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## Factors Destabilising the System of Polish Local Government Finances Based on the Example of the City of Kraków in 2018–2023

### Abstract

*Objective:* The goal of the paper is to characterise the factors destabilising the financial system of Polish local governments in the years 2018–2023 based on the example of the city of Kraków.

*Research Design & Methods:* To achieve the goal, the research used the analysis of law as well as the analysis of the major financial categories such as total incomes, debt, and operational surplus. These factors which had the major impact on destabilising the financial situation of Polish local governments were divided into those dependent on decision-makers (such as the size of subsidies provided for tasks or the tax policy pursued by the Polish government in recent years) and independent ones (including the effects of the COVID-19 pandemic and the war on Poland's eastern border, or an increase of energy and services prices).

*Findings:* Tax policy in particular had a significant impact on the condition of Polish local governments, causing significant revenue losses. The case of the city of Kraków proves this. All of the above-mentioned factors impacted local budgets and resulted in an increase in current budget expenses as well as limited investment opportunities of local government units.

*Implications / Recommendations:* In order to strengthen the financial position of local government, some systemic reforms dedicated to the tax policy and compensatory subsidy must be applied.

*Contribution / Value Added:* Some particular recommendations were proposed. Among them is the legitimacy of continuing works on changes to the self-government financing system. This should result in making the revenue base of territorial self-government units independent of decisions of central authorities as well as in strengthening the area of local taxes. The recommendation also relates to the compensation system and the objectivisation of the principles of allocating targeted subsidies.

*Keywords:* local government taxation, local government deficit, intergovernmental grants

*Article classification:* research article

*JEL classification:* H71, H72, H77

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## Introduction

The reform of local self-government in Poland is regarded as one of the fundamental achievements of the Polish post-1989 transformation. Introduced together with many other reforms – such as the reform of education, health, or social security – it brought the most important expected and effective results, among which worth mentioning is the autonomy of self-governing bodies or the paradigm of their financial independence. Poland built a self-government system based, *inter alia*, on the European Chart of Local Government (Europejska Karta..., 1994), which was based on the delegation of tasks to the self-government level, the transfer of property to self-governments, or the constitutional principle of adequacy of funds. The assumptions were also about guaranteeing local governments funds as their own revenues. These in Poland include mainly: local taxes, fees, shares in central taxes PIT and CIT, and revenues from property. However, there has been some controversy surrounding self-governments, as self-governments in Poland are not only responsible for the delivery of public services, as defined in a number of laws, *de facto* setting their minimum standard, but are also responsible for local and regional development. The development of a local government depends on its ability to finance investments either with its own funds or with credit or loans. Indeed, a local government in Poland cannot incur liabilities for any other purpose. The last years of local government in Poland were characterised by special conditions. These include objective causes such as the COVID-19 pandemic or the war beyond Poland's eastern border, increases in the prices of goods and services, but also the Polish government's tax policy. All of the above, especially tax policy, have left a strong impact on local government finances. The analysis of factors destabilising local finances confirmed that the greatest negative impact on the finances of Polish territorial self-government units was exerted by decisions introducing changes to PIT, which resulted in a significant loss of revenue for local governments. Cities with poviat rights were the most affected group<sup>1</sup>. The analysis of the destabilising factors was conducted in relation to the most important group of Polish local governments, i.e. municipalities and cities with poviat rights, which also include Polish metropolises. It is the big cities that have felt the effects of legislative changes the most. The financial situation of large cities was presented on the example of the city of Kraków, the second largest city in Poland, characterised by a stable financial situation for many years. The analysis included studies of changes in basic legal acts and their impact on the functioning of territorial self-government units. The comparative analysis method was used to assess changes in the financial situation of territorial self-government units (TSU). Income figures – particularly total income, PIT shares, property tax revenues, the level of indebtedness of selected units of groups of units, their operating surplus, and total expenditures for the years 2019–2023 – were used as the basis for the analyses. The main source of data is the aggregate figures available at [www.mf.gov.pl](http://www.mf.gov.pl), which consist of summary statements on the implementation of TSU budgets, as well as publications of regional chambers of auditors or TSUs themselves.

The main hypotheses that were examined are as follows:

Hypothesis 1: The changes introduced into the Polish tax system had an impact on local government finances.

Hypothesis 2: The introduced legislative changes did not contribute to the stabilisation of local government finances.

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<sup>1</sup> The Polish self-government system groups self-governments according to the following types: communes, poviats, cities with poviat rights, and self-governing voivodeships.

Hypothesis 3: In order to be able to establish the local government financing, some economic instruments should be introduced to the law system.

## Literature review

During the period under review, there were incidents that significantly affected the way local authorities operated. These factors had a destabilising effect on the organisation of work and their financial situation. These factors can be divided into two groups:

1. factors dependent on decision-makers, which can include the size of subsidies and grants provided to the local level, or decisions on tax policy changes. In both cases, the decision-maker was the central government;
2. factors independent of decision-makers, e.g. random factors such as the COVID-19 pandemic or the war across the eastern Polish border.

In both cases, it was ultimately up to the central government and local authorities to mitigate the effects of these events. For local government, the epidemic period brought about many new challenges: the need to organise public services under epidemic conditions, reduced revenue for budgets resulting, *inter alia*, from government-imposed restrictions on economic activity, or the additional expenditure needed to ensure sanitary safety in subordinate facilities. The survey conducted among representatives of local government units at the municipal level sheds some light on the effects of the epidemic on the implementation of the plans of local government units, the work of their officials, finances, and the quality of the provided services. Reports prepared by the Bank of National Economy (BGK) (Bank Gospodarstwa Krajowego, 2020), Council of European Municipalities and Regions (CEMR) (2020), NALAS (2020), Batory Foundation (Nelicki, 2020), Staniszewski's research (2020) or the European Committee of the Regions (2021) confirm the difficult situation of local authorities in relation to COVID-19 not only in terms of the impact on the economy, but, above all, in terms of the fall in local government revenues. This is also confirmed by the Fitch Agency ratings with regard to the decline in corporate income tax (CIT). Around 75% of all expenditure on public tasks passes through the budgets of municipalities, which, of course, shows the extent of their responsibilities, but also the size of their cash flow. The municipalities' expenditure is mainly focused on education, health, and social protection. Local governments are strongly dependent on transfers from the government, mainly from PIT shares and transferred subsidies. The autonomy of Polish local government revenues is lower than the EU average, indicating a greater dependence on central government transfers. Local governments have little autonomy in setting tax rates. The largest share of tax revenue is shared between the government and local government. Therefore, the tax reforms introduced for central taxes have far-reaching consequences for local governments. The tax reform introduced in 2019 included personal income tax allowances and exemptions, a higher minimum wage, increases for teachers, and new tax loss rules. It also had an impact on local and regional government budgets in 2020. For businesses, it meant some significant changes such as mandatory split payment, a revolution in declarations; additionally, a white list of VAT taxpayers was created and new exemptions in PIT were introduced. The proposed solutions (cf. Piszczek & Surówka, 2023a, 2023b) consisted, *inter alia*, in increasing the tax-free amount, reducing the tax rate in the first tax bracket by five percentage points, increasing the amount of the first tax bracket by approximately 40%, introducing reliefs for seniors and families, as well as the so-called relief for 'young' taxpayers under 26 years of age. All this meant that PIT revenues fell.

Indeed, taxpayers gained from the reform introduced by the Polish Order, but not entirely and not all of them. As of 2022, the health insurance premium ceased to be a tax-deductible allowance. Poles paying PIT started to be charged with a 9% contribution to the National Health Fund. It is based on gross remuneration after deducting the Social Security contribution. Until the end of 2021, the National Health Fund contribution had only burdened taxpayers with 1.25%. Moreover, the reform of the flat-rate tax on registered income introduced in 2021 resulted in an additional decrease in PIT income on a general basis. As emphasised by Piszczek and Surówka (2023a, 2023b), the income situation of those local government units in which business entities paying this tax are located worsened above all. Rural and rural-urban municipalities were affected to a lesser extent, as farmers are exempt from personal income tax. Therefore, the problem affects predominantly medium-sized and large cities (WEI, 2023).

It is noteworthy that the government has twice decided to transfer additional funds to local authorities to make up for the shortfalls that have arisen in their budgets, but the amounts have not compensated for the losses incurred in connection with the introduction of the Polish Order. In addition, it was decided to set up new instruments to support local governments, which include the Government Local Investment Fund or the Government Polish Order Fund: Strategic Investment Programme, the COVID-19 Counteracting Fund, funds passing through the National Fund to Protect Environment (NFOŚ), dedicated to local governments, or support from extra-budgetary funds. Access to these funds was set using not very clear criteria, which was emphasised by local governments, even accusing the government of discretion, unequal treatment, and unfair access. An extensive coverage of the effects of the COVID-19 pandemic, tax changes and their impact on the budgets of TSUs, or the effectiveness of the introduced instruments was provided, *inter alia*, by Malinowska-Misiąg (2022), Czudec (2021), Sześciło and colleagues (2021), Flis and Swianiewicz (2021a, 2021b), Kostyk-Siekierska (2021), Łubina (2021), Ofiarska (2021), Rudka and Kocemba (2021), Balcerek and Kosiarz (2020), Bazylak and colleagues (2020), Bober and colleagues (2020), Bojarowicz (2020), Izdebski (2020), Klimek (2020), Nelicki (2020), OECD and CoR (2020), Swianiewicz and Łukomska (2020), and others.

The finances of Polish local authorities were also affected by events beyond our eastern border. The huge inflow of war refugees, war-induced inflation, and disruptions to supply chains have had a major negative impact on local budgets. According to the Warsaw Enterprise Institute (2023), between 3.5 and 4 million immigrants arrived in Poland, 60%–75% of whom were Ukrainians. This meant concrete impacts on local budgets, e.g. in the form of transferred social benefits enjoyed by Ukrainian citizens with refugee status, which – according to data from November 2022 (Karpińska, 2022) – were as follows:

- 328,000 children benefiting from the 500+ programme;
- 12 thousand parents benefiting from Care Capital;
- 141 thousand benefiting from the 300+ benefit;
- 53 thousand benefiting from family benefits.
- In the area of education, the benefits covered:
  - 191 thousand pupils in schools, representing 65% of all Ukrainian children residing in Poland;
  - 43 thousand children receiving pre-school care (this number represents 50% of all pre-school children who had fled to Poland before the war).

The total cost of the above support related to children from Ukraine is approximately 200 million PLN per month.

Other financial support for Ukrainian refugees includes the following:

- more than 1 million people benefited from the 300 PLN school starter kit;
- approximately 1.7–2 billion people benefited from the 40 PLN for Poles receiving under their roof.

On the part of local governments and non-governmental organisations, the total estimated cost of assistance amounted to about 10 billion PLN. The Government also created an instrument called the Ukraine Assistance Fund, which can be used to finance many educational tasks, education, and childcare costs. The Law on Assistance to Citizens of Ukraine has also been amended (Dz. U. 2024, poz. 167). In addition to the financial instruments described above, a number of amendments to the already existing laws and the establishment of new legislation should be mentioned. Some of them include: The Law on Public Finance (2021), the Law on Revenues of Local Self-Government Units (2024), the Law on Special Solutions Related to the Prevention and Eradication of COVID-19, Other Infectious Diseases and Crisis Situations Caused by Them (2020), or the Law on Interest Subsidies on Bank Loans Granted to Businesses Affected by COVID-19 and on Simplified Proceedings for Approval of Arrangement in Connection with the Occurrence of COVID-19 (Bank Gospodarstwa Krajowego, 2020). These and many other provisions were intended to enable immediate action by the government and local authorities to minimise the effects of the pandemic or the war. The final factor is undoubtedly inflation as well as increases in energy prices, services, and wages. The effects of these increases are visible in all local budgets, as even the same volume of services carries a higher cost.

## Research methodology

The main objective of the research was to answer the question of which factors had the greatest impact on the financial situation of local governments. The research was conducted during the period 2018–2023. Two groups of units were examined, i.e. municipalities and cities with poviatic rights (MNPP). There are 2,477 municipalities in Poland, among which there are: 1,464 rural municipalities, 711 urban-rural municipalities, and 302 urban municipalities, including 66 municipalities that are also cities with poviatic rights. According to the Polish Constitution, municipalities are the basic units of local government (Article 164 of the Polish Constitution) (Konstytucja..., 1997). Cities with poviatic rights, on the other hand, are a very specific group of units, bringing together many residents and also providing many services. For example, MNPPs perform about 75% of all local government investments in Poland, while only the twelve largest Polish cities are home to more than 40% of the population. Therefore, MNPPs concentrate a major part of public and business services. They are also important centres of education and culture. The following main categories were examined to check the aforementioned hypotheses: sources of incomes coming from the shares in PIT and CIT, local property tax, as well as other sources of incomes such as subsidies and grants. To illustrate the financial condition, such categories like debt, investment expenditures, and operational surplus were examined, too. All data was taken from the official statistics prepared by the Regional Chambers of Audit and the Central Statistical Office. The reports that show the figures are – as per Polish law – publicly available at their websites and government websites, too. One of the websites used for research was [www.mf.gov.pl](http://www.mf.gov.pl).

*The level of own revenue of municipalities and cities with poviats rights (MNPPs)*

The income of Polish municipalities and MNPPs is mainly shaped by three income streams: income from participation in central taxes and income from local taxes – both categories included in own income – as well as income from subsidies and grants. In order to illustrate the changes that took place over the period 2018–2023, an analysis of the most important revenue categories for municipalities and MNPPs has been made, i.e. PIT share revenue and property tax revenue. Table 1 demonstrates how these income streams changed over the period under study. While it can be concluded that property tax revenue shows – for both municipalities and MNPPs – an essentially similar steady trend, this trend is downward for PIT shares. With regard to the ratio of property tax revenue to total revenue, for municipalities this ratio is at an average level of around 10.4%, while for MNPPs – it is at an average ratio of around 9.55%. As regards PIT revenue as a proportion of total revenue, it averages around 16.4% for municipalities in the period 2018 to 2022, falling to 12.70% in the final year, i.e. 2023. Nevertheless, an upward trend can be observed in the period 2020–2022 from 15% to 17%. As far as MNPPs are concerned, the trend is downward over the period under review. The share of PIT revenue in MNPPs’ total revenue falls from 27% in 2018 to 18.8% later on. It is worth noting that PIT shares are treated as an indicator of the self-reliance and strength of the local government unit, so their decrease translates into the loss of an important source building the economic and income potential of the local government unit (see Table 1).

**Table 1.** The share of personal income tax and property tax in the total income of municipalities and cities with county rights in the years 2018–2022 in billion PLN

Specification / Categories	2018	2019	2020	2021	2022	2023
The share of PIT in the total income in % – municipalities	17.00	17.00	15.00	16.00	17.00	12.70
The share of property tax in the total income in % – municipalities	11.00	10.00	10.00	10.00	10.00	11.40
The share of PIT in the total income in % – cities with poviats rights	27.00	27.00	24.00	25.00	25.00	18.80
The share of property tax in the total income in % – cities with poviats rights	9.00	10.00	9.00	9.00	10.00	10.30

Source: Own calculations based on the Central Statistical Office’s and the Regional Chamber’s of Audit data.

*The level of debt and operating surplus of municipalities and cities with poviats rights (MNPPs)*

The loss of an important part of own revenue results twofold over time. Firstly, its consequence is a reduction of the operating surplus in the budget. The operating surplus (OS) is the difference between current revenue and current expenditure. According to Polish law (Public Finance Act, 2022), it is not possible to pass a budget if the balance between these categories is not maintained. Hence, any element that may cause a decrease in current revenue or an increase in current expenditure is subject to special analysis and care by each local government. Secondly, if the level of the OS is reduced, then the investment potential of the territorial self-government units is reduced, too, as the surplus of the territorial self-government units is transferred primarily

to finance investments. The result of the ultimately declining operating surplus is an increase in the debt that local governments incur to cover capital expenditure, which is associated with higher debt service costs in subsequent years. Therefore, the next categories that were analysed included the indebtedness of the surveyed territorial self-government units and the category of the operating surplus. The trends in these categories are presented in Table 2. As can be seen, for both groups of territorial self-government units, the debt level increased in the period under study. In the case of municipalities, the increase is 29%, while for MNPPs it is more than 55%, with a large increase in debt in both cases particularly evident in the last year, i.e. 2023. On the other hand, when it comes to the operating surplus, which is the key category that determines the financial health of territorial self-government units, it is, unfortunately, falling drastically. These decreases are particularly visible in the case of MNPPs, for which maintaining investment dynamics – as noted – is crucial to social and economic development (Table 2 and Table 3).

**Table 2.** The change in the level of debt and operating surplus of municipalities and cities with county rights in the years 2018–2022 in billion PLN (current prices)

Specification / Categories	2018	2019	2020	2021	2022	2023
The debt level of municipalities	30.00	32.40	34.20	34.20	34.10	38.80
The debt level of cities with county rights	33.60	37.10	43.00	45.00	45.60	52.20
The operating surplus of municipalities	10.80	11.40	11.10	16.00	13.40	7.42
The operating surplus of cities with county rights	13.20	12.90	12.00	10.60	5.20	0.67

Source: Own calculations based on the Central Statistical Office's and the Regional Chamber's of Audit data.

**Table 3.** Change in the dynamics of debt and operating surplus of municipalities and cities with county rights in the years 2018–2023 [%]

Specification / Categories	2019/ 2018	2020/ 2019	2021/ 2020	2022/ 2021	2023/ 2022
The dynamics of the debt level of municipalities	108.00	105.56	100.00	99.71	113.78
The dynamics of the debt level of cities with county rights	110.42	115.90	104.65	101.33	114.47
The dynamics of the operating surplus of municipalities	105.56	97.37	144.14	83.75	55.37
The dynamics of the operating surplus of cities with county rights	97.73	93.02	88.33	49.06	12.88

Source: Own calculations based on the Central Statistical Office's and the Regional Chamber's of Audit data.

### *The level of the main economic categories and prospects of financial stabilisation for the City of Kraków*

The city of Kraków is one of the cities with poviats rights, it belongs to the Union of Polish Metropolises (twelve largest cities), it is the second most populous city in Poland, and it has the second largest budget in terms of income and expenditure after Warsaw. The city has always been financially strong, with numerous Polish and foreign companies located here. However,

the last few years of Kraków's existence have confirmed a trend that can also be observed in many Polish municipalities and especially in MNPPs. The previously described conditions – such as government policy in the area of tax changes, especially PIT, or rising costs of services due to increased energy prices, wages, and salaries, or new expenses due to the pandemic or the war behind the eastern border – constitute the cause of the difficult financial situation, which is proved by Tables 4–6.

Table 4 includes the most important categories characterising the city, such as: total revenue, PIT revenue, property tax revenue, total expenditure, investment expenditure, debt, the operating surplus, and the budget result. When comparing the most important categories, such as total income and total expenditure, it should be noted that in the period under review (apart from the year 2020), the growth rate of total income was in each case lower than the growth rate of total expenditure. As a result, the city closed each year with a budget deficit, which shows strong growth dynamics, especially in the last two years (approximately 319% in 2022 and approximately 199% in 2023, respectively). The city strives to maintain the level of capital expenditure, but with a declining operating surplus this comes at the expense of incurring liabilities, the dynamics of which averages around 120% in each year. The city ended the year 2023 with a negative operating surplus of minus 0.74 billion and an all-time highest deficit of minus 1.67 billion.

It is also worth mentioning that an important component of the city's income, i.e. income from PIT shares, was showing lower dynamics than the total income category throughout the period under review, and recent years have confirmed strong declines in this category. Undoubtedly, the factor that had a decisive impact on the deteriorating situation of the city, in particular on the drastic decrease in the operating surplus, in addition to the growing costs of services, was the real loss of revenue from PIT shares. With regard to the rising costs of services, it is worth noting that the city made a number of significant changes to plans during the period under scrutiny, increasing the amounts allocated to tasks (Table 6). Increases in expenditure are observed in all of the examined services. However, the highest rates are recorded for education – a 24% increase in execution to plan; health – by 27%; and social care expenditure – by 13%. For these and other provided services, in a situation of reduced revenues from own income, the city had to ensure funding and liquidity.

**Table 4.** Selected financial categories in the years 2018–2023 – the City of Kraków – in billion PLN (current prices)

Specification / Categories	2018	2019	2020	2021	2022	2023
Total income (TI)	5.31	5.91	6.20	7.19	7.22	7.33
PIT tax	1.61	1.79	1.77	2.02	2.02	1.71
Property tax	0.53	0.54	0.56	0.60	0.64	0.71
Total expenditures (TE)	5.57	6.21	6.67	7.45	8.05	8.98
Investment expenditures	0.79	0.90	0.84	1.22	1.34	1.46
Debt	2.55	3.07	3.48	4.19	4.69	6.05
The operating surplus	0.32	0.36	0.08	0.68	0.01	(0.74)
TI – TE (budget result)	(0.27)	(0.30)	(0.47)	(0.26)	(0.83)	(1.65)

Source: Own calculations based on the Central Statistical Office and the Regional Chamber's of Audit data.



**Table 5.** Change in the dynamics of selected financial categories in the years 2018–2023 in the City of Kraków [%]

Specification / Categories	2019/2018	2020/2019	2021/2020	2022/2021	2023/2022
The dynamics of total incomes (TI)	111.30	104.91	115.97	100.42	101.52
The dynamics of PIT tax	111.18	98.88	114.12	100.00	84.65
The dynamics of property tax	101.89	103.70	107.14	106.67	110.94
The dynamics of total expenditures (TE)	111.49	107.41	111.69	108.05	111.55
The dynamics of investment expenditures	113.92	93.33	145.24	109.84	108.96
The dynamics of debt	120.39	113.36	120.40	111.93	129.00
The dynamics of the operational surplus	112.50	22.22	850.00	1.47	–7,400.00
The dynamics of budget deficit (TI–TE)	111.11	156.67	55.32	319.23	198.80

Source: Own calculations based on the Central Statistical Office's and the Regional Chamber's of Audit data.

**Table 6.** The percentage changes in plans as of 30 September and 31 December as well as budget execution as of 31 December in relation to the plan as of 1 January – selected sections, year 2023 [%]

Budget classification chapter	Adjustment as of 30.09	Adjustment as of 31.12	Budget execution / plan as of 31.12 / 01.01
Transport and communication	103.95	111.92	106.73
Public administration	104.54	109.85	107.82
Education	111.89	125.04	124.00
Health care	129.95	137.71	127.16
Social assistance	109.74	114.00	113.58
Communal services and environmental protection	105.91	108.19	105.14
Culture and the protection of national heritage	112.49	108.29	107.83

Source: Own calculations based on the Central Statistical Office and the Regional Chamber of Audit data.

Concluding reflections on the financial situation of the City of Kraków, it is worth analysing some categories for the years 2021–2027, presented in Table 7. The years 2021–2023 include data from budget execution, while the period 2024–2027 is based on data from the City's multiannual financial forecast. This data confirms the high indebtedness of the city. The debt-to-total-income ratio in 2023 shows an alarmingly high level, namely 81.09%. This ratio decreases in subsequent years, but nevertheless remains high at around 70%. We also observe high debt service costs, with the highest ratios in 2024 – 37.75% and 2025 – 36.36% when compared to capital expenditure. These are high ratios. The operating surplus, which, according to the plan, should be in positive territory from 2024 onwards, looks unrealistic. The operating surplus of 0.17 billion had been planned for 2024. At this point, we do not have data to confirm this level for the first half of this year.

In summary, the financial situation of the City of Kraków, like that of many other Polish cities or municipalities, is very difficult. This has been influenced by a number of events beyond the city's control, including government policies, whose impact on the city's finances has been destabilising.

**Table 7.** Selected financial categories in billion PLN and selected indicators in % for the City of Kraków in 2021–2027 – execution and plan (current prices)

Specification / Categories	2021	2022	2023	2024	2025	2026	2027
Debt [bln PLN]	4.19	4.69	6.05	6.41	6.65	6.34	5.98
The operating surplus [bln PLN]	0.68	-0.01	-0.74	0.17	0.46	0.97	1.26
Debt service cost [bln PLN]	0.06	0.19	0.37	0.37	0.32	0.19	0.21
Debt / total income [%]	58.27	64.95	81.09	79.92	78.23	70.84	63.48
Debt service cost / investment expenditures [%]	4.91	14.28	20.11	37.75	36.36	25.33	26.25

Source: Own calculations based on the Central Statistical Office's and the Regional Chamber of Audit data. Years 2021–2023 – execution; years 2024–2027 – plan.

## Discussion

The analysis of the financial situation of municipalities, cities with poviat rights, and the city of Kraków confirms several important trends that have emerged in recent years and to which extremely turbulent external conditions have contributed, such as the COVID-19 pandemic, the war in Ukraine, as well as the changes introduced in Poland by new legislation under the government's policy called the Polish Order. As a result of these factors, it can be observed that the financial situation of Kraków, as confirmed by a review of the most important economic categories, looks worse in comparison to other local governmental units. The reviewed indicators such as the dynamics of the debt or the dynamics of the operational surplus confirm very unstable financial situation of the City of Kraków. An important indicator, namely debt to total income [%], confirms that Kraków is a city in high debt. Also the costs of servicing the incurred debt are constantly increasing. In the case of Kraków, the indicator in the form of debt service cost / investment expenditures [%] changed between 2021 and 2024 by almost eight times (grew from ap. 4.9 to ap. 37.8). However, one of the most alarming trends is the decrease in the operating surplus, which in 2023 reached minus 0.74 bln PLN. This will translate into problems in the future with regard to financing local services and implementing development tasks.

The discussion so far, supported by an extensive empirical analysis, shows that the finances of territorial self-government units in Poland require restructuring in order to stabilise their financial situation. These changes should consist, *inter alia*, in the reconstruction of own revenues reduced due to the Polish Order, in particular through significant increase of PIT contributions for territorial self-government units; such a postulate has been raised by all self-government organisations: the Union of Polish Cities, the Union of Rural Municipalities of the Republic of Poland, and the Union of Polish Metropolises. Discussions on changing the model of financing Polish self-governments are currently underway at the Ministry of Finance of the Republic of Poland.

Another important area for action should be the area of local taxes. The issue of reforming property tax, agricultural tax, forestry tax, and vehicle tax, among others, has been raised for decades. Undoubtedly, an area that would improve the condition of local authorities is an increase in the educational part of the subsidy, since, as is generally known, despite the principle of the adequacy of funds to the tasks, educational tasks are underestimated, which results in many cities, such as Kraków, paying extra from their own funds for these tasks. Kraków is paying over 40%. Questions have also been raised concerning the reconstruction of the compensation system in force in Poland. These and other solutions would serve to stabilise local government

finances. It is worth emphasising that until the end of the current year 2024, despite the already visible difficult situation, self-governments can benefit from relaxed fiscal rules introduced by the previous government. However, without radical changes to the system of financing self-governments, amendments to the Act on self-government entities' revenues, changes to the rules of participation in central revenues, and the reconstruction of the rules of the equalisation system, it will not be possible to conduct stable financial management by self-governments.

## Conclusions

The aim of this article was to present the most important factors destabilising the system of local government finance in Poland. Among others, the effects of the COVID-19 pandemic, the Russian-Ukrainian war, and their impact on the budgets of Polish local government units were characterised. Both factors caused interruptions and disruptions in supply chains, which affected the condition of companies and the level of revenues to the state budget as well as the budgets of local self-governments, and which triggered an increase in the prices of services, energy, and salaries. All of the above was discussed based on the example of Kraków, showing the disruptions in budget policymaking, planning, and, above all, causing an increase in running costs. Also discussed are the changes introduced by the Polish government as part of the Polish Order programme, which had a direct impact on the income levels of the surveyed groups of local government units, i.e. municipalities and cities with poviats rights. Also mentioned are the government's intervention activities consisting in channelling aid to local governments, e.g. under the Assistance Fund for Ukraine. These and other activities, including the compensation of revenue losses to local self-governments, were aimed at mitigating the risks that the factors destabilising territorial self-government unit finances had entailed.

The conducted analysis allows conclusions and recommendations to be made. Undoubtedly, one of the recommendations is the legitimacy of continuing works on changes to the self-government financing system. These actions and changes should result in making the revenue base of territorial self-government units independent of the decisions of central authorities and in strengthening the area of local taxes. This recommendation also relates to the compensation system and the objectivisation of the principles of allocating targeted subsidies. On the other hand, the recommendation addressed to self-governments is to plan future activities rationally, taking into account changes that recent events have brought to the territorial self-government units' budgets, both on the revenue side and on the expenditure side. Planning should be characterised by realism and a sense of responsibility for future generations in the event of incurring debt, especially as the costs of servicing external financing have risen sharply in recent years, as evidenced by the case of Kraków.

Certainly, future research on the level of the operating surplus should be continued and a closer examination of the structure of expenditures in terms of individual municipal services should be undertaken, especially those which weigh most heavily on the budget, such as transport or education. This will make it possible to answer the question of whether the changes in the rules of financing territorial self-government units which have been announced since January 2025 will contribute to the improvement and stabilisation of the financial standing of Polish territorial self-government units.

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#### **Data Availability Statement**

All data will be available and shared upon request.