

**Marek Dylewski**

WSB University in Poznan

e-mail: marek.dylewski@wsb.poznan.pl

### **PLANNING THE STRUCTURE OF SGE DEBT AS AN OPPORTUNITY FOR LOCAL DEVELOPMENT**

### **PLANOWANIE STRUKTURY ZADŁUŻENIA JST SZANSĄ NA STABILNY ROZWÓJ LOKALNY**

**Summary:** Projects and programmes realized in the public sector, including self-government entities, are supposed, above all, to satisfy the needs of the society. From the perspective of self-government entity the objective of the task is a given local or regional community. The vast majority of projects and programmes are realized with the use of debt instruments. Self-government public debt is subject to limitation; therefore, it is important not only to comply with the legally binding limits in terms of incurred debt but also to plan the structure of self-government public debt together with the instalments due for payment in a given period and together with the buyout of debt instruments. The purpose of the following paper is to present the significance of the planning approach in creating stable and balanced local development in the perspective of empirical study, and the current approach towards debt planning by self-government entities (SGE).

**Keywords:** finance, self-government finance, debt, planning, local development.

**Streszczenie:** Projekty i programy realizowane w sektorze publicznym, w tym jednostek samorządu terytorialnego, mają przede wszystkim na celu zaspokojenie potrzeb społeczeństwa. Z punktu widzenia jednostki samorządowej celem realizacji zadań jest dana społeczność lokalna lub regionalna. Zdecydowana większość projektów i programów realizowana jest z wykorzystaniem instrumentów dłużnych. Samorządowy dług publiczny podlega ograniczeniom. Dlatego ważna jest nie tylko zgodność z prawnie obowiązującymi limitami zadłużenia, lecz także planowanie struktury długu publicznego wraz z harmonogramem jego spłaty w danym okresie do ostatecznego terminu spłaty/wykupu. Celem artykułu jest prezentacja podejścia do planowania i jego znaczenia w tworzeniu stabilnego i zrównoważonego rozwoju JST z punktu widzenia badań empirycznych oraz przedstawienie bieżącego podejścia do procesu planowania długu przez jednostki samorządu terytorialnego.

**Słowa kluczowe:** finanse, finanse samorządu terytorialnego, dług, planowanie, rozwój lokalny.

DOI: 10.15611/br.2015.1.01

JEL classification: H74

## 1. Introduction

Projects and programmes realized in the public sector, including self-government entities, are supposed, above all, to satisfy the needs of society. From the perspective of a self-government entity, the objective of a task is a given local or regional community. It would be difficult to imagine that the enterprises financed with public resources might not be assessed in terms of their usefulness and that the effects that their realisation is to have might not be measured. The vast majority of projects and programmes are realized with the use of debt instruments.

Self-government public debt is subject to limitation; therefore, it is important not only to comply with the legally binding limits in terms of incurred debt but also to plan the structure of self-government public debt together with the instalments due for payment in a given period and together with the buyout of debt instruments. The purpose of this paper is to present the significance of the planning approach in creating stable and balanced local development in the perspective of an empirical study, and the current approach towards debt planning by self-government entities (SGE).

## 2. Planning self-government debt versus decision-making process

One needs to ask a question about the criteria that need to be applied while taking decisions concerning disbursement of public resources concerned with selection of projects and programmes supporting local development. In the commercial sector, the basic criterion is the effectiveness of economic processes that take place in a company. The public sector is in a different situation as its major objective is rendering services to society, that is, realizing socially useful projects and programmes. Therefore, the criterion of effectiveness is particularly difficult to be used here, but this does not mean that it is impossible. Decisions in terms of projects and programmes selection should be taken in an effective and efficient way. By effectiveness one needs to understand achieving optimal relation between set objectives and tasks and the real effects of their realization [Kosikowski, Ruśkowski (eds.) 2003, p. 682; Dylewski 2007, pp. 163–164].

Efficiency of realizing public tasks can be examined on two levels [Kosikowski, Ruśkowski (eds.) 2003, p. 682; Dylewski 2007, pp. 297–302]:

- set tasks: in this case the way of realizing public tasks that guarantees the best achievement of set social objectives, that is, seeking alternative solutions that would give the best effect from the perspective of satisfying social needs will be the most efficient;
- financial resources at the disposal: in this case the solution to be sought is the one that at the lowest possible expenditure gives comparable effect with the alternative ones.

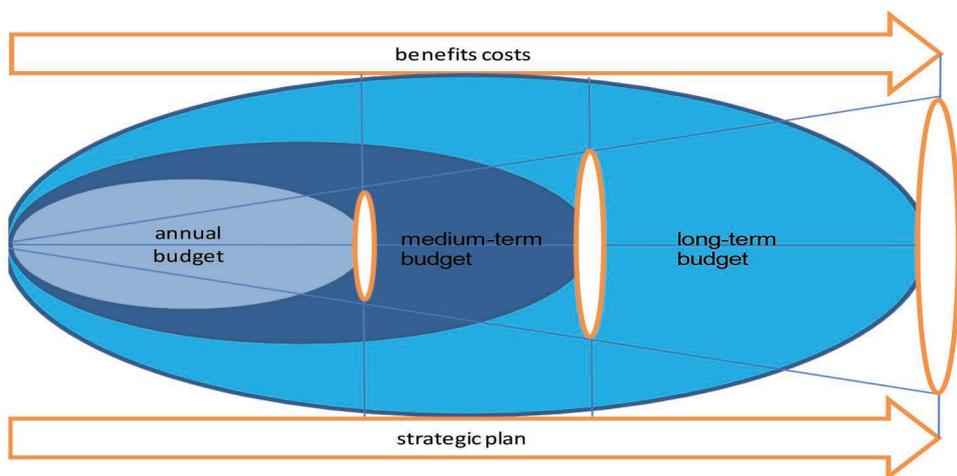
One can only talk about the effectiveness when one can precisely define inputs and outputs, which in the sector of public finances is not always possible. This is due, among other things, to the goals set in front of public-sector units, including local government units, which may be qualitative in nature and are difficult to quantify, as they are often analyzed not only in relation to the effect, but are also valued with respect to the impact on the environment and external benefits of public expenditures [Filipiak 2011, p. 144; Poniatowicz, Salachna, Perło 2010, pp. 48–49; Stiglitz 2004, p. 330]. It should be noted that the effects of certain public expenditures occur after many years, resulting in a lack of precise timing of costs and benefits, which is a precondition for effectiveness measurement [Filipiak 2011, p. 150; Poniatowicz, Salachna, Perło 2010, p. 49]. In general, the public sector uses the cost-benefit analysis to compare the costs and benefits of public goods projects to decide if they should be undertaken [Gruber 2007, p. 203].

The cost-benefit analysis in the public sector is more complicated and more subtle than in the commercial sector. Government decisions affect many people simultaneously. The cost-benefit analysis as used by the government must, therefore, be concerned with maximizing the community welfare [Aronson 1985, p. 215]. The evaluation problem is more complicated for the government because social benefits and costs may not be reflected in market prices and in practice there are several possibilities for measuring the benefits and costs of public sector projects [Rosen 1995, p. 249].

Realization of projects and programmes of self-government entities imposes a particular obligation of each enterprise assessment from not only the perspective of immediate and current benefits but also from the perspective of long-term benefits. This means that such assessment needs to be performed not only in terms of the budget of a given year, but especially in terms of medium- and long-term time horizon. Taking into consideration the expenditure and the effects concerned with realising tasks in self-government entities allows for a full and complex look regarding enterprises that are to be realized [Dylewski 2007, p. 164]. A schematic perspective of costs and benefits depending on the planned horizon is presented in Figure 1. The essence of this approach is the statement that together with prolonging the time horizon of planning, the perspective, that is taking into consideration the opportunity to service debt and incur new debt obligations by means of perceiving the effects and phenomena resulting from the decisions taken in a given period, is widened.

Except for the already mentioned criteria, one needs to take into consideration the criteria stemming from the legally binding regulations. The Public Finance Act of 27 August 2009 presents the following rules of planning debt [Public Finance Act of 27 August 2009, art. 243]:

1. Limiting SGEs' debt (rule 1), according to which a decision making body of a self-government entity cannot approve a budget whose realization will lead to the situation in which in a budgetary year and any other year that follows the budgetary year the relation of the total amount of credit and loan repayment together



**Figure 1.** Costs and benefits of projects and programmes in terms of a planning horizon

Source: based on own research results.

with accrued interest (in a given year) on account of credit and loans, the buyout of securities together with the accrued interest and discount and also together with potential repayments on the amounts resulting from provided guarantees and sureties to the planned budget income will exceed the arithmetic mean of the relation, calculated for the last three years, of its current income enhanced by the asset sale gains and reduced by current expenditure to total budget income calculated according to the following formula:

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

where:  $R$  – planned for a budgetary year total amount on account of credit and loan instalment repayment mentioned in art. 89, sec. 1, items 2–4 and art. 90 of the Act, and on account of buyout of securities issued for the purposes mentioned in art. 89, sec.1, items 2–4 and art. 90;  $O$  – planned for a budgetary year interest on credit and loans mentioned in art. 89, sec.1 and art. 90, interest and discount on securities issued for the purposes mentioned in art. 89, sec.1 and in art. 90, and repayments resulting from provided financial guarantees and sureties;  $D$  – total income in a budgetary year;  $Db$  – current income;  $Sm$  – asset sale gains;  $Wb$  – current expenses;  $n$  – the budgetary year for which the relation is determined;  $n - 1$  – year prior to the budgetary year for which

the relation is determined;  $n - 2$  – two years prior to a budgetary year;  $n - 3$  – three years prior to a budgetary year.

2. Balancing SGEs' current budget (rule 2) – a decision making body of a self-government entity cannot approve a budget in which planned current expenses exceed the planned current income increased by budget surplus from previous years and available funds. At the end of a budgetary year, incurred current expenses cannot exceed executed current income increased by budget surplus from previous years together with available funds. Incurred current expenses can be higher than executed current income increased by budget surplus from previous years and available funds only by the amount related to current expenses realisation with the use of the resources that were not transferred in a given budgetary year.

One needs to bear in mind that the legislator imposed the use of the above-mentioned rules onto the planning process of a long-term financial forecast. Article 226 of the Public Finance Act of 27 August 2009 presents not only the basic features of a long-term financial forecast (LTFF) as a planning instrument, but also requires that rule 1 together with the effects of incurred debt should be incorporated into a forecast. In Article 227 of the Public Finance Act of 27 August 2009 the legislator demands that the debt forecast, which is part of a long-term financial forecast, be drawn up for the period within which liabilities must be repaid and for which obligations are planned to be incurred. This is a legal prerequisite for planning long-term debt and for the effects of incurred self-government public debt. It must be stressed, however, that the legislator does not impose any planning methodology but only indicates the rules and the content that need to be part of LTFF.

The aforementioned criteria of planning and setting limits of self-government public debt and costs of debt service indicate only the legal restrictions not the real possibility of debt absorption by a given self-government entity. On the basis of presented relations of current budget balancing conditions, one might find it difficult to draw particular conclusions – it is just information on the basis of which a forecast can be prepared. In reality the two mentioned rules do not present a real possibility of debt absorption based on available funds as a function of debt service in the future (rule 3). It must be indicated that the sole and unquestioned application of rules 1 and 2 may result in overinvestment of some entities which will not be able to service their debt. Other SGE, due to the application of the mentioned rules, will be forced to limit local development. In the planning process it must be remembered that according to Wagner's Law, the increase in public spending is noticeable and treated as a continuous tendency in economies of particular countries or self-governments [Komar 1996, p. 257; Gaudamet, Molinier 2000, pp. 75–78; Piotrowska-Marczak 1997, pp. 15–16]. This increase is due to the role of self-government while intervening during an economic downturn and also due to the necessity of enhancing inhabitants' life quality which results from self-governments' responsibility for creating social and economic development.

It might be concluded on the basis of the above discussion that, on the one hand, a correct approach towards debt should be the ability to service it so that it will not threaten current tasks realization and, simultaneously, will allow stimulating local development with the use of debt instruments. It needs to be stressed, however, that it cannot be done as the legislator introduced two rules of planning the amount of self-government public debt that were mentioned above. Therefore, the realistic debt planning should be based on three rules: two imposed by the legislator and the third one whose objective is to ensure balanced and stable local community development.

### **3. Planning self-government entities debt from the perspective of empirical data**

#### **3.1. Research method**

The issue of self-government entities debt was viewed from different perspectives, referring not only to the expectations of self-government authorities in terms of desired changes, but also in terms of the influence of debt onto a financial situation, ability to realize tasks, using planning tools and potential and current opportunity to create local development. The thesis that was verified was the one according to which the existing legal solutions in terms of incurring debt pose a serious threat to the development; especially, they limit the possibility of incurring debt in order to realize investment supporting local development.

The research was conducted among self-government entities. The research method was a questionnaire. A total of 397 questionnaires were obtained, which means that answers were obtained from 397 local government units. The population specificity and the fact that self-government entities need to comply with a constitutional disclosure principle as far as their financial management is concerned influenced the sampling process, which was done randomly. Seven voivodships out of sixteen voivodships functioning according to the new administrative division were randomly selected, which constitutes 40% of the overall voivodship population. There were two major reasons for voivodship random sampling: increasing the sample representativeness and increasing the comparability between particular self-government entities which can be obtained by examining the entities within the same voivodship. Phase II of sampling consisted in the division of the sample into three layers: voivodship, poviat and commune. Phase III of sampling consisted in selecting self-government entities from each layer. Within each selected voivodship a number of self-government entities functioning there were designated.

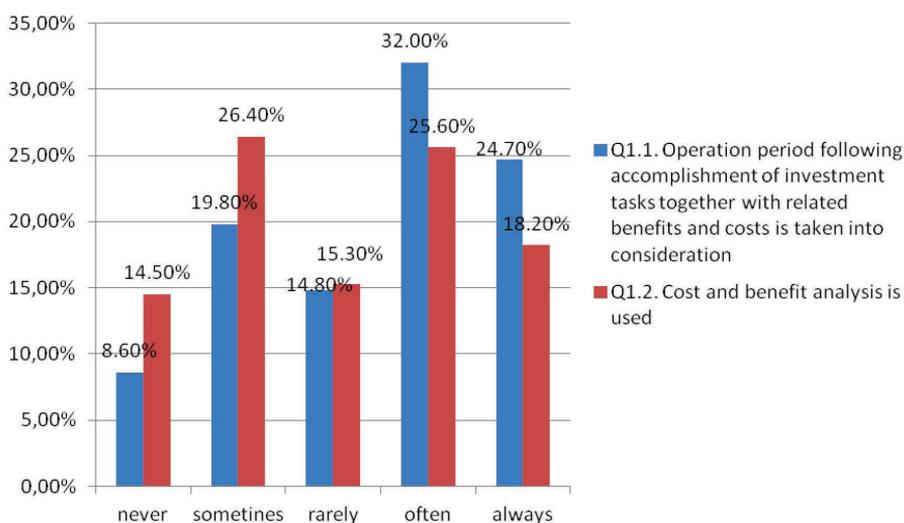
It was assumed that due to the SGE specificity and the size of the selected research tool, field research would be conducted by means of a direct contact of an

interviewer with respondents on the basis of PAPI method (direct interview with the respondent with the use of a traditional questionnaire form).

The following paper presents only some of the obtained results which concern the influence of selected legal solutions in terms of SGE debt opportunity onto the ability to create local development. The following study was financed as part of a scientific project with budgetary resources for science in the years 2010–2013 as a research project no. NN 113 063139.

### 3.2. Study results

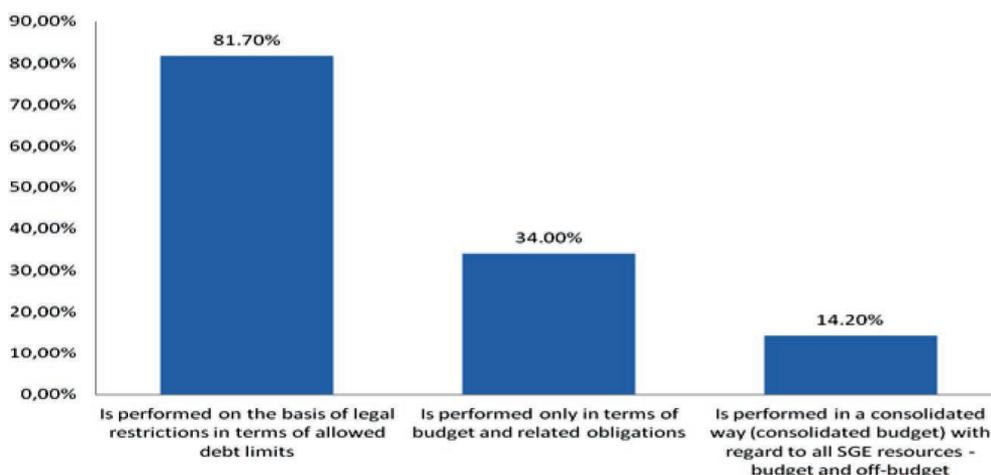
In order to learn as much as possible about the approach towards debt planning and the correctness of the decision-making process respondents were asked a question on the used methods of costs and benefits analysis and about taking into consideration the effects of the decision taken. The effects in question are operation costs concerned with the end and putting the subject of the investment project or programme into operation together with the costs concerning the debt service and repayment. More than 50% of the respondents claimed that in represented by them self-government entity in terms of planned projects and programmes the period of operation taking place after investment tasks, and benefits and planned costs of self-government public debt service, are: often (32%) or always (24.70%) taken into consideration. Simultaneously, only 8.60% of the respondents admitted that in their SGE these variables are never taken into consideration. However, the cost and benefits analysis is used much less often. The results of the obtained answers are presented in Figure 2.



**Figure 2.** Planning methods used in SGE debt planning

Source: based on own research results.

Another issue that the respondents were asked about was the question on the planning approach used in debt planning for projects and programmes supporting local development realisation (compare Figure 3). The analysis and the assessment of the possibility of incurring debt in order to realise projects and programmes in the majority of SGE is performed on the basis of legal restrictions in terms of accepted debt limits (81.70%). Only 14.20% of the respondents replied that such analysis and assessment is performed in a consolidated way while taking into consideration all the SGE resources (budget and off-budget) that may influence the current and future ability to fulfil the entrusted obligations, and according to 34.00%, it is prepared only in terms of annual budget and its expenses (including debt expenses).

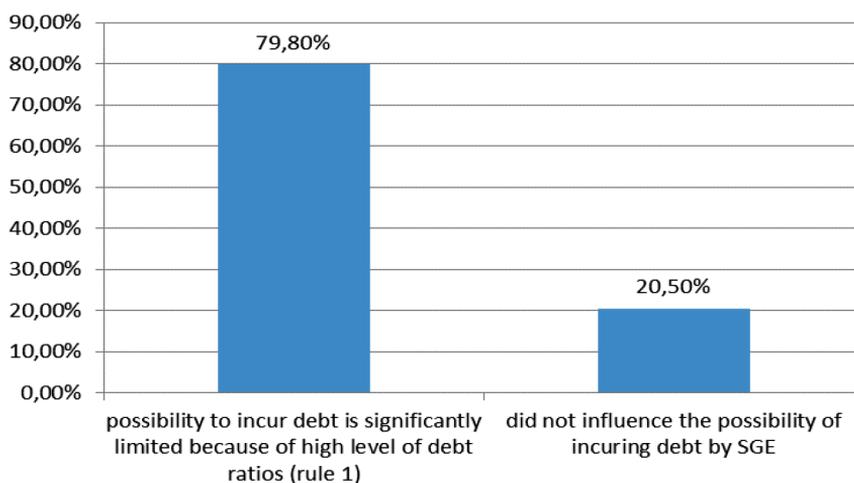


**Figure 3.** The planning approach used by SGEs in terms of planning self-government public debt in order to finance projects and programmes supporting local development

Source: based on own research results.

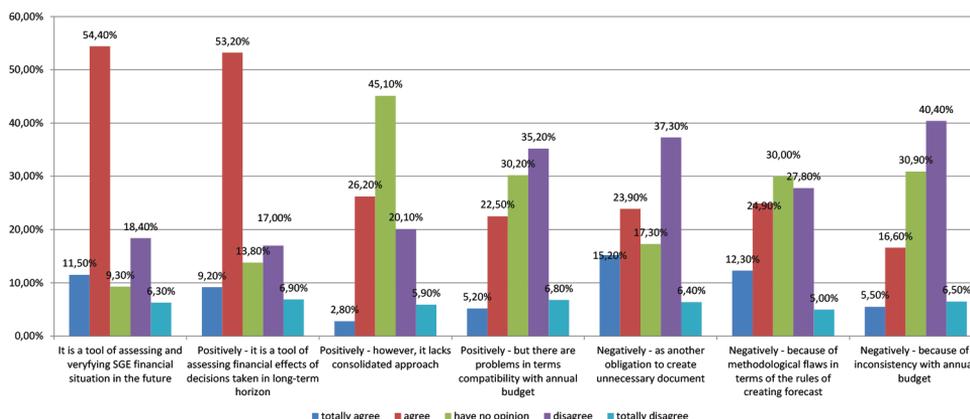
Moreover, 79.80% of the respondents believe that the aforementioned two rules of planning SGE debt significantly limited the possibility of incurring debt by SGE because of the high level of debt ratios (compare Figure 4).

The legislator introduced a tool of long-term planning which is a long-term financial forecast (LTFF). It is closely related to debt planning and its time horizon cannot be shorter than the period of debt repayment. In theory, LTFF should take into consideration the aforementioned three rules of how to approach debt planning and it should be used to realize stable local development in which, apart from current tasks, also investment projects and enterprises together with servicing the debt incurred for investment are included. The respondents were asked a question on LTFF efficiency (responses are presented in Figure 5).



**Figure 4.** The planning approach used by SGEs in terms of self-government public debt planning in order to finance projects and programmes supporting local development

Source: based on own research results.



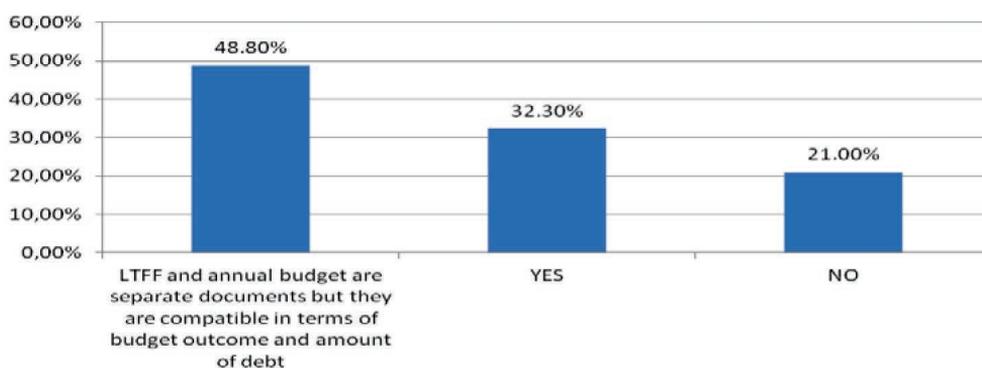
**Figure 5.** How do you assess the usefulness of a self-government long-term financial forecast?

Source: based on own research results.

The distribution of the answers to the question on the assessment of a self-government entities long-term financial forecast (LTFF) might indicate that the response is positive. As many as 62.40% of the respondents assess it positively and agree that it is a tool to assess financial effects of taken decisions in long-term horizon. As many as 43.70% of the respondents do not agree with the negative assessment of the necessity of creating another useless document, while 17.30% of

them do not have any opinion on that matter. As many as 46.90% of the respondents do not agree with the negative assessment related to the lack of consistency with the annual budget, while 30.90% do not have any opinion on that matter.

Another issue concerned determining the relation between LTFF with rule 2 of debt level planning. In order to do that, the respondents were asked a question about the relation between LTFF and the current budget. As many as 69.80% of the respondents believe that long-term finance forecast is not superior to the annual budget (compare Figure 6). One might conclude from the above responses that the approach towards debt planning is erroneous, especially in terms of assessing effects of the influence of future decisions of investment and debt character onto the current budget. This means that the respondents see the importance of LTFF; however, they simultaneously plan incorrectly from the methodological point of view. Having a tool that is supposed to order and enforce desirable behaviour, they only complete another “table” that is then assessed by supervising authorities.

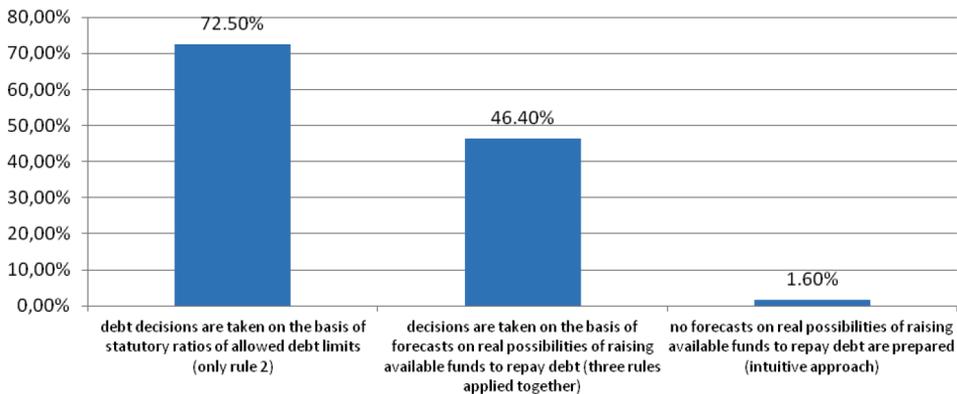


**Figure 6.** Relation between LTFF and annual budget (function of planning long-lasting local development)

Source: based on own research results.

In order to prove that the planning approach is not applied, the responses on the applied approach towards decision planning regarding debt need to be mentioned (see Figure 7). The majority of respondents (as many as 72.5%) make decisions on debt, that is plan incurring debt together with its future repayment, only on the basis of planning rule 1 mentioned above. Only 46.4% take into consideration all three rules, as they consider not only individual debt limitation, but also the effects of the incurred debt, that is, they take into account the real possibility of financing debt repayment together with debt service costs. What needs to be considered here is available resources.

To recapitulate, it needs to be emphasized that not all the respondents notice the necessity of debt planning as the function of stimulating local development.



**Figure 7.** Use of the planning approach based on three rules

Source: based on own research results.

A positive phenomenon is the fact that they recognize the significance of the planning approach, which is a huge step towards making decisions methodologically together with assessing their effects in the future.

## 4. Conclusion

Despite the fact that the legally binding Public Finance Act of 27 August 2009 imposed the writ of the planning approach towards incurring debt and the necessity to assess its effects by means of drawing up a long-term financial forecast and the obligation to balance the budget, it is difficult to assume that SGEs fully understand the significance of planning tools in a decision making process. It needs to be indicated that the majority of entities recognize the need to plan debt. However, this need is not fully and correctly developed and the planning methods are not yet mastered.

Despite the fact that SGEs have learned how to use cost and benefits analysis and to incorporate its effects into the long-term financial forecast, they do not always succeed in annual planning. They apply only selected, imposed by the law, elements that relate LTFF with the current budget.

To sum up, it needs to be pointed out that while planning, SGEs need to take into consideration the objective of their activity which is stimulating and creating local development. In order to make this development stable and balanced, they need to plan and they also need to incur debt to ensure this stability and balance.

## References

- Aronson J.R., 1985, *Public Finance*, McGraw-Hill.
- Dylewski M., 2007, *Planowanie budżetowe w podsektorze samorządowym*, Difin, Warszawa
- Filipiak B., 2011, *Finanse samorządowe – nowe wyzwania bieżące i perspektywiczne*, Difin, Warszawa.
- Gaudamet P.M., Molinier J., 2000, *Finanse publiczne*, PWE, Warszawa.
- Gruber J., 2007, *Public Finance and Public Policy*, Worth Publishers, New York.
- Komar A., 1996, *Finanse publiczne w gospodarce rynkowej*, Oficyna Wydawnicza BRANTA, Bydgoszcz.
- Kosikowski C., Ruśkowski E. (eds.), 2003, *Finanse publiczne i prawo finansowe*, Dom Wydawniczy ABC, Warszawa.
- Piotrowska-Marczak K., 1997, *Finanse lokalne w Polsce*, Wydawnictwo Naukowe PWN, Warszawa.
- Poniatowicz M., Salachna J.M., Perło D., 2010, *Efektywne zarządzanie długiem w jednostce samorządu terytorialnego*, Wolters Kluwer, Warszawa.
- Public Finance Act of 27 August 2009. Journal of Laws No. 157, item 1240 as amended.
- Rosen H.S., 1995, *Public Finance*, Richard D. Irwin.
- Stiglitz J., 2004, *Ekonomia sektora publicznego*, PWN, Warszawa.