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THE IMPACT OF THE COVID-19 PANDEMIC ON SUBNATIONAL FINANCE: POLISH EXPERIENCE

Abstract. In the face of the COVID-19 pandemic, governments worldwide established various mechanisms to facilitate the pandemic response and ensure the state's functioning. As a consequence, the economic impact of the COVID-19 crisis varies in countries, depending on the region. We are looking for answers to research questions: how the COVID-19 pandemic influenced the finances of local government institutions in 2020–2021; Is it possible to distinguish the types of units where this impact was greater or smaller, and whether and how the pandemic-related legislation influenced the fiscal relations between the state and local government, especially in the context of the local government institutions' financial independence. We have noticed that financial solutions dedicated to local government units, as well as making local government fiscal rules more flexible, allowed to maintain the potential of the local economic base. They also had a diversified impact on the Polish local government institutions' income level.

Keywords: local government units, interregional diversity, public finance, covid-19.

Introduction

The COVID-19 pandemic is a new situation experienced by both economies and societies around the world and has also largely affected the activities and finances of local government units (LGU). In Poland, municipalities, poviats (county) and voivodships (region) perform a wide range of public tasks involving the provision and financing of local public

goods, collecting and spending one-third of public funds. Therefore, numerous questions arise regarding the impact of the pandemic on LGU' activities and finances. This problem is also critical for the overall consequences of the pandemic crisis, which showed that the public authorities' activities to combat the COVID-19 effects take insufficiently into account the coordination of activities and financial management of government and local government institutions. Generally, in the teeth of a crisis situation, centralisation of public finances is a remedy frequently opted for.

Meanwhile, in conditions of high financial tensions, a crisis caused by, for example, an epidemic, the government institutions' activities should consider the importance of public services provided and financed by LGU' or the option to apply income and expenditure instruments of local and regional interventionism. Hence, the activities of public finance sector institutions aimed at counteracting crisis phenomena must notice the role and functions of local government in such situations and avoid reducing its share in the impact on the economy and society. Furthermore, in the light of the broadly understood responsibility of local government bodies for the provision of local public goods and the need for rational management of public funds, in the conditions of crisis phenomena, it is vital for local government bodies to make free decisions about the collection of income and revenues, the size and structure of incurred expenses and expenditures or developing and implementing anti-crisis programs.

The first studies on the pandemic's impact on the Polish local government finances were published in the second half of 2020 (Bazylak et al. 2020, Bober et al. 2020, Owsiak 2021, Malinowska-Misiąg 2022, Swianiewicz et al. 2022). The authors focused on determining the scale and scope of changes in the level and structure of LGU' revenue and expenditure and changes in the deficit and debt level of the local government subsector. However, it was obviously too early to determine in detail the scale and scope of these changes and how they affected local and voivodship development. Nevertheless, the analyses highlighted a significant income reduction from personal income tax (PIT) and corporate income tax (CIT) and, to a lesser extent, from real property tax. The total loss in the LGU' revenues was estimated at PLN 8–9 billion, while the spending to counteract the pandemic was defined as 1–2% of the current expenditure. The first studies on the negative impact of the pandemic on the Polish LGU' finances emphasised that, due to the relatively short period of analysing reports on the performance of LGU' budgets, a thorough assessment of the pandemic impact on LGU' finances should consider the diversity of the local government

sub-sector. Thus, the type and scale of the pandemic consequences for the finances of rural municipalities and those of cities with poviat rights are very different.

From an international perspective, the issue of local authorities' first reactions to the COVID-19 crisis in the European Union states was developed in the OECD study on crisis management at various levels (OECD 2020). That document emphasised the solid territorial dimension of the COVID-19 crisis, pointing out that local and voivodships governments were at the forefront of crisis management. Based on the survey conducted in the first period of the COVID-19 pandemic, the study stated that local government authorities under pressure recorded a remarkable increase in spending (64%) on social services, public health and social benefits. In short to medium term, most subnational authorities expect the crisis related to the COVID-19 pandemic will negatively affect their finances, causing a dangerous "scissor effect" associated with soaring spending and plummeting income (OECD 2020). Other COVID-19 pandemic impact studies on local government finance tried to identify factors differentiating the pandemic impact on local government finance in individual countries. They demonstrated the level of fiscal decentralisation, budget revenues structure and sensitivity to economic fluctuations, LGU' fiscal stability, and the scope and forms of support from state authorities (Allain-Dupre et al. 2020: 2–44, Chernick et al. 2021: 699–732). The first research results on the consequences of the COVID-19 crisis also confirmed that the level of municipal fiscal imbalance as the result of the Covid-19 crisis is not proportional to the situation on the central level, and municipal financial resources are not commensurate with their responsibilities as outlined by the constitution and the law and they are more severe in tourist municipalities (mass tourism) and urban ones with developed public transport (Nemec and Spacek 2020: 837–846). Kochanov et al. (2020) showing also that the central government does not reduce the consequences of the pandemic related to tax revenue losses. A similar results of the study was also obtained by Mackiewicz et al. (2022).

In this article, we are looking for answers to research questions: how the COVID-19 pandemic influenced the finances of LGU in 2020–2021, primarily in terms of income and expenses, as well as their financial result; Is it possible to distinguish the types of units where this impact was greater or smaller, and whether and how the pandemic-related legislation influenced the fiscal relations between the state and local government, especially in the context of the LGU' financial independence.

Legal regulations during the COVID-19 pandemic in the field of local government finance

In Poland, the legal regulations that were adopted following the pandemic development have had a significant impact on the finances of local government units. Generally, it should be emphasised at the outset that these provisions were addressed directly or indirectly to municipalities, poviats and voivodships. Moreover, they were mainly characterised by frequent changes without analysing their effects on the local government finances. That is particularly the case of legislative changes to tax law which shift the implementation of specific public tasks from government administration to local government without appropriate financial compensation. Additionally, they disrespect the adequacy of LGU' budget revenues to the scope and cost intensity of public tasks carried out to remedy the adverse effects of the pandemic.

The legal regulations issued to counteract the COVID-19 pandemic and its consequences were initiated by the Act of 31 March 2020 on special solutions related to the prevention, counteracting and combating of COVID-19, other infectious diseases and the crises caused by them (Covid-19 Act). According to this act, executive bodies of municipalities, poviats and voivodships were allowed to change the plan of revenues and expenses of the local government unit budget, including transfers of expenses between departments of budget classification and changes in the multiannual financial forecast and budget expenditure plan related to the LGU' implementation of new investments or investment purchases.

The provisions relating directly to municipalities, poviats and voivodships, which were to facilitate their operations in the pandemic crisis, mainly concerned the loosening of fiscal rules by:

- introducing the possibility of non-compliance with the principle of balancing the budget's current part with the amount of the planned, current expenses incurred to implement tasks to counteract COVID-19 and the planned income shortage caused by COVID-19
- increasing the limit of liabilities due to credits, loans and issued securities
- introducing the option to postpone the transfer of funds under subsidies by richer LGU for the benefit of those less wealthy, the so-called "Robin Hood fee."
- introducing the option of an early transfer of instalments of the educational, equalising, balancing and voivodship parts from the state budget to the LGU' budgets.

The legal regulations that have significantly influenced the finances of local government units during the COVID-19 pandemic, especially in terms of tax revenues collected, also include amendments to the Personal Income Tax Act (2020). These provisions reflected the changes in the government's tax policy. They concerned the exemption of individuals under the age of 26 from paying personal income tax on income below PLN 85,528 in the fiscal year, reducing the tax rate from 18% to 17%, and increasing the tax-deductible amounts. As a result, the level of accumulated revenues of LGU' budgets was affected to a much greater extent than those of the state budget.

Apart from legal regulations which significantly influenced the level of obtained budgetary revenues of municipalities, poviats and voivodships and limited the scope of their financial independence during the COVID-19 pandemic, several other legal provisions were adopted. They sanctioned the growing significance of discretionary transfers from the state budget and central funds to the LGU' budgets. A decision was made to establish the Governmental Fund for Local Investments (GFLI) (resolution no 102 2020), setting the amount of financial support for local government units at PLN 12 billion. Based on an algorithm, PLN 5 billion from that amount was transferred to the budgets of municipalities and cities with poviat rights, PLN 1 billion to poviats, and the remaining PLN 6 billion was transferred to the budgets of all levels of local government under the competition procedure (see Table 1).

Table 1

Funds use by local government units under the GFLI 2020–2021 program, [zloty]

voivodship	municipalities	share	cities-poviats	share	poviats	share
Dolnośląskie	231 782 056	6.75%	104 998 472	6.66%	46 440 515	4.68%
Kujawsko-pomorskie	160 602 965	4.68%	113 129 871	7.18%	56 470 996	5.69%
Lubelskie	323 633 422	9.43%	21 823 628	1.39%	102 598 596	10.33%
Lubuskie	94 857 247	2.76%	44 912 639	2.85%	20 748 738	2.09%
Łódzkie	240 466 669	7.01%	109 420 358	6.94%	39 266 051	3.95%
Małopolskie	332 317 101	9.68%	109 820 590	6.97%	104 386 315	10.51%
Mazowieckie	384 423 860	11.20%	138 746 489	8.81%	134 609 718	13.56%
Opolskie	85 071 640	2.48%	31 502 464	2.00%	25 843 195	2.60%
Podkarpackie	224 396 206	6.54%	51 064 298	3.24%	60 802 614	6.12%
Podlaskie	130 506 696	3.80%	55 771 293	3.54%	43 371 580	4.37%
Pomorskie	201 637 739	5.88%	136 339 258	8.65%	47 423 722	4.78%

voivodship	municipalities	share	cities-poviats	share	poviats	share
Śląskie	259 919 094	7.57%	364 162 768	23.11%	85 167 633	8.58%
Świętokrzyskie	169 084 077	4.93%	23 069 661	1.46%	37 532 685	3.78%
Warmińsko-Mazurskie	150 128 491	4.37%	26 455 324	1.68%	46 615 898	4.69%
Wielkopolskie	305 415 252	8.90%	121 779 836	7.73%	99 582 396	10.03%
Zachodniopomorskie	137 459 924	4.01%	122 621 971	7.78%	42 102 538	4.24%
Total	3 431 702 439	100%	1 575 618 920	100%	992 963 190	100%

Source: own study based on data obtained from the Chancellery of the Prime Minister

Another government fund, next to the GFLI, whose operation raises much controversy in the context of transparency in transferring public funds to the LGU' budgets, is the government fund for road development (The Roads Act 2020). This fund was supplied with monies from many heterogeneous sources, including, among other things, contributions from the National Fund for Environmental Protection and Water Management, subsidies from the state budget, the State Forests or the State Treasury Companies' profit. Frequent doubts and controversies are mainly raised by the competitions' rules and procedures, adopted qualification criteria, method of appointing the applications-evaluating committee, or the practice of approving the final list of poviat and municipality tasks by the prime minister.

In general, it should be stated that public funds established based on laws adopted during the pandemic crisis in Poland are intended to support LGU financially. However, there are major doubts about the central, administrative, political and discretionary tools and mechanisms of allocating public monies from these funds to the municipalities' and poviats' budgets.

Introducing the above legal solutions to the local government finance system aroused much controversy at the time of their adoption. Their predictable consequences included limiting the share of own revenues in the entire revenue structure of budgets in municipalities, poviats and voivodships, lowering the transparency of local government finances and limiting LGU' financial independence and independence. Furthermore, the COVID-19 pandemic and the legal regulations adopted at that time in the field of local government finances highlighted the already tense fiscal relations between the state and local government. They also contributed, directly or indirectly, to the further marginalisation of the local government's systemic position in Poland.

Methodology

The budgets of almost three thousand LGU were analysed, rural commune (1,532 units), urban-rural (608 units) and urban municipalities (235), cities with poviat rights (66 units), rural poviats (314 units) and 16 voivodships. However, to maintain data homogeneity, the study did not take into account the municipalities that changed their status from rural to urban-rural during the study period and some self-governments (municipalities) that did not timely submit relevant reports.

In order to show the formation of LGU' significant budgetary parameters, the primary indicators were analysed. The research covers the period 2016–2021, for which the following indicators were analysed:

- own income share in total income,
- PIT share in own income,
- operating surplus share in total revenues,
- CAPEX share in total expenditure,
- transfers' share in total revenues

Their analysis is indispensable when discussing the issues of LGU' financial independence. They represent the attitude of the government sector authorities in shaping the LGU' finances, which is vital for maintaining financial independence. The level of LGU' income and expenditure, especially in periods of reduced economic activity, determines the local governments units' financial condition.

The data were obtained from quarterly reports (for four quarters): Rb 27S and RbDNS for 2016–2021.

Analysis of the LGU' financial situation in Poland in 2016–2021, with particular emphasis on the pandemic period

The LGU' financial situation in 2020–2021 was diverse. The analysis of the LGU' primary financial data in aggregate terms reveals that during the pandemic, the total incomes grew slower than in the previous years (in 2021, an increase of 9.3%, in 2020 by 9.5%, in 2019 by 11%). Both in 2020 and 2021, all LGU' recorded an increase in incomes; however, the pace of change varied (see Table 2). In 2020, the weakest increase in total income was recorded by cities with poviat status (6.8%), while the strongest by rural poviats (12.6%). In 2021, the situation reversed, and cities with poviat rights noted the highest growth (10.7%), while rural countries saw the lowest (4.3%). It is also worth pointing out that the total revenue growth

rate in 2020–2021 was higher than that of total expenditure. That indicates local authorities' cautious approach to planning expenses, both current and assets-related.

Table 2

Budget data of local government units in 2016–2021, [in thousand]

	2016	2017	2018	2019	2020	2021
	urban municipalities					
Total income	22 592 395	24 432 242	26 842 669	29 818 355	32 389 680	35 122 715
Total expenses	21 806 263	24 631 997	27 844 013	29 950 113	31 921 074	33 499 788
Operating surplus	1 898 469	1 825 039	1 951 533	1 840 977	1 399 579	3 117 229
Budget deficyt/surplus	786 131	–199 755	–1 001 344	–131 758	468 606	1 622 927
	rural communes					
Total income	43 608 547	47 955 594	52 466 775	58 491 004	65 045 677	71 986 587
Total expenses	42 041 078	48 254 761	55 068 930	58 428 567	61 854 144	66 056 629
Operating surplus	4 911 397	5 051 161	5 250 437	5 699 198	6 015 952	7 791 325
Budget deficyt/surplus	1 567 469	–299 168	–2 602 156	62 437	3 191 533	5 929 959
	urban-rural communes					
Total income	34 295 096	37 429 488	40 611 860	45 249 162	49 821 546	54 380 186
Total expenses	33 097 112	37 712 641	42 580 359	45 380 894	48 203 118	51 397 548
Operating surplus	3 410 749	3 411 169	3 474 104	3 676 007	3 580 598	5 352 594
Budget deficyt/surplus	1 197 983	–283 153	–1 968 499	–131 732	1 618 428	2 982 638
	cities with poviat rights					
Total income	74 420 130	78 529 540	85 507 790	93 894 371	100 314 429	111 045 555
Total expenses	71 941 500	78 504 052	87 014 612	96 885 456	103 502 168	108 203 486
Operating surplus	6 194 823	6 336 539	7 162 087	6 343 375	3 306 795	10 641 276
Budget deficyt/surplus	2 478 630	25 488	–1 506 821	–2 991 085	–3 187 739	2 842 069
	rural poviats					
Total income	23 948 339	25 388 531	27 959 347	30 696 261	34 568 622	36 053 278
Total expenses	23 300 596	25 360 416	28 656 571	29 630 698	32 313 926	34 172 719
Operating surplus	2 063 841	2 073 145	2 057 714	2 762 091	2 710 526	3 712 726
Budget deficyt/surplus	647 743	28 115	–697 224	1 065 563	2 254 695	1 880 558
	voivodships					
Total income	13 505 630	14 771 385	16 953 684	18 754 957	20 956 586	22 826 558
Total expenses	12 617 385	14 317 429	16 582 312	18 375 964	19 707 968	20 802 074
Operating surplus	1 905 966	2 362 887	3 087 521	3 673 313	4 211 853	5 800 843
Budget deficyt/surplus	888 245	453 956	371 372	378 994	1 248 618	2 024 485

Source: own study based on quarterly reports (for four quarters): Rb 27S and RbDNS for 2016–2021.

Due to the budget revenues growth rate exceeding that of expenditures, the local government closed 2020 with a budget surplus (ca. PLN 5.6 billion), which in 2021 was even higher and amounted to ca. PLN 17 billion. These changes gain significance compared with the negative budget result from 2019, 2018 or even 2017. In those years, LGU showed a budget deficit of PLN 1.7 billion, PLN 7.4 billion and about PLN 300 million, respectively.

The growing income in the pandemic period does not mean that the local government in Poland has obtained new, let alone own and permanent, sources of public tasks' financing or that their scope has been substantially reduced. The proposed changes meet the LGU' dramatic situation but are not systemic changes and weaken the LGU' systemic position in society and the economy. These changes only temporarily improve the LGU' financial situation. Consequently, the positive budgetary results in the pandemic period were primarily due to the temporary co-financing of the local government sector with funds from the central budget (ca. PLN 13 billion in 2020 and PLN 12 billion in 2021). The aforementioned GFLI was of great importance, whose financing came from the COVID-19 Counteracting Fund. Within its framework, municipalities (including cities with poviat status) and poviats received government funds for investment projects, including constructing roads, nurseries and kindergartens. It should be emphasised that these monies were budgeted by local government units as their own revenues, although they came from subsidies and could only be used for investment purposes. Money unspent in a given year was transferred to the following year, thus inflating the budget surplus and presenting an apparently excellent financial status. Including the above funds within the own revenue category temporarily improved the own income to total income ratio. However, such measures prevent a detailed analysis of the income generated by the local government, i.e. the income determining the LGU' financial independence.

Table 3

Indicators of the financial condition of local government units in years 2016–2021

	2016	2017	2018	2019	2020	2021	2016	2017	2018	2019	2020	2021
	urban municipalities						cities with poviat rights					
own income share in total income	55%	54%	53%	52%	51%	52%	62%	61%	61%	58%	56%	57%
PIT share in own income	39%	40%	42%	42%	38%	38%	41%	42%	44%	45%	43%	43%
operating surplus share in total revenues	8%	7%	7%	6%	4%	9%	8%	8%	8%	7%	3%	10%
CAPEX share in total expenditure	12%	15%	22%	18%	15%	14%	14%	19%	18%	16%	15%	14%
transfers' share in total revenues	45%	46%	46%	48%	49%	49%	38%	38%	39%	41%	44%	43%

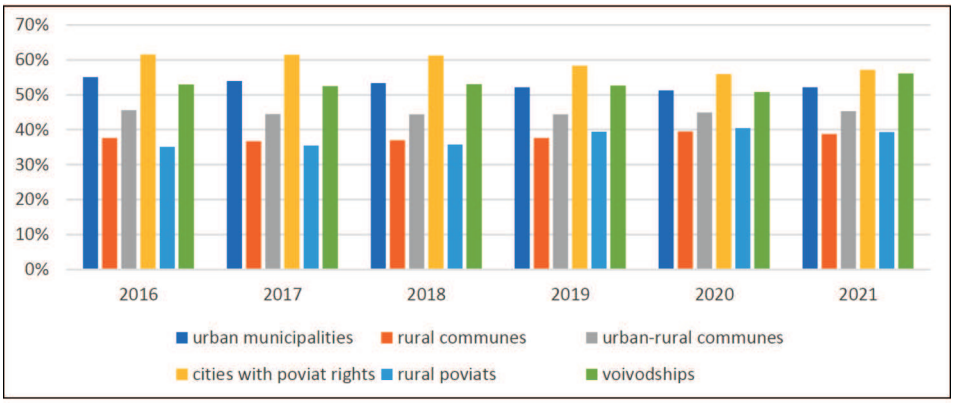
	2016	2017	2018	2019	2020	2021	2016	2017	2018	2019	2020	2021
	rural community						rural poviats					
own income share in total income	38%	37%	37%	38%	39%	39%	35%	35%	36%	39%	40%	39%
PIT share in own income	36%	37%	39%	39%	34%	35%	54%	55%	56%	52%	44%	49%
operating surplus share in total revenues	11%	11%	10%	10%	9%	11%	9%	8%	7%	9%	8%	10%
CAPEX share in total expenditure	11%	15%	22%	18%	16%	16%	13%	16%	21%	18%	16%	16%
transfers' share in total revenues	62%	63%	63%	62%	60%	63%	64%	64%	64%	60%	59%	62%
	urban-rural community						voivodships					
own income share in total income	46%	44%	44%	44%	45%	45%	53%	52%	53%	53%	51%	56%
PIT share in own income	36%	37%	39%	39%	35%	35%	19%	19%	18%	18%	17%	16%
operating surplus share in total revenues	10%	9%	9%	8%	7%	10%	14%	16%	18%	20%	20%	25%
CAPEX share in total expenditure	11%	14%	20%	16%	14%	15%	26%	30%	36%	38%	35%	36%
transfers' share in total revenues	54%	55%	55%	55%	55%	56%	61%	62%	60%	61%	64%	60%

Source: own study based on quarterly reports (for four quarters): Rb 27S and RbDNS for 2016–2021.

The indicators' analysis primarily shows the diversified status of LGU' particular finance groups in 2016–2021. In particular, attention should be paid to the indicators' levels for 2016–2019 and 2020–2021. The analysis of the own income to total income ratio showed that rural communes and poviats recorded the highest increase during the pandemic. This result is quite surprising considering the historical development of this indicator. On the other hand, the most significant decrease in the indicator's value occurred in cities with poviat rights, while a bit smaller in municipalities and voivodships (Graph 1). That was caused by the falling tax revenues, fees and commissions paid by inhabitants.

Graph 1

Own income share in total income



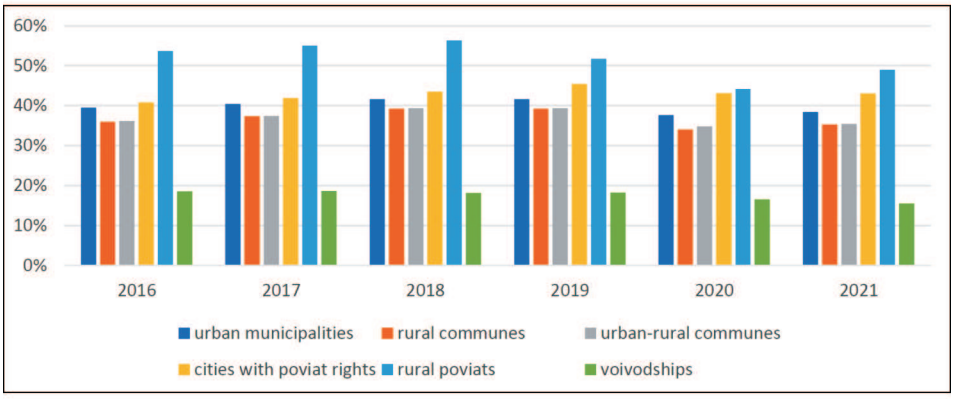
Source: own study based on Table 3.

In cities with poviat status, the analysed indicator's minimum, maximum and median values also decreased. The median value shows that this indicator was lower than 49% in 2020 and 50% in 2021 in half of the cities with poviat rights. In 2016, this indicator was 54%, and it decreased each year. During the pandemic, a significant change in the median occurred in the voivodships. The median growth, from 38% in 2020 to 44% in 2021, resulted primarily from a faster growth rate of own revenue rather than from the total voivodships' revenue. In the other LGU groups, the median of own income to total income compared to 2019 increased or remained at the same level. The data analysis shows that, except for rural communes and poviats, the median increased in 2021.

The falling share of own income in total income in cities with poviat status was already seen in 2019 when the personal income tax rate was reduced. However, it should be emphasised that PIT income constitutes a vital source of LGU' income. In 2019, the monies from PIT constituted 24.5% of income in cities with poviat status and 20.4% in poviats. Therefore, the PIT income is prevailing for these units' independent performance of public tasks. In the case of poviats, the PIT income is basically the only significant source to finance public tasks, especially optional and investment ones. The falling PIT revenues in 2020 (by 1.9%) only aggravated the LGU' difficult situation. The most significant decrease in PIT revenues in own income occurred in rural poviats (– 15%) and rural and urban-rural municipalities (Graph 2).

Graph 2

PIT share in own income



Source: own study based on Table 3.

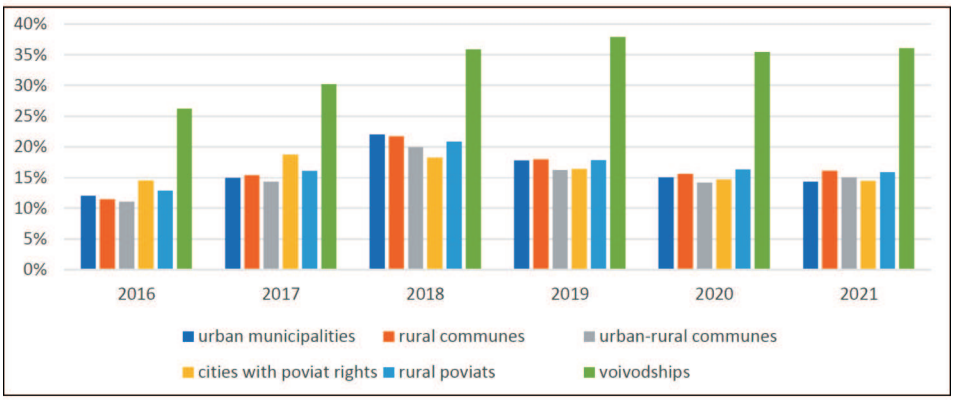
In 2021, despite the growing PIT revenues, this tax share in own income did not reach the level observed before the COVID-19 pandemic. This phenomenon occurred in all types of local government units. It was mainly due to the high growth rate of own income. When analysing the decrease in the share of personal income tax, it is worth emphasising that all LGU groups witnessed falling minimum, maximum and median values. For example, in rural poviats, the median was 72% in 2020 and 74% in 2021 (in 2019, it was 78%). The median deterioration in all types of LGU indicates an overall significant decrease in the median value.

The growth of spending to counteract Covid caused an increase in current expenses and, consequently, a decrease in the operating surplus. As a result, the operating surplus to total income ratio alarmingly shrank, especially in cities with poviat status. It was also relatively low in urban municipalities. In 2021, the indicator remarkably improved in all types of local government units. The current income growth rate exceeding that of current expenditure significantly contributed to generating a higher operating surplus (Table 3).

The substantial limitation of socioeconomic activity in the first year of the Covid 19 pandemic affected the level of investments implemented by LGU. The CAPEX level sank most in the pool of municipalities and cities with poviat status. In 2021, capital expenditure increased, although it still remained below the pre-pandemic level (see Graph 3). That may indicate an LGU' prudent approach to expenditure. In the face of unstable development conditions, it is perfectly legitimised. Moreover, the decline in the operating surplus, especially in 2020, was also reflected in the level of investments.

Graph 3

CAPEX share in total expenditure



Source: own study based on GUS data.

Transfers from the government budget, mainly the subsidies in 2020–2021, did not contribute to enhancing the local governments' financial freedom but only prevented the general deterioration of the financial condition. When analysing the results of the subsidies share in total income, significant differences are seen in the development of this indicator. Also, the growing dynamics of the increase in transfers from the central to the local government is observable. Rural municipalities and poviats, and voivodships enjoyed the highest share in budget transfers in 2020–2021. A significantly lower share was characteristic of urban-rural and urban municipalities. The lowest percentage was that of cities with poviat rights. It proves the highest degree of financial independence of this group of local government units, but also the adopted policy of the government sector towards this group of LGU. When comparing the data for 2020–2021 against previous years, no fundamental increases and decreases in the indicator level were perceived (see Table 3). That was because some funds transferred to the LGU' budgets were not referred to as transfers and were classified as own income, thus hindering the final assessment of the indicator (e.g. monies within GILF).

Discussion

In the face of the COVID-19 pandemic, governments worldwide established various mechanisms to facilitate the pandemic response and ensure the state's functioning. As a consequence, the economic impact of the COVID-19 crisis varies in countries, depending on the region. For example, regions with tourism-dependent economies will be more affected by the coronavirus than others (McNeill and Asquith 2022: 757). Similarly, capital or other metropolitan regions show a relatively higher risk of employment disruptions compared to other provinces (OECD 2020a). The asymmetric effects may also originate from the particular LGU' financial independence level. The scope of the effects may also differ depending on the LGU' pre-crisis fiscal condition. The level of own income at the LGU' disposal and the transfers' share in total income indicate the local government's financial independence and condition. Government-level grants and subsidies are expected to either remain unchanged or increase during the crisis period (OECD-CoR 2020). It is also worth emphasising that effects may occur that are delayed in time depending on the LGU' level. The direct impact may be more robust for municipalities than for regions; however, in the medium term, it may be more significant for regions than for

municipalities. These distributed effects depend on the structure and level of the LGU's income and expenditure, geographic location (large metropolitan areas or smaller towns), economic activity (tourism, industry) or even the demographic profile.

The asymmetric regional and local effects of the crisis within countries are characteristic of all states affected by the pandemic (OECD 2020). In Poland, the most challenging situation occurred in large cities, which were forced to generate increased funds for combating and counteracting Covid 19. Together with the reduced socioeconomic activity, especially in the first half of 2020, it brought about a reduction in their income. Local economies with a large share of these jobs, as well as jobs in other vulnerable industries like transportation, services, and travel, will feel the sting of unemployment more so than communities with smaller shares of these jobs. The reduced revenues from personal income tax, which in cities with poviat status account for over 40% of own revenues, played a fundamental role in a significant decrease in the operating surplus and, as a result, a lowered level of investments. It is in line with OECD – CoR studies (2020) which predicted that among subnational governments, tax revenues would be the most severely affected, followed by fees and charges for using the infrastructure.

State-run balancing systems for LGU may have a pro-cyclical impact on financing at the local government level (OECD 2020b). Simultaneously, it should be emphasised that although equalisation systems may help mitigate regional disparities, this effect may be limited and depend on the balancing system distribution formula. For example, in the case of Poland, no precise criterion for the distribution of funds under the GILF resulted in a significant difference between the awarded amounts of co-financing. In the case of poviats, it ranged from PLN 500,000 to over PLN 42 million per poviat, and in the case of cities with poviat rights, it spanned from slightly over PLN 2.1 million to over PLN 101 million per city. Moreover, the funds were distributed without allocation criteria based on reliable indicators, such as the size of the local population, its development level, etc. (Rudka and Koceba 2021).

Due to the structure of tax changes in Poland (started in 2019 and radically implemented in 2021) and the expected weakening of GDP growth following the Russian aggression against Ukraine, the LGU' financial condition may deteriorate significantly in the coming years. Fiscal changes will primarily impact the own income of local governments with a high share of PIT in the income – especially cities with poviat rights. In these units, income from PIT covered nearly 1/4 of 2021 income. Following the lower

current revenues, LGU may have problems balancing the budget's operational part. The decrease in local government revenues from personal income tax combined with the compensation from the government in the form of budget transfers instead of own revenues also poses a significant threat to the LGU' financial independence. In Poland, the share of transfers in the total income of rural municipalities or poviats, or voivodships, predominates. Chernick et al. (2020) have shown that the most significant shortfalls in income are expected in municipalities that are more dependent on transfers from the state and local sales and income taxes than on less variable property taxes. Transfers are considered an inherent element of the public finance system in the context of the implementation of the subsidiarity principle and the principle of the adequacy of funds to tasks. However, their dominant share in the LGU' total income may threaten their financial independence.

At the same time, the local governments' finances are strongly affected by rising costs, e.g. energy, fuel, and wages, creating pressure to increase debt.

It is also worth noting that the pandemic-caused changes may have strengthened the budgets of some smaller towns. The growing popularity of distributed, niche tourism (as an alternative to mass touris) has created opportunities for developing smaller municipalities with tourism potential. The trend of increased activity in housing construction in the poviats surrounding the largest metropolitan areas and the growing demand for "second homes" in areas of high natural value, which has already been observed in the previous years, may also be favourable.

Summary

Several financial solutions dedicated to local government units, as well as making local government fiscal rules more flexible, allowed to maintain the potential of the local economic base. They also had a diversified impact on the Polish LGU' income level. Indeed, the period of the pandemic and the changes in the Polish tax system indicate a progressive dependence of local government finances on central transfers. The financial independence of Polish self-governments is successively severely limited, and a strong dependence on the state budget may result in difficulties in planning and implementing the local government budget. It is hugely complex to quantify the impact of the COVID-19 crisis on the LGU' finances as there are many uncertainties about its severity, duration, variability across territories and

the effectiveness of support mechanisms introduced by local and national public authorities. Due to the multifaceted nature and unprecedented scale of the COVID-19 crisis, it is difficult even to compare its effects with previous ones, including the 2008–2009 financial crisis. A study carried out jointly by the OECD and the European Committee of the Regions with 300 representatives of regional and local authorities in 24 European Union states (OECD 2020) shows that in short to medium term, most sub-national governments expect that the socioeconomic crisis associated with COVID-19 will negatively affect their finances.

The assessment of the pandemic's impact on the LGU' financial condition is additionally hindered by the lack of transparency of public finances in Poland. The existing reporting, especially in the number of earmarked funds created in recent years, does not allow for learning the directions of spending public funds in the entire sector. As a result, detailed analysis can only be performed at the level of selected individual budgets and reports on their performance. It is, therefore, necessary to develop and publish public finances disclosure and transparency standards in line with, for example, international standards.

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