

IMPACT OF EU FUNDS ON FINANCIAL AUTONOMY OF THE KRAKOW MUNICIPALITY IN THE YEARS 2007–2013

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Abstract

Joining the European Union by Poland made it possible for municipalities to acquire resources from the EU funds in order to finance its current and capital expenditure. The objective of this article is to present the impact of the EU funds on financial autonomy of the Krakow municipality in the years 2007-2013. However, the impact of revenues from the EU funds on the municipality's financial economy is twofold. On one hand, the revenues from the EU funds improve its financial autonomy, by supplementing the shortage of own resources, on the other hand, to be granted subsidy from EU funds the municipality is required to provide its own contribution, thus increasing its debt. This article notes the need to strengthen the mechanism of self-governance and responsibility in the management of municipality's property in the face of tightening the principles concerning the level of permitted debt of municipalities and the need to assure continuous investment policy.

Keywords: *financial autonomy, EU funds, indebtedness of municipalities, Krakow capital expenditure.*

1. Introduction

Stripping of the communist system and political transformation in Poland began in 1989. The democratic changes were connected with the reconstruction of the local government structure where a municipality became its basic unit. Making it responsible for the execution of public service tasks required granting of legal and financial ability to exercise them. Financial autonomy was meant to enable the fulfillment of statutory goals and to make it possible for a municipality to assume the role of an investor to be oriented on the maximization of social, environmental and economic effects of current investments.

Acquisition of EU subsidies requires a substantial adjustment of the financial economy to the specific functioning of EU funds. It is an effect

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of additionality of the funds to the municipality's own contribution to the cost of an investment project. In order to acquire resources from EU funds, municipalities run into debt. A municipality's financial capacity is an essential matter in this context, as is the permitted debt ratio of a local government unit [LGU].

The Krakow municipality's financial autonomy analysis was carried out based on the revenue and expenditure autonomy ratios, assessed on the basis of income, revenue and expenditure of the Krakow municipality in the 2007-2013. The results identified that the resources acquired by the Krakow municipality from EU funds in the years 2007-2013 increased the municipality's investment opportunities. Nevertheless, it should be noted that the value of revenue from EU funds was reflected in the city's debt. In the light of the dual impact of the revenue from EU funds on the municipality's financial autonomy, the attitude of local authorities that manage the finances needs to be responsible and far-sighted.

2. Self-governance conception and financial autonomy of municipality

Self-governance refers to the state organization principle which assumes the existence of local governments supplied with a scope of autonomy and the consideration of legal grounds of their functioning and competencies in the basic law. The political changes after 1989 aimed at providing municipalities with instruments required for a self-governing policy – autonomous and equal in relation to higher level units.

Due to the comprehensiveness of required constitutional changes, they were conducted by three stages. In 1989, the Act on amending the Constitution of the Polish People's Republic [PRL] was passed, which guaranteed the participation of local governments in ruling (the Act of 1989). Subsequently, the core principles regarding the system and functioning of local governments were covered by the Constitutional Act, called the "Small Constitution" (the Act of 1992). On the basis of this document, the local government became the basic organizational form of the local public life, including the municipality as a basic local government unit. The Act assigned competencies to local government units to exercise their own tasks along those ordered by the government administration, where, in the case of the latter, it was emphasized that the state would have to provide the local governments with adequate financial resources. The "Small Constitution" also specified the revenue sources of local governments (the Act of 1992, Articles 70-73).

The Constitution of the Republic of Poland, passed in 1997, confirmed the determinations of the previous acts in reference to the local government, providing more details regarding certain provisions (the Act of 1997). The

supervision over the local government's organizational activity according to the Act, was given to the Prime Minister and the province governors, whereas its financial activity was subordinate to the regional chambers of the audit. The local government units were granted legal personality, i.e. the right of ownership and participation in transactions under civil law.

The indication of municipality as the basic local government unit meant the "obligation to maintain municipalities in the public administration system and the state territorial structure, but also the obligation to provide them with appropriate place, and thus to supply such a set of tasks and competencies, so that it could be stated that local self-governance is based on municipality" (Niewiadomski, 2011, Nb 9). Thus, the municipality has attributed the role of an entity shaping public life on the local level.

Self-governance is also a postulate towards the attitude of local authorities connected with the economy of activities. It is both a privilege to build the local Republic of Poland and the responsibility for what it is like and what it will be like.

Making the municipality competent to exercise its own and ordered tasks required the provision of sources of financing. In general, financial autonomy is the power expressed in the act to possess the financial resources sufficient for the performance of the tasks. This includes the obligation of the state to provide local governments with the resources sufficient for the performance of its tasks, among of which the unit's own revenue should prevail (Kornberger-Sokołowska, 2001, p. 39). The primary attribute of municipality's financial autonomy is the possession of the property and financial resources under autonomous budgets (Chojna-Duch, 2007, p. 178).

Municipality's financial autonomy also implies the possibility of forming the revenue and expenditure structure by the local government, which takes place under the revenue and expenditure self-governance.

According to Kornberger-Sokołowska, Zdankiewicz and Cieślak (2010, p. 39), the revenue self-governance is determined by the presence of the following elements:

- supply of own sources of revenue attributed for an indefinite period the concurrent assignment of a certain scope of sovereignty to the extent of this revenue creation,
- possession of property, which shall not only be the source of revenue, but it may also be used as a security of future credits,
- possession of legally guaranteed access to financial markets,
- possibility to act on the basis of an independently adopted annual budget.

Municipality's expenditure autonomy concerns the performance of its own tasks and financing them from self-created budgets, as well as decision-

making in determining the directions of capital expenditures and possible sources of financing them (Surówka, 2013). It is determined by the value of the municipality's income and revenue, shaped by its fiscal sovereignty and available instruments, such as taking loans.

In Surówka's opinion (2013, p. 26), municipality's expenditure autonomy comes down to:

- determining the priorities in the resource disbursement directions,
- forming the economic expenditure structure,
- managing the assumed property,
- shaping the budget balance,
- incurring municipal debt.

3. Additionality of EU resources as the principle of acquiring EU funds vs. municipality's financial capacity

The municipality runs its financial economy basing on the income and revenue, the level of which may be affected by it within the limits specified in the Act. Development needs of the territory require from the municipality to actively shape the local policy and incur the related capital outlays. Due to the fact that the own revenue of the municipality is inadequate to its spending needs, the option to co-finance the capital expenses from EU funds is attractive for municipalities. The use of EU funds is subject to the financial principles applicable in the case of the relationships between the Union and the member states, among which the most significant, from the perspective of engaging the local potential, is the additionality principle.

The additionality principle means that a project is co-financed from the EU funds only in the part, the value of which is determined by the project character. The EU resources should supplement the domestic activities. Acquiring the resources from EU funds requires the provision of the own so-called contribution. Its value depends on the project type, in particular, its capacity to generate profit. It means that public service tasks are granted more funds than commercial projects. For example, with reference to municipal investments, such as the construction of waste-water treatment plant, the minimum contribution of the municipality is approx. 15%.

In order to provide the resources required for the acquisition of EU funds, municipalities run into debts. The municipality's potential to incur debt is determined by its financial capacity and the permitted debt ratio specified in the Act.

In the opinion of E. Kornberger-Sokołowska (2007), the local government unit's financial capacity is determined, most importantly, by:

- relation to own revenue to total revenue, which also specifies the level of revenue self-governance of the local government unit,
- operating result being the difference between current revenue and current expenditure. The surplus makes it possible to incur liabilities without prejudice for the performance of current tasks. The deficit indicates the lack of capacity to cover current expenditure from current revenue and leads to the debt increase. It is of major importance when incurring liabilities and constructing the unit's budget,
- creditworthiness – it is evaluated by banks on the basis of methodology other than the one applied in the case of economic entities. The budget construction and revenue structure are subject to evaluation.

An important element when incurring liabilities by local governments is the way of calculating the permitted debt ratio. By the end of 2013, pursuant to the Act on Public Finance (2005, Articles 169-170), two local debt amount limits were effective. The first one was the 15% limit of the relation of the planned repayment of credits, loans and the redemption of bonds including interest and the discount in a given budget year to the budget revenue. The second was the 60% limit of the relation of the total debt amount to the budget revenue. At present, pursuant to the Act on Public Finance (2009, Article 243), the municipality's financial capacity is characterized by individual debt ratio (IDR), where the permitted debt level is determined by the shape of the relation between the debt servicing value and the resources which in the legislator's opinion can be appropriated to its repayment, i.e. most of all the operating surplus from the last three years. In addition, the unit's decision-making authority cannot adopt a budget in which current expenditure is higher than planned current income increased by operating surplus from the previous years and by free resources.

The purpose of amending the Act within the scope of the debt ratio is to limit the debt incurred by local governments, which implies the necessity to implement pro-saving policies by municipalities. It may affect the cuts of current expenditure and capital expenditure in the local policy. This solution also introduces impediments related to the acquisition of financial resources for the coverage of own contribution. In the years 2009–2010, the debt of local government units considerably increased. This is connected with liabilities intensively incurred for fear of losing the creditworthiness in the light of the new principles of calculating the debt ratio according to the value of operating surplus worked out for the last three years (Korolewska & Marchewka-Bartkowiak, 2011).

Particular budget items in Krakow in the years 2007–2013 are presented in Table 1.

Table 1. Krakow’s budget in the years 2007–2013 on the basis of the amounts generated in ml PLN

Year	Total revenues		Total expenditures		Deficit / surplus	Total revenues	Total expenses
	Current revenue	Capital gains	Current expenditure	Capital expenses			
2007	2 540	270	2 270	739	-200	385	185
2008	2 725	266	2 532	623	-165	367	202
2009	2 873	288	2 713	706	-259	582	323
2010	3 070	315	2 804	560	20	331	316
2011	3 020	316	2 822	497	17	400	410
2012	3 092	354	3 032	456	-42	477	435
2013	3 381	354	3 175	465	96	307	337

Source: Own elaboration on the basis of the reports on the implementation of the Krakow budget in the years 2007–2013 retrieved from <https://www.bip.krakow.pl>, and the data from the Central Statistical Office [GUS] available at the website <http://stat.gov.pl>.

On the basis of the data regarding the budget of the Krakow municipality, it can be observed that:

- increasing level of current revenue and current expenditure and the imbalance between them,
- a greater increase of expenditure than revenue, resulting in a considerable operating deficit in the years 2007–2010. Expenditure showed an upward trend every year, except for 2010, when a decline was noted as compared to the previous year (2%),
- the budget deficit occurred in 4 years of the researched period: in 2007–2009, 2012 and 2014. In the years 2007–2009, it reached the highest values, with the maximal of 259 million PLN in 2009. It is connected with the drop in the municipality’s own revenue, occasioned by the economic crisis, the increase in the number of own tasks (among others, the Act dated 2010 on support for the development of telecommunication services and networks, 2015, the Act dated 2011 on family support and foster care system, 2015), and amending the regulations on permitted debt of municipalities. Since 2010, the city has noted a budget surplus. In 2011, it implemented measures to reduce the city’s debt level, approaching 60% of the total revenue (the debt limit effective by the end of 2013). The City Council made the decision that “any other ‘savings’ resulting from the tender settlements within the framework of the performance of investment tasks would be dedicated exclusively to repayment of the city’s credit obligations up to the amount of 20 million PLN, and subsequently to increasing of current expenditure in the field of education” (the Resolution of the Krakow City Council in the matter of the Krakow City budget for year 2011, 2011, paragraph

16). The deficit is calculated on the basis of the amounts planned in the budget, what encourages to overvalue the planned revenue by municipalities (Surówka, 2013),

- revenues of Krakow's budget increased during the almost entire researched period in connection with credits taken by the city, the repayment of granted loans, the existence of free resources as a surplus in bank account, the property sell-off and the issue of bonds, which took place in the years 2009 and 2011–2012 in the amount of 300 million PLN, and in 2013 in the amount of 220 million PLN.

Krakow's financial economy raises reservations related to the city debt. The reduction of the deficit in the years 2010–2013 is connected with the necessity to reduce the risk of losing the financial capacity, before the enforcement of the new principles of calculating the debt ratio.

4. Impact of EU funds on financial autonomy of the Krakow municipality in the years 2007–2013

The period 2007–2013 covers the economic cycle of the country, i.e. the relative revitalization of the first three years, the depression of 2010 and the re-revitalization in the years 2011–2013. Substantial variability of macroeconomic factors affected the level of local revenue and expenditure, determining the financial autonomy of municipalities.

The years 2007–2013 also comprise the investment cycle connected with the financial perspective of the European Union and the allocation of foreign resources. In the researched period, the Krakow municipality intensively acquired resources from structural funds and the Cohesion Fund. It signed co-financing agreements worth 1,630 million PLN. Co-financing of projects from EU funds was set at the level of 766 million PLN, which constituted 47% of the total value of projects. Financial autonomy may be examined based on the municipality's revenue and expenditure autonomy ratios. Their adjustment by the revenues from EU funds will show how much these resources affect the municipality's autonomy in the realization of revenues and expenditures.

The Krakow municipality's revenue autonomy, in the context of the creation of own revenues, is reflected by the SD ratio. The level of revenues from EU funds depends on the local authority's engagement in the acquisition thereof. Therefore, they constitute own revenues of the municipality and hence they are included in the SD ratio's numerator (Formula 1, 2, 3, and 4).

$$SD = \frac{DW + PUE}{DB} \cdot 100 \quad (1)$$

Where:

SD – revenue autonomy

DW – own revenues

DB – total budget income, including revenues from EU

PUE – revenues from EU funds

After deducting the revenues from the EU funds, it constitutes SDK.

$$SD_K = \frac{DW}{DB \downarrow PUE} \cdot 100 \quad (2)$$

Where:

SD_K – revenue autonomy corrected by revenues from EU funds

DW – own revenues

DB – total budget income, including revenues from EU

PUE – revenues from EU funds

The revenue autonomy ratio SD informs about the municipality's autonomy in the creation of its own revenue (Table 2). The higher it is, the more autonomous the unit is from the revenue transferred from the state budget. The impact of the municipality on the creation of its own revenue comes down to a widely-defined development policy of the city, consisting in the creation a place that is conducive to entrepreneurship, business and attractive for the inhabitants. An active social policy, which reduces unemployment, is also important.

Table 2. Revenue autonomy ratios in the years 2007–2013

Description	2007	2008	2009	2010	2011	2012	2013
Total own revenue [ml]	1 991	2 149	2 203	2 143	2 284	2 370	2 617
Total revenue [ml]	2.809	2.991	3.161	3.385	3.336	3.446	3.736
Revenues from EU funds [ml]	46.92	28.13	70.95	113.59	13.24	3.43	60.55
Autonomy ratio SD [%]	72.55	72.79	71.95	66.67	68.85	68.88	71.68
Revenue autonomy ratio SDK [%]	72.08	72.54	71.30	65.51	68.73	68.85	71.21
Decline/increase of revenue autonomy SDK – SD [%]	-0.47	-0.26	-0.64	-1.16	-0.12	-0.03	-0.47

Source: Own elaboration on the basis of the reports on the implementation of the Krakow budget in the years 2007–2013 available at the website <https://www.bip.krakow.pl>, and the data from the Central Statistical Office [GUS] available at the website <http://stat.gov.pl>.

Revenue autonomy, expressed by SD ratio, dropped in the researched period (Figure 1). SD ratio is subject to considerable fluctuations, but it shows a downward trend. The lowest value was reached in 2010, at 66.67%. The municipality's revenue autonomy, corrected by revenues from EU funds, was even lower. The difference between the ratios was the biggest in the years 2007–2010, and in 2013.

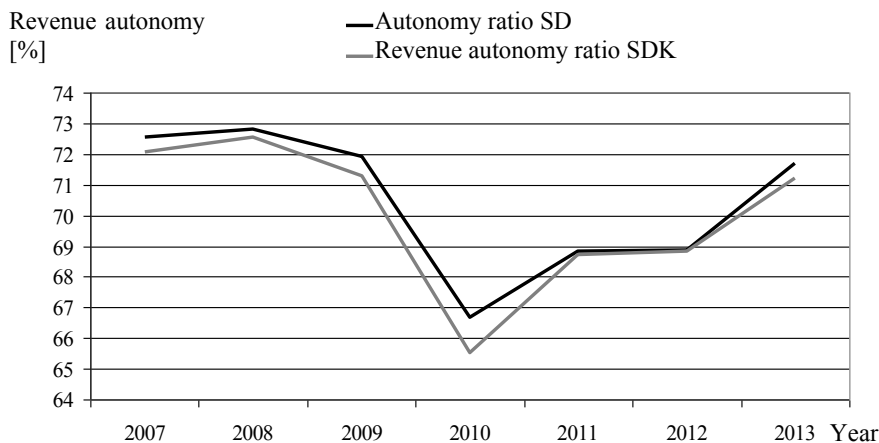


Figure 1. Revenue autonomy of the Krakow municipality in the years 2007–2013

Source: Own elaboration on the basis of the reports on the implementation of the Krakow budget in the years 2007–2013 available at the website <https://www.bip.krakow.pl>, and the data from the Central Statistical Office [GUS] available at the website <http://stat.gov.pl>.

The level of revenue autonomy dropped by 5.8% in the years 2007–2010 and increased by 5.1% in the years 2011–2013. The drop was affected by the revenues from CIT and PIT taxes, which were reduced as a result of the economic crisis, and the receipts from the tax on civil law transactions, which strongly depends on the number of transactions in the real property market. The increase of revenue autonomy in the years 2011–2013 was connected with the city's rising from the economic recession and the related rise in the property tax rate in Krakow. The rate was raised, despite the objections of councilors, from one of the lowest level in Poland at 0.56 PLN in 2010 (Rapalski, 2010) to 0.62 PLN in 2011. At present, it amounts to 0.75 PLN (the Resolution of the Krakow City Council in the matter of the determination of property tax rates, 2015).

The value of revenues from EU funds in the municipality's budget is determined by its financial standing and the policy of its authorities. The

level of these resources is observed to evolve on a regular basis. Their level at the beginning and the end of the researched period is similar (on average 53 million). They reach the maximum value in 2010 (113.59 million) and go down in 2012 (3.43 million). The 2010 peak was related to the acquisition of subsidy in the amount of nearly 45 million PLN, in connection with the implementation of the project Wastewater Treatment Plant Płaszów II, stage II. This amount constituted almost 40% of receipts from EU funds in 2010. It should be noted that in the period preceding the acquisition of high revenues from EU funds, the Krakow budget noted a record-breaking deficit for the researched years 2007–2013 at the level of 259 million PLN in 2009. To a large degree, it was related to the coverage of the capital expenses settled in the following year.

The drop in revenues from EU funds in the years 2011 and 2012 was related to the economic crisis. The total city revenue dropped in 2011 by 1.42% as compared to the previous year, which constituted more than 48 million PLN and lowered the Krakow municipality's investment opportunities, which determined the refund of expenditures in the following years.

Deducting the revenues from EU funds additionally, reduces the revenue autonomy of the municipality. The biggest drop of SDK ratio was in 2010 – 1.16%, which was the effect of the high level of subsidies from EU funds and of the drop of own revenues of the municipality.

The municipality's expenditure autonomy can be analyzed basing on expenditure autonomy ratio SW , which informs about the contribution of the municipality's capital expenditures in possible sources of financing them.

$$SW = \frac{WI}{PO + DB} \cdot 100 \quad (3)$$

Where:

SW – expenditure autonomy

WI – capital expenditure

PO – total revenue

DB – total budget income, including revenues from EU

After deducting the revenues from the EU funds it constitutes SW_K . The difference $SW_K - SW_1$ shall determine the scale and direction of the change of municipality's expenditure autonomy.

$$SW_K = \frac{WI - PUE}{PO + DB - PUE} \cdot 100 \quad (4)$$

Where:

SW_k – expenditure autonomy corrected by revenues from EU funds

WI – capital expenditure

PO – total revenue

DB – total budget income, including revenues from EU

PUE – revenues from EU funds

Expenditure autonomy ratio SW (Table 3) specifies the scope in which the unit decides about the directions of expenditures and land development priorities. Its decline indicates limited investment opportunities of the municipality and an increased importance of current expenditure. In the researched period, the municipality's capital expenditure considerably declined. This is related to the conception of the lack of self-financing of municipalities, i.e. the inadequacy of own revenues to current expenditure, which in consequence are realized at the cost of capital expenditure.

Table 3. Expenditure autonomy ratios in the years 2007 -2013

Description	2007	2008	2009	2010	2011	2012	2013
Capital asset-related expenditure [ml]	739	623	697	560	483	440	401
Total revenue [ml]	385	367	582	331	400	477	307
Total income [ml]	2.809	2.991	3.161	3.385	3.336	3.446	3.736
Revenues from EU funds [ml]	46.92	28.13	70.95	113.59	13.24	3.43	60.55
Expenditure autonomy ratio SW [%]	23.14	18.56	18.63	15.08	12.92	11.22	9.92
Expenditure autonomy ratio SWK corrected by revenues from EU funds [%]	21.99	17.87	17.06	12.40	12.61	11.15	8.56
Drop/growth of expenditure autonomy SWK – SW1 [%]	-1.15	-0.69	-1.57	-2.68	-0.31	-0.08	-1.37

Source: Own elaboration on the basis of the reports on the implementation of the Krakow budget in the years 2007–2013 available at the website <https://www.bip.krakow.pl>, and the data from the Central Statistical Office [GUS] available at the website <http://stat.gov.pl>.

Expenditure autonomy, expressed by expenditure autonomy ratio SW, declined by more than a half, dropping by 13.21% (Figure 2). After deduction of the revenues from EU funds, the drop is even more noticeable – a decline of SWK by 13.44%. The lack of revenues from EU funds among the possible sources of financing reduces the municipality's expenditure autonomy on average by 1.12%. The biggest limitation of expenditure autonomy took place in 2010 and amounts to 2.68%.

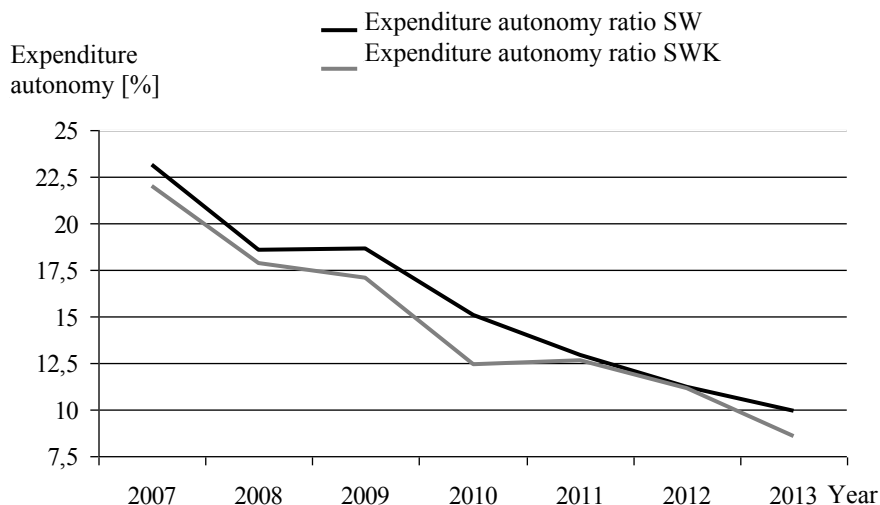


Figure 2. Expenditure autonomy of the Krakow municipality in the years 2007–2013

Source: Own elaboration on the basis of the reports on the implementation of the Krakow budget in the years 2007–2013 available at the website <https://www.bip.krakow.pl>, and the data from the Central Statistical Office [GUS] available at the website <http://stat.gov.pl>.

At first, the impact of the receipts from EU funds on expenditure were small (2008). In 2009, the discrepancy between the edge lines of SW and SWK ratios increased and was maintained until 2010, when the municipality obtained the highest revenues from EU funds. The ratio trend lined part again in 2013. The specificity of the investment cycle based on the revenues from EU funds usually requires incurring prior capital expenditure facilitating the acquisition of a subsidy. One may notice the relation between the level of total revenue and the level of revenues from EU funds: the increased level of total revenue precedes high amounts of subsidies from EU funds. The expansive investment policy of Krakow and the progressing debt in the years 2007–2009 determined the provision of a high level of revenues from EU funds in 2010. Since 2011, in connection with the influence of legal and macroeconomic factors on the financial policy of the city, the amount of debt incurred was limited. It was balanced by the issue of bonds, which covered the deficit. The capital expenditure in the years 2011–2012 was also financed by these revenues. Since they were settled, the level of subsidies from EU funds grows in 2013, what was significant in the context of upcoming settlement of contracted subsidies. The capital asset-related expenditure amounted to 669 million in 2014.

5. Conclusions

The debt of local government units is a part of the national public debt. Since joining the European Union by Poland, one can observe a progressing growth of liabilities incurred by local government units on account of loans and credits. This results from the fact of the lack of self-financing and realization of current and investment tasks basing on repayable financial resources. It is also an effect of capital expansion related to the possibility to co-finance the expenditure from EU funds. A large part of the local expenses is realized subject to EU subsidies, sometimes leading to a “forcing out of other expenses of local governments” (Kopańska, 2014, p. 106).

The revenues from EU funds are an additional tool of the development policy of local government units. Their contribution to the financing of municipal expenses has become, over time, a prestigious factor of local management. The investments co-financed from the European resources are marked by information boards which indicate the source of financing and operating program under which the project was completed. This makes it possible for the inhabitants to evaluate the effects of efforts and to shape a positive image of the Community and local authorities. The prestige of taking advantage of the co-financing from European resources is also connected with the occurrence of rankings identifying the engagement of municipalities in the acquisition of funds with the effectiveness of overall operation of local government units. These rankings often skip the matters of disbursement, the settlement of funds, their absorption, running into debts and also the financial autonomy of municipalities.

Currently, municipalities may take advantage of EU funds under the financial perspective 2014–2020, which is the last period of support from EU funds for the Polish municipalities on such a high level. Therefore, it is important to see the necessity to conduct autonomous financial policies after the year 2020. It becomes a priority to popularize the mechanism of self-governance and responsibility in city property management, also due to the necessity to maintain completed projects in the future.

The lack of revenues from EU funds in the future will have to be compensated by the tools available for the municipality: fiscal sovereignty, development of other self-generated revenues and revenue structure management.

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Biographical note

Karolina Szczepaniak – Ph.D. student at the Cracow University of Economics, graduated from Spatial Economy at Cracow University of Economics (2015) and Russian Studies at the Jagiellonian University (2009). In 2015 defended her master's thesis in the field of financial management of the city of Krakow in the light of the use of EU funds. Awarded second prize in the competition for the best master's thesis in the field of Entrepreneurship, Innovation and Regional Development organized by the Foundation Sapere Auso and MARR. Her research interests include spatial aspects of city management, local finances and the socio – economic consequences of the 90s political transformation in Poland.