bankowej w Poznaniu
2016, t. 70, nr 5

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Decentralization and Debudgeting as Manifestations of Structural Changes within the Public Sector in Poland

Abstract. *This article discusses the problems of the structure of the Polish system of public finance in the context of decentralization and debudgeting (debudgetization). The considerations are based on the data from reports on the execution of the state budget for the year 2015. The analysis reveals a wide range of internal transfers within the system, an important redistributive role of the state budget, and numerous forms of extra-budgetary economy. The system is characterized by a considerable degree of decentralization, which, however, is founded more on the decentralization of tasks and expenditures, than on the transfer of public revenues in the form of taxes. These features have led to a situation where structural changes result in poor manageability of the total public revenue and expenditure. Despite their numerous advantages with regard to a higher flexibility and rationalization of financial economy, the processes of decentralization and debudgetization also have some negative consequences.*

Keywords: *public finance sector, decentralization, debudgetization, state budget*

Introduction

Modern systems of public finance form complex structures characterized by a decentralization of public services and a diversity of organizational and legal forms. Moreover, their specific tools and solutions vary substantially depending on historical, political, economic, and geographic conditions. There are, however, two elements that are shared by contemporary public finance systems in democratic states. These are decentralization and various forms of extra-budgetary

economy designed to meet specific, socially important, public services; a process which is also known as debudgeting (or debudgetization). In recent years the share of the subsector of local government revenues in the GDP of Poland has amounted to about 13%, which puts the country above the average for all of the EU countries. The share of the subsector of local government expenditures is slightly higher and, for example stood at 14.1% in 2011, and at 13.1% in 2013. The importance of the local government subsector in the Polish economy is reflected in the fact that it spends over 30% of total public funds in Poland. The other group of entities, which play a role in the Polish economy, consists of appropriated funds and executive agencies, which are the most important entities for the extra-budgetary economy. In 2015 there were twenty-eight state appropriated funds in Poland. Their expenditure towards social security amounted to 40% of the total public expenditure in Poland. The important areas of public services, for which the funds were established, include social security and welfare, privatization, national security and defense, science, as well as, cultural and environmental protection. The management of the State Treasury property lies within the executive agencies. Currently there are ten entities that have been granted the status of an executive agency. The number of appropriated funds and agencies (formerly known as governmental funds and agencies) in Poland has varied considerably over the years.

The processes of the decentralization of public finances are manifestations of the subsidiarity and adequacy principles, and the foundation of appropriated funds and agencies is yet another form of financial management. An attempt to create a form of collecting and spending public funds, which would be an alternative to the budget, aims at withdrawing from the rigid rules of the economy that is restricted by the framework of the budget in order to ensure a smooth implementation of important tasks that the state is held responsible for. This process may, in particular, concern social security, health care, etc. The aim of this discussion is to present selected theoretical topics related to the processes of decentralization and debudgetization, and to describe the relations between the segments of the public finance sector in Poland and their effects on the overall result of the sector.

1. The concept and importance of decentralization and debudgetization

Modern systems of public finance are characterized by specific features that have evolved under historic, economic, and social conditions in individual countries. However, despite a large number of unique institutional and financial arrangements, it is possible to indicate the processes that are common in most democratic countries. These include decentralization and debudgetization of pub-

lic finance, which have consequences for the control over public revenues and expenditures as a whole. The manageability of the system of public finance means that there is a possibility of making quick and flexible decisions concerning the management of the total public funds, particularly their spending in a versatile and unpredictable environment. Such control has its limitations as the decisions on public funds require long and cumbersome legislative and executive procedures. Decentralization in the context of financial autonomy has been a subject of many a study and analysis due to the distribution of the state tax revenues and the programs of subsidizing local governments, which pose a burden for the state budget. However, the range of services financed with appropriated allocations, which enable many countries to canalize local public expenditure, is wide and covers most areas of public activity [Kim, Lotz & Blochliger 2013: 27].

The decentralization of public finance limits the overall management of public funds as the funds are partially placed outside the direct control of the state government. Although the state legislator defines the scope and type of financial decentralization, it can no longer interfere with the financial autonomy of local government entities. Financial autonomy relies on independent policies for collecting tax and non-tax revenues, and for the spending of such revenues. In practice, the degree of independence in spending is usually higher than that in collecting revenues. Despite the common belief that local government revenues should be based on own revenues, the limited scope of revenue autonomy results mainly from two factors: namely the transfer of a growing number of public services, which do not have enough funding from local tax revenues, onto the municipal level; and the attractiveness of subsidies and grants from the state budget, which operate as a form of control over local government entities. Another important element of financial autonomy and independence is a possibility of local governments to incur financial liabilities on the financial market, which contributes to a rise in the level of public debt in the country. This fact also results in the poor controllability of public funds as a whole. The legal norms that limit borrowing at the local government tier, and a relatively small proportion of local government debt in the total public debt, only mitigate but do not solve the problem as much depends on the level of imbalance within the sector. A high degree of unpredictability for financial crises may, despite the curbs, for example on liabilities in foreign currencies, lead to the bankruptcy of towns and communes.

Although it limits the manageability of the system, decentralization of public finance remains a fundamental and essential attribute of a territorial self-government, of a more rational spending of public funds, and of better catering to social needs. The other of the discussed processes, the so-called debudgetization of public finance, poses a far more serious problem. Broadly speaking, debudgetization is directly responsible for the formation of various enterprises within the extra-budgetary economy, which means, in Polish conditions, a proliferation

of appropriated funds. The term *debudgétisation* comes from France where it is widely used in literature on public finance law [Buisson & Deruel 2001: 68; Muzellec 2000: 57; Saïdj 2000: 75]. The phenomenon of debudgetization is generally understood as a deviation from the organizational and financial principles characteristic of the entities within the public sector, enabling the implementation of the tasks excluded from the budget under the rules that are different from the ones that have been laid down for these entities in the Budget Law. Debudgetizing includes any action with a purpose to circumvent the rather rigid mechanism of financing public services and has the characteristic features of a budgetary economy. The concept of debudgetization has been used in the Polish literature in the context of budgetary principles [Kosikowski & Ruśkowski 2003: 311] and the problems within public finance generated by the origin of appropriated funds, state agencies, and other extra-budgetary entities in the public finance sector [Stankiewicz 2007]. Excessive debudgetization contradicts two important budgetary principles: the principle of non-assignments (in the material and financial sense), and the principle of unity (in the formal and legal sense). A failure to comply with these principles is viewed critically by the doctrine in various aspects. However, from the economic vantage point, the growing issue nowadays is that the comprehensive management of revenues and expenditures and the flexibility of the decision-making process have been extremely impaired in such a volatile and dynamic environment.

The reasons for, and the consequences of, establishing appropriated funds and other forms of an extra-budgetary economy have been widely described in the literature on the subject [Szołno-Koguc 2007; Owsiak 2005: 148; Denek, Sobiech, Wolniak & Wierzbicki 1995: 72; Kosikowski & Ruśkowski 2003: 405]. The reason for establishing extra-budgetary funds, which is most commonly quoted, is a need to search for an alternative to the rigid budgetary principles of collecting and spending public funds [Alińska & Woźniak 2015: 86]. This is all about bypassing the annual nature of the budget and its consequences, such as rigid limits and plans on expenditure. What is also important is to ensure stable and efficient sources of funding for particular tasks. There are also political factors related to limited control by the decision-making bodies over the use of funds and incurred liabilities. The positive effects of debudgetization include more flexible financial management and a more stable, legally granted, source of funds for a particular task of a given entity. The positive effect, which has not yet been emphasized, is the possibility of using the competition mechanism in providing selected services and a partial payment for them. Unfortunately, in practice, there are numerous negative effects that raise much controversy. J. Stankiewicz [2007: 37-39] enumerates five basic negative effects of debudgetization: the parliament tends to lose part of its political power over a section of the state finances; the principle of transparency of public finances is impaired; there is an impediment

to efficient and optimal management of state finances, as well as, a susceptibility to various pathologies in the management of public funds, and finally, public finances become excessively politicized. The author emphasizes the problem of the manageability of the whole public finance system by enumerating the sources of difficulties in the efficient management of public finance. In his view, debudgetization:

- makes the state finances more rigid as a whole, by excluding a part of the funds from the budget and earmarking them for particular expenditures,
- indirectly leads to less flexibility and liberty in the decision-making process,
- makes the optimal use of the funds impossible, allowing funds to be frozen [Stankiewicz 2007: 38].

Decentralization and debudgetization result in problems with the coordination of fiscal policy. Mature democracies use both formal and informal fiscal rules such as [Boadway & Shah 2011: 477] budgetary balance controls, debt restrictions, tax and expenditure controls, referenda for new taxing and spending initiatives, and penalties for noncompliance.

2. Revenue and expenditure balance for the sector and the problem of internal transfers

The public finance sector in Poland consists of three subsectors: the central government, the local government, and the social security sectors. The same pattern is used to present the revenue, expenditure, and the summary result of the sector. The local government sector is directly related to the decentralization of public finances, whereas the social security sector relies on debudgetization.

Non-equivalent cash flows (revenues and expenditures) that are characteristic of public finances are called transfers. They usually take the form of a public entity's expenditure, which is a non-refundable, free transfer of funds. Transfers include taxes, contributions, public and legal charges, donations, subsidies, grants, benefits, allowances, and pensions. Grants and subsidies constitute a group of very important transfers within and outside the public finance sector. They are divided into general subsidies and appropriated allocations depending on such criteria as the purpose of, and the conditions for, the grant. Other important categories include earmarked subsidies and specific grants. Earmarked subsidies are granted to a particular entity or a group of entities as a general financial support for their activities. The subsidy programs tend to avoid this type of transfers as they are usually arbitrary and economically inefficient.

From the point of view of an analysis of the balance of public finances, it is essential to differentiate between internal and external transfers. This is also in-

dispensable for a consolidation of all revenues and expenditures, which, in turn, serves as a basis for drafting a balance sheet. Internal transfers involve moving funds between entities that belong to the public finance sector the effect of which is not a change in the amount of money at their disposal, but a change to the structure of the final spending. External transfers, on the other hand, involve the transfers of such funds as benefits for individuals or subsidies for enterprises to entities that do not belong to the sector. A consolidation of public sector revenues and expenditures is an operation that eliminates the double-counting of the transferred funds. On the revenue side, such an operation excludes the sums of money transferred to other entities in the public sector from the revenues of each subsector. On the expenditure side, the sums transferred to the entities which are also included in the public finance sector are omitted. After consolidation, the expenditure stands for the sum that was transferred to the entities outside the public sector.

The revenues of the public sector in Poland, without the mutual transfers between the subsectors and within the subsectors, have been presented in Table 1. Only the receipts from outside the sector are considered to constitute the revenue of the public finance sector and its subsectors. Therefore, the total revenue of the sector as a whole (including the subsectors) is lower than the sum of revenues presented in the reports by the individual entities that belong to this sector. In 2015, the revenue of the public finance sector, after consolidation, amounted to 687,781.8 million PLN. In 2015, the ratio of the consolidated revenues to GDP stood at 38.4%, and was lower when compared to the previous year by 0.9 per-

Table 1. Summary of Public Finance Sector Revenues for 2015 (in millions of PLN)

Specification	Public Finance Sector*	Central Government Subsector**	Local Government Subsector**	Social Security Subsector**
Total revenue	687,781.8	382,931.0	232,812.8	293,383.2
Tax revenues	327,979.7	259,382.2	69,370.4	0.0
– indirect taxes	186,713.5	187,058.6	0.0	0.0
– CIT	32,756.7	25,730.4	7,076.1	0.0
– PIT	83,140.1	45,040.0	38,100.1	0.0
– other taxes	25,369.4	1,553.2	24,194.2	0.0
Non-tax revenues	359,802.1	123,548.8	163,442.4	293,383.2
– dividend	6,836.1	6,351.2	382.1	102.8
– receipts from the NBP revenues	0.0	0.0	0.0	0.0
– custom duties	2,928.9	2,928.9	0.0	0.0
– contributions	196,734.3	407.2	0.0	220,815.8
Other revenues	85,890.1	47,609.0	147,042.9	71,761.1
EU funds	67,412.7	66,252.5	16,017.4	703.5

* Excluding intra-sectoral transfers, ** Excluding intra-subsectoral transfers.

Source: *Report on the execution...* 2016: 333.

centage points [Report on the execution... 2016: 320]. The decline resulted from a fall in both tax and non-tax revenues.

Receipts from taxes are the primary source of revenue for the public finance sector. In 2015, they stood at over 327 billion PLN, which means that they grew nominally by 2.8%, and 3.7% in real terms, when compared to 2014. Tax revenues accounted for 48% of the total revenues for the sector. Non-tax revenues, on the other hand, exceeded 359 billion PLN and rose by 0.7% nominally, and 1.6% in real terms, in comparison with the previous year's figures. Non-tax revenues accounted for 52% of the total revenues for the sector.

Table 2 presents a summary of consolidated expenditures. The expenditure of the sector as a whole, and of individual subsectors, is defined as only those funds that were transferred outside of the sector. The total expenditure for the sector is therefore lower than the sum of expenditures reported by the organizational entities that belongs to the public finance sector.

Table 2. Summary of Public Finance Sector Expenditure Divided into Subsectors for 2015
(in millions of PLN)

Specification	Public Finance Sector*	Central Government Subsector**	Local Government Subsector**	Social Security Subsector**
Total expenditure	731,838.0	426,693.6	229,305.2	297,184.4
Grants and subsidies	58,756.0	188,987.7	12,029.9	292.1
Benefits for individuals	296,996.4	26,692.0	17,360.7	267,489.0
Other current expenditures	242,270.3	101,930.5	157,532.1	8,582.6
Capital expenditure	84,852.4	61,880.9	40,049.3	820.7
Expenditure for public debt servicing	30,713.8	28,953.4	2,333.2	0.0
EU own funds	18,249.1	18,249.1	0.0	0.0
Deficit/Surplus (revenue – expenditure)	–44,056.2	–43,762.6	3,507.6	–3,801.2

* Excluding intra-sectoral transfers, ** Excluding intra-subsectoral transfers.

Source: *Report on the execution...* 2016: 333.

After consolidation, the expenditure of the sector amounted to 731.8 billion PLN in 2015. The share of expenditure in the GDP was 40.9% and was lower by 0.7% when compared to the previous year. Social security spending, which includes pensions, family allowances, unemployment benefits, benefits and allowances for individuals, and scholarships invariably constitute a large part of the expenditure. In 2015, the consolidation on the expenditure side relied on both

direct and indirect fiscal principles, which define the foundations for a budget draft.

The comparison between the revenue and the expenditure allows for an analysis of the financial result. In 2015, the deficit of the public finance sector exceeded 44 billion PLN. The summary in Table 2 demonstrates that the central government subsector, with a deficit of 43.7 billion PLN, had the largest share in the result for the entire public finance sector. The local government subsector recorded a surplus while the social security subsector had a deficit of 3.8 billion PLN. Clearly, in the unconsolidated approach, it is the central government sector (mostly the state budget) that bears the entire burden of the deficit for the sector as a whole. This is important from the point of view of the economization of debt as the cost of the State Treasury debt is lower than in the case of other entities. Taking into account the level of controllability and manageability of the system of public revenue and expenditure as a whole, it is possible to enumerate several negative elements such as a high level of internal transfers, rigidity in the liabilities of the state budget towards other public entities, and a necessity to service debt, which may easily spin out of control in a political or economic crisis.

Table 3 presents a summary of the analysis of the results for the public finance sector for the year 2015. It demonstrates relations between individual segments and the effect of those relations on the financial results. The local government sector presented in the summary is strictly associated with the decentralization processes discussed in this paper, whereas the social security subsector and other entities rely on the so-called debudgetization.

After the consolidation that excluded mutual transfers, there is a new situation in the area of surplus and deficit in individual subsectors, which is presented in the 'net' line of the table. The state budget records a surplus of 130.3 billion PLN, while the local government and social security sectors have a very high deficit of 99.6 billion PLN and 56.5 billion PLN respectively. The system is characterized by an imbalance on the side of revenues and tasks attributed to the entities in the analyzed subsectors. A reallocation of public funds inside the public finance sector in the form of various transfers substantially changes the financial situation of individual subsectors. While supporting appropriated funds and state agencies can somehow be justified (despite the long-standing criticism of such support), such a vast extent of external funding for the local government sector is incompatible with its financial independence and autonomy, which have been advocated for years. The ultimate effect of decentralization and debudgetization of the system of public finance in Polish conditions manifests itself in the ever-growing redistributive role of the state budget with all the possible repercussions. Certainly this effect was not intentional. It was rather a result of the reform and evolution of the system after 1990.

Table 3. Relations between segments of the public finance sector and their financial results for 2015 (in billions of PLN)

Specification	Central Government Subsector	State budget	Executive agencies	Other entities	Local Government Subsector	Budget for entities	Other entities	Social Security Subsector	Social Insurance Fund	Old-Age and Disability Pension Fund	Other entities	Public Finance Sector
1. Total revenue	420.1	289.1	11.7	110.3	245.7	199.0	46.6	302.7	193.5	20.4	88.8	968.5
Intra-sectoral transfers	49.3	4.7	7.7	37.0	134.5	99.3	35.2	96.9	64.5	18.9	13.5	280.7
2. Revenue exclusive of transfers	370.8	284.4	4.0	82.3	111.1	99.7	11.5	205.9	129.0	1.5	75.4	687.8
3. Total expenditure	463.9	331.7	11.2	120.9	242.2	196.4	45.7	306.5	199.5	19.9	87.1	1012.5
Intra-sectoral transfers	205.2	177.6	5.2	22.4	31.4	27.7	3.7	44.1	5.2	2.2	36.7	280.7
4. Expenditure exclusive of transfers	258.7	154.2	6.0	98.5	210.8	168.7	42.0	262.4	194.2	17.7	50.5	731.8
5. Results (1-3)	-43.8	-42.6	0.5	-1.6	3.5	2.6	0.9	-3.8	-6.0	0.5	1.7	-44.1
6. 'Net' result (2-4)	112.1	130.3	-2.0	-16.2	-99.6	-69.1	-30.6	-56.5	-65.3	-16.1	24.9	-44.1

Source: *Report on the execution...* 2016: 323.

In such a situation it is the state budget that is hit by the turbulences, which can be clearly seen in the analysis of the 2014 and 2015 data, even after the amendment to the budget in 2015. The planned state budget deficit for 2014 amounted to 28,976,820 thousand PLN and 49,980,000 thousand PLN in 2015 [Report on the execution... 2016: 23].

In 2015, as in previous years, the transfers from the state budget in the form of grants and subsidies accounted for the largest share in the total state budget expenditure and stood at 51%. The execution of expenditures in the category of grants and subsidies in 2015 rose by 11% when compared to 2014. This was mainly due to an increase in the allocations from the state budget to the Social Insurance Fund for 2015 (11,702,861 thousand PLN more than the amount of subsidies used by the Social Insurance Fund in 2014). Such a significant difference resulted, inter alia, from the higher spending on old-age and disability pensions following the indexation of these benefits. The current expenditures of budgetary entities (18.7%) and the servicing of the State Treasury debt (8.8%) also accounted for a significant part of the total expenditure. In light of the subject matter of this discussion, it is symptomatic that, as early as 2015, the state budget expenditures towards the implementation of the current tasks of the local government entities, 44.2% in total, and the allocations to the appropriated funds, 35.4% of the expenditure for the whole group, accounted for the largest section of the subsidies and grants from the state budget. Thus, 20.4% of the funds belonging to this group of expenditures, including 12.6% for earmarked subsidies, were spent towards other grants [Report on the execution... 2016: 82-89].

Conclusions

The structural changes to the public sector in Poland are reflected in the processes of decentralization and debudgetization which parallel the creation of a market economy after 1990. The system that has resulted from these changes is characterized by several features, the most important of which are the following:

- a highly important redistributive role of the state budget in the general redistribution of public funds
- a large scope of internal transfers associated mainly with subsidizing local government entities and the Social Insurance Fund
- an imbalance in the primary and secondary sources of deficit, which ultimately pose a burden for the state budget.

The aforementioned features make the management of public revenues and expenditures difficult. It should be admitted, however, that, in a way, it is a natural phenomenon in the conditions of decentralization and debudgetization of the public finance system. The basic conclusion from these considerations leads to

a postulate of more decentralization in the revenues of the sector and a higher amount of tax revenues attributed to the local government. As far as the large scope of debudgetization is concerned, apart from the postulate of limiting appropriated funds (which may be irrational at times), it may be reasonable to introduce changes to the way the Social Insurance Fund operates, particularly in reference to the way the Fund is financed, which, in turn, should lead to even more serious structural changes to the system of old-age and disability pensions.

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Decentralizacja i debudżetyzacja jako przejawy zmian strukturalnych w sektorze publicznym w Polsce

Streszczenie. W artykule podjęto problem struktury polskiego systemu finansów publicznych w kontekście decentralizacji i debudżetyzacji. Rozważania oparto na danych ze sprawozdań z wykonania budżetu państwa w 2015 r. Przeprowadzona analiza wskazuje na duży zakres transferów wewnętrznych w systemie, dużą redystrybucyjną rolę budżetu państwa oraz duży zakres różnego rodzaju form gospodarki pozabudżetowej. System charakteryzuje się znaczącym stopniem decentralizacji, ale opartej głównie na decentralizacji zadań i wydatków, w mniejszym zaś stopniu na przekazaniu dochodów publicznych w postaci podatków. Cechy te sprawiają, że zmiany strukturalne w niewielkim stopniu umożliwiły zarządzanie całością dochodów i wydatków publicznych. Procesy decentralizacji i debudżetyzacji mimo wielu zalet związanych głównie z uelastycznieniem i racjonalizacją gospodarki finansowej, mają więc również negatywne konsekwencje.

Słowa kluczowe: sektor finansów publicznych, decentralizacja, debudżetyzacja, budżet państwa