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Municipal Bonds and their Significance in Financing Local and Regional Development

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Abstract:

Purpose: *The purpose of this paper is to analyze the popularity of issuing bonds by local governments in Poland and to try to find an answer to the question of why local governments in Poland prefer to finance debt in other ways.*
Design/Methodology/Approach: *The provisions of laws and financial reports on the implementation of the state budget were analyzed.*
Findings: *Self-government units choose simpler instruments to finance pro-development tasks.*
Practical Implications: *The results of the analysis should provide important guidance to policymakers in simplifying procedures and popularizing knowledge of municipal bonds.*
Originality/Value: *The work covers timely and important issues for local and regional governments and fills a research gap in the field, combining theoretical issues with practical insights.*

Keywords: *Municipal bonds, financing of socio-economic development, debt of self-government units.*

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1. Introduction

With increasing growth and socio-economic development, local government units (municipalities, counties and provinces) need tools to support the financing of local infrastructure development. It is important that they are available to both strong – highly developed – and weaker shamrocks.

The result of development is the continuous improvement of people's living conditions, which manifests itself through: changes in the system of social relations, social structure, society's preferences, social criteria and rules of action, behavioral patterns, attitudes and consciousness that facilitate the improvement of people's coexistence and interaction, as well as their sharing of the effects of economic development (Salecka, 2018).

Another way for a local government unit to acquire an additional source of financing is to issue bonds. Such a possibility is provided for in the Law on Bonds (Dz. U. 2015 item 238), the Law on Public Finance (Dz. U. 2021 item 305, 1236, 1535, 1773, 1927, 1981), the Law on Municipal Self-Government (Dz. U. 1990 No. 16 item 95, as amended), the Law on County Self-Government (Dz. U. 1998 No. 91 item 578, as amended), and the Law on Provincial Self-Government (Dz. U. 1998 No. 91 item 576, as amended).

Municipal bonds, also known as municipal bonds, are debt financial instruments issued by local governments. In Poland, the Warsaw Stock Exchange and its subsidiary BondSpot established the Catalyst bond market in 2009. This was seen as an important step in the development of the Polish municipal bond market, as it gives local government units a chance to raise funds for investment projects relatively easily and cheaply (Huczek, 2010).

In Poland, municipalities rarely issue bonds, using other instruments to finance their expenditures. The purpose of this paper is to analyze the scale of the phenomenon and try to find an answer to the question of why local governments in Poland prefer to finance debt in other ways.

2. Literature Review

The topic of municipal bonds is sometimes discussed in the literature, but usually the solutions of a specific country are analyzed (Eltrudis, 2022; Gaur and Singh, 2023; Hutahayan *et al.*, 2023; Ivanyshyn and Pecheniuk, 2021; Jakšić and Cicmil, 2022; Jakšić and Uzelac, 2022; Vukovic *et al.*, 20219; Cristea *et al.*, 2022; Thalassinos and Thalassinos, 2006), which may be inspiring, but do not apply directly to Poland.

Municipal bonds, along with revenue bonds, are, to date, the only capital market instruments whose issuers by law are local government units. In September 2009, a new securities trading system called Catalyst appeared in the structure of the Polish capital market. Its specific architecture (four submarkets) and purpose (trading in debt financial instruments) allow a wide range of issuers to raise funds, including such entities for which the capital market, including primarily the floor of the Warsaw Stock Exchange, was previously unavailable, i.e., cooperative banks, limited liability companies, as well as self-government units (Mosionek-Schweda and Panfil, 2014; Pociovalisteanu and Thalassinos, 2009).

Municipal bonds are one of the forms of raising capital by self-government units in Poland - through the issuance of bonds, these units incur debt with bond buyers, at the same time committing themselves to repay this debt by a specified date and to meet additional benefits (most often monetary) precisely defined in the terms and conditions of the bond issue (Mikita, 2008).

The purpose of issuing municipal bonds is usually to raise funds for the current activities of the self-government units related to financing planned investments and the related deficit and/or to change the terms and form of existing debt, as well as to roll over debt in the form of issuing further securities to raise funds for repayment of existing obligations arising from previously incurred loans and borrowings and/or issued bonds.

According to Article 89 of the Law on Public Finance (Journal of Laws 2021, Item 305, 1236, 1535, 1773, 1927, 1981), self-government units may raise loans and borrowings and issue securities for:

- coverage of the transitional deficit of the budget of the local government unit occurring during the year;
- financing of the planned deficit of the budget of the local government unit;
- repayment of previously incurred liabilities from the issue of securities and incurred loans and credits;
- advance financing of activities financed by funds from the budget of the European Union.

As Mikita (2008) points out, the possibility of issuing municipal bonds in Poland has existed for years - there are well-known examples of issuance from the partition period or the interwar period. In the 1990s, several cities, including Gdynia, took legal steps to enable the issuance of municipal bonds. In most cases, they were aimed at purchasing new motor vehicles for the city's transportation system and building and/or upgrading roads (Nam, Parsche, and Reichl, 2001). The introduction of Catalyst was expected to increase the popularity of these securities. The introduction of Catalyst was expected to increase the popularity of these securities.

3. Research Methodology

The current legal acts under which the indebtedness of self-government units in Poland is possible were analyzed, as well as the reports published on the government's website on the implementation of the Budget Act adopted by the Council of Ministers. On this basis, the distribution of the debt of each level of local government units was determined, and the share of bonds in this debt was calculated.

It was assumed that such a method of aggregating data would provide a clear picture of the situation, verifying the popularity of municipal bonds as a source of financing for self-governments in Poland.

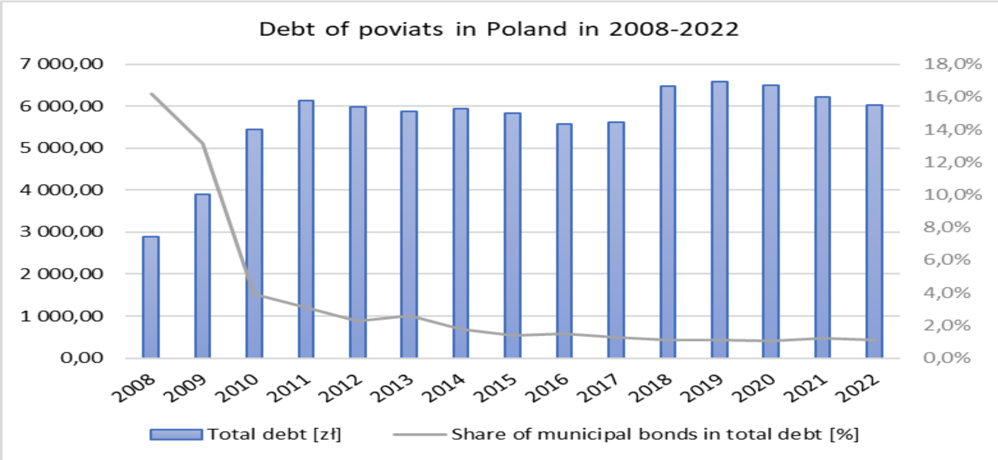
4. Results

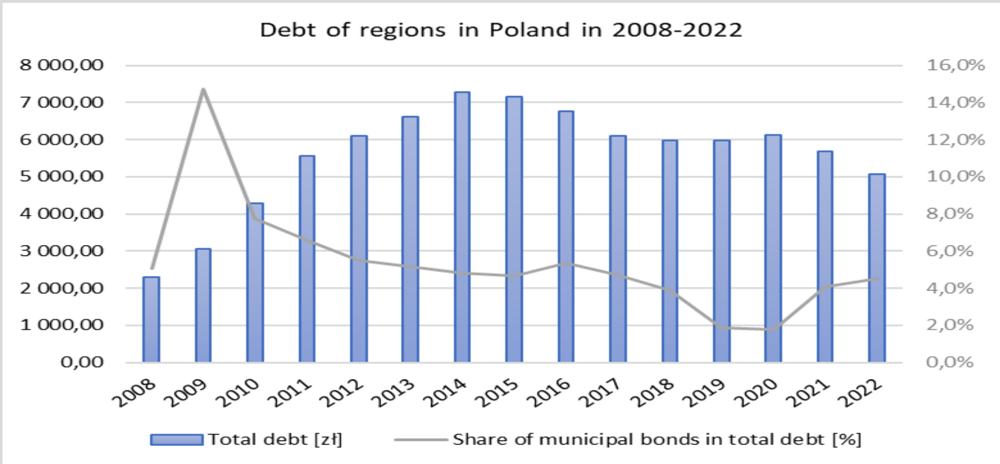
Despite the fact that the total indebtedness of local governments is increasing practically all the time, the share of municipal bonds, especially at the district and provincial levels, is insignificant. This can be attributed to the fact that the issuance of bonds is not an easy undertaking, if only from an organizational point of view.

Besides, it requires having specialized knowledge and participation of representatives of the banking sector. In addition, municipal bonds are not very flexible and cheap instruments, and on the other hand, the flexible approach and strong competition from banks means that bank credit still remains, and will probably remain so for a long time, the primary source of financing the budget deficit of local governments and the implementation of investment tasks by the local government sector.

An analysis of the level of debt of different levels of local government units in Poland shows that the introduction of Catalyst has not only failed to increase the popularity of municipal bonds, since 2009 there has been a visible decline in their share of total self-government unit debt (Figure 1).

Figure 1. *Debt of self-government units in Poland from 2008 to 2022.*





Source: *Own study based on Brzozowska, 2018 and Annual reports on the implementation of the Budget Law adopted by the Council of Ministers for 2019-2022.*

In the case of municipalities, the level of overall indebtedness increased during the period under review, which may be due to the need to provide an own contribution to the implementation of projects co-financed by the EU under the 2007-2013 financial perspective, which de facto started in 2010, and the 2014-2020 perspective, in which the greatest demand for external funds began in 2018.

Despite the fact that Catalyst started in 2009 and the popularity of bonds in financing the debt of local government units was expected to increase, there was then a decline of several percent in the share of this source of deficit financing.

The debt level of counties doubled between 2008 and 2022, and the years of its growth are analogous to those of municipalities. Here, too, the share of bonds in the overall debt level has fallen, and as of 2014 is less than 2%.

The regions were the only ones to see an increase in the share of bonds in total debt in 2009. However, it already declined in 2010, and this trend continued until 2020, after which a gentle increase to around 4% is observed again.

5. Discussion

Self-government units need funds for investments that affect the level of socio-economic development in their areas. The results of the analysis show that municipal bonds are still not a more attractive instrument for self-government units than loans and credits. Although the total debt of the local government sector is growing, the share of municipal bonds in financing this debt is not only not increasing proportionally, but is decreasing.

This may be due to easier access to obtaining a bank loan, which is offered by all commercial banks that view the public sector, especially JST, as a safe and secure, stable borrower. It should be noted that also decision-makers dealing with financial issues at the local government level consider bank credit as a simpler and more transparent instrument compared to municipal bonds.

The results of the analysis carried out are surprising especially because the numerous factors of the advantage of municipal bonds over loans and credits are known (Table 1).

Table 1. *Factors of advantage of municipal bonds over loans and credits*

Municipal bonds	Credits and loans
– legal basis: the law on bonds – no need to provide own capital contribution – the possibility of attracting a larger number of investors – lower interest costs – smaller documentation to be prepared, – faster preparation of the process and closing of the transaction – flexibility in the use of funds raised as a result of the issue – repayments adapted to the possibilities of the budget – no requirement for repayment security – no requirement to conduct a procurement procedure public – possibility of promoting the issuer – with larger amounts are faster to obtain – long bond maturities) – higher flexibility in light of debt limits	– granted on the basis of banking law (loans) and the Civil Code (loans) – one creditor, in the case of a banking syndicate several – the need to provide an own contribution – low flexibility in setting the terms of loans and loans – obtaining is dependent on having creditworthiness creditworthiness – the need to provide legal security – the obligation to carry out a procurement procedure public procurement procedure when selecting a bank and when applying for a loan of more than PLN 130 thousand – close monitoring by the bank during use of the credit

Source: *Own study based on Brzozowska, 2018 & Art. 2, ust. 1 pkt 1. Law on Public Procurement.*

6. Conclusions

The problems of optimizing the acquisition of repayable sources of financing by local governments are very topical, especially in the conditions of attempts to reduce the growing public debt in Poland and increase the number of own tasks of municipalities, which is not followed by an increase in the sources of their financing. There is no control and monitoring mechanism built into the structure of the bond issue, so there may be problems related to the ability to respond quickly to changing circumstances affecting the effectiveness of the entire project.

Realities show that the Catalyst bond market in Poland in 14 years of operation is developing, but it is not a dynamic/conforming development. Practical implications should include expanding knowledge, particularly by financial affairs staff, of the possibilities of raising funds through municipal bond issues and the possibility of issuing revenue bonds to finance tasks that have the potential to generate future revenues.

The present study is subject to the limitations of an in-depth analysis of what investment tasks were financed both with funds from the issuance of bonds and from borrowing by the various levels of local government.

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