

# An Ability of Communes to Incur Debts over the Years 2007-2017 Based on Lower Silesian Province

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## Abstract:

**Aim:** This paper aims to establish whether and to what extent new rules have changed possibilities of incurring a debt by communes since 2014 as well as what changes occurred in the level of their debts over the three years preceding the introduction of the individual debt ratio. As far as its subject is concerned, it aims to compare the influence of new solutions on local government units in the area of Lower Silesian province in cumulative terms.

**Design / Research methods:** The aim has been attained by comparing the level of debt to be incurred by communes pursuant to the new regulations as well as to the previously binding fifteen-percent limit of a debt service. The analyses were carried out for years 2007-2017. Statistical methods and a ratio analysis were applied.

**Conclusions / findings:** The IDR formally limited an ability of local government units to incur liabilities. However new solutions (in cumulative terms) did not decrease the scale of making use of debts. The application of IDR also diminished the capacity of communes to incur debts however the limitation was of formal nature.

**Originality / value of the article:** The subject of the paper falls within the topic of publications concerning the necessity of applying debt limits, changes made previously and current solutions as well as the impact of the IDR on financial management of local government units. This publication is original in terms of analyzing the influence of the IDR on local government units and communes in the area of Lower Silesian province.

**Implications of the research (if applicable):** The paper constitutes a contribution to the discussion on limitations of the IDR as well as the necessity of changing a present debt limit of local government units.

**Limitations of the research (if applicable):** The results of analyses and formulated conclusions do not constitute an evaluation of creditworthiness of particular communes. They depict their situation in cumulative terms and reveal consequences of the IDR in the form of a quota not showing other consequences (application of alternative financing

methods). The research may be continued by analyzing the impact of IDR on particular types of communes and individual commune. They may concern the character and the scale of other consequences of the IDR.

*Keywords: Individual debt ratio of communes, Creditworthiness of communes, Liabilities of communes.*

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## **1. Introduction**

According to the regulations of the Act on Public Finance dated 27th August 2009 new rules defining a permissible level of debt incurred by local government units have been applied since 2014. Therefore, two previous limitations have lost their validity with respect to a sixty-percent limit of debt as well as a fifteen-percent limit of handling a debt (the Act on Public Finance 2005; the Act on Public Finance 2009).

This paper will make an attempt to verify the following research hypothesis: an individual debt ratio has changed a formal capacity of communes to use the debt. This paper aims to establish whether and to what extent new rules have changed possibilities of incurring a debt by communes since 2014 as well as what changes occurred in the level of their debts over the three years preceding the introduction of the debt ratio namely 2011, 2012 and 2013. As far as its subject is concerned, it aims to compare the influence of new solutions on communes from the Lower Silesian region as well as local government units in this area in cumulative terms. The analyses have covered financial economy of communes and local government units with respect of making use of the debt by them. The analyses will be carried out based on years 2007-2017. Methods used when attaining the goals involve simple statistical methods and a ratio analysis.

Results of analysis as well as conclusions formulated on the above basis do not constitute an evaluation of changes to creditworthiness of particular local government units. They are of general nature and refer to a sector of communes and a sector of local government units in the Lower Silesian province in cumulative terms.

## **2. Individual debt ratio**

The implementation of new solutions in limiting a debt of local government units involving introduction of a method which to a larger extent takes into account creditworthiness of particular units was preceded by numerous postulates and discussions. Pursuant to a justification of the bill on public finance dated 27<sup>th</sup> August 2009, new solutions defining the limit of debt incurred by local

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government units resulted from postulates raised by them. They mainly put forward a motion to stop applying regulations limiting a debt in the way inadequate to their economic creditworthiness (Justification of the bill on public finance dated 27<sup>th</sup> August 2009, print out No 1181, <http://orka.sejm.gov.pl>, p. 40; 1.09.18). Also the literature raised the issue of implementing new solution regarding the debt of local government units (Wiśniewski 2010: 336; Sawicka 2012: 25). Simultaneously other proposals for solutions defining a permissible level of debt for local government units were made. One of them involved making a level of debt entirely dependent on creditworthiness of a local government unit based on a synthetic measurement accumulating indicators of this capacity (Wiśniewski 2010: 341).

A new solution, the so called individual debt ratio or in other words a permissible repayment ratio (Leksykon budżetowy) based on historical data regarding incomes, an operational surplus and income from sales of assets of particular local government units to a larger degree than in 2013 takes into accounts an individual standing of communes, districts and provinces.

As each solution used for limiting a debt is burdened with certain faults, the one currently used may also be commented on. One remark to be made is that the situation from previous periods translates into a possibility of incurring a debt over subsequent years. As far as future debts are concerned, their possibility is affected by the income from the sale of assets which is limited and unrepeatable. Finally, the ability to incur debts is affected by a small number of parameters, only three of them.

At the same time an individual debt ratio has an advantage of a simple structure and transparency, money from the sale of assets may be a source of paying off a debt and when considered in the individual debt ration it improves the capacity to repay the debt of those units which have sold the assets. Another advantage is flexibility involving consideration of individual profitability of local government units conditioning their ability to pay off the debt (Romowicz 2014: 229).

Also the literature has criticized new solutions, an individual debt ration namely. Arguments have been raised regarding the selection of parameters constituting the base of its structure, their limited number, a three-year period used for calculation as well as the actual creditworthiness of the evaluated unit (Sawicka 2012: 33; Reško, Wołowiec 2012: 37-43). The ratio has been negatively evaluated as in the event of re-financing a debt, an individual debt ratio limits credit rating of a unit and it takes into account the liabilities twice: the previous ones and re-financing

ones (Dylewski 2017: 10-11; Romowicz 2014: 227-237; Governmental bill on changing an act on public finance and some other acts). Comments have been made about introduction of regulations regarding a level of debt (Jurewicz 2017: 17). Moreover, the use of IDR as well as its structure results in the fact that some local government units make use of other than a credit, a loan or standard debt securities to gather resources which is connected to an increased financial risk (Budner-Iwanicka 2017: 35-42).

As a result of the evaluation of the IDR, under the influence of postulates of local government officers, NIK (Supreme Audit Chamber) as well as regional accounting chambers a government draft of amendments to the Act on Public Finance dated 27.08.2018 was prepared and filed to the Parliament on 18.07.2018. The bill assumes changes to the previous way of limiting a debt by means of the individual debt ratio. The changes mostly concern the method of calculating a limited amount, parameters affecting a permissible amount of debt handled, a period used as the basis for establishing the IDR, the scope of limited liabilities as well as cases not requiring the use of the IDR (Governmental bill on changing the Act on Public Finance and some other acts 2018).

### 3. The limit of handling a debt of local government units in the Lower Silesian province over the years 2007-2017

The fifteen-percent limit of debt service controlling the debt of local government units stopped being used in 2014. The extent it was used over the analysed eleven-year period significantly changed (ranging from 28.43% to 56.31%). The level of this ratio for all local government units in the area of the Lower Silesian province in 2017 was lower by 38% than in 2007. The highest level of the use of debt service as total was achieved over the three years preceding the introduction of the IDR as a new debt limit, namely 2011-2013. It is confirmed by all local government units as well as by the sectors of communes and townships. (Table1.)

**Table 1. The utilisation ratio of a 15% limit of debt service by local government units in the Lower Silesian province\* (resources actually allocated to servicing the debt /fifteen percent of a debt limit (15% of the planned income) over the years 2007-2017 [%]**

Years	Local government unit	Communes	Cities with district rights	Country districts	Lower Silesian province
2007	45.93	45.07	43.79	46.06	56.79
2008	38.93	38.48	32.55	41.30	52.72
2009	34.62	35.40	44.70	37.76	5.86

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2010	49.96	39.66	81.49	44.85	4.23
2011	52.64	53.64	69.12	39.60	11.73
2012	53.62	58.94	61.07	45.75	20.51
2013	56.31	58.31	61.62	37.12	54.76
2014	43.07	36.68	16.64	109.00	63.44
2015	42.98	38.52	51.71	19.72	19.00
2016	35.71	31.02	48.00	20.81	31.81
2017	28.43	28.66	45.68	28.03	38.41

Source: based on Performance of budgets in local government units in Lower Silesian province for 4<sup>th</sup> quarter 2007-2017; [www.wroclaw.rio.gov.pl](http://www.wroclaw.rio.gov.pl) [20.07.18]; Biuletyn RIO we Wrocławiu, [www.wroclaw.rio.gov.pl](http://www.wroclaw.rio.gov.pl) [1.06.18].

\*The level of liabilities accounted for as a public debt without exclusions due to the issue of securities, credits and loans taken out in relation to an agreement concluded with a party administering resources from the EU.

Amounts allocated to repayment of principal instalments, the buy-out of securities as well as amounts for interest, commissions, discounts on securities as well as payment due to warranties and guarantees came to zł 730,503 ml in 2007 and to zł 757,317 ml in 2017 similarly whereas the lowest level of such resources was attained in 2009 (zł 300,218 ml), and the highest in 2013 (zł 1,288.208 ml), (Tables 1 and 2).

In the analysed period, communes achieved a debt service on the average level approximately, meaning the level of this ratio for all government units in the area of Lower Silesia. The amounts allocated for these purposes by these communes came to zł 335.352 ml in 2007 and zł 382.304 ml in 2017. The most money on the debt service was spent by communes in 2012 namely zł 610.343 ml, whereas the least in 2009: zł 300.218 ml (Table 1 and 4).

**Table 2. Individual debt ratio and a fifteen-percent limit of debt service \* of local government units in the area of the Lower Silesia province over the years 2007-2017**

Years	New debt limit** [%]	New debt limit in amounts(product of a debt limit and overall incomes [ml zł]	Limit of debt service (15% of planned income) in amounts [ml zł]	Amounts actually allocated to servicing a debt in amounts* [ml zł]	Utilization ration of a new debt limit: the level of resources actually allocated to servicing a debt */a new debt limit in amounts [%]
2007			1,604.721	730.503	
2008			1,680.757	673.776	
2009			1,795.272	300.218	
2010			1,917.393	987.645	
2011	10.29	1,425.856	2,078.507	1,121.329	78.64
2012	8.42	1,231.066	2,193.111	1,198.411	97.35
2013	9.87	1,466.083	2,287.900	1,288.208	87.87
2014	10.93	1,683.820	2,388.278	1,028.640	61.09
2015	11.00	1,673.231	2,342.412	1,006.683	60.16
2016	10.37	1,698.579	2,495.303	891.078	52.46
2017	10.50	1,838.313	2,664.086	757.317	41.20
2018	11.27				

Source: based on Performance of budgets in local government units in Lower Silesian province for 4<sup>th</sup> quarter 2007-2017; [www.wroclaw.rio.gov.pl](http://www.wroclaw.rio.gov.pl); Biuletyn RIO we Wrocławiu, [www.wroclaw.rio.gov.pl](http://www.wroclaw.rio.gov.pl) [1.06.18].

\* The total of expenses and outgoings on servicing a debt.

\*\*The amount for a particular year was calculated based on the data concerning the performance of budgets for three previous budget years.

Termination of the sixty-percent debt limit and a fifteen-percent debt service as well as introduction of the individual debt ratio involved changes to individual creditworthiness of local government units. In cumulative terms, the amounts which could be allocated by local government units from the Lower Silesian province to repay a debt and service it, determined by the IDR, were lower than those defined by the limit of fifteen percent of income. That was the case in 2014 and over the earlier years (2011-2013) for which the IDR was hypothetically calculated. It means that a new formula of limiting a debt of local government units restricted their capacity to incur debts in total. In 2014 the relation of the IDR calculated for all local government units in total to the amount of a fifteen-percent limit reached 70%, in 2015 it was 63% and over the two subsequent years it came to 69%. This limitation of an ability to use repayable funds is of formal nature. The analysed amounts actually allocated to repayment and service of a debt were much lower than the permissible ones resulting from the IDR. The utilization of IDR by local government units in the area of Lower Silesia province, over the years 2014-2017 ranged from 61.1% to 41.2% whereas year by year the use of IDR diminished. It happened with a simultaneous growth of the IDR. The highest but hypothetical utilization of the IDR calculated in the period before new rules of limiting a debt became valid occurred over the years 2011-2013, (Table 2).

The IDR calculated in 2014 for 19 units was on over 15%, in 2015 there were 27 units, in 2016 there were 29 units, in 2017 the group comprised 33 units. Each year accounted for communes and 1 country district. The IDR defined for them more favourable creditworthiness than the no longer functioning fifteen-percent debt limit (Performance of budgets in local government units in Lower Silesian province 2017).

At the same time in 2017 6 unit out of local government units in Lower Silesian province did not comply with the IDR, 83 achieved the IDR in the range from 0% to 5%, 72 on the level between 5%-10% whereas 37 units exceeded 10%.

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**Table 3. The debt of communes from the Lower Silesian province\* over the years 2007-2016**

Years	Debt of communes [ml zł]	Number of communes in debt*	Share of indebted communes in the total number [%]	Debt per one indebted communes [ml zł]	Dynamics of debts of communes[t <sub>1</sub> /t <sub>0</sub> ]
2007	1.078.698	163	3	6.618	0.99
2008	1.177.456	162	4	7.268	1.09
2009	1.584.895	164	2	9.664	1.35
2010	2.264.769	163	3	13.894	1.43
2011	2.589.514	162	4	15.985	1.14
2012	2.621.348	161	5	16.282	1.01
2013	2.356.702	160	5	14.730	0.90
2014	2.400.015	161	4	14.907	1.02
2015	2.302.624	163	2	14.127	0.96
2016	2.202.205	159	6	13.850	0.96
2017	2.443.679	161	4	15.178	1.11

Source: based on Performance of budgets in local government units in Lower Silesian province for 4<sup>th</sup> quarter 2007-2017, www.wroclaw.rio.gov.pl [1.06.18].

\*Over the years 2007-2012 the number of communes from Lower Silesian province reached 166 units whereas over the years 2013-2017 it came to 165 units.

Over the years 2007-2017 the debt of communes from Lower Silesian province went up by about 126%. The most significant growth in debt occurred in 2010 and 2011. Since 2012 both in case of all local government units as well as in particular sectors the debt dynamics has significantly slowed down. The increase in the total debt of communes was accompanied by a growth in a debt per one commune over the period of eleven years by 130%. Over the entire period analysed, the share of communes incurring liabilities was quite significant. In 2016 there were 96% of communes whereas over the remaining years the number was larger, (Table 3).

In 2017 the debt of communes constituted liabilities for credits, loans and issued bonds with limited rights to sell. The liabilities were incurred by 161 communes and they amounted to zł 2,429.7 ml. There were also payables incurred by 46 communes amounting to zł 14.0 ml (Performance of budgets in local government units in Lower Silesian province 2017).

**Table 4. The individual debt ratio and the fifteen-percent limit of debt service of communes from Lower Silesian province over the years 2007-2017**

Years	New debt limit** [%]	New debt limit in amounts (the product of a new debt limit and income in total [ml zł]	Limit of debt service (15% of planned income) in amounts [ml zł]	Funds actually allocated to debt service * in amounts [ml zł]	Utilization ration of a new debt ratio: the level of funds actually allocated to servicing a debt*/a new debt service in amounts [%]
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2007			744.053	335.352	
2008			801.016	308.212	
2009			848.014	300.218	
2010			953.928	378.289	
2011	11.16	701.846	998.119	535.343	76.28
2012	9.02	598.462	1,035.579	610.386	102.00
2013	9.74	630.930	1,010.351	590.640	93.61
2014	11.56	791.623	1,067.113	412.778	52.14
2015	12.44	870.292	1,087.049	418.747	48.11
2016	12.30	970.573	1,198.878	371.911	38.31
2017	12.32	1,068.568	1,334.003	382.304	35.78
2018	12.32				

Source: based on Performance of budgets in local government units in Lower Silesian province for 4<sup>th</sup> quarter 2007-2017; [www.wroclaw.rio.gov.pl](http://www.wroclaw.rio.gov.pl) [20.07.18]; Biuletyn RIO we Wrocławiu, [www.wroclaw.rio.gov.pl](http://www.wroclaw.rio.gov.pl); [1.06.18].

\* The total of expenses and outgoings for servicing a debt.

\*\* The amount for a particular year was calculated based on the data concerning the performance of budgets for three previous budget years.

Communes from Lower Silesian province in each analysed year in cumulative terms achieved an IDR on the higher level than its value for all local government units. Such a situation occurred in 2014 as well as for the years 2011-2013. In case of communes similarly to all units, the IDR has been growing since 2014. Another similarity was that a formal ability of communes to make use of liabilities defined by the IDR in all analysed years was lower than that defined by the limit of fifteen percent of income. In 2014 the IDR was determined on the level of 74% of a hypothetically calculated indicator of fifteen percent of income. Over the years 2015-2017 it was on the level of 80%. Similarly, funds actually allocated to a debt service were significantly lower than the permissible amounts of the IDR. The level of a formal ability to repay and service the debt ranged from 35.78% to 93.61% in 2013 and 52.14% in 2014. Additionally, this relations declined over subsequent years. Only in 2012 resources allocated to repayment and debt service were higher than the IDR however it had not practical meaning, (Tables 2, 4).

A 126-percent growth in debt of communes over the eleven years and a 130-percent growth in debt per one commune were accompanied by an increase of debt by 136% per one inhabitant from zł 525 to zł 1,241.0 zł (1). At the same time the debt of all local government units from Lower Silesian province per one inhabitant grew by 242% from 746 zł to zł 2,548.0 zł (Performance of budgets in local government units in Lower Silesian province 2007).

These changes were accompanied by a growth in the income ratio decreased by grans per one inhabitant (4). Its changes translate into the ability to repay a debt. The observed changes were more favourable for communes as in the analysed period the relation grew by 64% from zł 2,036.0

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in 2007 to zł 2,992.0 in 2017, and for all Lower Silesian units it rose overall by 42.6%, from zł 3,195.0 in 2007 to zł 24,559.0 in 2017.

Another indicator evaluating a risk of local government units is the relation of a debt to personal income (2). In communes this relations grew until 2011 and then in 2017 and over the entire eleven-year period it increased by 68.5%. Over that period this ratio for local government units in total rose from 31% in 2007 to 75% in 2017 (Performance of budgets in local government units in Lower Silesian province 2007, Performance of budgets in local government units in Lower Silesian province in 2017).

Another ratio whose value for communes significantly rose in the analysed period involves a relation of a debt to property expenditure made in the previous year (3). The change amounted to 142.5 percent points and that was a rise by 128%. For all local government units from the area of Lower Silesia province it denoted a growth from 104% in 2007 to 325% in 2017. In case of communes with a debt exceeding two-and – a half times the property expenditure it shows its application to financing these expenses and its accumulation in time. Additionally, this higher averaged relation for all types of local government units and its growth in time indicate a more favourable situation of communes, their potentially greater to incur more debts and a lower credit risk (Czudec, Kata 2012: 5-20), (Table 5).

**Table 5. Debt ratios for communes from Lower Silesian province over the years 2007-2017**

Year	Debt/number of inhabitants [zł] (1)	Debt/ income of one's own (2)	Debt/property expenditure in the previous year [%] (3)	(Income-grants)/ number of inhabitants [zł] (4)
2007	525	34.78	87.90	2,035.62
2008	573	36.54	118.73	2,151.16
2009	771	50.36	131.72	2,171.07
2010	1,101	67.62	174.61	2,291.60
2011	1,259	73.73	150.28	2,382.25
2012	1,249	68.47	170.05	2,539.94
2013	1,192	62.07	186.31	2,664.15
2014	1,215	59.36	204.74	2,793.20
2015	1,167	55.23	168.67	2,889.51
2016	1,118	51.24	188.20	2,991.90
2017	1,241	53.00	253.67	3,179.50

Source: based on Performance of budgets in local government units in Lower Silesian province for 4th quarter 2006, 4<sup>th</sup> quarter 2007-2017 ; [www.wroclaw.rio.gov.pl](http://www.wroclaw.rio.gov.pl); Biuletyn RIO we Wrocławiu, [www.wroclaw.rio.gov.pl](http://www.wroclaw.rio.gov.pl); [1.06.18].

Positive trends in an ability to repay a debt are reflected in changes to the income decreased by grants as calculated by an inhabitant. Over an eleven-year period analysed this ration for communes from Lower Silesian province increased by 64% (4).

#### **4. Evaluation of outcomes of introducing an IDR for communes from Lower Silesian Province- summary**

The research hypothesis about an individual debt ratio introduced in 2014 limiting a debt of local government units and changing their formal ability to incur a debt has been verified. This paper aimed to make an attempt to establish whether and to what extent new rules changed possibilities of incurring a debt by communes from Lower Silesian province since 2014 as well as to find out about changes to the level of their debts over the years 2011-2014.

The impact of IDR on the possibility of incurring debts by communes was evaluated by comparing the level of debt which communes could incur according to new regulations and according to the fifteen-percent limit valid until 2014.

The permissible debt defined by amounts to be allocated to service a debt namely an individual debt ratio calculated for all local government units from Lower Silesian province allowed me to establish that both for the years preceding the introduction of a new formula 2011-2013 as well as for the period of new rules binding 2014-2018 a formal ability of incurring debts by local government units was restricted. The relation of amounts defined by the IDR to the hypothetically calculated fifteen-percent limit of debt was lower in 2014 reaching 70%. However when comparing a permissible level of debt to its actual level for all local government units from Lower Silesian province, the new limitation in cumulative terms did not decrease the scale of incurring debts. Over the year of the IDR validity, the highest level of utilisation was achieved in 2014 reaching slightly over 61%.

In case of communes from Lower Silesian province over the years 2011-2018 the IDR was on a higher level than the ratio calculated for all local government units in this province. Similarly to all local government units, the application of the IDR decreased their ability to incur debts as this ratio was on a lower level in the analysed period compared to the hypothetically calculated fifteen-percent limit of debt service. This limitation resulting from the IDR also in case of communes was of formal nature as the actual level of debt was lower than the permissible amounts. Over the years 2014-2018 the utilisation of IDR by communes was on the level not exceeding 81%.

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Changes to the way of limiting a debt of local government units occurred together with changes to the level of their debts as well as an economic ability to repay their liabilities. 2011 and 2012 were periods when the growth pace of debts incurred by Lower Silesian government units slowed down whereas 2013 noted a drop in their debts. 2014 and subsequent years observed another period of growth in debts of all local government units in Lower Silesian province in cumulative terms however in 2014 there was an increase in debts of all types of local government units in total. In 2015 and 2016 this growth was caused by an increase in debts of cities with district rights whereas in 2017 by a growth of debts of communes together with a drop in debts of remaining local government units. At the same time the analysed period observed an rise in debt as calculated by one inhabitant of all local government units and communes. Also a debt as compared to the personal income increased. Over the years 2011-2017 in local government units this ratio rose by 142% whereas in communes by 68.5% occurring in and 2011 and 2017.

Incurring debts has been a significant source of financing activities of local government units and additionally its role over the years has increased. In 2007 the relation of a debt of local government units from Lower Silesian province to their income amounted to 20% whereas in 2017 it grew twice fold. In case of communes in 2007 this relations amounted to merely 22% and rose by about 1/3. The role of debts is also indicated by the relations of debts to property expenditure made in the previous year. The growth of this ration for communes over the eleven analysed years amounted 128% (Performance of budgets in local government units in Lower Silesian province for 2012-2017; [www.wroclaw.rio.gov.pl](http://www.wroclaw.rio.gov.pl); Biuletyn RIO we Wrocławiu, [www.wroclaw.rio.gov.pl](http://www.wroclaw.rio.gov.pl)).

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