

14/2004

Raport Badawczy
Research Report

RB/75/2004

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Will Utilize EU Funds For Support
of Regional Development**

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Warszawa 2004

HOW POLISH LOCAL GOVERNMENTS WILL UTILIZE EU FUNDS FOR SUPPORT OF REGIONAL DEVELOPMENT

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1. INTRODUCTION

Local infrastructure projects are essential to future economic prosperity of local communities in Poland. These projects will facilitate regional development and contribute to economic growth. However, they require large outlays of money that are beyond the currently available resources of Polish local governments.

European Funds, which include the Structural Funds, and the Cohesion Fund will play a very important role in financing infrastructure projects when Poland joins the EU in May 2004. Determination of the rate of assistance, under the structural funds, for infrastructure investment projects has already been presented in the Polish National Development Plan 2004–2006 (NPR) and seven Sectoral Operational Programs (SOPs). The assessment of the input by local governments (JST), required for all anticipated projects to be co-financed by EU funds, is included in the NPR, although scattered all over the Plan. Estimation of financial participation of the private sector, and of the state budget in financing local infrastructure is also included in the NPR.

The estimates given in the NPR by Polish government say that the JST will have to ensure over 944 million Euro in total, for all operational programs agreed with the EU. However, some conditions have to be satisfied and more thorough analysis carried out to ensure resources from local governments budgets for co-financing projects included in the Integrated Operational Programs. In addition, some macro economic conditions have to be satisfied to keep public debt to the GDP ratio below the level determined in the Maastricht Treaty. Provisions for these conditions are included in the Polish Constitution and legal regulations, but have not been formulated in the NPR.

The EU funds available over 2004–2006, may not be fully utilized by JST, because they will not have sufficient own funds to secure their share (about 25% to 30% of the total investment costs). Local governments can borrow to cover part of their own share required for projects financed by EU funds. However, some JST may not be able to borrow, to add to their own budget money, for covering their share in project financing, they may not be credit-worthy. Each JST should determine how much budget resources it has available to fund capital projects, and how much it can afford to borrow to finance infrastructure. A maximum

**Table 1. Sources for financing local infrastructure investment under European Funds (in million Euro)
In Poland over 2004 -2006**

Operational Program	Total investment	Structural Funds	Cohesion Fund	Local governments	State budget and public funds	Private funds
1A. IOPRD	4,385.2	2,869.5		750.5	376.5	388.7
1B. INTERREG	261.2	196.1		52.0	13.0	0
1C. Programs under the COHESION Fund	2,196.6		1,866.6	100.0	100.0	130.0
2. R&MFP	1,947.8	1,055		10.0	253.9	628.9
3. HRD	1,755.8	1,270.4		31.6	494.2	26.4
TOTAL, including the Cohesion Fund	10,546.6	5,391.0	1,866.6	944.1	1,237.6	1,174.0
		7,257.6				

National Development Plan (NDP -NPR) 2004-2006 assessment, Warsaw, 2003.

- IOPRD** - Integrated Operational Program of Regional Development
INTERREG - Interregional Initiative
R&MFP - Restructuring and Modernization of Food Processing and Development of Rural Areas
HRD - Human Resources Development

capacity to borrow for all local governments has to be determined. Only a very small number of municipalities have done such credit assessment for 2004 -2006.

This paper evaluates what part of the EU funds anticipated to co-finance Polish local infrastructure, can be absorbed by local governments in Poland and under what conditions. We give an overview of Polish and select EU regulations regarding financing local investment in Poland and suggest appropriate changes to the existing legal regulations which will make possible maximum utilization of the EU funds offered to Poland. For example strict dependence of local government indebtedness on public debt and GDP may hamper utilization of structural funds for regional development, and slow down the growth of Polish economy. We assess financial feasibility of Polish JST to finance investment from their own budgets and with help of debt, to cover their share in projects financed by structural funds. We also discuss estimations presented in the NPR with regard to their practical accuracy.

2. FUNDS FOR FINANCING LOCAL INFRASTRUCTURE AND BASIC CONDITIONS OF THEIR UTILIZATION

2.1. Estimates of financing sources

In Table 1, based on data given by the Polish government in the NPR, we present sources of financing local infrastructure in Poland over 2004 -2006, and estimates of the resources levels from the above sources. We present data for all operational programs, which can be utilized for local infrastructure financing. The largest, *Integrated Operational Program of Regional Development (IOPRD)*, will involve about 40% of all funds, while Infrastructure financing under the *Cohesion Fund*, and the remaining operational programs: the *Restructuring and Modernization of Food Processing and the Development of Rural Areas*, and the *Human Resources Development* involve respectively about 21%, 19%, and 17% of all EU funds. The smallest INTERREG program involves only about 2.5% of all funds. In our analysis we do not include the following operational programs: *Support of Competition of Enterprises, Fishery and Fish Processing*, and *Transportation*, which are not explicitly designed for financing local infrastructure, and do not involve local government.

The JST will have to ensure over 750.5 million Euro to finance (IOPRD), and over 844 million Euro, in total, for all operational programs, agreed with the EU and included in the NPR (over 944 million Euro including the Cohesion Fund).

We can note from Table 1, that the share of Structural Funds and the Cohesion Fund in total investment expenditures is 68.81%, and the shares of local governments, public funds, including the state budget, and the private funds equal 8.95%, 11.73%, and 11.13% respectively.

2.2. Basic analysis of financial status of local governments

We analyze financial situation of Polish local governments (JST), and their feasibility to finance investment. We first assess a capacity of local governments to finance investment from their own revenue, and then, with the help of debt (we estimate their capacity to borrow) - all in order to assess the ability of JST to cover their share in projects co-financed by Structural Funds.

The capacity to issue debt by local government is restricted by Polish legal regulations, by financial status (lack of creditworthiness) of individual local governments, and, what currently seems the most important, by the general economic activity of Polish government.

In our opinion the major restriction of the law is that local governments in Poland can borrow only within some legal limits, which are explicitly related to public national debt and GDP. For example, Polish national Law on Public Finance require that every year, for an individual JST, the total amount of debt outstanding as a percentage of revenue, is not higher than 60%, and the total debt service as a percentage of total revenues does not exceed 15%. If the relation of public debt to GDP exceeds 60%, local governments can not borrow at all. In addition, the JST can not borrow when their total debt outstanding in relation to their total revenues exceeds 60%, even when they could have safely repaid the debt without violating liquidity and budget safety for several future years.

Any percentage of public debt outstanding to GDP over 50% results in additional restrictions on new debt issuance, both by local governments and by the state. For example, when the value of total public debt outstanding exceeds 55%, then, cost of debt service in local budget, by law, cannot exceed 12% of its total revenues. Precise description of restrictions and procedures regarding issuance of debt by local government is given in Appendix.

Strict dependence of local government finances and indebtedness on public debt and on the Polish national economy as a whole may hamper utilization of structural funds for local development, decrease local infrastructure investment and slow down regional development and, as a result, the growth of Polish economy.

2.3. Macro economic data and assumptions used in analysis

In Table 2 we present data and select assumptions of economic growth projections, which are later used for calculations. The results of these calculations, regarding economic growth of Polish economy and budget and investment activity of local governments, are presented in Tables 3, and 4. In all presented tables, the data for the years 2002 and 2003 are reported values, while the figures for 2004 - 2006, with some exceptions, are anticipated values calculated as simple projections of the previous year values and formulas given in Table 1. For example, in order to calculate the 2005 projection of central government revenue, we multiply the value of the revenue in year 2004 by the growth rate of GDP, i.e. a ratio of GDP_{05} to GDP_{04} . Calculation of projection of central government expenditure in consecutive years is based upon official assumptions concerning ratio of central government budget deficit to GDP. For example, the 2005 projection of central government expenditure is calculated as 2005 revenue and a sum of the product of the 2005 Deficit to GDP ratio, and the nominal value of 2005 GDP: $Exp_t = Rev_t + [(BDef/GDP) \times GDP]_t$. In general, in our projections of revenue and expenditure, we multiply previous values by a product of the GDP growth rate, and the inflation rate and appropriate coefficients. The operating expenditures of both local and central government are defined as all expenditures, which can not be categorized as capital expenditures (debt interest is classified as operating expenditure).

In our basic scenario (No 1), we assume that in 2004, 2005 and 2006 the GDP growth rate equals 5%, while the inflation rate (CPI) equals 2% in 2004, and 3% in 2005 and 2006. Our assumptions of the basic scenario follow economic projections of Deputy Prime Minister J. Hausner, and the Ministry of Finance, who anticipate GDP growth of 5% in the 2004 budget, and

at least 5% growth rate in 2005 and 2006. They anticipate inflation rate of 2% in 2004 and between 2% and 3% over 2005-2006. These assumptions are close to projection released by the National Bank of Poland, which assumes the GDP growth rate in 2004 of 4% to 5%, and the inflation rate between 2% and 2.2%. In addition, we assume that the operating expenditures (including wages and pensions) both of the central and local government levels grow at a slower rate than the revenues. The basic scenario can be called optimistic, but only from the macro – economic point of view because it assumes savings in central and local government administration expenditures, and also some savings in the welfare sector. These savings in expenditures in the amount of 3.4 billion zloty in 2004 are included in so called Hausner saving program.

In scenario No 2, which we call moderately pessimistic, we assume the GDP growth rate equal to 4.5%, in 2004, and to 4% in 2005 and 2006. In addition, we assume that the operating expenditures of local government grow at a rate equal to the growth rate of revenues. No decrease in the growth rate of wages and pensions is anticipated. Thus, as can be seen in Table 2, both the revenues and operating expenditures grow according to the following formula:

$$Rev_{t-1}(1+CPI_t)(1+0.5GDPgr_t)$$

In the basic scenario this formula is slightly different for operating expenditures, and assumes the form: $Rev_{t-1}(1+CPI_t)(1+0.25GDPgr_t)$, which results in slower growth of these expenditures.

3. ANALYSIS OF INTERRELATIONS BETWEEN POLISH ECONOMY, PUBLIC FINANCES AND LOCAL GOVERNMENT FINANCES

3.1. Description of the model used for analysis

We designed a special equilibrium model for calculations and analysis of interrelations of central and local government finances and budgets. The objective of calculations, presented in Tables 3 and 4 of this paper, is to estimate the amount of resources, Polish local governments can use for financing investment - from their own budget revenues, and from debt, provided the EU funds for financing local infrastructure are available as presented in Table 1. In addition, we analyze the impact of the resources from the E.U. Structural Funds, over 2004 -2006, on the growth of infrastructure local investment.

The basic principle in our model is that all inflows to the local government's budget (revenues including EU funds and extra proceeds from debt issuance) equal all financial outflows (expenditures including interest and debt repayment). In addition, we require in our model that all regulations and restrictions of the Law on Public Finance be observed. Total amount of debt outstanding, as a percentage of revenue, can not be higher than 60% and the total debt service as a percentage of total revenues can not exceed 15%. It turns out that these restrictions are not critical for all JST together. Theoretically, there is a lot of room for local governments to borrow. As a result of calculations we also observe the relation of Public Debt to GDP. Whenever this relation exceeds 50%, or 55%, we take appropriate actions in our calculations, regarding the budget deficit to revenue ratio, consistently with the restrictions described in the Appendix.

Using Table 3, we below describe basic features of our model.

Table 2. Assumed general economic indicators in [%], data, in [million zloty], and projection formulas

1	Year	2002	2003	2004	2005	2006
2	Scenario 1					
3	GDP growth rate (GDPgr) [%]	1.4	3.5	5.0	5.0	5.0
4	CPI[%]	1.9	1.6	2.0	3.0	3.0
5	NBP interest reference rate (REPO) [%]	9.0	5.6	3.7	3.8	4.0
6	EUR/PLN [z]; <i>assumed in the budget</i>		4.31	4.25	4.25	4.25
7	Central gov. budget revenues	145.1	155.7	154.5	$Rev_{04} \frac{GDP_{05}}{GDP_{04}}$	$Rev_{05} \frac{GDP_{06}}{GDP_{05}}$
8	Central gov. budget expenditures	185.1	194.4	196.3	$Rev_t + [(BDef/GDP) \times GDP]_t$	$Rev_t + [(BDef/GDP) \times GDP]_t$
9	Local gov. budget revenues	80.03	80.02	$Rev_{t-1}(1+CPI_t)(1+0.5GDPgr_t)$	$Rev_{t-1}(1+CPI_t)(1+0.5GDPgr_t)$	$Rev_{t-1}(1+CPI_t)(1+0.5GDPgr_t)$
10	Local gov. operating expenditures	83.20	85.51	$OExp_{t-1}(1+CPI_t)(1+0.25GDPgr_t)$	$OExp_{t-1}(1+CPI_t)(1+0.25GDPgr_t)$	$OExp_{t-1}(1+CPI_t)(1+0.25GDPgr_t)$
11	Debt of the State Treasury	326.76	369.19	423.26	492.0	534.0
12	Extra revenue from privatization	0.57	0.137	0.30	0.30	0.30
13	Scenario 2 (changes with re. to Scenario 1)					
14	GDP growth	1.4	3.5	4.5	4.0	4.0
15	Central gov. budget expenditures	185.1	194.4	198.25	$Rev_t + [(BDef/GDP) \times GDP]_t$	$Rev_t + [(BDef/GDP) \times GDP]_t$
16	local gov. operating expenditures			$OExp_{t-1}(1+CPI_t)(1+0.5GDPgr_t)$	$OExp_{t-1}(1+CPI_t)(1+0.5GDPgr_t)$	$OExp_{t-1}(1+CPI_t)(1+0.5GDPgr_t)$
17	Central gov. Budget Deficit/GDP [%]	5.18	4.77	5.26	4.20	3.30

Table 3. The model solutions - Optimistic scenario; Data in billion zloty, indicators, in [%]

	Year	2002	2003	2004	2005	2006
1	Central Budget Deficit / GDP [%]	5.18	4.77	4.81	4.20	3.30
2	Local gov. <i>Gros</i> Operating Surplus	11.60	10.49	12.06	16.96	23.39
3	Resources from E. U. Funds			0.2	3.3105	4.5135
4	Contribution of Local Governments			3.009	3.009	3.009
5	Local gov. Total Debt Outstanding	14.06	17.68	21.545	28.635	29.554
6	New Debt of Local gov.	7.948	8.38	7.0	11.50	7.0
7	Total Debt Service	3.51	4.01	3.96	5.22	7.20
8	Local gov. <i>Net</i> Operating Surplus	9.07	7.51	8.92	12.55	17.31
9	Local gov. Investment expenditures	14.77	15.98	16.19	24.23	24.46
10	Investment expenditures /Total expenditures [%]	21.58	22.98	22.55	32.36	31.33
11	Total Debt Outstanding /Total Revenue [%]	17.57	22.09	25.69	31.18	29.12
12	Debt Service / Total Revenue [%]	4.38	5.01	4.72	5.68	7.09
13	Public Debt /GDP [%]	47.23	51.069	54.335	59.256	59.312
14	Local gov. budget inflows	88.548	88.540	91.161	103.646	108.78
15	local gov. budget outflows	85.724	88.489	91.134	103.526	108.64
16	GDP	772.2	812.014	869.667	940.545	1017.20

In row 1 of Table 3 we present *Central Government Budget Deficit to GDP ratio*. The deficit (according to the cash budget method used in Poland) is a simple difference between Central government budget revenues and expenditures (given in Table 1), at the end of each year over 2002 -2006 period.

In row 2 – we have *gross Operating Surplus*, which is defined as revenues in excess of operating expenditures. This surplus can be used to fund capital expenditures as well as for financing debt repayment, and will not be used to fund operating expenditures. A decrease in the operating surplus in relation to total revenues is very often a sign of decreasing capability to finance investment, and may indicate future difficulties with financing debt service. The value of the operating surplus to revenue below 10% is dangerous for any city. The level of operating surplus could be increased by either increasing revenues or by decreasing operating expenditure.

In row 3 we present resources from EU funds (Structural Funds and the Cohesion Fund), as they will be available for financing local investment - as cost reimbursement resources. Therefore, in 2004, only 200 million zloty will be available to local governments, and over 2004 -2006 altogether only 8, 024 billion zloty, as compared to potentially available 7,257.6 billion Euro - 30,844.8 Polish zloty (see Table 1).

In row 4, we present the amount of resources, local governments will have to contribute as their own shares, in order to utilize the EU funds. The amount of these funds exceeds the share of local governments estimated in the NPR, and presented in Table 1 because all projects co-financed by EU funds will have to be financed during their implementation by JST, and only later, the money will be reimbursed from either the Structural Funds and the Cohesion Fund. Thus, the actual share of JST in financing local infrastructure projects will be higher over 2004, 2005 and 2006 than "theoretically" calculated in the NPR.

The amount of own financial contribution of local government presented in Table 1., as a total for the period 2004-2006 has been proportionally allocated among subsequent years. Taking into consideration the same calculations, we assumed that the share of local government in financing particular projects will be 1/3 on average. It means that the share of EU funds adds up to remaining 2/3. Some inconsistencies from the above mentioned assumptions contained in the Table 4 result from our estimations of deferrals in reimbursing expenditures made by local governments.

Values presented in rows 3 and 4 - EU funds and local governments share in financing local infrastructure projects, are exogenous in the model. The values presented below, in rows 5-9 and 13-15 are model solutions.

In row 5, we present values of Total Debt Outstanding at the end of year t. It consists of the Old debt, resulting from debt contracts concluded until the year, for which we prepare the budget prognosis (in our model the old debt includes all credits and bonds; resulting from debt contracts concluded until the end of 2003), and the new debt, which we anticipate to issue.

In row 6, we present values of new debt - a level of credits and bonds, we anticipate to issue each year over the period 2004 -2006.

In row 7, we present the total cost of Debt Service over a given year.

Calculations of debt service are based on debt structure: the interest rates charged for all individual loans and bonds; and levels of each debt repayment, and repurchase of bond issues. We calculate separately the interest on new and old debt, and debt repayment. These two types of debt add up each year, and for cumulative debt including both, the old debt and the new, forecasted debt, we calculate the debt service for all consecutive years. Debt service also includes expenditures resulting from state and local government loan guarantees.

In row 8, we present the values of *the net Operating Surplus*, which is defined as operating surplus less costs of servicing the debt, both the existing debt, and the new debt, which we anticipate to issue over 2004 -2006. The net operating surplus can be in full used for financing investment. The larger the level of these resources the more funds is available for financing investment.

In row 9, we present the level of investment expenditure – which is the solution of our model, depends on budget own resources (the net operating surplus), extra resources from EU funds (Structural Funds and the Cohesion Fund), and on resources from new debt and from privatization.

In row 10, we present a ratio of investment expenditure to total expenditure. It is also the result of our model solution, and clearly shows the impact of the Structural Funds and the Cohesion Fund on local infrastructure investment.

Rows 11 and 12 present values of indicators defined in the Public Finance law calculated for all local governments together. In row 11 we have the total amount of debt outstanding as a percentage of revenue, and in row 12, the value of the total debt service as a percentage of total revenues. The values of both indicators result from the model solution.

In row 13 we present public debt (including state loan guarantees) to the GDP ratio. As stated in the Polish Constitution and in the Public Finance law, this ratio can not be higher than 60%, and when it exceeds 50% several restrictions apply (see Appendix).

In row 14 we present all inflows to the local government budgets. These inflows include revenues, extra revenues from debt, from privatization, from capital assets, and from EU funds, as well as budget surplus from previous year.

In row 15 we present all financial outflows (expenditures and debt repayment, including interest).

In row 16 we present nominal values of GDP, based on reported values in 2002 and 2003, and on its growth rate projections presented in Table 1.

3.2. Description of the methodology

Implementation of the model described in point 3.1 helps us obtain, for each year: 2004, 2005, 2006 - the *values of New Debt*, which local governments plan to issue, the *net Operating Surplus*, in all JST budgets together, and the *value of resources for financing Local Investment*. These solutions are obtained under the assumption that all financial inflows to local government's budgets equal financial outflows.

Table 4. The model solutions - Moderately Pessimistic scenario

	Year	2002	2003	2004	2005	2006
1	Central Budget Deficit / GDP [%]	5.18	4.77	5.26	4.20	3.30
2	Local gov. <i>Gros</i> Operating Surplus	11.60	10.49	11.14	15.02	20.29
3	Resources from E. U. Funds			0.2	3.3105	4.5135
4	Contribution of Local Governments			3.009	3.009	3.009
5	Local gov. Total Debt Outstanding	14.06	17.68	21.545	28.635	29.554
6	New Debt of Local government	7.948	8.38	7.0	7.0	2.0
7	Total Debt Service	3.51	4.01	3.72	4.72	6.25
8	Local gov. <i>Net</i> Operating Surplus	8.09	6.48	7.42	10.30	14.20
9	Local gov. Investment expenditures	14.77	15.98	15.458	14.416	15.259
10	Investment expenditures /Total expenditures [%]	21.58	22.98	21.31	18.92	19.065
11	Total Debt Outstanding /Total Revenue [%]	17.57	22.09	26.04	22.89	15.55
12	Debt Service / Total Revenue [%]	4.38	5.01	4.45	5.18	6.07
13	Public Debt /GDP [%]	47.23	51.069	54.595	59.246	59.294
14	Local gov. budget inflows	88.548	88.240	90.957	94.500	100.628
15	local gov. budget outflows	85.724	88.489	90.869	94.503	100.572
16	GDP	772.2	812.014	865.526	927.152	993.165

The above solutions of the model make it possible to compute the values of *Debt Service*, the level of *Outstanding local governments Debt*, and the level of *Public Debt*.

All calculations are carried out given exogenous projections of several variables, which include local and central governments revenue and expenditure, revenue from privatization, GDP growth, and the growth of operating expenditures of local governments.

In the model we exogenously assume and project the resources from European Union, CPI, NBP interest reference rate, and the Euro/ PLN exchange rate.

Thus, we look for such levels of resources from new debt and *net* operating surplus, which provide for maximum investment expenditure, and at the same time ensure a balance of financial inflows and outflows of the local government's budgets.

When the value of public debt to GDP exceeds 55%, as it happens for example in 2005, we should consistently with the Law on public finance, set the state budget deficit at a level, which ensures the ratio of the State Treasury Debt to GDP, in 2006, not higher than in 2004. Our model solution shows that the values of the State Treasury Debt are assumed wrongly - too high in 2004. However, we took the data from the Strategy of Public Debt Management, prepared by the Ministry of Finance in January 2004, and for the purpose of these paper we do not estimate new values of the State Treasury Debt.

4. PRESENTATION AND DISCUSSION OF RESULTS

The results presented in table 3 and 4 show, that the volume of debt that local governments can incur is extremely sensitive to trends of macroeconomic variables. Recently, the public debt to GDP ratio has dangerously moved toward the constitutional limit of 60%, and the limit may be broken in 2006, and, when worst comes to worst, even in 2005.

A change of 100 basic points in the nominal GDP growth rate over 2005 and 2006, yields a decrease in the local government investment of 36% in 2005 and 30.2% in 2006 (Table 5 - lower GDP growth rate Scenario). When we additionally assume, as in our moderately pessimistic Scenario, that the growth rate of wages, pensions and other operating expenditures

Table 5. Impact of EU funds on local government investment growth

Year	2004	2005	2006
Maximum level of local government Investment expenditures - <i>Optimistic Scenario</i> [billion zloty]	16.19	24.23	24.46
% change, compared to previous year	+1.3	+49.6	+1.0
Maximum level of local government Investment - <i>Lower GDP growth rate Scenario</i> [billion zloty]	15.458	15.51	17.06
% change, compared to previous year	-0.33	+0.34	+9.99
Decrease in local government Investment, compared to <i>Optimistic Scenario</i> , in [%]	4.22	35.99	30.26
Maximum level of local government Investment expenditures - <i>Moderately Pessimistic Scenario</i> [billion zloty]	15.458	14.416	15.259
% change, compared to previous year	-0.33	-0.68	+5.8
Decrease in local government Investment, compared to <i>Optimistic Scenario</i> , in [%]	4.62	40.50	37.60

equal the growth rate of the JST revenues, the decrease in the local government investment is even greater, and equals 40.5% in 2005 and 37.6% in 2006 (Table 5).

A change of 200 basic points in the nominal GDP growth rate may cause some activity of local governments on the capital market, which are legally prohibited. The same relates to the change in volume of public debt expressed in PLN due to great volatility in the exchange rate of Polish currency. The exchange rate assumed in our model is no longer realistic. Zloty has been strongly devaluated against EURO, and one Euro in 2004 will exchange at 4.75 zloty, and not at 4.25 zloty, as assumed in the state budget. Central budget revenues, expenditures and GDP, as well as public debt must be re calculated, at least for 2004.

Table 6. Availability of EU funds, and local government investment share

Year	2004	2005	2006
Maximum level of resources from EU - model calculations, [billion zloty]	0.2	3.3105	4.5135
Maximum level of resources from EU - NPR calculations*, [billion zloty]	7.000	10.842	10.000
Required JST share for Investment financing, model calculations, [billion zloty]	3.009	3.009	3.009
Required JST share for Investment financing, NPR calculations**, [billion zloty]	1.10	2.012	0.90
Maximum level of resources available to local governments for Investment financing - <i>Moderately Pessimistic Scenario</i> [billion zloty]	15.458	14.416	15.259
Utilization of available resources for investment projects, co -financed by EU funds, [billion zloty]	19.29	16.29	17.32

*The NPR estimates local government share at 944 million Euro = 4 012 million zloty

**The NPR estimates EU contribution to local investment in Poland at 7257 mill. Euro=30842 mill. zloty.

As we see in Table 6, Polish local governments altogether should not have any difficulties with providing resources for their own financial share, required in all projects co-financed by E U funds. We calculated, with the help of our model, that these resources would equal 3, 009 billion zloty each year over 2004 -2006 period. Even in the pessimistic scenario, the maximum level of resources available to local governments for financing investment (from the JST budgets, from debt and privatization) equals above 14.4 billion zloty each year over 2004 -2006 period. Thus, the infrastructure investment projects co-financed by E U funds will utilize only below 20% of potential resources available for financing investment.

From Table 6 we can also see that the resources from EU funds, have been overestimated for 2004 in the NPR calculations, while the resources for the same year, that local government's will have to secure as their share have been strongly underestimated.

In the paper we do not discuss conditions, under which private participation in financing public infrastructure projects is possible.

5. Conclusions

Successful implementation of the EU financial aid under the structural funds, and the Cohesion Fund, addressed to Polish local governments will have, under some provisions regarding development of Polish economy, very constructive impact on the level of local government's investment. This can be seen in Tables 3 and 4. In our optimistic scenario the level of infrastructure investment is about 40% higher in 2005 and 2006 than in 2003 and 2004. However, this impact may be much lower, when the growth rate of Polish economy will be slower than anticipated in the submitted for Parliament approval 2004 Budget, and budget expenditures for 2005 -2006. In this respect it is very important that originally designed Hausner saving plan (a decrease in administration and unjustified social expenditures) for 2004 -2006 is implemented.

Polish local governments altogether will be able to provide resources for their own financial share, required in all projects co-financed by E U funds. However, it may happen for groups of local governments, for example in rural areas, that the governments will not be able to provide sufficient resources from their own budgets, and banks will not be willing to borrow because of lack of creditworthiness of individual JST. In addition, many large cities will be able to issue and repay debt, which will ensure all safety provisions for budget liquidity, but will violate the restrictions of the law on public finance. The restrictions regarding debt service below 15% of budget revenues and the outstanding debt below 60% of budget revenues should be waived for cities with good financial status.

From the perspective of financing the National Development Plan (NPR) any substantial changes of law governing municipal borrowing do not seem necessary. The basic hindrance in borrowing money to finance municipal investments under the NPR is not unsatisfactory financial condition of local government sector in general, but first of all, a strong dependency of local government financial position on central budget activity, and other specific restrictions of the law on public finance. Debt incurred by local governments is a building block of public (general government sector) debt, which is characterized by the very strong crowding out effect, i.e. crowding out debt of other institutions of the sector by the debt of the State Treasury (central government). Thus, ability, and the scope of incurring debt by local governments to cover their own contribution to the NPR depends largely on national economic growth, central budget deficit, its relation to GDP and eventually – on relation of public debt to GDP. In the current year - 2004, this ratio for the first time will exceed a threshold which justifies launching a corrective procedure¹. This fact, while not yet destructive for municipal finance, diminishes the ability of local governments to finance infrastructure, and disturbs their optimism.

The GDP growth and the level of public debt may be decisive for future potential utilization of EU funds by local governments and by public sector. If the ratio of GDP to Public Debt exceeds 60% in 2005, then, in 2007 all budgets, the state budget and the local government's budgets will have to be balanced. This could be destructive to Polish economy. However, it requires further analysis over 2007 -2009 period.

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Appendix

Regulation of the Law on Public Finances regarding restrictions and sanative procedures of issuing debt by local governments

Polish Constitution imposes a limit on public debt at the level of 60% of GDP. The law on public finance precisely defines the term "public debt" and envisages a set of corrective procedures, which will automatically be launched, when the public debt to GDP ratio exceeds 50%. The stock of treasury guarantees is included in the public debt, and thus adds to a risk of an increase in the public debt to GDP ratio.

Any percentage of total debt outstanding to total revenues over 50% results in additional restrictions on new debt issuance, both by the state and local governments, until previous debt is retired to a level below 50%. When the value of total public debt exceeds 60%, then no deficit is allowed in the state and local government budgets. No debt can be issued and no guarantees granted either by the state or local government.

When the above ratio exceeds 50%, but is lower than 55%, the state budget deficit in relation to revenues, in the current year, determines the limit of the same ratio for the next year. The same macro - economic ratio applies to local government budget deficits.

When the second level of the public debt to GDP ratio exceeds 55%, the state budget deficit in the following year should be set at a level ensuring that the State Treasury debt to GDP ratio will not be higher than in the year, for which it was officially published. The government, i.e. The Council of Ministers should present to the Parliament a macro - economic program, which will reduce the public debt to GDP ratio below 55%.

As regards local governments, their ability to incur debt, in this case, is constrained in two ways. First, local government deficit is reduced according to a formula, which guarantees that it is not higher than public debt to GDP ratio. Second, the ratio of debt service to revenues is reduced from 15% to 12%.

When the public debt to GDP ratio is 60% or higher, central and local governments must have balanced budgets (or budgets with surplus). They can not issue new debt. In addition,

government sector cannot issue new guarantees, and the Council of Minister is obliged to present to the Parliament a program aimed at reducing the public debt to GDP ratio below 60%.

Incurring debt by local governments is subject to the following restrictions:

- in the case of debt issued to cover budget deficit:
 - debt service is paid at least once a year;
 - a discount is not higher than 5% p.a.
 - capitalization of interest is not allowed
- maximum face value of debt expressed in PLN has to be set on the day of transaction
- debt service in a given year cannot be higher than 15% of the same year budget revenues
- Outstanding debt of local government cannot be higher than 60% of its budget revenues.

