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FISCAL FEDERALISM AND THE COVID-19 CRISIS: THEORETICAL ASPECTS AND POLAND'S EXPERIENCE

Abstract. The article analyzes the specifics of the COVID-19 crisis and its impact on the public finance system, taking into account the key problems of the theory of fiscal federalism. The purpose of this article is to examine the impact of the pandemic crisis on the fiscal relations taking place between different levels of public authority (*intergovernmental relations – IGR*), considered in the context of the decentralization of the public finance system and the associated distribution of public functions and resources. The article refers to the model features of these relationships, as defined in the theory of fiscal federalism. It also examined the responses of European countries to the negative effects of the COVID-19 crisis, taken within the framework of the IGR, in order to limit the negative effects of the pandemic at different stages. An attempt was also made to answer the question of how the current pandemic crisis may change the multilevel governance (MLG) patterns set forth in the doctrine. The Polish public finance system was used as an example for detailed analysis in this regard.

Keywords: coronavirus pandemic, fiscal federalism, intergovernmental fiscal relations, subnational government.

1. Introduction

The theory of fiscal federalism is one of the modern economic concepts that refers to the idea of decentralization of the public sector and multi-level public finance. The concept of *fiscal federalism*, however, has broader implications than the decentralization process itself. This is because fiscal federalism means a certain comprehensive concept of management in the public sector and a certain public financial policy that determines the strategy of state action, indicating areas where the integration of general and local interests takes place. Decentralization, on the other hand, as part of this concept is the process of transferring powers and decisions to a sub-state

level of public authority. Thus, in this context, fiscal federalism is not only the idea of rational management of public funds based on the formula of ceding certain fiscal powers from the central authority to lower levels of public administration, but also the concept of multi-level management in the public sector, the implementation of which is aimed at increasing the efficiency of the process of providing public goods and services by this sector. The multi-level distribution of public power is also considered an effective method of securing freedom in democracies (Hayek 1960), as well as maximizing aggregate prosperity – each jurisdiction can choose its own public consumption bundle, as opposed to when the same bundle is available in all jurisdictions (Oates, 1972).

Taking into account the fact that the basis of federalism as a developmental idea opposed to the idea of centralism is the assumption of leaving the widest possible range of decision-making power within the closest possible reach of the citizen – the consumer of public goods and services (Klepka, 2013: 189–190), the local government subsector plays a key role in this regard. Thus, the effect of decentralization, understood as an effect and consequence of the implementation of the idea of federalism, is usually greater self-reliance and independence of local governments from the central authority. This is especially true for the financial self-reliance of local government units (LGUs). Among other things, the theory of fiscal federalism is treated as a sub-discipline of public finance, dealing with the issue of optimal distribution of fiscal power among different levels of government (central government, state governments, regional and local governments). Key in this regard are the relationships that occur between the different levels of public authority (intergovernmental relations – IGR).

As one of the most destructive and unprecedented modern global crises, the COVID-19 pandemic, in addition to devastating public health, has also significantly altered the aforementioned relationships. Most countries have adopted a centralized approach to dealing with the effects of the pandemic crisis, so to speak, contrary to the demands of the idea of fiscal federalism. Worryingly, however, in some countries the pandemic has even become a pretext for violating democratic standards and eroding democracy (Lewkowicz et al., 2022) and the systemic weakening of local self-government. In the author's opinion, this unfortunately also applies to Poland.

The purpose of this article is to examine the impact of the crisis caused by the COVID-19 pandemic on the specifics of IGR, understood as the distribution of functions among the different levels of government in a country, and the related fiscal relations taking place between the different levels of

government. The article refers to the model features of these relationships, as defined in the theory of fiscal federalism, and examines the responses of European countries to the negative effects of the COVID-19 crisis, taken within the IGR to deal with the pandemic at different stages, and attempts to answer the question of how the current pandemic crisis can change and shape the future of the IGR.

2. Fiscal federalism and intergovernmental relations – theoretical background

One of the contemporary economic concepts relevant to the idea of multi-level government public finance is fiscal federalism theory¹. Richard Musgrave (Musgrave, 1959) is considered its precursor, but the origins of the concept are to be found in the works of Johannes Althusius, a German jurist and theorist of state and law who lived at the turn of the 17th century. He is considered to be the first theorist of federalism (Benoist 2000: 25–58, Chmielewska 2012: 11–29). In his work entitled *Politica Methodice Digesta, Atque Exemplis Sacris et Profanis Illustrata* (1603), he postulated the following key principles for the functioning of public administration (Wągrodzka 2011: 27):

- (1) plurality of levels of governance – public authority, diversified at different levels;
- (2) autonomy – each level of government has a certain level of independence/sovereignty;
- (3) solidarity – participation of different communities in a common public good.

Fiscal federalism as a sub-discipline of public finance is based on the assumption that the system of public finance is closely linked to the structure of public institutions and the nature of intergovernmental relations (IGR) between them. The literature points to the following positive effects of properly formed IGRs taking place between different levels of public authority (Heinemann-Grüder et al. 2017: 16):

- (1) decentralization of decision-making and functional decentralization, thereby strengthening local government by assigning it competencies and resources appropriate to the public tasks it performs;
- (2) increasing transparency in the public finance sector and efficiency in decision-making by public decision-makers;
- (3) increasing public policy coherence – intergovernmental cooperation ensures continuous dialogue between different levels of public authority;

- (4) taking more account of different perspectives and public goals in public policy, implemented on the basis of intergovernmental cooperation and consensus, which in turn increases the integration of this policy and, in addition, acceptance of and respect for the rule of law;
- (5) greater public policy coherence with the federal dogma of “unity in diversity,” based on the assumption that territorial divergence of policies is permissible, and that the role of intergovernmental coordination is to ensure the functionality of the system as a whole.

The theory of fiscal federalism focuses on the search for the optimal extent of public sector decentralization (optimal federalism) and the optimal distribution of public finance sector functions across different levels of public authority (Piotrowska-Marczak 2009: 16–22). The essence of this concept is well captured by the term multilevel governance (MLG), first used in 1993 by American political scientist Gary Marks (Marks 1993: 391–410). Diversification of public authority, its tasks and powers, and its financial resources is seen in the theory of fiscal federalism as an effective instrument for increasing the efficiency of public sector operations and optimizing the process of providing public goods and services. The theory assumes that redistributive functions should be the domain of the central (government) level, taking care of the appropriate distribution of public goods, while allocative functions should be the domain of local government. As a result, public goods and services are likely to be provided efficiently and in accordance with the diverse preferences of residents of local communities (Paluszak 2002: 93). At the same time, MLG theorists point out that the differentiated levels of power must be optimally matched (Bache & Flinders 2004). A properly formed IGR system serves this purpose.

It is worth adding that federal fiscalism as a theoretical concept has been subject to evolution. This is alluded to by Wallace E. Oates, who distinguishes between fiscal federalism in traditional terms, i.e., The First Generation Theory (FGT) and Second Generation Fiscal Federalism (SGT) (Oates 2005: 349–373, Oates 2008: 313–334).

One of the main assumptions of FGT is that public policymakers have good intentions and care about correcting the imperfections of the market. In this context, FGT can be assessed as a rather naive concept and one that simplifies economic reality because it ignores the problem of government failure. It makes the rather utopian assumption that public authority is a rational power that seeks to maximize the welfare of citizens (the argument of the perfection of public authority), while not pushing its own political interests.

The SGT takes a much more critical and multi-faceted approach to these issues. It is assumed that a number of non-economic considerations influence the decisions made by public policy makers. In order to identify and diagnose them, SGT draws on the achievements of various theoretical trends. As an example in this regard, one may point to the new institutional economics (NIE). The leading representatives of this trend were the British economist Ronald Harry Coase (Coase 1984: 229–231) and American economists, i.e. Oliver E. Williamson (Williamson 2002: 595–613) and Douglass C. North (North 1990a, 1990b). In the trend in question, a special role is attributed to institutions, as specific rules of the game developed by the society. Thus, the influence of non-economic factors (e.g., social, historical, political, legal factors) on the functioning of the market and the economy is exposed. An important function of the aforementioned institutions is to reduce transaction costs, understood as the costs of communicating between market players. The SGT draws on the contributions of various NIE-related theories, such as Public Choice Theory, Constitutional Economics, Economic Theory of Democracy, Theory of Agency, Property-Rights Theory and Transaction Cost Theory, for example.

The key questions and problems exposed in the theory of fiscal federalism were aptly identified by Richard M. Bird (Bird 2003: 1–42). He formulated them as follows:

- (1) Who should perform which public tasks in the context of optimizing public spending? – the question of expense attribution;
- (2) Who should collect which taxes? – the question of revenue attribution;
- (3) How do we mitigate the vertical inequalities in government revenues and expenditures that exist in the local government subsector? – the question of vertical fiscal imbalance and mechanisms for its equalization;
- (4) Whether and how to balance the horizontal imbalances that exist between the needs of territorial communities and their diverse resource potential? – the question of horizontal fiscal imbalance and mechanisms for its equalization;
- (5) Who should curb/limit LGU debt and under what rules? – the question of local debt rules;
- (6) What is the institutional system that determines the optimal solution of the problems defined in questions 1–5? – the question about of institutional aspects of fiscal federalism.

The questions/dilemmas of fiscal federalism identified in this way take on particular importance in crisis situations. Undoubtedly, these include the current, unprecedented, and global crisis of the SARS-CoV-2 virus pandemic, known as the COVID-19 or 2020+ crisis. As mentioned earlier,

Table 1

Linking COVID-19 to typical policy recommendations on fiscal federalism

Subject matter	Main problems	Recommendations
(1) Subnational fiscal capacity	– SCGs own revenues only partially cover expenses (low tax autonomy); – SCGs have limited capacity to respond to fiscal needs (low spending power).	Strengthen sub-national taxation and spending powers to allow governments to respond better to local needs and regional variations: – better align own-source revenues with sub-central spending; – raise sub-central tax autonomy to ensure sufficient capacity; – strengthen fiscal equalization systems.
(2) Delineation of responsibilities across levels of government	– extensive joint government initiatives (overlap); – administrative borders that do not correspond to geography of issues (e.g. transport/planning exclusively local).	Clearly delineate responsibilities both horizontally and vertically to improve efficiency and equity (delineate functions and responsibilities across levels of government).
(3) Intergovernmental co-ordination	– intra-national barriers to labour mobility; – inadequate performance evaluation and monitoring; – failure to centralize coordination functions of government.	Minimize barriers to internal trade and enhance inter-governmental co-ordination. Improve transparency, data collection and performance monitoring to enhance co-ordination.

Source: (Forman et al.: 8).

according to the theory of fiscal federalism, the relationship between the different levels of public authority plays a key role in the effective response of public policies to crisis situations. At the same time, the literature emphasizes that (quote): *not only have intergovernmental relations shaped the response to the crisis, but the crisis is shaping the future of intergovernmental relations* (Fiscal Federalism 2022: 251).

In view of the radical changes that the global economy and society are experiencing in the context of the COVID-19 crisis, the idea of fiscal federalism will need to be revised and adapted to the specifics of the post-crisis period. This includes the deepening crisis of socioeconomic inequality and greater interdependence between central policy and policies carried out at lower levels of government. This will undoubtedly translate into changes in the specifics of intergovernmental relations.

Kass Forman, Sean Dougherty and Hansjörg Blöchliger synthesizing the fundamental challenges in this area, identify said challenges under the following three thematic areas (Forman et al.: 8):

- (1) subnational fiscal capacity, i.e., the differential fiscal capacity of individual lgu to deal with the pandemic crisis determined both by the size of their own budget revenues and the associated differential financial autonomy of local governments;
- (2) delineation of responsibilities across levels of government – SNGs are responsible for a range of public tasks relevant to epidemic threat reduction (through screening, population monitoring, crisis communications, coordinated care for vulnerable populations, enforcing confinement policies, ensuring public order, providing the health treatment and services to those infected, social protection, providing financial support to citizens who cannot work, and on business support);
- (3) intergovernmental co-ordination understood as the harmonization of actions taken under emergency conditions by different levels of public authority and/or jurisdictions.

Table 1. presents the contemporary, specific problems and challenges of fiscal federalism identified under the aforementioned three areas emerging in the context of the COVID-19 crisis, while synthesizing the recommendations of the referenced authors on how to solve and mitigate them.

3. The COVID-19 crisis – specifics and implications for the public finance system

The peculiarity of the COVID-19 crisis is that it is not only a global health crisis originating from outside the market, but at the same time a crisis with extreme socio-economic and financial consequences, historically comparable in principle only to the times of wars. In just a few months, the COVID-19 pandemic caused a much larger drop in global GDP than the 2008–2009 global financial crisis. According to International Monetary Fund estimates, global GDP has already shrunk by about 3.9% in the first year of the pandemic (2020) compared to 2019, marking the biggest economic slowdown since the Great Depression of 1929–1933 (World Economic Outlook Database). An even greater decline in GDP was recorded in European Union member states. In the corresponding year, it was almost 5.9% compared to the year before the pandemic (Eurostat Database).

The following can be considered as key specific features of the COVID-19 crisis:

- the epidemic and global nature manifested by uncontrolled and dynamic transmission of the SARS-CoV-2 coronavirus resulting in enormous social costs²;

- enforced social isolation and limited mobility;
- a drastic decline in social and economic activity as a result of lockdown;
- disruptions in global supply chains;
- inefficiency of health care systems in many countries;
- a sharp decline in production and consumption;
- a sharp increase in the burden on state public finance systems due to the launch of aid fiscal support packages and the associated fiscal stress.

The COVID-19 crisis led to a significant deterioration of public finances in most countries, and the processes taking place in its wake are often referred to as the “covidization” of public finances. This is a result of the unprecedented use of a number of extraordinary economic instruments, both on the monetary and fiscal policy side. In monetary policy, it is, for example, lowering interest rates, or increasing the money supply in the economy by the central bank through quantitative easing. Another way is the overt financing of expansionary fiscal policies bearing the hallmarks of “helicopter money”³. In fiscal policy, on the other hand, it is mainly anti-crisis measures based on the formula of increasing public spending and cutting taxes.

In this context, the public authorities’ stimulus packages can be divided into the following forms:

- (1) fiscal stimulus – stimulating the economy by cutting taxes or increasing government spending;
- (2) monetary stimulus – stimulating the economy, e.g. by lowering interest rates, and consequently encouraging investors to invest due to cheaper credit facilities;
- (3) quantitative easing – increasing the money supply through unconventional supply-side stimuli, such as central banks buying long-term assets (e.g., bonds); as a result, investors have fewer bonds in their portfolios and more cash that they could reinvest.

The purpose of the stimulus packages was to revive the economy and lift it out of recession. The support provided in the packages was aimed at preventing a decline in consumption and maintaining economic activity, in line with the assumption in Keynesian economics that recessions are not self-correcting and therefore require government intervention. Interventions were either in the form of fiscal stimulus or monetary stimulus. The fiscal stimulus model is a way of influencing the economy through government spending and taxes – governments use fiscal stimulus packages to increase demand for goods and services by cutting taxes and increasing government spending, ultimately minimizing the burden of recessions, and stimulating

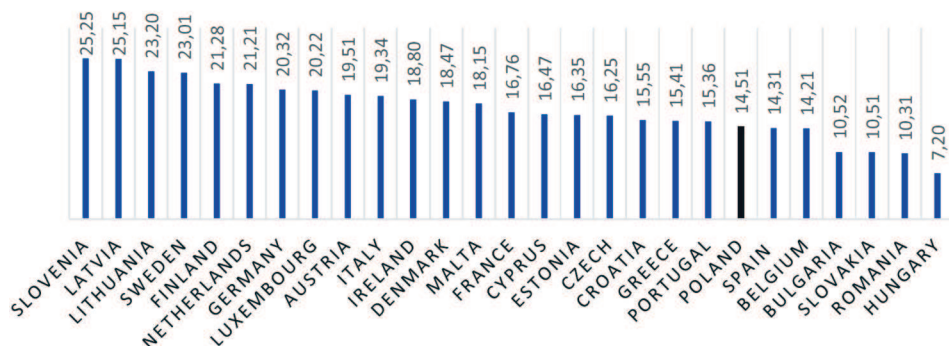
economic growth. The monetary stimulus model, on the other hand, is essentially a monetary policy model used by central banks to manage the money supply. Central banks using it sought to ensure economic growth by increasing the amount of money in the economy.

In addition, in order to identify and systematize government responses to the COVID-19 crisis, the literature proposes a detailed ordering of the various instruments used in the stimulus packages, dividing them into the following categories (Governments' Responses to Covid-19):

- (1) 'cash' (the government considered cash transfers),
- (2) 'wage' (there were some support measures covering wage),
- (3) 'credit scheme' (the country instituted credit schemes),
- (4) 'tax credit' (the government adopted a fiscal policy like providing tax credits),
- (5) 'tax delays' (there was a fiscal policy like delays on tax),
- (6) 'export' (the country had measures supporting traders),
- (7) 'interest rate' (the first two years of the pandemic, i.e. 2020 and 2021, a low interest rate policy was prevalent).

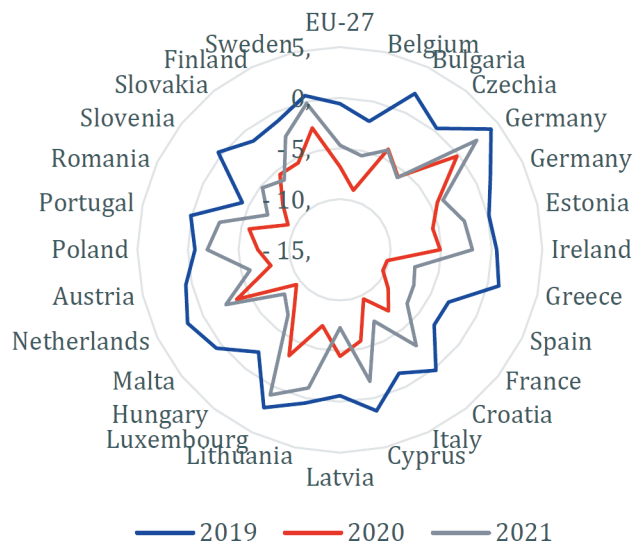
Figure 1 illustrates the scale of fiscal responses to the pandemic by individual EU member states during the first two years of the pandemic. The leaders in this regard were Slovenia and Latvia, where the value of stimulus packages exceeded $\frac{1}{4}$ of GDP. Poland, with a rate of 14.5% of GDP, ranks seventh from the bottom. Lower stimulus packages as a percentage of GDP were recorded in the EU only in countries such as: Hungary, Romania, Slovakia, Bulgaria, Belgium, and Spain.

Figure 1
Governments' fiscal responses to COVID-19 as a percentage of GDP
(EU-27; 2020–2021)



Source: (Governments' Responses to Covid-19).

Figure 2
General government net lending(+)/net borrowing as a percentage of GDP (EU-27; 2019–2021)



Source: (Eurostat Data Explorer, GOV_10DD_EDPT1).

The fiscal restraints applied in public policies, the associated increased public spending, and at the same time lower tax revenues have resulted in increased budget deficits and, consequently, public debt.

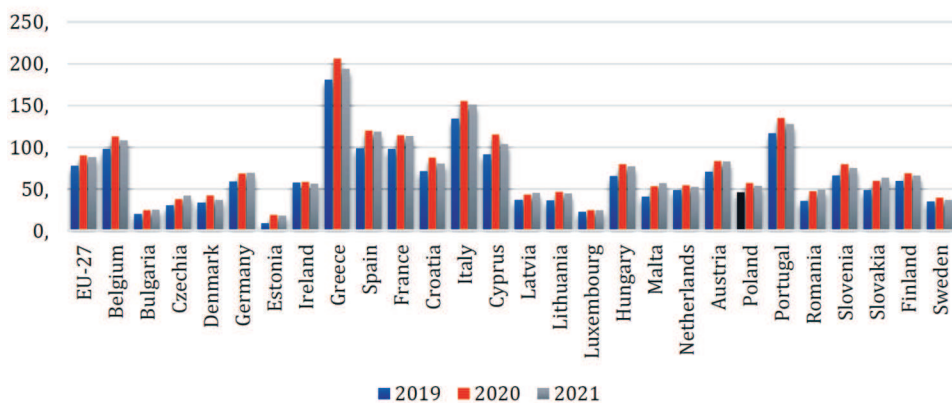
As a result of the severe recession and the necessary pandemic mitigation efforts, public finances in EU member states have also been significantly affected. Their budget deficits and debt ratios have risen sharply. The average deficit level in the EU-27 increased by about 6 percentage points in 2020 (from 0.6% of GDP in 2019 to 6.8% of GDP in 2019), and the average debt ratio increased by almost 13 percentage points over the same period (from 77.5% of GDP to 90% of GDP, respectively).

Figures 2 and 3 illustrate how the fiscal performance and debt of the public finance sector (general government) in each country changed in the first two years of the pandemic (2020 and 2021), compared to the year before the pandemic crisis (2019).

In Poland, the state of epidemic was introduced from March 20, 2020. However, it was abolished on May 16, 2022, replacing it with an epidemic emergency. As in most countries, here the COVID-19 crisis also had a significant negative impact on the public finance system, causing a pandemic “scissor effect” in the system.

Figure 3

**General government debt as a percentage of GDP
(EU-27; 2019–2021)**



Source: (Eurostat Data Explorer, GOV_10DD_EDPT1).

The essence of this phenomenon was discussed much earlier, i.e. in the context of the 2008–2009 financial crisis, by H. Blöchliger along with other authors (Blöchliger et al. 2010). Its essence is the simultaneous increase in public spending and decrease in public revenues. The negative health and socioeconomic impacts caused by the pandemic crisis required a drastic increase in public spending related to, among other things, support for businesses, job protection, social benefits, reinforcing the financial system, public investment and health care, etc.⁴ The assistance offered was modified on an ongoing basis and adapted to the current epidemiological situation within the framework of government support instruments, namely the so-called “crisis shields” and financial shields.

Table 2 shows the total amount of government spending allocated in Poland to counteract the negative effects of the COVID-19 pandemic in 2019–2020, broken down by the three main sources of funding.

Symptomatically, the majority of aid activities in Poland have been financed through entities outside the public finance sector⁵. This has been viewed negatively by many public finance theorists, including, among others, W. Misiąg, emphasizing that (quote): *The way in which projects carried out in the framework of countering the pandemic and its financial consequences are financed has drastically reduced the transparency of the functioning of public finances – this is due both to the transfer of financing of many tasks outside the public finance sector and in the tendency, which has already been visible for several years, to create unclear and poorly sub-*

Table 2

Value of government aid programs related to countering the effects of the COVID-19 pandemic in Poland (2020–2021; PLN billion)

Sources of funding	2020	2021
Expenses of the state budget and the budget of European funds	23.2	18.5
Financial shields of the Polish Development Fund (Polski Fundusz Rozwoju – PFR)	63.5	10.5
Covid-19 Counteracting Fund (Fundusz Przeciwdziałania Covid-19)	92.7	50.7

Source: (Report 2021a: 19–20, Report 2022a: 21–22).

stantiated links between extra-budgetary institutions of the public finance sector (Misiąg 2020: 24).

The pandemic has not only “jacked up” public spending in Poland to record levels but has also weakened the revenue side of Poland’s public finance system. Public revenues have declined, especially those related to tax sources. For example, revenues from PIT collected using the tax scale (state budget revenues including the shares of LGUs) amounted to PLN 73.4 billion in 2020 and were lower by PLN 5.6 billion, or 7.1%, compared to receipts on this account in 2019 (Report 2021a: 77). It is worth noting, however, that this was not only the result of the effects of the pandemic crisis, but also the legislative changes made in the context of the PIT before the crisis, i.e. in 2019.

The consequence of the state’s extensive support of the private sector in dealing with the negative effects of the epidemic was a deep imbalance in public finances. The deficit of the state budget in 2020 amounted to PLN 85 billion, and the deficit of the entire general government sector exceeded PLN 161 billion. In 2021, the corresponding figures were already at a lower level, i.e. respectively: PLN 26.4 billion and 49 billion (Report 2021a: 410, Report 2022a: 408). Unfortunately, these figures do not reflect the true scale of fiscal imbalances in Poland’s public finance system due to the fact that the vast majority of public spending related to pandemic mitigation is invisible in the state budget. This is a result of the clearly intensified process of debudgetization of state finances during the COVID-19 crisis as a consequence of planning and carrying out large financial operations outside this budget.

The imbalance in public finances had to result in an increase in public debt. In Poland, its high growth rate was recorded, and, to be clear,

this was primarily in the government subsector component and not in the local government component. In 2020, the state public debt (SPD – calculated using the national methodology) amounted to PLN 1.1 trillion (an increase of PLN 120.9 billion compared to the end of 2019). In the same year, general government debt (EDP – calculated according to EU methodology, i.e., the *European System of Account ESA2010* standard) was much higher, at PLN 1.3 trillion (an increase of PLN 290.7 billion, compared to the end of 2019) (Debt Management Strategy 2021: 7). In contrast, EDP debt calculated from the end of 2019 to the end of 2021 increased by as much as PLN 363.8 billion, or 35%, to reach PLN 1.4 trillion at the end of 2021 (Public Finance Sector Debt 2021: 1, Public Finance Sector Debt 2022: 1).

Such a high growth rate of public debt was mainly influenced by government sector debt related to the activity of the two funds mentioned earlier, namely the Polish Development Fund and the COVID-19 Counter-acting Fund. At the end of 2021, the debt financing expenditures related to these funds amounted to more than PLN 276 billion, and according to preliminary assumptions, at the end of 2022 it will amount to PLN 350 billion, and in 2025 – Even up to PLN 410 billion (Dudek et al. 2022: 26). The funds in question are institutions that are fully dependent on central public authorities, carry out a significant part of the financial operations related to the pandemic, and are not formally included in the public finance sector, and are therefore not subject to the budgetary control and reporting mechanisms appropriate to that sector. As a result, the public debt they create is not visible in Poland's public debt statistics, the SPD, as defined in the Public Finance Act of August 27, 2009 (Act 2009). Instead, it is evident in government sector institutions debt (EDP), calculated according to EU methodology. This is one of the reasons that the difference between SPD and EDP amounted to as much as PLN 262 billion at the end of 2021, i.e. about 57 billion euros at the then-current exchange rate (sic!). The public debt associated with combating the effects of the pandemic (pandemic debt) is practically invisible in the Polish state budget – most of the financial operations associated with it have been creatively “pushed” outside this budget. This is a worrying phenomenon, clearly limiting the transparency of the Polish system of public finances and making it difficult to comprehensively assess the functioning of the public finance sector under pandemic conditions. Taking public spending and public debt outside the budget means reducing public control over entire segments of public finances, due in part to the lack of parliamentary oversight. These are actions that are harmful and dangerous in terms of fiscal stability, but some-

what convenient for politicians. It should be added that the transparency of public finances has been steadily deteriorating in Poland for several years now, and the pandemic has only served as another pretext to exacerbate this process.

In the context of public debt, the rapidly rising cost of servicing it in Poland is also an important issue. According to the European Commission's forecasts, in 2023 the average related costs in Poland will be almost the highest of all EU countries, higher costs are projected only for Hungary (AMECO Database). This is related, among other things, to the soaring yields on Polish government bonds (in June 2020, a record of sorts was set in this regard – the yield on 10-year bonds exceeded the highest level in 20 years, i.e. 8%).

4. Fiscal federalism and COVID-19 crisis from Polish LGUs' perspective

The pandemic had a negative impact not only on the finances of Poland's government subsector, but also on the local government subsector. Admittedly, in light of the statistics, the situation of the local government subsector in aggregate did not look as disastrous as predicted by many experts in the field of local finance issues (Swianiewicz & Łukomska 2020, Pewiński 2020, Krawczyk 2021). For example, in 2020, the budgets of the local governments closed collectively with a budget surplus of PLN 5.7 billion (with a planned deficit of PLN 21.2 billion), while in 2021 – a budget surplus of PLN 17.4 billion (with a planned deficit of PLN 19.4 billion). Aggregate revenues of local government budgets in 2020 increased by PLN 26.4 billion (9.5%) compared to the previous year, expenditures – by PLN 8.4 billion (6.2%). In turn, in 2021, the corresponding figures were as follows: an increase regarding aggregate budget revenues – by PLN 28.5 billion (9.3%), aggregate budget expenditures – by 16.8 billion (5.6%) (Report 2021b, Report 2022b).

Unfortunately, data on the budget revenues of local governments are distorted by the fiscal interventions of the central government. The achieved budget surpluses of the local governments in 2020 and 2021 resulted, among other things, from government subsidies received from the Government Fund for Local Investment (GFLI) and the Government Road Development Fund (GRDF), which, symptomatically and reflecting the re-centralization trends taking place in Poland, was originally called the Local Government Roads Fund.

The former fund (GFLI) in 2020 subsidized Polish local governments to a total of PLN 10.3 billion, while in 2021 – to the amount of PLN 4.9 billion. On the other hand, significantly smaller transfer revenues were received by the LGUs from the GRDF, i.e. PLN 2.6 billion each in 2020 and 2021, respectively (Task Report 2021, Task Report 2022). The seemingly not bad financial situation of the LGUs during the first two years of the COVID-19 crisis was also undoubtedly influenced by earmarked subsidies received by municipalities and cities with powiat rights under the government's *Rodzina 500+* (*Family 500+*) program. These funds transferred to local governments by the central administration under the government's social program amount to about PLN 40.6 billion annually (RIO Activity Report 2021, RIO Activity Report 2022). These transfer revenues have significantly improved the picture of the income potential of municipalities and cities with powiat rights, yet the local governments are not their beneficiaries. The role of the LGUs is solely to distribute these funds to individual families.

The examples given demonstrate a centralized model for dealing with the pandemic crisis in Poland. While in countries such as Great Britain, Sweden, Finland, the Czech Republic the key category of government support at the time of the pandemic was subsidies compensating local government units for the loss of budget revenues caused by the pandemic, divided according to objective criteria and transparent algorithms, in Poland the government support system is based on targeted subsidies divided arbitrarily. The literature emphasizes that (quote): *the government's attempts to support local governments with further programs of targeted subsidies granted in a discretionary manner are an ad hoc solution, aiming to turn local governments into clients of the central government, thus destroying the very foundation of self-governance and contradicting the constitutional principle of subsidiarity* (Appeal of the Local Government Expert Team 2020: 2).

The Government Fund for Local Investment (GFLI) can be used as an example in this regard. This is a special program of non-refundable support for local governments, financed by the Bank of National Economy (BGK) within the framework of the aforementioned COVID-19 Countering Fund. The support received by the local government from this fund can only be used for investment purposes. In Poland, there was controversy over the arbitrary and non-transparent manner of distribution of these funds to individual municipalities and poviats, based on political and discretionary criteria instead of transparent distribution algorithms. For example, E. Malinowska-Misiąg's research on *per capita* own income (excluding GFLI funds) shows that most of these funds have gone to the local governments where income has increased compared to 2019 (Malinowska-

Misiąg 2022: 60). Specific anomalies are also confirmed by the research of J. Flis and P. Swianiewicz (Flis & Swianiewicz 2021: 1–12), as well as the author team of D. Sześciło, A. Gąsiorowska, R. Łapszyński, and S. Zakroczyński (Sześciło et al. 2021). They show that clientelism in government-local government fiscal relations has become a dangerous trend in Poland, and the pandemic crisis has clearly exacerbated this trend. It is difficult to disagree here with the opinion of the cited authors that such actions are primarily (quote) *a denial of the idea of self-governance and decentralization, which implies building the strength of local communities bottom-up (e.g. by increasing the own revenue base) rather than waiting for favors from the capital. Finally, it is a terrible model from the point of view of the efficiency of the central government* (Sześciło et al. 2021: 13).

The method of estimating the gap in tax revenues of local governments in 2020 was regulated by Article 15 of the Act of March 2, 2020, *On special solutions related to the prevention, counteracting, and combating of COVID-19, other infectious diseases and crisis situations caused by them* (Act 2020). Decrease in revenue was calculated as the difference between the executed budget revenues of the local government and the planned revenues shown by the local government in the budget report for the first quarter of 2020. In the above account, the following tax revenues were to be taken into account: shares of LGUs in PIT and CIT revenues; taxes: on real estate, agricultural, forestry, transportation vehicles, on civil law transactions, tax on individuals, paid in the form of a tax card; revenues from fees: stamp duty, exploitation, local and spa fees. The loss of tax revenues calculated according to these rules was recorded in 2020 in as many as 1,625 LGUs (58% of the total number of LGUs), and collectively amounted to PLN 2.1 billion. In doing so, it was observed that the impact of the COVID-19 pandemic on the finances of the different categories of LGUs varied. The largest tax revenue losses were recorded in municipalities (PLN 0.8 billion) and cities with powiat rights, including the capital city of Warsaw (PLN 0.9 billion).

In the next pandemic year (2021), the estimation of the analyzed loss was changed. It is regulated by Article 78 (2) and (3) of the Act of November 19, 2020, *on Special Solutions to Implement the Budget Act for 2021* (Act 2021). Pursuant to the legal regulation in question, the shortfall in the revenues of the LGUs resulting from the occurrence of COVID-19 was a reduction in revenues, calculated as the difference between the revenues planned in the budget resolution for 2021 and the projected revenues for 2021 shown by the LGUs in the long-term financial forecast (LFF), effective as of March 31, 2020. Execution of the above revenues at a level lower

than the amounts projected as of March 31, 2020, occurred in 385 LGUs, i.e. in 13.7% of their total number. Calculated in this way, the aggregate revenue loss amounted to PLN 1.5 billion. This time it was highest in municipalities and the capital city of Warsaw (0.6 billion each, respectively) (RIO Activity Report 2021, RIO Activity Report 2022).

In the first year of the pandemic, LGUs experienced a revenue shortfall related to their share of PIT and CIT income taxes. The total revenue of local governments on this account fell to PLN 66.4 billion in 2020, while in 2019, i.e. even before the pandemic, it stood at more than PLN 67.1 billion (RIO Activity Report 2021, RIO Activity Report 2022).

Admittedly, at first glance, the decrease does not seem so significant, but these are data averaged for all LGUs, and it is worth noting that the highest losses of analyzed revenues were recorded by the largest cities, i.e. those territorial units in which there was a simultaneous accumulation of public spending related to the negative effects of the pandemic. As in the case of the state budget, this drop in revenue is not only the result of the recession caused by the pandemic, but also the tax law changes introduced in 2019. In this way, the effects of the pandemic and the central government's policies have overlapped, weakening the financial potential of Polish LGUs. Thus, this can be seen as a negative example of fiscal relations occurring between the central government and local governments.

Table 3. shows the categories of local government finances relevant to the concept of fiscal federalism, which were affected by the COVID-19 crisis.

Table 3**Selected categories of LCU budgets in Poland (2019–2021; PLN billion)**

Item	2019	2020	2021
Communes			
own income (excluding shares in PIT and CIT)	34.2	41.4	41.7
income from shares in PIT and CIT	24.2	24.2	27.5
general subsidy	30.4	31.6	40.7
total subsidies	46.2	51.9	53.4
current expenditure	112.4	122.5	129.5
property expenditures	22.9	21.2	23.2
overall budget performance	−0.1	5.4	10.7
operational budget performance	11.4	11.1	16.4
total debt	32.4	34.2	34.2
Poviats			
own income (excluding shares in PIT and CIT)	5.8	7.6	6.5

Item	2019	2020	2021
income from shares in PIT and CIT	6.5	6.4	7.2
general subsidy	11.6	13.4	15.0
total subsidies	6.7	7.1	7.3
current expenditure	24.3	27.0	28.7
property expenditures	5.3	5.3	5.4
overall budget performance	1.1	2.2	1.9
operational budget performance	2.8	2.7	3.7
total debt	6.6	6.5	6.2
Cities with poviat rights			
own income (excluding shares in PIT and CIT)	27.6	29.5	32.5
income from shares in PIT and CIT	27.5	26.6	30.4
general subsidy	17.1	18.8	22.8
total subsidies	21.8	25.4	25.3
current expenditure	81.0	88.3	92.5
property expenditures	15.9	15.2	15.6
overall budget performance	-3.0	-3.2	2.8
operational budget performance	6.3	3.3	10.6
total debt	37.1	43.0	45.0
Voivodeships			
own income (excluding shares in PIT and CIT)	1.1	1.6	1.5
income from shares in PIT and CIT	8.8	9.1	11.2
general subsidy	2.6	3.2	3.7
total subsidies	6.3	7.1	6.4
current expenditure	11.4	12.7	13.3
property expenditures	7.0	7.0	7.5
overall budget performance	0.4	1.2	2.0
operational budget performance	3.7	4.2	5.8
total debt	6.0	6.1	5.7
LGUs total			
own income (excluding shares in PIT and CIT)	68.8	79.9	82.2
income from shares in PIT and CIT	67.0	66.4	76.4
general subsidy	61.7	67.0	82.3
total grants	81.0	91.5	92.5
current expenditure	229.1	250.5	264.1
property expenditures	51.0	48.7	51.8
overall budget performance	-1.7	5.7	17.4
operational budget performance	24.1	21.4	36.6
total debt	82.0	89.8	91.1

Source: (Report 2020, Report 2021b, Report 2022b).

The data presented shows that, compared to the year before the pandemic (2019), during the years of the pandemic crisis, the dependence of local government budgets on transfers from the central budget has clearly increased, so the share of transfer income, i.e. subsidies and grants, has increased⁶. Thus, the financial self-reliance of local governments was limited.

The COVID-19 crisis has also affected the budget expenditures of local governments. Current expenditures have primarily increased, in part because the central government has imposed many new obligations on local governments to combat the effects of the pandemic (including additional expenses for disinfecting public spaces, health care, protective masks, protective clothing, medical equipment, disinfectants for hospitals, lodging and food for medics, care for the elderly, assistance for businesses, financial support for schools, etc.). It should be added that the trend of rising budget expenditures is intensifying and will further intensify in the context of double-digit inflation and the outright exponential increase in the cost of energy carriers.

A worrying trend in the analyzed period was also the deceleration of property (investment) expenditures, observed in virtually all types of LGUs. This, among other things, is a consequence of the increase in current expenditures related to mitigating the negative effects of the pandemic crisis. It should be added that current spending is, so to speak, natural competition for capital (investment) spending. This is determined, among other things, by the formal-legal construction of the so-called individual debt ratios – IDRs, set forth in Article 243 of the Act on Public Finance (Act, 2009), in which the ability to repay the debt of the local government is determined on the basis of the operating surplus treated as the main indicator of the level of financial security. Larger current expenditures mean a smaller operating surplus, and thus a lower investment potential for the LGU.

The deceleration of investment spending presented in Table 3 resulted, among other things, in an improvement in the overall budget performance of local government in Poland. The data presented shows that 2020 saw an aggregate budget surplus of PLN 5.7 billion across all local governments. In 2021, it was shaping up to be even higher, i.e. at PLN 17.4 billion. In fact, only the budgets of cities with poviatic rights closed with a deficit (of PLN 3.2 billion) in the first year of the pandemic. Symptomatically, the second year of the pandemic also saw a significant improvement in the aggregate operating results of the LGUs. While before the pandemic crisis, i.e. in 2019, the total operating surplus of the local government amounted to PLN 24.2 billion, in 2020 it dropped to PLN 21.4 billion, while in 2021

its size increased to PLN 36.6 billion. It is also worth noting something not seen in the data presented in the table, namely, in most of the different types of LGUs the total current surplus was higher than planned at the beginning of the year, in some types of LGUs – even more than twice (for example, in poviats and rural, urban, and urban-rural municipalities). The surpluses recorded were primarily due to a large decrease in property expenditures and the transfer of government support for investment from the aforementioned GFLI at the end of the year.

In contrast to the government subsector, the Polish local government subsector also saw relatively low debt growth rates compared to earlier years, despite the fact that debt limits for LGUs were relaxed as part of the fight against the pandemic. Among other things, certain exclusions from the limits have been introduced, such as those for liabilities incurred in connection with the loss of revenues for the local governments as a result of the COVID-19 epidemic. The conservative debt policy of the LGUs was mainly due to the focus of local authorities on solving current problems related to offsetting the negative effects of the pandemic crisis, rather than on investment activity financed through debt instruments.

At the same time, the literature stresses that the pandemic crisis has further highlighted the relations between the central government and local governments that have already been strained for many years. This was due to both divergent positions on the application of the necessary solutions (e.g., on the issues of how to fight the pandemic, top-down tax changes and their negative consequences for the finances of the LGUs, or the arbitrary and non-transparent way of distributing funds under the aforementioned GFLI), as well as the lack of sufficient support for local government administration by the government administration (Owsiak 2021: 64 and 79, Position of the Board of the Association of Polish Cities 2020, Position of the Board of the Association of Polish Poviats 2020). The observed conflict between the central government and local authorities is almost permanent. As early as 2013, i.e. many years before the pandemic crisis, the authors of the *Samorząd 3.0* report pointed out that local communities, treated as silent executors of the increasing number of public tasks thrown at them, are beginning to develop a demanding attitude, replacing dialogue and attempts to build systemic solutions with the demand “give us more money.” It was also stressed that the government, on the other hand, lacks mechanisms for influencing local government policies by shaping incentives – influence is reduced to top-down directives from specific ministries. As a result, the positions of the government and local self-government are becoming more and more distant from each other: the state treats local self-government

as a “foreign body,” local residents see it as another manifestation of the malfunctioning of the government apparatus, and local self-government itself serves here only as an object over which there is a dispute (Raport Samorząd 3.0 2013).

One gets the impression that the coronavirus pandemic has served as another excuse for the central government to further centralize and weaken the financial position of local government. This is done in a number of ways. One of them is the systematic imposition of additional public tasks by the central administration on local administrations, where the decision-making power lies with the central government. This trend has been going on for many years, but the current pandemic crisis has clearly intensified it. David Sześciło characterizes it with the term *decentralization of problems and centralization of resources*, aptly diagnosing its essence with the following words (quote): *In sensitive spheres of public tasks, the central government tends to burden local governments with the most difficult responsibilities and to assign them the most problematic areas of responsibility, while it leaves to itself control over key decisions or resources, mainly finances* (Sześciło 2018: 7). Maciej Turała, on the other hand, in the context of the specifics of the aforementioned process, uses the term *deconcentration of the central government to the local level*, treating this process as an intentional way of “diluting” the financial autonomy of the local governments by the central public authorities (Turała 2020: 344 and 352). As a result of such actions, in the context of the fiscal relations we are interested in, the Polish local government is becoming more of an administrator and executor of orders from the central administration than a real decision-making entity. The financial self-reliance of local governments in the spending dimension is diminishing, as the source of funding for additional tasks carried out by local governments is primarily transfer revenue, including mainly discretionary grants. An additional problem is the non-transparent rules for transfers related to additional tasks.

Another aspect of the growing trends of re-centralization is the removal of local government control over subsequent areas of public tasks and their transfer to the central administration. This process is often referred to by the colloquial term *salami effect*, based on the analogy of peeling off slices of salami. Examples in this regard from before the pandemic include the central administration’s assumption of control over provincial environmental protection funds (2017), the failed attempt to increase the state’s influence over regional chambers of audit (in 2017, the amendment to the act was vetoed by the president, arguing that it would give the central government the ability to interfere too much in the activities of local governments), the cen-

tralization of water management and the establishment of the State Water Management Company Wody Polskie (2018)⁷. The most recent examples in this regard include increasing the powers of education superintendents as the government administration and pedagogical supervisory body over local government schools (2022), as well as the government administration's attempt, argued by the pandemic and health crisis, to weaken the role of poviats hospitals (government draft of the act on modernizing and improving the efficiency of hospitals – 2021), which *nota bene* constitute the largest group of public hospitals in Poland⁸.

Another aspect of re-centralization is the almost universal formula in times of pandemic crisis of issuing (based on the so-called covid special act) orders to local governments by voivods (examples: subordination of municipal guards to the police, subordination of municipal hospitals to voivods, obliging local government health care facilities to provide a certain number of "covid beds" and an adequate number of ventilators, etc.) (Sześciło 2021: 2–7). From the point of view of the fiscal relations we are interested in, it is important to note that these orders most often resulted in a significant increase in the spending needs of the LGUs, thus "shifting the cost-intensive aspects of the fight against the pandemic onto the shoulders of the LGUs."

Re-centralization of public power in Poland also materializes in the formula of creating more and more new legislative solutions (harmful inflation of the law), often argued by the necessity of actions related to limiting the negative effects of the pandemic, resulting in weakening of the financial potential of LGUs. As examples in this regard, the tax changes to the personal income tax introduced by the Polish government and mentioned above (originally in 2019 and then in 2022 under the so-called Polish Tax Deal) are a significant blow to the financial structure of local government⁹. It should be noted that this tax accounts for more than 51% of the income of the local government, and tax preferences introduced by the central government (e.g. raising the tax-free amount to PLN 30,000, tax exemptions for families with many children and for active people of retirement age, or raising the limit allowing taxpayers engaged in business activity to be taxed in a lump sum – the lump sum income tax is not subject to distribution to local government budgets) are at the same time measures that limit the sources of income of the local government. The lack of stability of the law, its frequent changes without taking into account the opinions of local government circles, and the increasing opacity of these regulations – all this has and will continue to have a negative impact on the stability of the system of local government finance in Poland.

5. Lessons from the COVID-19 crisis: conclusions and demands for necessary reforms in local government finance

The pandemic crisis not only exposed the systemic weaknesses in Polish local finances that had been growing for many years, but also served as a pretext for the government administration to intensify the process of re-centralizing public power in Poland. Unfavorable trends in local government finances point to the urgent need to reverse the trend of progressive centralization of the state and repair the state-local government fiscal relations, restoring the compatibility of the system of financing TSUs with the constitutional position of local government in Poland. These changes, in line with the demands of fiscal federalism, would have to be based on certain principles and actions.

First, the financial autonomy of local governments should be strengthened through systemic changes to the structure of local government's own tax revenues, based on the attribute of real local tax authority. Current local government shares of PIT and CIT tax revenues do not meet the aforementioned condition. It is therefore necessary to replace them with local government supplements to state income taxes. As a result, the effects of centrally determined tax preferences would not have such a devastating effect on the local government portion of related revenues, and the size of these revenues would be determined primarily by local rather than central tax policy. It would also be advisable to introduce the participation of local governments in the flat-rate income tax at a level analogous to the participation in the PIT levied using a tax scale. It would also be advisable to return to the discussion regarding the introduction of the participation of local governments in value-added tax (VAT). Such changes would significantly reduce the vulnerability of LGUs' financial systems to potential crises.

Second, a systemic reform of correctional & equalization mechanisms relating to both income and expenditure disparities of Polish LGUs is necessary. The COVID-19 crisis exacerbated the problem of fiscal inequality, while exposing the weaknesses of the fiscal equalization system. Introduced in the wake of the pandemic crisis, the new component of the general subsidy, i.e. the development part of the subsidy, has not effectively compensated for the loss of income of LGUs in terms of PIT and CIT taxes. Crisis experience also indicates that when reforming fiscal correctional & equalization mechanisms, special attention should be paid to the specific spending needs of Poland's largest cities. Not only the negative effects of the pandemic crisis, but also a number of other ongoing crises (e.g., the refugee crisis, the climate

crisis, the energy crisis, etc.) are accumulating in the aforementioned units. Properly shaped fiscal systems and relations are those that take into account the peculiarities of these territorial units as high-risk entities, while providing them with the necessary fiscal resilience to the effects of extraordinary emergencies.

Third, in Poland, the transparency of the public finance system, *nota bene* already severely limited but even devastated during the COVID-19 crisis, should be rebuilt as soon as possible. Openness of public finances and related fiscal policy, understood as actual transparency and transparency of financial decisions made by public decision-makers is, in the context of the concept of fiscal federalism, one of the most important institutional foundations of an efficient and effective state and local government.

Fourth, it is difficult for the author of this study to agree with the numerous demands appearing with increasing frequency, both in the public debate and in academic publications, for a thorough redefinition of the division of tasks and functions of the various levels of government and the need to change the basic assumptions of the concept of fiscal federalism. In extreme cases, it is even stated that adherence to the postulates of this concept in practice is an obstacle to effective and efficient crisis management and pandemic control, and only the centralization of public power can facilitate this process. At the same time, the crisis becomes a pretext for undermining doctrinal principles of public finance (such as, for example, the principle of fiscal decentralization, the principle of material unity of the budget and non-funding, the principle of balancing public revenues and expenditures, the principle of public finance discipline and fiscal consolidation, the principle of openness and transparency of public finances, etc.). In the opinion of the author of this paper, this is a road to nowhere. You cannot justify the processes of destruction and spoiling of the public finance system with a crisis situation. The anti-crisis instruments used by public authorities should, by definition, be of an emergency and temporary nature. It is also unacceptable to undermine, in the name of fighting the pandemic crisis, the idea of local self-government and its key pillar of fiscal autonomy. Among other things, in this context, M. Turała, quoted earlier, states (quote): *The coronavirus pandemic has initiated a number of interventions aimed at protecting and preserving selected economic sectors of groups. Perhaps, time is ripe for considering another momentous decision – to either openly declare that a decentralized local government is no longer needed and that tasks will only be deconcentrated from the national government to its regional and local subordinate units or to protect the future existence of a financially autonomous, decentralized local government which allows for the*

implementation of the subsidiarity principle not only in theory, but also in practice (Turała 2020: 352).

In conclusion, the pandemic crisis has increased the presence of the public sector in most countries' economies, which is basically a normal trend in crisis situations. What is problematic, however, is the fact that the pandemic has served as a pretext in Poland for an apparent acceleration of the re-centralization process and the systemic weakening of local government finances. In this context, the functioning of a number of doctrines and principles advocated in the concept of fiscal federalism, such as the principle of financial autonomy of LGUs, the adequacy of the competencies and tasks carried out by LGUs to the financial potential, fiscal equalization of the adequate income potential and differential spending needs of LGUs, multi-level public governance, openness of public finance and fiscal policy, etc., have been broken or weakened.

A kind of "merit" of the COVID-19 crisis, on the other hand, is that it brought to light the most important deficits concerning fiscal relations taking place in the state-local government area. An essential lesson from the crisis should be the need for public policymakers to realize the need for systemic institutional reforms in the area of local finances, aimed at restoring the real financial autonomy of local governments in Poland, in accordance with the principle of adequacy of the size of their own financial resources to the assigned public tasks.

N O T E S

¹ The word *federalism* used in the name of the theoretical trend may be misleading, as it may suggest that the concept in question applies only to states with a federal structure. Meanwhile, it also applies to unitary states (of which Poland is one), provided that the public finance systems operating in them are decentralized.

² According to WHO data, a total of more than 614.4 million people have contracted COVID-19 worldwide, while the number of related deaths was more than 6.5 million. Analogous data for Poland are respectively: 6.3 million and 117,600 people (WHO Coronavirus COVID-19 Dashboard), <https://covid19.who.int/> (accessed: October 1, 2022).

³ This metaphor was first used as early as the 1960s by the American economist Milton Friedman – the founder of monetarism – to illustrate the negative effects of expansionary monetary policies (Friedman 1969: 4–7).

⁴ Eurostat data shows that Poland had surprisingly low public spending in 2020 related to the latter support area, i.e. reinforcing the health care system. Poland was the only country in the group of 27 member states where health care spending decreased as a proportion of GDP compared to 2019, and the rate at 5.3% of GDP was among the lowest in the EU. Lower rates were recorded only in the three Baltic states of Latvia, Lithuania, and Estonia. By comparison, the highest rate in the EU-27 was for Germany, at 11.2% of GDP. While Germany's *per capita* health care spending in 2020 was around € 4,500, Poland's was only € 0,700 (Early Estimates 2020).

⁵ Examples in this regard include the Polish Development Fund (PFR), which is a joint stock company owned by the State Treasury, and the COVID-19 Counteracting Fund as a state special purpose fund, financed by cyclical bond issues carried out by the government-owned Bank of National Economy (Bank Gospodarstwa Krajowego – BGK).

⁶ In contrast to Polish regulations, in accordance with the concept of fiscal federalism, the participation of LGUs in state income taxes (PIT and CIT) is not treated as an item of local government's own income, i.e. tax titles that strengthen the financial autonomy of local governments in the income dimension. They are treated as items of transfer income, for which the tax authority is exclusively on the side of the government level, not local government.

⁷ The environmental disaster on the Oder River (July–August 2022) demonstrated the weakness of this institution and can serve as a textbook example of the negative effects of centralizing certain public tasks.

⁸ Poland's health care system is one of the most centralized in all of Europe. This is determined by the way it is financed, as since 2003 there has been a single institution in the system (the National Health Fund – Narodowy Fundusz Zdrowia (NFZ)) responsible for financing health services.

⁹ Although in order to mitigate the negative effects of the Polish Deal tax reform on the local governments, a new component of the general subsidy, the so-called development part of the subsidy, was introduced into the system of local government finances, this did not effectively compensate the local governments for income losses in terms of PIT and CIT taxes.

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