Projects primary objective is to ascertain how fiscal sustainability of municipalities and cities in Poland over the period 2004-2018 has been affected by the degree of their tax autonomy, that is their ability to finance themselves through local taxes instead of relying on transfers from the central government. Secondary objective is to further assess the impact of tax autonomy on the effectiveness of fiscal rules, the level of politically motivated spending in election years, and efficiency of European Union-funded investments.

Poland is a moderately decentralized country in terms of government expenditure and revenue when compared to other industrialized countries. In all developed countries, including Poland, local government expenditure is larger than local government own-source revenue. The differential is called the vertical fiscal gap, which is usually filled by transfers from central government. Such vertical fiscal gaps are larger, particularly in Poland, when only autonomous local tax revenue instead of all local nominally own-source revenue is considered. Autonomous local tax revenue includes only revenues from taxes over which local authorities have at least limited control in terms of rates and reliefs. On the other hand, taxes shared with the central government are often collected without any control by local governments and in that way are indistinguishable from intergovernmental transfers, like the PIT and CIT in case of Poland. Poland has a particularly high vertical fiscal gap when tax autonomy is considered. This gap appears to be growing, at least since 2004. Such a gap may be detrimental to fiscal balance and public sector productivity, as governments tend to be less careful when spending money that they received in transfers without themselves paying the political cost of tax collection. International empirical research shows that vertical fiscal gaps lead to higher government spending and indebtedness, together with lower public sector productivity. However, the effect of vertical fiscal gaps on fiscal sustainability as such has never before been analyzed. Fiscal sustainability will be investigated by panel econometrics methods in the framework of fiscal reaction functions, which test whether fiscal authority responds to debt increases by improving its fiscal stance. If response is positive and statistically significant, fiscal policy is judged as sustainable.

Justification for the undertaking of the problem is two-fold. First, societal ageing in European economies presents a challenge for public finance, as costs of government programs can no longer easily financed by debt to be covered by future generations. Better understanding the interplay between government tiers would allow for an improvement of long-term fiscal sustainability. Second, as ageing depresses economic growth, growth inclusiveness becomes ever more important. Available research shows that growth inclusiveness can be improved by fiscal decentralization. At the same time, it is crucial to understand how to design such decentralization in a fiscally sustainable fashion.

The project is expected to be a significant contribution to the literatures on fiscal decentralization and fiscal reaction functions, as well as to provide policy-relevant recommendations for the fiscal design of government tiers in Poland.