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## SELECTED CONTENTIOUS ISSUES OF PUBLIC FINANCE IN POLISH CONSTITUTION

### Summary

Transformations in the sphere of public finance in Poland and the new legal regulations which they entail have given rise to a debate on future constitutional solutions concerning this sector. There is also a need for an assessment of the existing constitutional provisions regarding this area. The constitutional aspects of public finance should be studied on the grounds of dogmatic and legal analysis, with reference to the theory of public finance.

The budget act (and its main component – the state budget) is a complex and multifaceted document containing provisions based on both cash and accrual approaches, regarding annual and multi-annual perspectives alike. The phrase ‘financial plan’, which is used in the literature in reference to the state budget, does not reflect the legal standing of this act as it is, above all, an annual public-law authorisation granted to the government by the parliament. Potential changes in the constitutional provisions on the state budget should aim at developing legislation concerning budget planning principles, such as the principle of completeness, accuracy, balance and others.

The constitution should also contain modified or altered paragraphs regarding: i. the validity of governmental project of the budget until the budget act is passed (e.g. introduction of budget prorogation), ii. President’s prerogative to shorten the parliamentary term (if a budget is not passed within stipulated time), iii. increasing the budgetary authority of the Senate, iv. the limits of public debt and the possibilities of its financing (laws on state debt, public deficit and its financing are already provided by the EU law), v. the system and financing of local government units (identifying the types of tax revenue of local governments and specifying the range of business activities which they can conduct), vi. issues related to taxation (preferably taking into account not only the legal perspective, but also social and economic ones).

**Keywords:** public finance, state budget, budget act, Constitution of the Republic of Poland

**JEL classification:** H30

### 1. Introduction

Social, political and economic transformations may, and should, have an impact on the contents and state of regulations, also in the sphere of the public finance sector. Therefore, a debate on the present provisions of the Constitution as regards the shape and functioning of public finance in Poland is more than justified. It is

necessary to conduct an assessment of the present constitutional arrangements concerning the sphere of finance.

A coherent constitutional framework for the regulation of the public finance has a tremendous impact on the practical functioning and growth of the private sector, the activity of the authorities and public sector entities, economic stabilisation, and, finally, the possibilities of social development.

The aim of this paper is to analyse selected provisions of the Constitution of the Republic of Poland related to public finance, and to suggest certain modifications. The alterations proposed here regard the legal concept of the state budget, the constitutional phrasing of budgetary principles, several laws on budgetary procedures, tax provisions, and certain aspects of the functioning of local governments.

The above issues are analysed in the light of the theory of public finance, using the dogmatic and legal method, and through comparing the current constitutional regulations with those of other countries and with the constitutions of the Second Polish Republic.

## **2. Legislative perspective of state budget and budgetary principles in the Constitution**

The budget act, including the annexes, is an extensive and multi-faceted document. It contains a number of regulations, some of which have the form of appendices. The amounts of the state budget specified in the act are expressed in cash accounting terms. The revenues and costs in the financial plans of the implementing agencies, budget economy institutions, state special funds, and state legal persons (presented in appendices) are expressed in accrual terms. The financial operations and plans included in budget acts should be described by means of appropriate terminology: revenues and expenditures (of the state budget), incomes and expenses (in the case of special funds and other entities of the public sector), receipts and payments (for the plan of financing the borrowing needs), depending on the specific character of a given area of the state's financial economy, and on whether the cash accounting or accrual method is used.

In order to execute a budget, it is necessary to use many different expenditure and income procedures, conducted throughout the year, and consisting of thousands of individual acts and formalities, especially associated with conclusion and performance of contracts. It is necessary to translate the provisions of the budget act into various types of implementation procedures. A specific feature of budget acts is that they contain multi-annual arrangements permitting long-term financial commitments. They regard tasks, expenditures, and limits for a given year, or several years ahead. These long-term arrangements determine the legal construction of the budget acts, particularly of the annexes on the European funds budget and multi-annual programmes.

Alterations to the Constitution as regards the legal construction of the budget and budget acts should aim to create provisions regarding budgetary principles, es-

pecially the principle of completeness. Special funds, operated by Bank Gospodarstwa Krajowego (BGK), which include, among others, the National Road Fund, are not covered by budget acts, which violates the principle of budget completeness. If budget principles were enshrined in the Constitution, they would not be ignored by the legislator. When working on the budget project, the government should take into consideration the provisions of the Constitution regarding the various budget items, as well as those related to the application of the budgetary principles. Some constitutions directly specify the budgetary principles which ought to be obeyed by the government and the parliament. For instance, Art. 110 of the Constitution of FRG stipulates such principles as the principle of anteriority, periodicity, completeness, unity, gross budgeting, specialisation, clarity, truthfulness, transparency, and equilibrium.

A constitutional perspective should not see the state budget as a financial plan (as it is frequently called in the literature) because it is a structure comprising several thousand of financial plans and arrangements of varying consequence. The budget and budget act contain regulations concerning the government's authorisation to incur expenditure and borrow money, the structure of remunerations, base amounts, multi-annual programmes, rates of public tributes, social insurance financing, and LGU financing. Budget acts specify the revenues and expenditures of the state budget, the revenues and costs of special funds, executive agencies and other entities, and various elements of the public financial economy required by the legislation. The term 'financial plan' is not broad enough to cover the state budget and budget act, and does not reflect the actual legal structure of these acts.

It seems justified that the following clauses are added to the Constitution: "the budget specifies all the revenues and expenditures of the state" and "the Budget Act encompasses the state budget and other arrangements concerning the public financial economy".

### **3. Failure to adopt a budget act before the beginning of fiscal year**

If the state budget is not adopted by the Parliament before the beginning of the budget period, the question arises as to the legal basis of state financial policy starting from the beginning of the fiscal year to the day the budget act is passed. The pre-war Constitution of the Republic of Poland of 17 March 1921, in Art. 25, specified the budget powers of the Sejm, the Senate, the President, and the government. It stipulated that the President declared each state budget as an act:

- a) adopted by the resolution of the Sejm if both the Sejm and the Senate analysed the budget within the set time limits, and the Sejm either approved or rejected the amendments of the Senate,
- b) adopted by the Sejm or the Senate if the Sejm (or the Senate) approved the budget within the set time limits,
- c) drafted by the government if neither the Sejm nor the Senate passed the resolutions regarding the entire budget within the set time limits.

This last solution, however, is not applicable if the Sejm rejected the entire budget draft presented by the government.

Additionally, the provisions of Art. 25 (should the Sejm be dissolved) introduced the possibility of using an interim budget and gave the government the power to incur expenses and collect revenues within the limits laid down in the budget act for the preceding year.

In accordance with the Constitution of 23 April 1935, the government submitted a budget draft to the Sejm not later than four months before the beginning of a fiscal year. The Sejm had 90 days to examine the draft, beginning from the day on which it was submitted, whereas the Senate had 20 days for the same task, beginning from the end of the period granted to the Sejm. Article 58, par. 5 introduced solutions identical to those specified in the Constitution of 1921 (amended in 1926), stating that the President declared the announcement of the budget in the version established by both legislative chambers, only by the Sejm or only by the Senate, or – in the fourth case – as a government's project (if neither the Sejm nor the Senate approved it within the set time limits). Article 60 provided that the state might not remain without a budget. It stipulated that in the case of the dissolution of a legislative chamber, or lack of budget (or interim budget), the government was entitled to collect revenues and make expenditures under the budget from the previous year until an interim or actual budget was adopted.

Article 47 of the Constitution of France defines the procedure of passing financial bills. It delegates budgetary authority to the National Assembly, the Senate, and the government. If the National Assembly fails to complete the first reading within the period of 40 days (counting from the submission of the draft), the government submits the draft law to the Senate, which is obliged to approve or reject it within the period of 15 days. If the Parliament has not taken a position on the act within 70 days, the provisions of the draft law may come into force by means of an ordinance passed by the Cabinet (i.e. under decree law). Furthermore, if the finance bill which specifies the revenues and expenditures for a given fiscal year has not been submitted, the government addresses the Parliament and makes an urgent request for authorisation to collect taxes and makes available by decree the funds needed to meet commitments already voted for. In France, the collection of taxes depends on the adoption of an annual financial bill and it is possible to adopt a draft law of the financial bill by ordinance (when the Parliament fails to reach a decision) and also – when a draft budget has not been submitted within the set time limit – the old budget is effective for the subsequent fiscal year.

A different solution is provided for in the Constitution of the Federal Republic of Germany of 23 May 1949 (Art. 111). It stipulates that if the budget for the following year has not been adopted by law, until the new budget comes into force, the government is entitled to make expenditures necessary for maintaining institutions, established by a law and to carry out all the measures authorised by a law, to meet the legal obligations of the Federation, and to continue construction projects, procurements and the provision of other benefits or services, or to continue to make

grants for these purposes, to the extent that amounts have already been appropriated in the budget of the previous year.

The Constitution of Romania of 21 November 1991, in Article 138, par. 3 states that if the Law on the State budget and the Law on the State social security budget fail to be passed by at least three days before the expiry of the budgetary year, the previous year's state budget and the state social security budget continue to be applied until the adoption of the new budget. This is, of course, the method of proration in the purest form.

In the light of the law of the European Union, if the budget has not been adopted at the beginning of a fiscal year, a sum equivalent to not more than 1/12 of the budget appropriations for the preceding financial year may be spent each month.

According to the provisions of the Polish Constitution of 1997, a budget is established in the form of a budget act. As specified in Art. 219, par. 3, in exceptional cases, the revenues and expenditures of the state for a period shorter than one year may be specified in an interim budget. Article 219, par. 4 provides that the Council of Ministers manages state finances on the basis of a draft budget if neither the state budget nor an interim budget have come into force by the first day of the fiscal year. Therefore, it is not the budget (parliament act), but the government's project that applies. While the Council of Ministers conducts fiscal policy on the basis of the budget draft law, the above regards the draft in the version submitted by the government to the Sejm, not the draft after amendments made in the two houses (the Sejm and the Senate) under the legislative procedure.

The applicability of the government project is a dubious solution from the perspective of the legal concept of a state budget and the history of its emergence, associated with the evolution of the Parliament's right to pass budget laws. "The applicability of the government project" is a situation in which the Parliament does not decide upon the state budget as long as the "government project is applicable" (i.e. in the first weeks or months of a fiscal year). "The applicability" of the budget project drafted by the government (until the budget law has been proclaimed) undermines the significance of the budget act and the political position of the organs adopting the state budget (i.e. the Sejm and the Senate). To restore to the parliament its due historical authority over the state budget, the present solution (supremacy of the government's interim budget) ought to be changed. The Constitution should introduce a law which would equally respect the importance of all the participants of the legislative process, e.g. one similar to the regulations provided for in the constitutions of the Second Republic of Poland or the Constitution of France.

On the other hand, as specified in Art. 225 of the Constitution, if (after 4 months from the day of submission of a draft Budget to the Sejm) a draft budget has not been adopted or presented to the President for signature, the President may shorten the Sejm's term of office within 14 days. This provision forces the Sejm to make budget decisions within stipulated time. However, it seems that the President's authority to shorten the term of the lower house of the Polish Parliament should it fail to adopt a budget is not a good legislative solution, either. What are its consequences for the state budget or economic and political stability? The application of

this law results in a lack of budget (as a parliamentary act) and a lack of a political body which could adopt it (because of the curtailed term). This is more likely to increase the budget chaos rather than to control it. The constitutional solutions from the time of the Second Republic and the provisions included in the French constitution offer far greater legal possibilities to adopt state budgets. Additionally, they introduce a certain security measure to prevent a situation when the state remains entirely without a budget, and namely prorogation of the budget, when at the beginning of a fiscal year the budget which comes into force is the one adopted by the parliament in the preceding year and regards the financing of the tasks of that year. Without a doubt, some of the decisions of the budget from the preceding year may have to be transferred, or otherwise altered, as stipulated by the provisions of the Act on Public Finance which regard the state budget procedure.

#### **4. Provisions of the Constitution of the Republic of Poland regarding debt incurred by State: the issue of budget balance**

The Constitution of the Republic of Poland states that it is not permissible to contract loans or financial guarantees which would engender a national public debt higher than three-fifths of the value of the annual gross domestic product (Art. 216, par. 5). This provision echoes the laws on public debt included in the legislative system of the European Union. The Treaty establishing the European Union and the protocol on the excessive deficit procedure, contained in an annex to the Maastricht Treaty, permit a deficit and public debt within certain limits. These limits (accepted by the new states entering the EU) are: 3% for the ratio of deficit to GDP and 60% for the ratio of debt to GDP. The latter of these two criteria has been included in the Polish Constitution. Therefore, when public debt exceeds the limit of 60%, the provisions of the Constitution will be infringed. Poland is the only country in the world which has included in its Constitution this EU law on public debt.

The Constitution of the Federal Republic of Germany (in Art. 109) states that the Federation and the States adhere to budgetary discipline ensuing from legal acts based on EU treaties and take into consideration the general requirements of overall economic equilibrium. Article 115 introduces a principle according to which budget equilibrium is maintained if revenue obtained from credits (allocated for financing the budget deficit) does not exceed 0.35% of the nominal gross domestic product. However, certain exceptions to the rule of 0.35 GDP are mentioned in the same Article. They concern: the upswings and downswings of the economic cycle, natural catastrophes, and extraordinary emergency situations.

German economic authors indicate that the adoption of the debt ceiling is a result of the influence of the EU law. They point to the different levels of legislative norms: EU regulations (especially Art. 126 of the Treaty), the Constitution, acts, executive decrees.

The Spanish Constitution of 27 December 1978, in Art. 135, regulates issues regarding deficit and public debt, and their limits. In accordance with Art. 135, par. 1,



all the organs of public administration must comply with the principle of budgetary stability. The state and regional governments are not allowed to incur structural deficit which exceeds the limit established by the European Union for its member states. The level of public debt in relation to the gross domestic product of the entire state may not exceed the reference level specified in the Treaty on the functioning of the European Union. The thresholds of the structural deficit and the levels of public debt may be exceeded only in the case of natural catastrophes, economic recession, or other emergencies beyond the control of the state and particularly harmful to the financial situation or socio-economic balance of the country. The presented provisions of the Constitution of Spain take into consideration the regulations of the European Union, but are not their carbon copy.

The author of this paper believes that it is necessary to consider modifying the provisions of the Constitution of the Republic of Poland which regard the limit of public debt (60% of GDP). The Polish Constitution should not be the only constitution in the world which introduces this restriction. The limit (as well as the limit of the annual deficit) is imposed by the EU law, which is a considerable restraint in itself. Meanwhile, the significance of constitutional norms is different to EU regulations: each functions on a different plane. The debt ceiling prescribed by the Constitution may become a serious problem in the case of hazards threatening the state's security, which after all cannot be excluded. It is the author's conviction that the limitations imposed on debt and deficit by international law and the EU law which are in force in Poland are perfectly sufficient: they are more flexible and carefully researched, assessed, and agreed upon. The Constitution should not copy EU laws verbatim but should propose its own, original (substantive or procedural) solutions regarding debt reduction. It can be, e.g., stipulated that debt may be used mainly to finance investment expenditures and other expenditures of special importance.

Article 123 of the Treaty on the functioning of the European Union, prohibits the European Central Bank and the central banks of the member states (national central banks) to grant loans to cover deficits or any other credits to EU institutions, central governments, regional, local, and other public authorities. Additionally, neither the European Central Bank nor national central banks must directly acquire their debt government papers. However, this principle is evaded: the European Central Bank does acquire national government papers, but not directly from governments.

Art. 220, par. 2 of the Polish Constitution states that budget acts may not provide for covering budget deficits incurring debt in the states' central bank. However, in other periods and in the legal systems of other countries, the financing of budget deficits from the funds of central banks has occurred and is still taking place. Before the Constitution of 1997 came into force, NBP (the National Bank of Poland) financed part of the Polish budget deficit in the form of a loan granted to the government or through the purchase of government securities.

It should, however, be noted that if the aforementioned limitation regarding the financing of deficit using the funds from the central bank is included in Art. 123 of

the Treaty on the Functioning of the EU (which Poland needs to comply with), there remains the question whether the Polish constitution should duplicate EU laws.

### **5. Tax aspects in the Constitution of the Republic of Poland**

The current constitutional provisions regarding taxes largely express a legalistic attitude. They prescribe that bills are passed to introduce particular taxes and determine their construction (subject, entities, rates and exemptions). The Constitution tackles the subject of taxes only in Art. 217, which emphasises the role of the tax law. However, taxes play only an auxiliary role in the state and society. They do not perform any major functions and are not an end in themselves. They are only a source from which state expenditure is covered. In other words, they serve the purpose of financing the government's tasks and responsibilities codified in the national legislative system.

Are tax constructions directed at any social or economic objectives and values? They certainly are. While making tax laws, the legislator should take into account social, economic and developmental aspects, not only the correct tax technique. Social and economic considerations are in fact inherent in each tax act. The question remains whether it is indeed necessary to mention the impact of taxes in the Constitution. In the author's view, it does not seem essential.

Tax laws can express the principles of social fairness, take into consideration the situation of poorer social groups, stimulate positive processes (demographic, or innovation – and investment-related). However, these functions do not necessarily need to be imposed by constitutional regulations.

### **6. Aspects of local authorities in the Constitution of the Republic of Poland**

The author is convinced that the present system of local government implies fragmentation and dispersion of self-government, which may cause an overlapping of the tasks and expenditures of particular units, especially at the local level. Small rural and urban municipalities and related country districts constitute structures which are relatively weak in terms of financial and economic power. When they perform their tasks individually, the effect of such financing may be insubstantial. Should the forces and funds of local self-governments, therefore, be combined and consolidated? In the author's opinion, they should. A stronger connection (also financial and economic) of municipalities and country districts is justified. Therefore, it is worth considering if country districts should not become unions encompassing the surrounding municipalities and closely linked with them. This is also connected with the problem of financing the tasks of country districts from the tax revenues collected by municipalities.

It needs to be added that urban districts (i.e. towns with county rights) are relatively strong and financially independent units. This usually cannot be said about in-



dividual rural municipalities, rural-urban municipalities, or counties. Establishing appropriate connections between smaller local government units ought to result in improving the functioning of local self-governments in Poland. If such a solution is adopted, relevant modifications should be included in the Constitution.

Furthermore, issues related to the taxes of self-governments should be considered. Article 167 of the Constitution states that territorial self-governments have their own revenues. The phrase 'own revenues' refers mainly to the taxes granted to self-governments by virtue of the law. In the author's opinion, the Constitution should distinguish between two types of taxes: state and local ones. The latter would serve the purpose of financing LGUs' tasks. In fact, local taxes are more numerous than state taxes. In view of the above, it is particularly essential to recognise their importance in the provisions of the Constitution. Additionally, it is possible to indicate the kind of taxes which should accrue to local government units (e.g. those connected with the estates located in the area of an LGU and related to the incomes of local inhabitants). On the basis of the tax revenues of a given local government, systems of financial compensation to local governments (compensatory subsidies) are constructed. The issue of financial compensations in the system of LGUs also ought to be part of constitutional law.

The capacities of LGUs at all levels would be improved if self-governments were allowed to conduct free economic activity, not only in the sphere of narrowly-defined public services, but also in the area of local and regional infrastructure, transport, regional or local banking, and other economic activity aimed at local and regional development. The strength of a local government unit depends on its economy. Thanks to a strong economic background it can efficiently pursue its objectives, and be an active actor of social and economic life. The provisions of the Constitution ought to be conducive to strengthening the economic vitality of local governments.

A separate contentious issue is the structure of the bodies which supervise LGUs. Should supervision (of the financial aspects) be the responsibility of regional accounting chambers, i.e. organs which investigate self-governments solely from a legalistic point of view and which are not executive organs responsible for the implementation and financing of public tasks? Or should it be the responsibility of a government organ (governor, minister) partly responsible for the execution of tasks and utilisation of budgetary resources? Regional accounting chambers may perform controlling, advisory, consultative and jurisprudential functions, but is their supervisory function justified? This issue should be the subject of a separate analysis and debate.

## 7. Conclusions

The above comments are open-ended and intended as an invitation to debate. The discussed issues should become subject of deliberations among economists and lawyers. In the author's opinion, the changes taking place in Poland since 1997 and

the assessment of the current legislative solutions call for a constructive debate on the possible alterations to the constitutional provisions regarding public finance.

In the light of the above, the following articles and paragraphs of the present Constitution of the Republic of Poland could be revised: Art. 216, par. 5, Art. 219, par. 1 and 4, Art. 220, par. 2, Art. 225, Art. 167, par. 2, and Art. 171, par. 2.

The modifications of the provisions regarding state budget suggested in this paper should aim at the development of laws concerning the concept of budget and constitutional conceptualisation of budgetary principles, as well as regulation of budget procedure. Additionally, it is justified that extension of constitutional provisions regarding taxes as well as the position and functioning of territorial self-government are considered.

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